ABI Commission to Study Reform of Chapter 11
Remarks of Hon. Joan N. Feeney,
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Thank you for the opportunity to appear on behalf of the National Conference of Bankruptcy Judges ("NCBJ"). I am honored to be included in the first public meeting of the ABI Commission. The missions and work of the ABI and the NCBJ overlap in many respects. The main goals of both of our organizations are to improve the bankruptcy system, to provide education to bankruptcy professionals, and to enhance public awareness of the value of the bankruptcy courts and system in our economy and society.

The NCBJ applauds the ABI for establishing a commission to study chapter 11and propose reforms that will better balance the goals of reorganization and maximization of asset values for creditors. The areas of study that you intend to explore are comprehensive, well-founded and timely. The NCBJ is ready and willing to assist the Commission in its review and formulation of proposals and recommendations to Congress. Our 350 members of sitting and retired bankruptcy judges have a wealth of knowledge and experience on the front lines and in the trenches of all types of chapter 11 cases, including large and small corporations, partnerships, limited liability companies as well as individuals. Our role as judges requires us to listen to all constituencies, encourage consensus, and, when that fails, to serve as independent adjudicators of complex and important factual and legal issues affecting the rights of all interested parties, many of whom are not directly before the court. The bankruptcy judges of

the NCBJ are uniquely qualified to serve you as neutral experts on any chapter 11 issues through testimony, papers, or in any format you request.

As our members can attest, chapter 11 often functions well and when it does, everybody wins. Chapter 11 can harness market forces to keep failing companies alive and to give debtors breathing room to restructure their businesses or investments. As such it is a much better alternative than a liquidation or government intervention. The chapter 11 model is still the best in the world, although as the Commission has recognized, there is room for improvement.

Chapter 11 has evolved since the enactment of the Code in ways that the drafters may not have imagined or intended. The typical business case that most bankruptcy judges see is not a business that needs a breathing spell to fix its business problems. Today, many if not most chapter 11 business debtors are leveraged with secured debt far beyond asset values, often in complex tiers. They arrive at the bankruptcy court close to or dead-on-arrival with few prospects other than liquidation in a chapter 11. A quick sale to the highest bidder is often promoted as the only option. The world of corporate finance has changed. Secured creditors and distressed debt traders who have purchased debt are often in control of the chapter 11 and seek to advance their own agenda and maximize their interests only. There are inter-creditor agreements that purport to bind all parties. The prospects for unsecured creditors to recover anything are abysmal. The chapter 11 debtor is in a corner and often will agree to terms in cash collateral and borrowing orders that are onerous and oppressive out of desperation. Professionals are required to negotiate a carve-out for their fees including both those who represent the debtor and creditor's committee. Management is often put in a conflict situation, trying to maintain operations during the case while their jobs are in jeopardy. The sale is often

for a price less than the amount of secured debt and the unsecured creditors get a carve- out, if the secured party is willing. Who knows whether these quick sales get the best price as they are always presented as emergencies without much marketing or notice? The pervasive argument that the debtor is a "melting ice cube" may be warranted in some cases, but certainly not all. After a quick sale is approved, the plan is that the committee frequently gets to prosecute the avoidance power recovery actions as the sole source of its dividend. There is a public perception that the only beneficiaries of this type of case are the professionals and the executives who brought it to chapter 11. Whether this is true or note, perceptions matter and influence legislative action.

I do not agree with those academics who predict the demise of chapter 11. But chapter 11 has to adapt to the changes in the American economy, the worlds of finance and business, and globalization, as well as its increasing utilization by high-income individuals who do not qualify for chapter 13 relief. Thus, its provisions must be adaptable to adjust to the very broad range of debtors and problems posed by the debtors who seek relief under its umbrella. There is no doubt that speed is often paramount to prevent deterioration of asset values in many cases, and the Code and the Rules need to adapt to such needs. The Code should recognize that bankruptcy judges need discretion in exercising authority over chapter 11 cases, to foster consensus and to formulate remedies according to the circumstances of a case.

Changes to chapter 11 are needed to make it stronger, increase the likelihood of reorganizations over liquidations, to save American jobs and to enable the real estate market to recover. Chapter 11 is still the most transparent and neutral multi-party forum, bringing all parties to one table and giving them time to figure out the appropriate consensual course of

action. Failing a negotiated solution to a chapter 11 case, a bankruptcy judge must decide whether to confirm a plan or convert or dismiss a case. The judge should not be hampered by strict and inflexible rules as there is no one-size-fits-all solution to legal and business problems.

There are many different types of chapter 11 debtors. Chapter 11 is a much bigger tent than mega-cases. Although the provisions for small business cases are streamlined and seem to work well, the 2005 amendments for individuals, many of whom are high-income and many of whom simply have debts over the chapter 13 limits, have caused much confusion, resulting in wasteful litigation about various issues including application of the absolute priority rule, the requirements for plan duration, and submission of income. Chapter 11 for individuals needs reform as well. As is evident from the 2005 amendments, changes can have unintended and unforeseen consequences. Recommendations for reform should be tested for all types of debtors.

