

**STATEMENT OF JOHN COLLEN
TO THE AMERICAN BANKRUPTCY INSTITUTE'S
COMMISSION TO STUDY THE REFORM OF CHAPTER 11**

**SUBMITTED AT
THE NATIONAL CONFERENCE OF BANKRUPTCY JUDGES
SAN DIEGO, CALIFORNIA**

OCTOBER 26, 2012

First, I thank the Commission for its time and for its consideration of this statement.

**I.
QUALIFICATIONS**

My name is John Collen. I am a partner located in the Chicago Office of Tressler LLP, where I head the firm's national insolvency and restructuring practice. Since 1980, the year I was admitted to the bar, my practice has focused on representing parties in interest in complex chapter 11 matters. I have handled all phases of chapter 11 matters, from filing through post-confirmation matters, and have represented the interests of diverse parties, including debtors, secured creditors, unsecured creditors, landlords, retirees, creditors' committees, and franchisees' committees.

I have been an ABI member since 1989, and am co-chairman emeritus of the Real Estate Bankruptcy Committee, which I helped found. I am a member of the American College of Bankruptcy, Class XIV. In addition, since 2004, I have been an Adjunct Professor of Law in the Bankruptcy LLM Program at St. John's University Law School in New York, where I teach Partnership, LLC and Alternative Entity Bankruptcy. I hold an AV rating from Martindale Hubbell. Further information about my biography and practice is available on my firm's website, www.tresslerllp.com.

My general contact information is:

John Collen, Esq.
Tressler LLP
233 South Wacker Drive, 22nd Floor
Chicago, Illinois 60606-6399
Phone: (312) 627-4000 / Direct line: (312) 627-4193
Fax: (312) 627-1717
jcollen@tresslerllp.com

II.

VIEWS EXPRESSED ARE PERSONAL ONLY

The views expressed in this statement are solely my own, and do not reflect the views, nor carry any explicit or implied approval or disapproval, of any organization with which I am professionally affiliated, including, without limitation: Tressler, LLP, including any of its partners, employees or clients; St. John's University Law School; The American College of Bankruptcy; and the American Bankruptcy Institute.

III.

SUMMARY

In Parts IV and V of this statement, I shall address three Bankruptcy Code sections, namely, 11 U.S.C. §§503(b)(9), 365(d)(4) and 1121(d)(2) which I urge be reformed, on the grounds that those sections, in their current form, actually inhibit the success of chapter 11 cases. In Part VI, I shall discuss the troubling scope and implications of the United States Supreme Court's recent decision in *Stern v. Marshall*, ___ U.S. ___, 131 S.Ct. 2594 (2011) and advocate that bankruptcy judges be made Article III judges. The critique is intended to be concise, practical and somewhat informal, rather than academic.

IV.

THREE CODE SECTIONS IN NEED OF REFORM

In 2005, Congress passed the BAPCPA (Bankruptcy Abuse Prevention and Consumer Protection Act of 2005), P.L. 109-8. That legislation enacted numerous changes to the United States Bankruptcy Code, 11 U.S.C. Sec. 101, et seq. (the "Code"), and created the following sections in their current form: 1) section 503(b)(9) which, in substance, affords administrative claim status to any vendor selling goods to a debtor in the ordinary course of business within 20 days prior to the commencement of a case; 2) section 365(d)(4) which, in substance, creates an absolute maximum time limit of 210 days within which to assume or reject leases for non-residential real property; and 3) section 1121(d)(2) which creates an absolute limit of 18 months after the order for relief within which the debtor can retain the exclusive right to file a chapter 11 plan and creates a further absolute time limit of 20 months after the order for relief within which the debtor may retain the exclusive right to solicit plan acceptances.

As discussed below, each of these sections have problematic consequences.

I. **11 U.S.C. §503(b)(9): The Problem**

Prior to the enactment of this section, there was a bright line such that debts rising pre-petition were (in the absence of security or priority) simply general unsecured claims. Vendors of goods who acted timely under 11 U.S.C. §546 could exercise reclamation rights provided by The Uniform Commercial Code. Otherwise, a pre-petition vendor was a general creditor. Current 11 U.S.C. §503(b)(9) changes that by converting into an administrative creditor every

vendor who sells goods to a debtor in the ordinary course of business within 20 days of bankruptcy.

The criticism is simple. As a consequence of 11 U.S.C. §503(b)(9), chapter 11 estates face increased administrative claims. This can put huge demands on cash on hand as of the filing date should sellers of goods seek immediate payment of administrative expense under §503(a). Further, it can make compliance with §1129(b)(9)(A) challenging or, in some conceivable cases, impossible. That section requires that, in order to be confirmable, a chapter 11 plan must provide for the payment of all administrative claims in full in cash on the effective date (unless the claimant agrees otherwise).

2. 11 U.S.C. §365(b)(4): The Problem

Prior to the enactment of this section, debtors who were parties to unexpired leases of non-residential real property had 60 days to elect to assume or reject those leases, or such additional time as the court might grant within that 60 day period or within any extensions thereof. It was common to obtain multiple extensions of time to assume or reject leases or to obtain a single extension of time through plan confirmation.

