MANAGED FUNDS ASSOCIATION

WRITTEN STATEMENT
OF

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ON BEHALF OF
MANAGED FUNDS ASSOCIATION

For the American Bankruptcy Institute
Field Hearing on
Chapter 11 Reform

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TESTIMONY OF DANIEL B. KAMENSKY, MANAGED FUNDS ASSOCIATION

To the Commissioners of the American Bankruptcy Institute
Commission to Study the Reform of Chapter 11:

My name is Daniel B. Kamensky, and I am a Partner at Paulson & Co. Inc., a leading global investment firm. As with many leading hedge funds, we are headquartered in the United States, though we oversee investments around the world, for investors from across the world, and with employees and offices in three continents. I am here today to speak on behalf of the Managed Funds Association ("MFA") in my capacity as Chairman of its Bankruptcy and Creditor Rights Working Group. On their behalf, I am pleased to provide this statement in connection with the American Bankruptcy Institute Commission Field Hearing on Chapter 11 Reform.

The Managed Funds Association represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, and Australia.

Hedge funds are private investment funds that play an important role in our financial system by providing liquidity and price discovery to capital markets, as well as capital to companies to allow them to grow or improve their businesses. Hedge funds provide sophisticated risk management to an increasingly diverse range of investors and myriad public trusts, including pension funds, charitable organizations, and university endowments and foundations. In serving their clients, hedge funds engage in a variety of investment strategies across many different asset classes and market segments; in so doing, they can help investors diversify their individual risk, thereby reducing their overall portfolio investment risk. This, in turn, dampens general market volatility. Through these functions, the U.S. capital markets as a whole have been strengthened by the growth and diversification of hedge funds. As such, these functions are critical to the orderly operation of our capital markets and of our financial system as a whole.

MFA believes that efficient, well-functioning capital markets play an important role in the bankruptcy process, just as they do in our overall financial system. In turn, MFA believes that the proper functioning of the U.S. bankruptcy process is important to the broader U.S. economy because having a bankruptcy system that has both certainty and transparency gives confidence to investors as to how their investments will be treated in the most difficult circumstances which is in turn essential for the development of robust capital markets.

MFA believes that active participation by financial participants in the bankruptcy process facilitates the effectiveness of the bankruptcy process and maximizes value for the benefit of all stakeholders, including creditors, shareholders and employees. Hedge funds provide working capital to companies to allow them to have breathing space to restructure and exit financing to allow companies to grow after a successful reorganization. In addition, hedge funds oftentimes take an active role on post-effective date boards of directors and become long-term stakeholders, roles which further align them with maximizing the enterprise's value. This benefits all stakeholders, including employees and the broader communities in which these companies operate. As a result, MFA believes that increased participation by distressed investors in the bankruptcy process is a positive development that should be encouraged.[1]

Hedge funds are sophisticated parties well-versed in the bankruptcy process. When they become involved in a bankruptcy case, the debtor and other creditor constituencies gain knowledgeable counterparties with whom they can engage. In this way, active capital markets in bankruptcy create a more efficient bankruptcy process – and efficiency in bankruptcy both improves creditor recoveries and reduces the likelihood of liquidation to the benefit of all parties in interest and the economy as a whole.

Hedge funds are also well-equipped to provide debtors with the capital investments they may need to emerge from bankruptcy as a successful going concern. By way of example, the Testimony of Ted Basta provided in connection with this Field Hearing references the example of hedge funds recapitalizing the iconic automobile supplier, Delphi, after years of bankruptcy, despite heavy volatility in the capital markets and the company's uncertain path towards profitability. Delphi is just one example among many that show how consistent rules of the road allow investors to have the confidence to provide significant capital that enables companies to reorganize successfully. As Delphi also shows, an active secondary market in debt and trade claims means that existing creditors can adjust their own risk profiles and, should they choose, sell their bank debt, bonds or other claims to utilize their capital in the most advantageous way.[2]

In addition, the structure of hedge funds, as compared to certain other financial creditors, gives hedge fund participants a vested interest in seeing the debtor succeed. Investors who purchase claims often become the new owners of a company upon emergence, and therefore have a strong incentive to maximize value and improve the company's overall business performance. In fact, commentators have concluded that active involvement by distressed

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[1] MFA strongly rejects the misperception that increased participation by distressed investors has not facilitated the effectiveness of the bankruptcy process. *Cf.* Robert J. Keach & Albert Togut, *Commission to Explore Overhauling Chapter 11*, Am. Bankr. Inst. J. 36 (June 2011); Statement of Bettina M. Whyte, Member, ABI Comm. to Study the Reform of Ch. 11 (Initial Public Hr'g, Washington D.C., April 19, 2012), available at commission.abi.org.

[2] *See* Thomas Moers Mayer, *Liquidity, Disclosure and their Enemies: Securities Issues and Trading Freezes in Chapter 11* (June 2004) (submitted to the Am. Coll. of Bankr. Comm.; Best Practices in Connection with the Disclosure of Information in Chapter 11), at p.2 (asserting that liquidity of securities and other claims provides fairness to the reorganization process).

investors in a bankruptcy case increases the company's enterprise value and improves its performance post-reorganization.[3]

Thus, MFA believes that efficient, well-functioning capital markets provide significant benefits in bankruptcy, which, in turn, benefit our economy as a whole. MFA believes that the economy as a whole benefits from the unique success of the bankruptcy process in the U.S., especially when compared to insolvency regimes in other jurisdictions around the globe, because the U.S. process encourages solutions that maximize value and preserve companies as going concerns.[4] Therefore, MFA is pleased to take the opportunity to express its views on the ways in which the Bankruptcy Code might better facilitate active participation by investors in the bankruptcy process.

Fundamentally, we believe that steps should be taken to facilitate the active engagement of financial creditors in the bankruptcy process by (i) promoting equality of treatment among similarly situated creditors, (ii) promoting liquidity and capital investment, and (iii) increasing transparency, accountability and the distribution of adequate information to creditors. We submit that the Bankruptcy Code should be revised to reinforce these goals, and that any amendments to the Bankruptcy Code that would undercut these goals would adversely impact the ability of companies to reorganize by reducing their access to the capital markets and, thus, result in a greater number of corporate liquidations.

A. Equality of Treatment for Similarly Situated Creditors

It is a basic tenet of the Bankruptcy Code that similarly situated creditors should be treated equally. The automatic stay (section 362), for example, prevents creditors from seizing assets based on a race to the courthouse so that the estate's assets can be distributed equitably among the company's creditors. However, recent amendments to the Bankruptcy Code have eroded this principle of equality – frequently to the specific disadvantage of financial parties who are treated as lesser creditors merely because they have lent money to the debtor. Suggestions for future amendments to the Bankruptcy Code that are premised upon the misconception that participation by financial parties adversely impacts the bankruptcy process only exacerbate this problem. This trend moves the bankruptcy process away from its fundamental grounding in principles of equality and discourages financial investors from participating in the bankruptcy process to the detriment of all parties in interest. It must be corrected.

