Statement of Judge Edith H. Jones,
Fifth U.S. Circuit Court of Appeals and
Member, National Bankruptcy Review Commission

Thank you for providing me the opportunity to comment on this Commission's renewed study of Chapter 11. Having served for two years on the previous federal bankruptcy review commission ("NBRC"), I understand the magnitude of the task you have chosen and wish you well in your demanding work. Please let me know if you need any further or issue-specific observations.

Before writing this statement, I reviewed statements of the Commissioners and many of the prestigious commenters who have presented their views. Two impressions struck me: how much the nature and status of creditor groups and debtors has changed since the NBRC was studying Chapter 11; and how much the issues nevertheless resemble those we debated. Thus, today's debtors, according to the comments, are usually leveraged to the hilt when they enter Chapter 11, with far fewer resources to tap for cash collateral as they try to reorganize. And today's creditors (in big cases) tend to be highly sophisticated secured creditors, hedge funds, and claims traders; their size, together with the proliferation of committees, dwarfs the waning influence of trade creditors and local lenders. The business landscape surrounding Chapter 11 has changed dramatically. Still, the ideological debates reflected in the NBRC Report and the dissent I authored from that commission's Chapter 11 recommendations continue to endure. The issues that preoccupy (and divide) commenters to this

Commission include the costs of Chapter 11, the time required to complete a plan, the relative treatment of creditor groups *inter se* and compared with the debtor; and the Code's complexity. However, because BAPCPA altered the treatment of trade creditors, the length of the exclusivity period and the timetable for rejection of leases, debtors' advocates now tend to support significant changes in bankruptcy law.

Implicit in many of the comments I read are the themes that (a) debtors need to regain leverage (*i.e.*, increased ability to litigate) against various adversaries; (b) there are too few confirmed plans because of BAPCPA's more stringent provisions; (c) debtors lack sufficient control in Chapter 11; and (d) the court's discretionary decision-making is superior to rules of the marketplace. Because I do not know which proposals the Commission will study in depth, it would take far too long to analyze each of them based on these themes. Instead, I offer the following general observations.

First, commenters acknowledge that debtors now are likely to be far more highly leveraged than in the past, to have far fewer tangible assets, and to depend more on human and intellectual capital that is not easily valued or transferred. These are extrinsic economic facts that the Bankruptcy Code cannot change. That claims traders purchase the interests of some creditor classes, and therefore reduce those classes' transactional costs of bankruptcy while affording them a quick payout, is another fact, even if it complicates debtors' strategies. Claims trading reflects the sophistication of modern financial markets. Furthermore, if the debtors entering Chapter 11 have more secured debt, it is because the financial markets have been creative in extending credit, and credit has democratically spread beyond the age when it was tied to real estate and hard collateral. If the ready availability of credit from non-local or non-traditional lenders is perceived as the problem, bankruptcy cannot address it directly. The risk that borrowers will incur excessive debt can be controlled by credit regulations, usury laws, or restrictions on lenders. (Of course, restricting credit availability directly would be foolish during this weak economic recovery.) Facts are stubborn things, as John Adams said. Because of extrinsic facts like these, it behooves the Commission to discern exactly what problems bankruptcy law can solve, what problems it cannot solve, and equally important, how a misguided attempt to "solve" problems in reorganization law may boomerang against the healthy renewal of the economy as a whole.

Second, the Commission should beware of staking out positions that cumulatively appear to promote the interests of "the bankruptcy community" over the general business community. In my view, a serious shortcoming of the NBRC Majority Report was its myopic emphasis on measures that favored debtors, the discretion of bankruptcy courts, and bankruptcy professionals. The bias did not endear the Report to Congress then and would not do so today because, in the end, far more Americans will be touched by bankruptcy as creditors than debtors. Responsible, even-handed reform measures should be pursued, if they are needed, and the interests of all affected parties must be explicitly balanced.

