ABI COMMISSION TO STUDY THE REFORM OF CHAPTER 11
Statement of Commissioner Kenneth N. Klee
April 19, 2012

Commissioners,

As we undertake our study of the reform of chapter 11, we should be mindful of the changes in the world and the economy that have occurred during the last 35 years. Although the 1978 Bankruptcy Code should serve as a reference point for our work, we should not feel bound by decisions made in 1978 that no longer work in 2012. Instead, we should craft a new business reorganization chapter to meet the needs of modern businesses and capital structures.

Our work should focus on businesses of all sizes. We must develop a cost-effective streamlined procedure for small businesses to reorganize. By the same token, we face a particular challenge in dealing with multi-debtor groups, particularly those that are transnational. The absence of a world government and significant international treaties creates large obstacles in providing a robust reorganization law. We have a global economy with transnational businesses, but little or no means to enforce laws extraterritorially. This deficiency has large implications for the crafting of the avoiding powers, the automatic stay, the priority scheme, and the discharge, among others.

We also should devote significant attention to the interface between bankruptcy and secured credit and securitization. Just because commercial lawyers have crafted non-bankruptcy laws to favor secured creditors and to encourage securitization transactions does not mean that a business reorganization law should respect those laws inviolate. We should carefully examine the cost of chapter 11 reorganization and who should bear the direct costs of the process and the indirect costs of delay imposed by the process. Other systems facilitate the sale of secured creditors' collateral during bankruptcy free and clear of liens, and we should carefully consider the wisdom of adopting a similar approach in the United States. Likewise, we should examine whether sale free and clear of successor liability is desirable and feasible.

The rampant expansion of secured credit has left little in the way of free and clear assets in many chapter 11 cases. Trade creditors are far less important today than in 1978 and often are left unimpaired in business reorganization cases. We should consider the implications this has on the formation of creditors' committees, DIP financing, sales, subordination, classification, and voting, among other issues.

The advent of securitization and bankruptcy remote vehicles has removed the life blood of accounts receivable and inventory from some large chapter 11 estates. We should carefully consider the wisdom of codifying broad equitable powers to enable a bankruptcy judge to pierce through form to substance when these transactions in essence are little more than disguised secured loans.

The rise of the service sector of the United States economy presents special challenges. Bankruptcy laws geared to traditional manufacturing companies do not fit well with service sector debtors. For example, the avoiding powers focus on the transfer of property of the debtor, not on services performed by the debtor. It is not clear whether a prepetition transfer of services should be avoidable. Although the services may preferentially confer value, they do not diminish the bankruptcy estate. Moreover, a levying creditor cannot levy on services. In a service business, the employees are the key assets of the business. We should consider whether bankruptcy policies should facilitate retention of key personnel when necessary to enhance the prospects for business reorganization.

Commissioners, let me close by urging us to reform executory contract law. Chapter 11 deals poorly with the interface between intellectual property and bankruptcy. Without question, a debtor in possession should be allowed to assume the debtor's own intellectual property licenses. The *Catapult* decision is flawed and we should recommend that it be overturned legislatively. Likewise, the landlord amendments of 2005 have caused premature rejections or liquidations by leaving insufficient for a debtor in possession to assume or reject nonresidential real property leases in chapter 11 cases. We should recommend restoring judicial flexibility to extend the assumption decision until confirmation of a plan.

My remarks this morning touch only a few of the important issues we will face in proposing to update chapter 11 of the Bankruptcy Code. I look forward to working with you as we study and deliberate on these important questions. The success of our efforts will have a lot to do in determining whether the United States can maintain its leadership in business reorganization law during the first half of the Twenty First Century.