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3 *See* Testimony of Edith S. Hotchkiss Before the ABI Ch. 11 Reform Comm. (ABI Field Hearing, New York, October 17, 2012).

4 *See, e.g.*, Ziad Raymond Azar, *Bankruptcy Policy: A Review and Critique of Bankruptcy Statutes and Practices in Fifty Countries Worldwide*, 16 Cardozo J. Int'l & Comp. L. 279, 373 (Summ. 2008) (identifying predictability and transparency, among other things, as factors that encourage creditor participation in the bankruptcy process).

1. <u>The Preferential Treatment of Creditors Disrupts the Bankruptcy Process.</u>

The Bankruptcy Code, as enacted in 1978, provided for six categories of unsecured creditors that were entitled to priority over other unsecured creditors.[5] Recent amendments to the Bankruptcy Code, including those enacted through the Bankruptcy Abuse Prevention and Consumer Protection Act ("BAPCPA") in 2005, have increased the number of priority classes and strengthened protections for particular interest groups, such as landlords and vendors, to the detriment of other creditors. These changes reflect a pervasive trend away from the fundamental concept of equality for similarly situated creditors in bankruptcy and, in the aggregate, make it harder for a company to reorganize. As such, MFA urges the Commission to take a fresh look at the existing categories of preferred creditors, and to strongly oppose any proposals that would create additional priority categories or other preferential treatment for particular creditor groups.

Statutory priority and other special treatment for favored creditors undermines the collective reorganization process in bankruptcy by bestowing un-bargained-for leverage and property rights on certain categories of creditors while impairing the bargained-for rights of otherwise similarly situated creditors. Because financial investors in most instances do not enjoy preferential treatment under the Bankruptcy Code, it is often the investors and other capital market players that face an uneven playing field. This imbalance may discourage financial investors from participating in the bankruptcy process. Alternatively, investors who remain willing to participate on this uneven field may mitigate their disadvantage by increasing their required cost of capital. This, in turn, may make it more difficult for a company to access the capital it needs either to avoid bankruptcy altogether or to emerge from bankruptcy as a going concern. Put simply, the sharper the disadvantage perceived by market participants, the less likely they are to invest in the process. MFA believes that their resulting absence would be detrimental to the ability of companies to successfully reorganize.

New categories of priority claims also can increase the cost for a company to emerge from bankruptcy. A particular priority claim viewed in isolation may not seem particularly problematic; however, in the aggregate, preferential treatment for a greater percentage of creditors has unintended adverse consequences, namely, to increase the capital costs of reorganization. To confirm a chapter 11 plan of reorganization, a debtor must pay all of its priority claims in full in cash; other creditors, who share the same priority outside of bankruptcy, typically receive a fractional recovery of cents on the dollar. When the number of parties who must be paid in full increases, additional capital must be expended. This makes it more difficult, and in some instances impossible, for companies to reorganize, which ironically may impose hardships on the very parties the priority categories seek to protect.[6]

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[5] *See* Legislative Reports for 11 U.S.C. § 507, 1978 Acts.

[6] Additionally, as the categories of creditors entitled to special protections has grown, debtors have been forced to engage in negotiations with each of these myriad parties over their potentially unique treatment under a plan. At a minimum, this further increases the costs of chapter 11 and slows down the reorganization process; at worst, it

Unequal statutory protections also risk altering the dynamic between creditor groups. Priorities and protections diminish recoveries for the non-preferred creditor pool. Non-preferred creditors who perceive this additional burden as unfair thus may be motivated to dispute priority treatment. Such intercreditor animosity poses a significant hurdle to achieving consensus among creditors, and increases the likelihood of litigation. In this way, statutory exceptions to the rule of equality cause additional disruption to the underlying bankruptcy process.

2. Differentiation Between Creditors Invites Manipulation by Management.

The Bankruptcy Code also mandates equal treatment for similarly situated creditors through its rules on classification for plan purposes: claims may be classified together only if they are substantially similar, and substantially similar claims may be classified separately only if there is a business or economic justification for doing so.[7] However, the Bankruptcy Code does not define what "substantially similar" means, and in adopting criteria for judging the appropriateness of plan classification schemes, courts have evidenced an increased willingness to accept a debtor differentiating between its creditors. This willingness to accept ever-finer differentiations between categories of unsecured creditors encourages debtor management manipulation and strategic discrimination against groups of creditors. To curb this trend, the Bankruptcy Code should be amended to restrict the scope of the "substantially similar" inquiry.

A recent case of concern in this regard is the decision of the Ninth Circuit Bankruptcy Appellate Panel ("BAP") in *Loop 76*.[8] In that case, the debtor classified the deficiency claim of its undersecured lender in a separate category from other unsecured claims for plan purposes. The lender challenged this classification as impermissible gerrymandering. The bankruptcy court disagreed, and the Ninth Circuit BAP affirmed. In its decision, the Ninth Circuit BAP concluded that, in evaluating classification of a claim, courts have broad latitude to consider all aspects of the claim's nature, not just its rank and priority as it relates to the debtor's assets. Thus, the Ninth Circuit BAP ruled that the bankruptcy court could properly consider a wide range of factors, such as the availability of recovery from a third party and ongoing litigation between the debtor and the lender, and upheld the bankruptcy court's determination that separate classification of the deficiency claim was appropriate in light of these extraneous factors.

Decisions such as this invite management manipulation of the classification rules for strategic purposes. This, in turn, creates uncertainty regarding creditor recovery and treatment under a plan. This is of particular concern for financial creditors. Outside of bankruptcy, a debt-holder who enjoys additional protections in the form of a guarantee from a third party has the same legal rights against the company that any non-financial creditor would. So too does a debt-

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may increase the likelihood of liquidation, if a debtor is unable to reach satisfactory arrangements with each and every one of these distinct groups of creditors.

[7] 11 U.S.C. § 1122(a).

[8] *Wells Fargo Bank, N.A. v. Loop 76, LLC and Genesee Funding, LLC (In re Loop 76, LLC)*, 465 B.R. 525, 540-1 (9th Cir. B.A.P. 2012).

holder who obtains its claim at a discount on the secondary market. To allow those protections to be changed in bankruptcy (an arena in which equal treatment and predictability are paramount) undermines the basic function of the system and discourages investors from participating in the process. To ensure equality of treatment and curb strategic discrimination by management, classification rules should be strictly construed: the "substantial similarity" inquiry for classification purposes should be focused solely on the nature of the claims as it relates to the debtor's assets. Factors such as the motivations of the parties in obtaining their claims, the prices they may have paid for them, or whether the claim holders may be entitled to look elsewhere to satisfy their claims, should not be relevant.