Third, the fulcrum of Chapter 11 should remain the absolute priority rule, as applied by the Supreme Court in *RadLAX Gateway Hotel, LLC v. Amalgamated Bank*, 132 S. Ct. 2065 (2012). Fairness and predictability among creditor groups and between the debtor and each secured creditor, are protected by the absolute priority rule. This rule codifies what the Supreme Court has long held: with few exceptions, bankruptcy law should not be a source of property rights but the means by which rights created elsewhere (in contract or state or federal law) are enforced. *Butner v. United States*, 440 U.S. 48, 54, 99 C. Ct. 914, 918 (1979).. The priorities created outside of bankruptcy furnish certainty for actors in the marketplace. If bankruptcy law is amended to alter the priorities among creditors or allow debtors to infringe the secured lenders' rights, credit markets will reflect increased risks and become more costly for all borrowers to access. If courts are able to modify priorities according to their perception of the "equities" of a case, the inconsistent results will encourage creditors to tighten lending contracts *ex ante* or, even worse, avoid risky lending at all costs. Credit, the lifeblood of entrepreneurship, will shrink.

Fourth, from a broad perspective, debate over the "reform" of Chapter 11 is really a debate about the rule of law in the bankruptcy court. Various proposals I reviewed seek the elimination of BAPCPA-imposed deadlines for exclusivity and for rejecting executory contracts; increased flexibility for bankruptcy judges to micro-manage each case; options to sur-charge secured creditors or DIP lenders; and the creation of open-ended formulas to consolidate separate corporate entities or collapse bankruptcy-remote vehicles. Each of the proponents no doubt has the best interests of Chapter 11 at heart. But all of these ideas threaten to undermine the rule of law itself. The rule of law means that *intelligible* standards of conduct exist as guides for personal decision making; the standards are democratically developed by legislatures or public rulemaking bodies; and they are enforced equally throughout the community. The greatness of American commercial law derives from its application of general and predictable rules that have fostered investment and wealth creation unimaginable in the history of the world. Investment, after all, is a bet on the future that rational men make only if they have a sense of what the future holds. The rule of law secures the property rights that underlie investment, growth, and rising prosperity.

Bankruptcy's and reorganization's fresh start are essential to the vitality of American commerce, but bankruptcy, too, must follow the rule of law. Too often, the judicial discretion exercised in pre-BAPCPA Chapter 11 cases meant that all bets were off for various creditor classes; that parties had to bear the high costs of litigating to protect their contract rights; and that cases would linger, with escalating administrative costs, in the courts for years. Creditors' pre-existing contract rights, in short, became uncertain in Chapter 11 cases. It is not my purpose simply to defend the changes in Chapter 11 wrought by BAPCPA, although I would defend them. My purpose here is to caution against proposals that throw the fate of Chapter 11 reorganization efforts largely in the hands of individual judges. It is simply not accurate that judges (including me) are usually better arbiters of property rights than our body of commercial law or better prophets of success than the marketplace. Replacing fixed rules and standards with enhanced discretion threatens to turn back the clock to the era when bankruptcy judges were viewed less as adjudicators than as referees. Reopening reorganization law to uncertainty, discretion, and subjective "equity" is at odds with the characteristics of the rule of law—intelligibility, democratic accountability, and evenhanded application. Retreating from the rule of law, which Justice Scalia aptly called a "law of rules," poses a systemic threat to our commercial system.

Fifth, a final observation from the appellate bench is appropriate. Guided by the Supreme Court's consistent approach, most federal judges no longer view bankruptcy law as a special equitable tool, but as a Code that is subject to general rules of statutory interpretation. This approach was emphasized most recently in *RadLAX*. Non-bankruptcy federal judges are well equipped to interpret law. We are less well equipped to review equitable or multi-factored decisions. Enacting "reforms" that confer enhanced discretion on bankruptcy judges will lead to very inconsistent results and, especially in high profile cases, increased calls for withdrawal of the reference.

Laudable as are the goals of fostering enterprise reorganization and preserving employment, Chapter 11 ultimately has to be viewed within the wider context of the American economy. Our national purposes are best served if Chapter 11 offers shelter for troubled businesses and the possibility of a fresh start while minimizing externalities in the financial, trade, and investment environment so that more enterprises will prosper and fewer will need protection.

Houston, Texas
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