Current 11 U.S.C. §365(d)(4)(A) creates an initial 120-day period within which to assume or reject leases for non-residential real property, and 11 U.S.C. §365(d)(4)(B) permits a single discretionary 90-day extension for cause. Failure to elect within the time limit creates a deemed rejection with the trustee obligated to “immediately surrender” the property to the lessor. *See, Id.*

A related and simultaneously enacted provision of the Code, 11 U.S.C. §503(b)(7), limits the administrative claim for rejection of a previously assumed lease to 2 years rent. Under prior law, the administrative claim for rejection of a previously assumed lease was not limited by the Code, and the claim for breach, determined under applicable non-bankruptcy law, could, in most states, extend to all remaining rent due under the lease (subject to mitigation). The prospect of liability on such a claim deterred premature or improvident assumptions, but since there was no necessary deadline, debtors could wait to assume a lease until they could be sure it was the right decision.

Here again the criticism is simple. Bluntly put: 210 days may not be sufficient to make an informed election, especially if marketing of the lease is involved, or if sales or leasing trends at a given location must be determined in order to decide if leasehold should be kept. The “price” of a premature assumption election, namely a two year administrative claim, may, in a given case, be an unwise gamble. The result, in some cases, will be rejection of a lease which would otherwise have been of value to the estate if only more time had been available to make an election.

3. 11 USC §1121(d)(2): The Problem

Prior to the enactment of this section, there was no statutory limit on extensions of time within which the debtor could seek to retain the exclusive right to file a plan or seek to retain the exclusive right to solicit plan acceptances. Now, section 1121(d)(2)(A) imposes an absolute limit of 18 months on a debtor's exclusive right to file a plan after filing the date of the order for relief, and 1121(d)(2)(B) imposes a limit of 20 months on the debtor's exclusive right to solicit acceptances.

Once again there is a simple critique. For a substantial enterprise which is attempting to reorganize, 18 months may not be enough time to make operational changes and measure their effect in constructing a feasible plan. The result may be the proposal of a premature plan – meaning that it may be unconfirmable compared to a hypothetical future plan, or that it may be confirmable but provide for an inferior distribution as compared to a hypothetical future plan. Further, creditors intent on their own approach to the case have an incentive to “hold-out” until they have the chance to file a counter-plan, which can inhibit cooperation.

4. The Cumulative Effect

It is admittedly very difficult to measure the effect of these changed Code provisions on the frequency of filings, or on the success of chapter 11 cases. Each case and each business is different from every other. External conditions change consistently, and no two periods in time have the same economic conditions or environment.

And yet . . . I have a firm conviction that the three Code sections just discussed have a negative impact on prospects for success. Section 503(b)(9) reallocates resources to a selected class of prepetition creditor in a way that makes cash management, and perhaps plan confirmation, harder. Section 365(d)(4) makes it harder for a debtor to judge whether a lease should be assumed or rejected, and riskier economically to make a wrong call. Section 1121(d)(2) restricts a debtor's ability to control a plan, even when it should have control, for example, to constrain a particularly obstreperous group or interest.

What I can say from my own counseling experience is that these provisions can be enough to keep a chapter 11 case from even being filed. *A fortiori*, they may reduce or inhibit the success of cases that are filed. By definition a successful chapter 11 case involves a confirmed plan which provides creditors with some premium over a liquidation case. 11 U.S.C. §1129(a)(7)(A)(ii). The loss of that premium is one cost of not confirming a plan, including failure to confirm a plan failure to confirm a plan because a case is never filed. There may be other profound costs as well, such as lost jobs and diminished tax revenues. Those are consequences which sound policy seeks to avoid.

V.
SOLUTIONS

1. Repeal 11 U.S.C. §503(b)(9)

I see no reason why Section 503(b)(9) simply should not be repealed, and restore the system as it existed pre – BAPCPA. That would lessen the cash burdens imposed by the section, as discussed above. Further, it would put prepetition sellers of goods and services back on a par with each other. I find no principled legal or moral argument why sellers of goods and services should be treated differently, with one group of sellers within 20 days of the petition receiving (in most cases) 100 cents on the dollar, and the other such group receiving only a fraction of that. Indeed, such disparate treatment is anathema to general bankruptcy principles. Imagine a chapter 11 plan that put all prepetition services providers in one class and all prepetition sellers of goods in another class, and then proposed disparate treatment for the classes. Such a plan would rather clearly run afoul of 11 U.S.C. §1129(b)(1), and be unconfirmable (absent consent). Congress, of course, has the raw power to create special classes and require disparate treatment of them. My only point here is that doing so runs contrary to a general philosophy of equality of distribution.

2. Repeal 11 U.S.C. §365(d)(4)

Section 365(d)(4) emerged partly as a result of long and effective lobbying for landlord interests. The desire of landlords to have certainty as to the future of a lease is understandable. However, landlords are fully protected post-petition for rent until a lease is assumed or assigned. Delay does not cost them rent. *See generally*, 11 U.S.C. §365(d)(3), requiring post-petition compliance with lease terms pending assumption or rejection of a non-residential real property lease.