B. Liquidity Enhancement

MFA believes that a well-functioning, active capital market is beneficial to all participants in the bankruptcy process and should be encouraged. But while the Bankruptcy Code and Rules permit debt and trade claim trading with minimal interference or oversight,[9] potential changes to the Bankruptcy Code, current practices and recent developments in case law risk curtailing this market. Chief among the threats to an active capital market in bankruptcy are: (i) the suggestion that creditors should receive lesser recoveries based on any discount at which they obtained their debt or trade claims; (ii) the risk of equitable subordination of traded claims; (iii) excessive restrictions on trading imposed by net operating loss ("NOL") protection orders; (iv) questions regarding parties' abilities to rely on their prepetition bargained-for rights; and (v) uncertainty regarding the financial safe harbors.

1. Pricing Considerations Are Irrelevant to the Treatment a Creditor Should Receive on Account of its Debt or Claim.

The price at which a creditor purchases debt or claims and the creditor's motivations for doing so are not relevant to any aspect of the bankruptcy process, except in rare circumstances where those motivations are illegal or fraudulent. Creditors who purchase debt on the secondary market should enjoy the full benefits of their transaction. In particular, it is imperative that the treatment of debt and other claims under a plan of reorganization be based upon the nature and value of that debt, and not upon the discount at which the creditor may have purchased it. Any suggestion of a contrary rule would signal the immediate end of the secondary market, and have immediate adverse consequences for the capital markets as a whole.

Specifically, if a debtor were able to write off its debt whenever the free market priced that debt at a discount to its par value (as is almost inevitable when the borrower is distressed), the entire premise upon which the capital markets rest – whether in bankruptcy or outside of it – would be upended. There is no such concept under state law, which generally respects the free assignability of claims. The price at which a stock or bond is acquired surely does not impact its

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9 *See* F.R.B.P. 3001(e) (requiring notice of certain types of trades).

economic characteristics.[10] Thus, there can be no "automatic" impairment of value in bankruptcy where the treatment of debt or other claims under a plan is keyed to the price at which it trades. To conclude otherwise would destroy entire trading markets, as there would be no point in purchasing a claim from a bank or trade creditor. Such creditors would be forced to remain burdened with debt holdings or accounts receivable that they do not want and which limit the effective deployment of their capital.

Indeed, it is precisely these considerations, and the uncertainty over the debt claim's eventual value, *i.e.*, how much a creditor will ultimately recover on account of it, that drives the discounts typically evidenced in the secondary markets. All participants in the secondary markets evaluate that risk, and myriad other factors, in determining the price at which they will buy and sell debt and other claims. The price that parties ultimately arrive at based on their analyses cannot, and should not, be itself relevant to what a debtor must pay to satisfy that debt.

It is this type of concern that fueled the vehement debate over Rule 2019 disclosures. Bankruptcy Rule 2019 requires the disclosure of certain information by creditor committees concerning their economic stake in the company. Prior to a 2011 amendment, however, this rule also required disclosure of the prices at which the committees' members obtained their claims.[11] Litigation over this provision was fierce, as investors feared that required disclosures of such commercially sensitive information could, among other things, weaken their bargaining power in negotiations and prejudice them in litigation. Investors warned that, faced with the need to disclose this information, parties might instead opt to abandon their *ad hoc* affiliation – eliminating such investors from positions in the bankruptcy process to the detriment of all.[12] Fortunately, recent amendments to this rule clarify that it is not necessary for a creditor to disclose its pricing information to adequately and appropriately participate in a group of similarly-situated creditors through an *ad hoc* affiliation. In most circumstances, the price paid should not have any bearing on how creditors are dealt with in the bankruptcy process.

By the same token, the motivations of investors in purchasing debt or other claims also should be irrelevant, so long as those motivations are not illegal. Thus, for example, strategic decisions by an investor to purchase debt to obtain a controlling interest or to take a position in the "fulcrum" class should have no bearing on how those holdings ought to be treated in a plan. Accordingly, Congress should take steps to address the consequences of contrary decisions, such

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[10] *See also e.g. In re Rickel Home Centers, Inc.*, 209 F.3d 291, 299 (3d Cir.), *cert. denied*, 531 U.S. 873 (2000) (noting in its section 365 analysis that "[t]he Code generally favors free assignability as a means to maximize the value of the debtor's estate").

[11] *See* Fed. R. Bankr. P. 2019(a)(4) (1991), *amended by* Fed. R. Bankr. P. 2019 (2011) (formerly requiring disclosure of "the amounts of claims or interests owned by the members of the committee. . ., the times when acquired, *the amounts paid therefor*, and any sales or other distributions thereof.") (emphasis added).

[12] *See, e.g., In re Northwest Airlines Corp.*, 363 B.R. 701 (Bankr. S.D.N.Y. 2007) (holding that an *ad hoc* committee of equity security holders was subject to former Rule 2019's pricing and other disclosure requirements); *but cf. In re Premier Int'l Holdings, Inc.*, 423 B.R. 58 (Bankr. D. Del. 2010) (holding that an *ad hoc* committee of noteholders was not subject to Rule 2019's disclosure requirements).

as the Second Circuit's 2011 decision to uphold the designation of no-votes on a plan by a creditor because of that creditor's strategic desire to acquire the company.[13]

2. Debt and Other Claims Transferred in the Secondary Markets Should Not Bear the Risk of Equitable Subordination.

Recent decisions have called into question whether debt and other claims that have been traded on the secondary market may be equitably subordinated based on the misconduct of a previous claimholder. This has injected considerable uncertainty in the market, which threatens to disrupt its basic functioning. The Bankruptcy Code should be amended to address the implications of these decisions, and make clear that a good faith transferee in the secondary market will not face subordination of its debt or claims on the basis of a prior owner's bad acts, regardless of what method of transfer was utilized.

In 2005, the Bankruptcy Court for the Southern District of New York held that Enron could use section 510(b) of the Bankruptcy Code to equitably subordinate certain debt claims based on the allegedly improper conduct of the debt's original owners, even though the debt had been subsequently transferred to innocent third parties in the secondary market.[14] The court characterized this threat as a risk "attendant to a bankruptcy proceeding," with which participants in the capital markets are – or should be – aware.[15] But this characterization is simply incorrect: even if a market participant can obtain an indemnity from the transferor of a debt claim, the pricing of that claim on the secondary market does not take into account the threat of subordination based on the transferor's misconduct.