Turning to the specific topics the Commission has chosen to study, I offer several ideas and comments which we suggest may warrant further study within these areas.

We commend your choice as a topic of Multiple Enterprise Cases and Issues and Bankruptcy Remote Entities, Bankruptcy Proofing and Public Policy. Corporate groups present complex legal and business issues, and the current Code does not contain adequate guidance on how they should be handled. There is much litigation, time and money spent on resolving these issues in many chapter 11 cases due to circuit splits. Substantive consolidation is not a remedy that is explicitly recognized in the Code - query whether it should be and what should the standard be? There are variations on consolidation, including partial and deemed consolidation, and there are differing views on these remedies, resulting in lack of uniformity in the case law.

Moreover, the law and procedure regarding alter ego and veil piercing is in a state of disarray. Clarification of the authority of bankruptcy judges to deal with the infamous "bankruptcy remote entities" would improve creditor recoveries and promote transparency in reorganizations. Parties have had to find equitable ways within the confines of the Bankruptcy Code to "get to" such entities, as required to make meaningful determinations in the chapter 11 process. However, legislation specifying remedies in this area is warranted to eliminate "shell games."

Relative to the topic of Governance and Supervision of Chapter 11 Cases and Companies, we think it is appropriate to study whether chapter 11 should promote scrutiny of management and provide remedies against failed management. One thought is to give parties more powers to examine grounds for, and request the termination of managers who do not prove themselves, or worse. Another idea is to expand cause for the appointment of chapter 11 trustees. Many of the most successful cases I have handled have been cases where a professional financial advisor has operated businesses as a chapter 11 trustee and cleaned house in ways that existing management was incapable of perceiving or implementing. This is not to say that the concept of debtor-in-possession should be displaced. But it may be appropriate to include new tools for dealing with inadequate management. A 2011 Cornell University study showed that the strongest contributor to post bankruptcy success is new management in place, based on findings that newly appointed leaders more often pursue new strategies, refocus efforts, and offer fresh insight and valuable outside perspectives imperative for a turnaround. Chapter 11 should have the tools to deal with failed managers.

And on a related note, executive compensation is still a burning issue. Although the subject of several amendments in 2005, the statute is not a model of clarity. Further

amendments are necessary to clarify the parameters of appropriate incentives and compensation.

For some time, there has been a split of authority on the issue of separate classification of deficiency claims. In those jurisdictions where deficiency claims cannot be separately classified, confirmation of real estate reorganizations in chapter 11 has been contested as debtors seek novel ways to circumvent the problem, driving up costs and delaying distributions. Legislation clarifying this issue would facilitate solutions in real estate cases.

With respect to valuations, there has been continuing controversy about enforcing reductions in principal with respect to home loans. It is important to point out that bankruptcy judges have been efficiently deciding such issues in the context of valuation of commercial real estate in chapter 11 cases. As timely and necessary as this commission is, chapter 13, which has suffered from lack of uniformity in its application could also benefit from an ABI commission! Several of our members have also suggested that chapter 9 needs reform due to the presence of gaps in the statute's provisions that reduce its effectiveness. Since many more communities may need relief under chapter 9 in the future, study and reform is timely.

Finally, with respect to the authority of bankruptcy judges, uncertainties related to Stern v. Marshall are affecting chapter 11 cases causing delay and increased costs. Some parties are not following the majority's direction that the decision be applied narrowly and advocate expansion of the decision beyond counterclaims to avoidance actions and other adversary proceedings brought by the estate representative. Many litigants are making inappropriate motions to dismiss adversary proceedings for lack of subject matter jurisdiction, failing to properly oppose *the authority* of the bankruptcy judge to enter a final order. Many litigants are using Stern issues tactically for purposes of delay. Delays caused by Stern v. Marshall

uncertainties prevents the swift adjudication of disputes and increases costs. In response to a challenge to authority, bankruptcy judges in a number of proceedings will make proposed findings of fact and conclusions of law, sending those to the district court for review. We urge this commission to recommend amendments to the Code to clarify bankruptcy judges' authority. One idea is that bankruptcy judges can enter final orders in all types of core proceedings if the parties to such proceedings consent to the entry of a final order, similar to what routinely takes place in "related to" proceedings.

In closing, I would like to make two requests of the Commission while you are formulating your recommendations. Because chapter 11 cases come in all sizes, ranging from mega-corporations to medium size businesses, partnerships, and limited liability companies, and also individuals, I request that in performing your review of chapter 11, you take into consideration how the changes you recommend will affect small business cases and individuals as well as the large and mega chapter 11 cases. It may be appropriate to carve out a special chapter 11 for mega-cases. Finally, I ask that the Commission reject simplistic proposals that are based on a rules approach and recognize that discretion of the bankruptcy judge is indispensable in the chapter 11 process.