

ABI Commission to Study the Reform of Chapter 11

First Public Meeting
April 19, 2012
2237 Rayburn House Office Building
Washington, D.C.

Statement of Jim Millstein

I am honored to participate as a member of the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11 of the United States Bankruptcy Code.

Both as a practicing lawyer and as an investment banker, I have spent the past thirty years representing corporate debtors, institutional creditors, official creditors' committees, unions, institutional investors, governments and acquirers of distressed companies, in restructuring transactions both in and outside of formal insolvency proceedings in the United States, Europe, Latin America and Asia.

Currently, I am the Chairman of Millstein & Co., a firm that provides financial and strategic advice to companies, creditors, investors and governments in connection with corporate restructurings, recapitalizations and reorganizations. Before forming Millstein & Co. in 2012, I served as the Chief Restructuring Officer of the United States Department of the Treasury, where I was responsible for the restructuring and recovery of a number of the Treasury Department's largest TARP investments in the financial sector and participated in the policy making process that led to the enactment of the orderly liquidation procedures incorporated in Title II of the Dodd Frank Consumer Protection and Financial Reform Act.

Before joining the Treasury Department in 2009, I was the Global Co-Head of Restructuring at Lazard Frères & Co, LLC, joining Lazard in 2000 after having practiced law for eighteen years with the law firm of Cleary, Gottlieb, Steen & Hamilton, ultimately as the head of its Corporate Restructuring practice. I am an adjunct professor of law at Georgetown University School of Law where I have taught the federal regulation of financial institutions.

The work of the Commission comes on the heels of the greatest financial crisis in the United States since the Great Depression, a crisis that led to the enactment of a major new insolvency statute. The so-called Orderly Liquidation provisions incorporated as Title II of Dodd Frank were enacted in part because of the perceived inadequacies of Chapter 11 in resolving the insolvency of a multinational financial conglomerate such as Lehman Brothers Holding.

Since the enactment of the Bankruptcy Code in 1978, the deregulation of the financial sector over the last thirty years, through a series of legislative and regulatory actions, facilitated and encouraged the creation of a group of enormous transnational financial institutions such as Lehman Brothers. The heavy reliance of such institutions on short term funding as well as their global footprints make reorganization of such institutions under Chapter 11, let alone any other single national insolvency regime, problematic without significant government and/or central bank funding and significant international coordination. The lack of a framework within which to coordinate national insolvency proceedings so as to mitigate the damage associated with these firm's failures and to equitably allocate among affected nations and national creditors the costs of their rehabilitation or liquidation is a challenge that even Dodd Frank does not adequately address.

The development of protocols to govern concurrent proceedings in different national jurisdictions has given modest procedural coherence to the coordination of the outcomes of such proceedings in respect of non-financial, transnational enterprises, however, differences in substantive creditor rights' law among the various nations means that territorial ring-fencing remains the order of the day, often producing vastly different outcomes for similarly situated creditors depending on the jurisdiction within which those claims are asserted. Moreover, because of the relative sophistication of our law and practice, where reorganization of a transnational enterprise is possible under Chapter 11, United States-based creditors often end up subsidizing the recoveries of foreign creditors. While Dodd Frank directs US regulators to work through this coordination problem (and there are some positive developments in this regard occurring under the auspices of the Bank for International Settlements) for the class of financial institutions eligible to be placed into orderly liquidation, the absence of an international insolvency regime for systemically important financial institutions means that any proceedings initiated under Title II of Dodd will involve similar ring-fencing and likely a similar subsidization of foreign creditors. In this respect, when it comes to the reorganization of transnational enterprises, the shortcomings of Chapter 11 are no different than the shortcomings of Dodd Frank's orderly liquidation: our insolvency regimes remain national, while economic activity is increasingly organized on a global basis.

Similarly, the evolution of credit markets in the United States since 1978 has altered the distributional consequences of various creditor protection provisions in the Bankruptcy Code:

First, by virtue of the significant protections afforded secured debt under Chapter 11, sophisticated creditors take pains to structure their credit extensions in secured form when lending to companies in distress. As a result, in cases where the aggregate amount of secured debt exceeds the going concern value of the enterprise, a Chapter 11 reorganization has become little more than a court-supervised assignment for the benefit of creditors. Query whether the Code shouldn't require a

price to be paid to the bankruptcy estate by secured creditors for the value of the clean title that the Bankruptcy Code allows a Bankruptcy Court to convey in a foreclosure only thinly disguised as plan or a 363 sale?

Second, since 1978, the growth of secondary trading in bank and bond debt and the development of pools of distressed investment capital have together transformed the voting rights afforded to impaired claims into a means for the acquisition of corporate control. Query whether there shouldn't be a set of procedural and substantive rules to protect creditors in Chapter 11 (and the integrity of the reorganization process) similar to the disclosure, all holders and creeping tender rules that protect common stockholders under the federal securities laws. Do the valuation standards under Section 1129 afford ordinary creditors similar rights to a control premium that the securities laws rules governing tender offers confer on ordinary shareholders?

Finally, the growth in derivatives markets over the past 30 years and the related expansion of the "qualified financial contracts" exemptions from the avoidance powers and automatic stay provisions of Chapter 11, taken together, have created enormous incentives to structure ordinary lending and guaranty transactions, as well ordinary commercial transactions, within one of the now many exemptions available to such contracts. With trillions of dollars now in play in the so-called swaps markets, we are in danger of having created a two tiered insolvency regime, where ordinary creditors are forced to bear the costs of the reorganization process while sophisticated financial institutions structuring their transactions to fit one of the now plentiful exemptions get away scot free. At some point, the multitude of exemptions will undermine the efficacy of Chapter 11 in solving the collective action problem of separate collection actions because separate collection actions will have become the rule rather than the exception where successful lobbying rather than successful reorganization will be the only path to recovery.

I look forward to working with my fellow Commissioners to address these issues so as to ensure that similarly situated creditors are once again treated similarly, the costs of business reorganization are borne proportionately by all creditors and Bankruptcy Courts have a chance to make the equity of redemption a meaningful right again.