On appeal, the Southern District of New York agreed, vacating the bankruptcy court's ruling.[16] The district court explained that, in light of the structure of the secondary markets, a purchaser may not be able to determine the identity of the seller of a debt or other type of claim –

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[13] *DISH Network Corp. v. DBSD North America, Inc. (In re DBSD North America, Inc.)*, 634 F.3d 79, 104-5 (2d Cir. 2011) (upholding decision to designate votes pursuant to section 1126(e) based on creditor's bad faith).

[14] *See Enron Corp. v. Springfield Assocs., L.L.C. and Westpac Banking Corp. (In re Enron Corp.)*, 2005 WL 3873893 (Bankr. S.D.N.Y. Nov. 28, 2005) (denying motion to dismiss equitable subordination claims held by subsequent transferees); *see also Enron Corp. v. Avenue Special Situations Fund II, LP et al. (In re Enron Corp.)*, 340 B.R. 180 (Bankr. S.D.N.Y. 2006) (permitting Enron to seek to disallow transferred claims under 502(d), which permits disallowance of claims if the claimant fails to turnover proceeds that are otherwise avoidable under the Bankruptcy Code); *In re KB Toys, Inc.*, 470 B.R. 331 (Bankr. D. Del. 2012) (same).

[15] *See, e.g., Enron*, 2005 WL 3873893, at * 18 ("Participants in the claims-transfer market are aware of, or should be aware of, the risks and uncertainties inherent in the purchase of claims associated with post-petition debtors, including the possibility of claims being subordinated . . . . The purchase of a claim, itself, evidences the transferee's willingness to assume the risks attendant to a bankruptcy proceeding. . . .").

[16] *See Enron Corp. v. Springfield Assocs., L.L.C. and Westpac Banking Corp. (In re Enron Corp.)*, 379 B.R. 425, 442, 444 (S.D.N.Y. 2007) (given the anonymity of the secondary market, "[n]o amount of due diligence on [buyers'] part will reveal that information [*i.e.*, information regarding bad conduct by prior owners], and it is unclear how the market would price such unknowable risk;" for the same reason, secondary purchasers cannot obtain indemnities from their anonymous sellers, an inability which "cripples any reliance on those agreements as sufficient protection").

much less the identity of all prior owners – or obtain sufficient information regarding the conduct of those prior owners to be able to accurately assess the risk of subordination. Thus, the district court acknowledged that "the unnecessary breadth of the Bankruptcy Court's decisions threatened to wreak havoc on the markets for distressed debt."[17]

This acknowledgement, however, does not alleviate the need for Congress to promptly address this issue. This is because the district court decision in *Enron* introduced a new complexity to this topic, holding that whether or not the threat of subordination (or disallowance under 502(d)) travels with the transferred claim depends on the nature of the transfer: debt and other claims that are *sold* are transferred free of such personal disabilities, but those that are *assigned* are not.[18] But as numerous commentators have pointed out, the market for claims does not readily distinguish between a sale and an assignment. Indeed, the terms are used almost interchangeably.[19] Thus, market participants remain unable to assess whether their particular trades will be subject to the taint of prior holders.

Given this uncertainty, MFA strongly encourages the Commission to recommend clarifying the law to make clear that debt and other types of claims that are transferred in the secondary market are transferred free from any taint of wrongdoing committed by a prior holder, regardless of the method of transfer. Until the law is clarified, prudence will require market participants to engage in a heightened level of due diligence and extended negotiation for robust indemnities. But the net effect of this uncertainty is clear: trading is curtailed, and where investors cannot obtain adequate information or assurances, they may opt not to invest at all.

Moreover, this disruption serves no valid purpose: equitable subordination is designed to curb bad acts by creditors. Applying the doctrine to debt or trade claims owned by innocent third party investors does not advance those goals. Other more appropriate remedies, *i.e.*, lender liability rules, already exist under the Bankruptcy Code and state law to accomplish this goal, and debtors should rely on those other remedies to address wrongful behavior.[20]

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[17] *Id.* at 448.

[18] *Id*. The district court remanded to the bankruptcy court for a determination of how the claims at issue were transferred, *i.e.*, whether by sale or assignment. The bankruptcy court did not ultimately rule on this issue, however, since the parties went on to settle.

[19] *See, e.g.,* Tally M. Wiener & Nicholas B. Malito, *On the Nature of the Transferred Bankruptcy Claim*, 12 U. Pa. J. Bus. L. 35, 49-51 (2009) (collecting practitioner commentary regarding this decision that noted, among other things, that Enron had conceded the sale versus assignment distinction was one without a difference for purposes of the instant litigation and that the UCC draws no such distinction); *see also KB Toys*, 470 B.R. at 340 (declining to follow the S.D.N.Y. decision on the basis that there was no way to readily distinguish between a sale and assignment of a claim in bankruptcy).

[20] The same is true with respect to disallowance under 502(d). While disallowance serves a different purpose, namely, encouraging compliance with turnover requirements in avoidance actions, other mechanisms under the Bankruptcy Code can be employed to serve this function.

3. **Debt and Claim Trading Is Unnecessarily Restricted by Overbroad NOL Orders.**

A debtor's net operating loss carryforwards ("NOLs") should be protected from changes of control in bankruptcy by statutory provisions in the Internal Revenue Code ("IRC"), not through the now-common practice of obtaining "NOL orders". MFA acknowledges that NOLs, which a company can use to offset future taxable income and tax liabilities, can be a valuable asset of the estate and that it is appropriate for a debtor to take steps to protect that asset.[21] However, many of the NOL orders presently in use are blunt instruments that severely curtail trading and effectively function as anti-takeover devices.

The starting point for this analysis is the policy behind the elimination of the courts' regulatory role in respect of claim transfers when Bankruptcy Rule 3001(e) was amended in 1991. At the time, the advisory committee explained that the amendment was specifically designed to "limit the court's role" regarding claims trading solely to "the adjudication of disputes regarding transfers of claims".[22] This amendment was consistent with state law regarding free assignability and it succeeded in increasing liquidity and creating a more active claims market – effects that MFA believes are beneficial to the bankruptcy process as a whole. Thus, under present bankruptcy law, court approval is not required for any claim transfer. Unfortunately, the now-prevalent NOL trading orders threaten to undermine the benefits that arose from the 1991 amendment.

Specifically, NOL orders have evolved to regulate trading in stock and debt by substantial holders for the purpose of preserving a debtor's ability to utilize its NOLs.[23] The NOL orders essentially function as braking mechanisms: they impose notice requirements for trades above a certain threshold percentage of the debtor's stock or debt (typically, 4.5%), so that the debtor has an opportunity to review – and, if necessary, object to – the proposed trade to ensure that it will not jeopardize the company's NOLs. The proposed trade is prohibited until the notice and objection periods run or, if an objection is raised, until a court approved the trade.