I believe that section 365(d)(4) creates incentives to reject leases by depriving a debtor of adequate time to make a fully informed decision and by penalizing premature assumptions. Further, I believe that what is really at stake is the estate's ability to monetize leasehold equity. Landlords control that outside of bankruptcy through anti-assignment clauses which keep a lessee from monetizing leasehold equity for its own benefit (although the lessee can continue to enjoy below market rent). But anti-assignment clauses are generally unenforceable in bankruptcy. *See*, 11 U.S.C. §365(f). Historically, a debtor's assignment of below market leases has been a source of revenue for reorganizing debtors by allowing them to monetize leasehold equity.

The real question of whether the estate should be able to easily monetize leasehold equity should be confronted head-on. If the answer is "yes," go back to the old system. If the answer is no, then why not just allow enforcement of pre-petition anti-assignment clauses? The current statute is not a policy; it is a tangle.

All I advocate is to confront the real question, answer it clearly and legislate accordingly. Honestly deciding who can monetize the leasehold equity avoids the need for any inherent statutory deadline to assume or reject, as long as the debtor is current in its post-petition lease obligations.

3. Modify §1121(d)(2)

Much debate surrounded placing an outer limit on the debtor's exclusivity periods. Proponents pointed to cases where debtor control extended year after year, frustrating creditor efforts to propose a plan. I tend to agree that there were instances of abuse under the old system. On the other hand, there clearly are conceivable instances where a debtor may legitimately need more than 18 months of exclusivity to file a plan.

An approach I would urge the Commission to consider is to permit extensions of time beyond 18 months, but perhaps with a heightened showing of need – something higher than “cause.” I doubt there is any single best formulation, but one I came up with is “clear and convincing evidence that such additional extension of time is in the best interests of the estate and of creditors generally.” The particular formulation is less important than the principle that, in a proper case, the court should be able to extend the exclusivity periods beyond 18 and 20 months.

VI.

STERN v. MARSHALL:
THE CASE FOR ARTICLE III BANKRUPTCY JUDGES

1. A Tale From The Front

The following is a very truncated version of a much longer story. I recently represented a premium finance company which sought to modify the automatic stay in a bankruptcy case in order to realize on its collateral assignment of unearned insurance premiums.¹ An opposing creditor objected to stay relief, saying it had a prior set-off right in the same premiums, and saying that, therefore, there was no remedy or relief available to my client and that it would be pointless to modify the stay (i.e., no “cause” existed under §362(d)(1) to modify the stay).

At the hearing on my motion, one of the issues raised by Bankruptcy Judge Metz, a very able and experienced judge, was whether *Stern v. Marshall* precluded his deciding the state law issue – i.e., that a set-off right trumps a collateral assignment of unearned premiums. After an hour of very able arguments by all counsel, and penetrating inquiries from the Court, the litigants agreed to stipulate to stay relief while expressly preserving the set-off claims for state court adjudication.

¹ *In re R.L. Carter Trucking, Inc.*, Case No. 10-14458-AJM-7 (Bankr., S.D. Ind.).

**STATEMENT OF JOHN COLLEN
TO THE AMERICAN BANKRUPTCY INSTITUTE'S
COMMISSION TO STUDY THE REFORM OF CHAPTER 11**

As one old enough to have lived through the Marathan²-EJR³-BAFJA⁴ saga, the foregoing episode was deja-vu, again. *Stern* has introduced the category of “statutorily core, but not constitutionally core,” proceedings such that a bankruptcy court cannot enter final orders in some sub-set of core proceedings. The problem is: “what is that subset?” And the short answer is: everyone is still trying to figure it out (meaning there is no consensus; I acknowledge there may be individuals who are convinced they have figured it out).

Of course, the problem only exists because bankruptcy judges are not Article III judges, and therefore can only finally adjudicate public rights rather than private rights.⁵ The problem evaporates if bankruptcy judges are made Article III Judges.

I recently attended an American College of Bankruptcy Roundtable in Chicago where there seemed to be a general agreement that bankruptcy judges ought to be Article III judges, but that such a solution is politically impossible. Perhaps it is. I am not a politician, lobbyist, or political junkie. But when there is only one sensible solution, it ought to be advocated. With enough noise and backing, it may just turn out not be impossible after all.

THANK YOU.

END

#553553

² *Northern Pipeline Const. Co. v. Marathan Pipe Line Co.*, 458 U.S. 50 (1982) (holding that bankruptcy judges, lacking Art. III status, could not decide matters constitutionally reserved to Art. III judges and invalidating former 28 U.S.C. §1471).

³ Emergency Jurisdictional Rule, promulgated by the office of U.S. Courts in the wake of the *Marathan* case.

⁴ Bankruptcy Amendments and Federal Judgeship Act of 1984, P.L. 98-353.

⁵ The jurisprudence on this distinction originates with the Supreme Court’s decision in *Murray’s Lessee v. Hoboken Land Improvement Co.*, 59 U.S. 272, 18 How. 272, 15 L.Ed. 372 (1856). I will resist the academic urge to debate whether that case was wrongly decided.