

**ABI COMMISSION TO STUDY THE REFORM OF CHAPTER 11**  
**First Public Meeting**  
**Washington, D.C., April 19, 2012**  
**Statement of Richard Levin<sup>1</sup>**

I would like to express my appreciation for the opportunity to present this statement at the first public meeting of the ABI Commission and for the opportunity to serve as a member of the Commission. I have long been interested and involved in bankruptcy reform. My first involvement was as counsel, from 1975 to 1978, to the House Judiciary Subcommittee that produced the bill that became the 1978 bankruptcy law. I have continued my involvement as an active Member, and currently as Vice Chair, of the National Bankruptcy Conference, a voluntary organization composed of persons interested in the improvement of the bankruptcy laws and their administration and whose primary purpose is to advise Congress on the operation of bankruptcy and related laws.

A soundly functioning business reorganization system protects jobs, preserves the value assets and provides fair treatment to constituencies in a distressed business. The House Judiciary Committee, in introducing current chapter 11 in 1977, described the purpose of the system in words that are equally applicable today:

“The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap. Often, the return on assets that a business can produce is inadequate to compensate those who have invested in the business. Cash flow problems may develop, and require creditors of the business, both trade creditors and long-term lenders, to wait for payment of their claims. If the business

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can extend or reduce its debts, it often can be returned to a viable state. It is more economically efficient to reorganize than to liquidate, because it preserves jobs and assets.” H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 200 (1977).

Those words were written to accompany a bill that embodied the first major revision to this country’s business reorganization system in 40 years. The Committee noted:

The major purpose of this bill is the modernization of the bankruptcy laws. The substantive law of bankruptcy and the current bankruptcy system was designed in 1898, in the horse and buggy era of consumer and commercial credit, and was last overhauled in 1938, nearly 40 years ago. It has only been since 1938 that the consumer credit industry has grown: and it has only been since the widespread adoption of the Uniform Commercial Code in the early 1960's that commercial credit has grown to its present magnitude. *Id.* at 3-4 (footnotes omitted).

While working on the 1978 bankruptcy law, 34 years ago, we fully understood and acknowledged that it would not last forever, that changes in the credit economy and the financial system would once again necessitate revisions to the bankruptcy laws. We were only half in jest in noting that the bankruptcy laws seemed to be on a 40-year revision cycle, and we could look forward to the “Bankruptcy Reform Act of 2018”. We did not realize how accurate a prediction that would be. An efficient and effective insolvency system must grow out of the legal, economic and financial system in which it operates. As the world has changed, so must the bankruptcy system.

The economic and financial system that existed in 1978 when Congress enacted chapter 11 has changed dramatically. In 1978, companies typically had substantial unsecured debt for borrowed money and for purchased inventory. Their secured debt was typically secured only by specific assets such as equipment, inventory or accounts receivable, not by all or substantially all of their assets, so that the companies typically had more than a nominal amount of unencumbered assets. Trade debt was a significantly larger proportion of a distressed debtor’s liabilities compared to bank or bond debt. Trade suppliers were often interested in compromising their claims to keep a

customer in business but still sought maximum recovery. Most debt for borrowed money came from banks rather than the capital markets. Banks held their loans, did not mark the loans to market (but took reserves on distressed loans), wished to collect as much as possible, were legally prohibited from taking equity in exchange for their claims and often wished to preserve their borrowers as bank customers. Most of a debtor's assets were tangible assets, rather than intangibles such as intellectual property and contract rights and relationships. Reorganizing companies did not often include complex corporate groups. Sale of a distressed business as a going concern was not typically considered a viable alternative, as opposed to reorganizing a business in place or shutting it down. Most distressed businesses operated solely or primarily in the United States.

The economic and financial environment today differs markedly. A large debtor typically has substantial debt for borrowed money, whether from bank loans or capital market debt; trade debt is a relatively insignificant part of the company's capital structure. A lender typically takes a security interest in all of a company's assets, and there often is a second and sometimes a third or fourth priority security interest encumbering those assets as well. A distressed borrower seldom has any unencumbered assets. Trade suppliers typically have better credit management and find that writing off their claims or selling them at a discount is better than spending time trying to collect. An active market has developed not only for trade claims but also for bank loans and non-public capital market debts, so that banks and bondholders, as well as suppliers, can exit a credit by immediate sale to a purchaser who is willing to pursue collection through the bankruptcy process, often with a view to acquiring the reorganized company or simply trading the claim on further at a profit. Banks mark their loans to market, creating an incentive to take advantage of the opportunity to monetize their distressed assets rather than working to collect. Banks' business models have changed from lending institutions to financial intermediaries who arrange loans but often do not hold them. Companies rely far more on contractual relationships – virtual companies that outsource many of their functions – and on owned or licensed intellectual property, such as patents, copyrights, trademarks and technical know-how. Large corporate groups, many of them trans-national enterprises, are common in chapter 11 today.

Transactions in distressed companies are now common and relatively easily accomplished.

There has been a similar dramatic shift in the underlying nature of business reorganizations for small businesses. Although chapter 11 was initially designed to accommodate both small and large businesses, it now includes special provisions for a small business case and special provisions for individual business debtors whose debts are too large for chapter 13. Even with the special small business provisions, chapter 11 has become cumbersome and burdensome for a small business attempting to reorganize. In addition to all of the changes in the financial and economic system that affect large business reorganizations, financing for small business today is often by credit card, which is a phenomenon that did not exist in 1978.

Although its fundamental structure and principles have not been amended since 1978, chapter 11, and the judges and lawyers who operate the system, have done extraordinary work to make the system handle distressed companies and preserve going concern values, jobs and capital investments through sale or reorganization. However, the chapter 11 system is itself in distress, having been asked to do far more than it was designed to do and to operate in an entirely different environment. There are increasing disputes in cases over the fairness, efficiency and the cost of chapter 11's operation.

The need for modernization of our business reorganization system is apparent. The Commission is doing important work in setting out on this project in the way it has proposed. The ABI is the largest umbrella organization of those involved with the bankruptcy system. There is no organization with a broader scope of experience expertise than the ABI. The Commission will be seeking input from all constituencies. This is not a debtor project or a creditor project. This is a project whose sole goal is to improve the operation of corporate reorganization. These factors should result in a strong, credible product that should receive favorable consideration from Congress.

I am proud to be a part of this effort, and I thank the Chairs for asking me to participate.