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[21] *See, e.g., Official Comm. of Unsecured Creditors v. PSS Steamship Co., Inc. (In re Prudential Lines Inc.),* 928 F.2d 565 (2d Cir. 1991) (debtor's right to NOL carryforward was property of the estate).

[22] *See, e.g.,* Wiener and Malito, at n. 34 (quoting the advisory committee notes to the 1991 amendment to Bankruptcy Rule 3001(e)).

[23] Section 382 of the IRC restricts a company's ability to use its NOLs if an "ownership change" occurs with respect to a corporation. Generally speaking, an "ownership change" occurs when the percentage of a company's stock held by certain substantial shareholders increases by 50% over a specified period, generally three years. IRC § 382(g). This limitation does not apply, however, if the ownership change results from transactions that are contemplated by the plan of reorganization pursuant to which historic stockholders and/or "qualified creditors" hold at least 50% of the total value and voting power of the reorganized debtor's stock. IRC § 382(l)(5)(A); *see alternatively* 382(l)(6) (elective bankruptcy exception). Qualified creditors fall into three categories: trade creditors; "old and cold" creditors, *i.e.*, those who held the claim continuously for at least 18 months prior to the commencement of the cases; and – importantly – *de minimis* creditors, *i.e.*, those who hold less than 5% of the company's stock after reorganization. IRC § 382(l)(5)(E); Treas. Reg. § 1.382-9(d)(1)–(3).

Non-compliance with the order results in the trade being void *ab initio*.[24] Thus, these procedures constitute a significant restriction on trading.

Critically, NOL orders give management the authority to prevent large changes in position. As such, they function as anti-takeover devices that prevent the accumulation of sizable holdings by single individuals, and give a debtor's existing management considerable control over the composition of the company's equity and creditor bodies. This control is inappropriate, and is subject to potential abuse. Moreover, by placing regulatory authority in the hands of the debtor, the now-common NOL orders serve fundamentally different ends from their original purpose: where they were originally intended to protect valuable debtor assets, they now can be utilized by management to exert control over creditors.

Exacerbating this problem, creditors have little leverage to contest the imposition of NOL orders or to contest a determination by the debtor that a particular trade is impermissible. This is because NOL orders are prospective, designed to protect against the *potential* loss of an asset that *may* be valuable at a later point in time.[25] It is therefore impossible to determine at the outset of a case whether the NOL order's restrictions are justified. But given the potential value of the debtor's NOLs to a successful plan of reorganization and success upon emergence, courts in many instances appear willing to see these trading restrictions as an appropriate price to pay.[26]

The current practice of NOL orders should be reconsidered. The IRC already provides a safe harbor for NOLs in the bankruptcy context. This safe harbor could be modified to allow more freedom for trading during the pendency of a bankruptcy case while still preserving valuable assets of the estate. For example, consistent with the provision included in a 1985 Senate Finance Committee staff report[27], the safe harbor could apply uniformly to companies

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[24] *See, e.g., In re Northwest Airlines Corp.*, Case No. 05-17930, Dkt. No. 836 (Bankr. S.D.N.Y. Oct. 28, 2005) (enjoining certain stock and claim transfers pending a 30-day notice and objection period, and offering opt-out procedures, in the event that a sell-down was later deemed necessary).

[25] *See, e.g., In re ATP Oil & Gas Corp.*, Case No. 12-36187, Dkt. No. 19, p.15. In its first day NOL motion, the debtor sought to set $94.5 million as the "Threshold Amount" of claims that a creditor could hold without being required to sell down in the future. However, because it acknowledged that it did not yet have a firm sense of what the triggering size of holdings would ultimately be, the debtor reserved the right not only to require a creditor who obtained more than that amount to sell down its holding at a later date, but also to change the designated threshold amount. *Id.* n.11.

[26] *But see* Mayer, at p.1 (arguing that the "injunctions [imposed by NOL orders] are rarely if ever justified: The value of the NOLs preserved will rarely if ever exceed the price paid by all creditors in the loss of liquidity.").

[27] Staff of the Senate Finance Committee, Subchapter C Revision Act, S. Prt. 99-47, 196-197 (May 21, 1985) (known as the "Green Book"). The staff issued the Green Book in response to a request by Senator Dole. The Senate held related hearings on September 30, 1985, but ultimately addressed Subchapter C reform through revisions to the Tax Reform Act of 1986, which originated in the House. The Green Book suggested an exemption from the section 382 annual limitation when the old loss corporation is under the jurisdiction of a court in a title 11 or similar case and the shareholders and creditors of such corporation (before the ownership change) own 50% of the stock (after the ownership change). The Green Book proposal included certain details eventually included in section 382(l)(5), including the interest-chargeback rule for debt converted to equity and the restriction on further ownership changes, but did not limit "creditors" to historic creditors or original holders of claims.

that reorganize under chapter 11 if more than 50% of the pro forma equity is distributed to creditors. With such a rule, trading would not be restricted unnecessarily, and management would cease to function as a *de facto* regulator of trading in the company's debt and equity.

4. Enforcement of Contracts and Bargained-for Rights

Certainty and predictability regarding the enforcement of remedies and rights in a court of law are critical to ensuring capital market participation in the bankruptcy process.[28] Specifically, lenders and investors must have confidence in their ability to realize upon their investment in the event of a bankruptcy. This includes reliance on the enforcement of contracts, applicable state and federal legal rights, including enforcement of lien priority, and the absolute priority rule.

Uncertainty, particularly in this area, causes illiquidity in the capital markets – not to mention the tremendous drain of resources diverted to litigation over the enforceability of various bargained-for rights, such as make-whole and no-call provisions[29], the applicability of the contractual rate of interest,[30] and the consequences of not enforcing such legal rights on a creditors' ability to vote or otherwise participate in the bankruptcy process. The net result of this uncertainty is increased cost, as participants who could be beneficial to the process opt not to participate or, if they do, charge more for their participation.

To end unnecessary litigation and encourage market participation in the bankruptcy process, the Bankruptcy Code should be amended to clarify that creditors' pre-petition bargained-for property rights under applicable non-bankruptcy law, including make-whole and no-call provisions as well as contractual rates of interest, are, subject to the automatic stay, enforceable in bankruptcy. MFA believes that the Sixth Circuit's decision in *Dow Corning* strikes the right balance in this regard and should be codified to avoid any further uncertainty.

5. The Bankruptcy Code's Safe Harbor Provisions Require Clarification.

MFA submits that statutory clarification also is necessary regarding the scope of the Bankruptcy Code's financial safe harbor provisions.[31] Congress enacted these provisions specifically to protect the capital markets, and financial participants in those markets, from any disruption as a result of a counterparty's bankruptcy filing.[32] This goal is accomplished by,

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[28] One need only peruse any loan agreement to see the interrelation of remedies, bankruptcy and capital markets. *See* Richard E. Mikels & Ella Shenhav, *Bankruptcy's Impact on Financial Markets*, Am. Bankr. Inst. J. (Dec/Jan 2011), at p. 1.

[29] *See* David M. Hillman & Lawrence S. Goldberg, *Treatment of "Make-Whole" and "No-Call" Provisions by Bankruptcy Courts*, 7 Pratt J. Bankr. L. 195 (April 2011).

[30] *See, e.g., In re Dow Corning Corp.*, 456 F.33d 668 (6th Cir. 2006); *UPS Capital Bus. Credit* v. *Gencarelli (In re Gencarelli*), 501 F.3d 1 (1st Cir. 2007).

[31] *See* 11 U.S.C. §§ 546(e), (f), (g); *see also* 11 U.S.C. § 362(b)(6), (7), (17).

[32] *See, e.g., Enron Creditors Recovery Corp v. Alfa S.A.B. de C.V. (In re Enron Creditors Recovery Corp.)*, 651 F.3d 329, 334 (2d Cir. 2011) (Congress enacted the safe harbors to "minimize the displacement" that a

among other things, allowing swaps, repos and similar transactions to be unwound notwithstanding the automatic stay, and protecting such transactions from avoidance actions. Thus, these provisions are meant to preserve liquidity and protect the capital markets as a whole.

The opaque language of these provisions, however, has in certain instances created more uncertainty – not less – in the financial markets regarding how the safe harbors function and what type of transactions are protected. Specifically, the provisions were intentionally drafted broadly, so that they encompass a wide range of market transactions and ensure that safe harbors continue to apply as the market continues to evolve and new types of transactions are utilized.[33] But this breadth has had an unintended consequence: based on the plain language of these provisions, some courts have held that the safe harbors extend to protect one-off private transactions that do not involve financial institutions who are active in the capital markets.[34]

In addition, to ensure that Congress's intended goal of preventing a bankruptcy filing by one party from triggering a cascade of disruption throughout the financial markets is served (and to avoid unnecessary litigation), the settlement payment definition in the safe harbor provisions should be tailored to more specifically conform to Congress' original intent.

C. Transparency, Accountability and Adequate Information

A final aspect of the Bankruptcy Code and Rules that requires reform is in the area of debtor and creditor interaction. It is MFA's strong belief that active and engaged creditor constituencies benefit the reorganization process, and that amending the Bankruptcy Code and Rules to improve transparency and management's accountability to creditors is an important step in facilitating creditor participation in the bankruptcy process.

1. Recognizing Misaligned Interests and the Need to Facilitate Participation by All Economic Stakeholders.

The interests of management and the company's general creditor body are often misaligned. While management reports to a prepetition board of directors that was elected by generally out-of-the-money equity holders (and who may hold equity themselves), in most cases, it is usually the creditors that will control the reorganized company upon emergence. Thus, decisions by management regarding the course of the bankruptcy case and how the company emerges may differ substantially from the desires of the future owners of the company.

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bankruptcy filing could cause in the markets) (internal citations omitted); *Hutson v. E.I. de Pont de Nemours & Co. (In re Nat'l Gas Distribs., LLC)*, 556 F.3d 247, 252 (4th Cir. 2009) (Congress enacted the safe harbors "in order to protect financial markets").

33 *See e.g.* H.R. Rep. No. 109-548, pt. 1, at 3 (2006) (stating intent to make sure that "newer forms of contractual arrangements" have the same protections afforded existing financial arrangements); *see also* Eleanor Heard Gilbane, *Testing the Bankruptcy Code Safe Harbors in the Current Financial Crisis*, 18 Am. Bankr. Inst. L. Rev. 241, 244-5 (Spring 2010).

34 *See* Gilbane, at 264-6 (noting that broader definitions are "not necessarily 'clearer'").

This misalignment can engender distrust by the creditor body in management's decisions[35] and, in so doing, disrupt the bankruptcy process. This effect is compounded by the fact that financial creditors are frequently underrepresented on the statutory creditors' committee that is responsible for protecting creditors' interests and frequently acts as the primary party with whom the debtor will engage.[36] This underrepresentation is due to trading restrictions and other considerations that make it impracticable or impossible for economic stakeholders to serve as committee members. Thus, under the existing structure, financial stakeholders may be excluded from key negotiations regarding the future of the company.

As a result, creditors often form *ad hoc* committees to function as the representative voice for the group. However, this is a costly band-aid to a significant gap in the statutory scheme, not a true remedy. In particular, *ad hoc* committees enjoy none of the protections afforded to statutory committees, and so the unrepresentative composition of the creditors' committee is a continuing problem that requires redress.

Moreover, the absence of major economic stakeholders on the statutory creditors' committees renders the committee an imperfect representative for the entire creditor body. Because committees often are populated by parties, such as trade creditors, who own only a small percentage of the company's total claims, when compared to the interests held by financial creditors, they may have specific interests and goals not shared by the overall creditor pool. This can significantly impact the role the statutory creditors' committee plays in plan negotiations: a committee of non-financial creditors may agree to support a plan, but that support no longer means that the debtors are assured of a consenting unsecured creditor class.[37] Thus, to facilitate an effective bankruptcy process, all creditor constituencies must have a voice in the process.

2. <u>Suggestions to Address these Structural Concerns.</u>

We offer for the Commission's consideration the following ideas regarding ways to address the misalignment of interests and incentives during the bankruptcy process.

a. Clarifying When a Chapter 11 Trustee May be Appointed.

In cases where management has engaged in outright fraud, dishonesty or illegal actions, the Bankruptcy Code directs that management be replaced by a chapter 11 trustee. The Bankruptcy Code also, however, allows for the appointment of a chapter 11 trustee "if such appointment is in the interests of creditors, any equity security holders, and other interests of the

[35] In this regard, MFA believes that the shortening of a debtor's exclusive periods under section 1121 pursuant to BAPCPA was a positive development in addressing this type of concern among creditors. Along similar lines, the MFA believes changes in the Code allowing greater oversight by appellate courts have been beneficial and should be reinforced to ensure adequate oversight and accountability over the bankruptcy process.

[36] 11 U.S.C. § 1102(a)(1).

[37] *See* Mayer, at p.5.

estate."[38] While courts recognize that subsection 1104(a)(2) envisions an alternate basis for the appointment of a trustee, namely, in circumstances other than fraud or mismanagement, in practice, this alternative is rarely utilized in the absence of clear misconduct.[39]

MFA therefore suggests that Congress should make clear that parties in interest and the U.S. Trustee may seek appointment of a trustee in circumstances other than fraud – where management entrenchment, misalignment of interests or other factors have significantly impaired the reorganization process such that a neutral third party is necessary to break the logjam. Appointment of a trustee should be authorized if the court believes that a trustee will be better equipped than management to navigate competing interests and facilitate a successful reorganization. The preference of all creditors should be taken into account – both in the appointment of an interim trustee and in any subsequent election.[40]

Because the installation of a trustee can be costly – namely, by delaying the reorganization process while the trustee becomes familiar with the company's operations and the status of the case to date and by losing the benefit of managers with historic knowledge and familiarity with the company's operations[41] – it may be appropriate to grant the court discretion to modify the trustee's role in appropriate circumstances to minimize these costs. In this, the varied roles envisioned for chief restructuring officers ("CROs"), particularly those who are appointed at the request of pre- or post-petition lenders, may be instructive.[42]

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38 *See* 11 U.S.C. §§ 1104(a)(1) and (a)(2).

39 It is far more common for a court to appoint a trustee under the mandatory provisions of section 1104(a)(1), and then recognize that section 1104(a)(2) would also be satisfied. *See, e.g., In re Marvel Enter. Gp., Inc.*, 140 F.3d 463, 474 (3d Cir. 1998) (after upholding appointment of a chapter 11 trustee for "cause" under section 1104(a)(1), noting that the "level of acrimony" between management and creditors in the case would also satisfy the "flexible standard" of section 1104(a)(2), because appointment of a trustee was in the best interests of creditors and the estate).

40 While the Bankruptcy Code and Rules include election procedures regarding the appointment of a permanent trustee in order to take the preference of all creditors into account, no comparable mechanism presently exists with respect to choosing an initial trustee to serve in the period before an election is held. *See* 11 U.S.C. § 1104(d) (requiring that the U.S. Trustee "consult" with "parties in interest" regarding such an appointment); Fed. R. Bankr. P. 2007.1. Moreover, the existing election procedures exclude secured creditors from voting, except with respect to any deficiency claim they may have. Collier on Bankr. § 1104.02[8][b][iv]; 11 U.S.C. § 702(a). We believe this exclusion should be revised in light of increasingly levered debtors whose creditor body may, in certain instances, be comprised primarily of secured creditors and/or whose fulcrum securities are junior secured classes, as discussed below.

41 *See, generally,* Azar, at 296-301 (regarding management replacement).

42 The option to appoint a CRO does not, however, obviate the need for reconsideration of the role and use of a trustee. The appointment of a CRO is not a panacea; depending on the circumstances of a CRO's appointment – namely, who selects and directs the appointment – the installment of a CRO may not adequately address creditor concerns regarding management entrenchment and, in fact, could lead to further misalignment if the CRO is beholden to the board or management.

b. Installing New Members to the Board of Directors.

In circumstances where appointment of a trustee is not appropriate or is impractical, an alternative means of addressing creditor concerns over misalignment of interests should be created. Specifically, consideration should be given to the possibility of empowering the Office of the U.S. Trustee to appoint one or more new directors to the company's existing board. To prevent abuse of this process, such appointments could be conditioned upon a showing before the court that additional directors would be in the best interests of creditors. The goal of such an appointment would be to improve creditor trust in the decision-making processes of management and the company's board during the pendency of the bankruptcy cases.

Because these new directors would be installed in response to creditor concerns, it would again be important for the preferences of all creditors to be taken into account in designating these independent directors. Furthermore, because the official creditors' committee may not – for the reasons previously discussed – adequately represent the creditor body as a whole, a mechanism for obtaining the necessary creditor input would be necessary, since reliance on the committee may not suffice.

c. Reconsidering the Mandate of the Official Creditors' Committee.

The mandate of a statutory creditors' committee should be reconsidered, particularly in cases where unsecured creditors are unlikely to receive a meaningful recovery. In recent years, debtors are often increasingly levered, resulting in junior secured creditor classes – not unsecured creditors – holding the fulcrum securities. In such cases, the statutory creditors' committee is not an equal negotiating partner of the debtor, since it represents creditors with a *de minimis* stake in the future company. In fact, the only avenue of recovery for unsecured creditors in such cases is typically litigation of sometimes dubious causes of action, which can cause the statutory committee to focus unduly on future litigation value.[43] It therefore may not be appropriate for a statutory creditors' committee to be appointed in these cases; or, at least, limits should be placed on the committee's role.

MFA suggests that, in such cases, better ways exist to deploy limited estate resources. The Bankruptcy Code's provisions regarding the appointment of equity or other statutory committees may be instructive in this regard.[44] For instance, the U.S. Trustee could be granted

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[43] *See* Jo Ann J. Brighton & Felton E. Parrish, *What's Left for Unsecured Creditors?*, Am. Bankr. Inst. J. 40 (Nov. 2008) (due to increasingly-levered companies and other trends, litigation offers the best avenue for meaningful unsecured creditor recoveries and committees are thus incentivized to be aggressive and adversarial). Notably, this focus on litigation of sometimes dubious benefit to unsecured creditors does not end with the bankruptcy case; liquidation trusts created under a plan often continue this pursuit, filing preference actions and other litigations claims that may ultimately yield little value for creditors. Because these trusts are subject to minimal oversight, thought should be given to how they may be better monitored and controlled, so that limited estate resources are expended as effectively as possible.

[44] *See* 11 U.S.C. § 1102(a)(2) ("On the request of a party in interest, the court may order the appointment of additional committees of creditors or of equity security holders if necessary to assure adequate representation of creditors or of equity security holders.").

the discretion not to appoint a statutory unsecured creditors' committee unless there is a material likelihood of unsecured recovery, or such a committee could be appointed with a more limited role, as is often done in equity committee appointments.

Alternatively, or additionally, steps could be taken to encourage the practice of appointing additional committees of creditors – as already permitted by section 1102(a)(2).

d. Aligning Professional Compensation to Competitive Market Forces.

A good example of the misalignment of interests between management/statutory committees that appropriate creditor involvement might remedy is professional compensation. Under the Bankruptcy Code, the debtors and court-appointed committees retain various advisors, whose fees are paid by the estate.[45] But, as discussed in MFA's September 21, 2012 letter to the Office of the U.S. Trustee regarding their proposed fee guidelines, estate-paid professionals often receive a *de facto* premium above what they would ordinarily charge outside of bankruptcy. Where clients outside of bankruptcy frequently negotiate alternate fee structures that include discounts and caps, no comparable mechanism exists in bankruptcy, where fee structures are typically negotiated by the company's existing owners, but where the bills are invariably paid by as a practical matter by the new owners. MFA recommends that the U.S. Trustee have appropriate statutory authority to ensure that similar alternate fee structures and discounts be applied with respect to estate professionals.

e. Improving Information Flow to Creditors.

Creditors often lack adequate information about the debtor that would allow them to fully participate in the process. While MFA is mindful of the need to preserve commercially sensitive information,[46] transparent financial reporting by companies is a requirement for any properly functioning market and a necessary component of meaningful creditor participation in the restructuring process.[47]

Unfortunately, the Bankruptcy Code and Rules as presently drafted do not ensure that creditors receive the necessary information about companies and their chapter 11 cases. This results from a variety of factors, including that companies may cease to publicly report financial information after filing, and that the form of monthly operating reports ("MORs") presently in use do not contain adequate information or analysis that is useful to the marketplace. While

[45] 11 U.S.C. §§ 327, 330, 1103.

[46] Confidentiality concerns are not limited to debtor information. Both creditors and estate professionals also confront the need to disclose confidential or proprietary information: the debate concerning Rule 2019 disclosures is a key example for creditors; whereas rate information and, particularly, any discounts that professionals have granted to other clients, are of concern to professionals. MFA suggests that appropriate mechanisms could be created to protect such information in cases where it need be provided, perhaps by providing certain information solely to the U.S. Trustee and on a confidential basis.

[47] *See, e.g.,* Azar, at 373 (noting importance of "the continuous flow of information to creditors throughout [the bankruptcy process]").

some of the recent amendments to the Bankruptcy Code and Rules have been directed at addressing this problem, these amendments have been largely ineffective. For example, BAPCPA imposed an affirmative obligation on the part of official creditors' committees to "provide access to information."[48] The resulting generally-accepted practice regarding this requirement is for creditors' committees to maintain a website that provides quite limited information, such as an overview of the chapter 11 process and key docket filings.[49] But such websites are almost entirely duplicative of the websites that debtors' claims agents already maintain, and thus increase costs for no tangible benefit.

Changes are also required with respect to debtors' monthly reporting requirements. Debtors are required to file MORs, the content of which is regulated by the Office of the U.S. Trustee and the forms they provide.[50] However, these guidelines and forms generally do not distinguish between types of debtors and types of bankruptcy cases, *i.e.*, reorganization or liquidation; MFA believes that MORs should, at a minimum, be specifically tailored to both of these considerations. MFA further believes that the form of MORs should be updated to more accurately reflect the type of information that would be useful to investors.[51] Moreover, the format in which information is conveyed to creditors – whether in a website or an MOR – could be improved. A substantial volume of information is often provided, but without any accompanying assessment or analysis by management or the committee as to its import.[52]

Steps should also be taken to prevent public reporting companies of a certain size from being able to sidestep their SEC reporting while in bankruptcy. In light of the volume of disclosures required by a chapter 11 debtor, the SEC has issued "no-action letters" to debtors that relieve them from continuing to meet their SEC reporting requirements during the pendency of the case.[53] However, as outlined herein, despite the volume of information that must be disclosed in bankruptcy, the form and content of this information remains problematic; thus, bankruptcy disclosures such as MORs are simply not adequate replacements for SEC reporting.

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48 11 U.S.C. § 1102(b)(3).

49 *See, e.g., In re Refco Inc.*, 336 B.R. 187, 198 (Bankr. S.D.N.Y. 2006); *see also id.* Ex. A.

50 *See* 11 U.S.C. §§ 704(7) and (8) (requiring periodic reports regarding the business and other information); F.R.B.P. 2015; *see also* Form of MOR for Corporate Chapter 11 Debtors for the Southern District of New York, updated March 12, 2008, available at http://www.justice.gov/ust/r02/reg_info.htm#ch11.

51 MFA would be willing to work with the Commission to craft proposed updated reporting guidelines.

52 Another example where information flow could be improved concerns creditor access to a debtor's claims docket. Presently, the claims agents who administer the claims docket are estate professionals; as such, a debtor who wishes to restrict access to its full claims docket may be able to do so, notwithstanding section 107(a), which provides that all papers filed on the docket must be made available to the public free of charge. However, claims agents are actually retained to facilitate administration of the case by the Clerk's Office, pursuant to section 156(c) of Title 28 of the United States Code. As such, any attempts by a debtor to regulate information in this way is impermissible.

53 *See* SEC Staff Legal Bulletin No. 2 (April 15, 1997), available at www.sec.gov/interps/legal/sbcf.2. One of the requirements to obtain a no-action letter is little or no trading in the debtor's securities – a factor which may lead to such letters being denied in many cases with active secondary markets. *See* Mayer, at 11 n. 18.

f. Creditor Input in Decisions Regarding Post-Reorganization Matters.

Because creditors often will become the new owners of a company upon its emergence from bankruptcy, the need for creditor involvement in the plan process does not stop with its proposed treatment of creditors' claims. Rather, meaningful creditor involvement is critical with respect to all elements of a plan of reorganization, because many of the plan's ancillary provisions and agreements will have a significant effect on the reorganized entity. Board composition is one such example: the company's future board of directors is invariably selected as part of the plan process. Yet minimal guidelines exist with respect to how those individuals are selected, and creditor input may be limited to consultation with the statutory creditors' committee, which may, for the reasons described above, be unrepresentative of the entire creditor body and hold only a small percentage of the overall claims. As a result, the creditor body frequently learns of the identities of new board members only after they have voted on the plan.

The Bankruptcy Code should be amended to specifically recognize that, in most instances, a company's creditors will become its future owners. Thus, creditors (to the extent they will be the future stockholders) should have the same role in selecting the company's future board members that they would have as stockholders outside of bankruptcy. Granting creditors – particularly larger creditors who will hold a significant stake in the reorganized company – a substantive role in this aspect of plan formation would, therefore, appropriately align the current process with existing principles of corporate governance outside of bankruptcy.

A similar issue arises with respect to management compensation, the negotiations of which have in certain instances significantly delayed the chapter 11 plan process. While MFA acknowledges that provision for available equity for management compensation and management's employment agreements must often be negotiated as part of the plan process, decisions regarding grants in the reorganized company's stock should be left to the company's new board and be made post-emergence. Doing so would be consistent with the recent amendments to section 503(c), which recognize that appropriate checks and oversight are often needed on management compensation decisions during chapter 11.

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In conclusion, I would like to thank the Commission on behalf of MFA, for allowing us to present our views on these matters. We are committed to working constructively with the Commission regarding the future of the bankruptcy process and look forward to our further engagement on these matters.