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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Bankruptcy Commission Urges Ch. 11 Overhaul

By **Andrew Scurria**

Law360, Washington (December 08, 2014, 12:14 PM ET) -- The commission tasked with recommending reforms to the 36-year-old U.S. bankruptcy regime released a long-awaited report on Monday saying that the current system doesn't work and urging Congress to give troubled businesses a better chance at rebuilding in Chapter 11.

The report by the American Bankruptcy Institute's Chapter 11 reform commission will frame **years of debate** within the restructuring community about strengthening the bankruptcy process as a turnaround tool. More than 150 bankruptcy professionals spent three years preparing the report in response to criticism that Chapter 11 has not kept pace with evolutions in modern finance that have diminished companies' ability to reorganize.

Designed to make the bankruptcy process cheaper, fairer and more effective, the report's 241 discrete recommendations call on lawmakers to reverse what it said were distortions that have emerged since the statute's last major overhaul.

"We do bankruptcy reform in this country once every 40 years," commission co-Chairman Robert J. Keach of Bernstein Shur Sawyer & Nelson PA said at a press conference in Washington, D.C. "The reason for that is that the world changes but the statutes don't."

Adopted unanimously by the commission's voting members, the nonbinding proposals are sure to spark unrest in the commercial lending industry, which has maintained that Chapter 11 needs only mild tweaks instead of a top-to-bottom overhaul.

The rise of secured credit since the Bankruptcy Code's 1978 enactment has left many worried that debtors are being left beholden to their top-ranking creditors to the detriment of other stakeholders. Much of the commission's report aims to diminish secured creditors' control over the bankruptcy process and the protections that come with collateral rights.

The report recommends eliminating a key requirement for "cramming down" a contested restructuring over the objections of top-ranking creditors and creating a mechanism to funnel recoveries to junior creditor classes when a company recovers in Chapter 11. Other reforms would change the way certain creditor payments are valued, cutting into recoveries.

The reforms reflect that secured creditors are driving too many bankruptcies to a quick prenegotiated sale or a fire-sale liquidation, according to co-Chairman Al Togut of Togut Togut & Segal LLP, instead of comprehensive reorganizations into "smaller but healthier" entities. The ABI, a nonprofit association, formed the commission in 2012 to see why fewer companies were using bankruptcy.

Among the commission's many findings were that business owners are putting off Chapter 11 since bankruptcy all but ensures they will lose control. By the time they do file, the

companies are too far gone "and it's game over," Togut said.

"One of the things that you'll see throughout this report is an effort by us to change the dynamic of Chapter 11. Instead of making it a deterrent that companies try to avoid, we want to make it a tool that companies use to save jobs," he said.

Banks and other lenders are likely to mobilize against certain reforms, having warned for years that putting their recoveries at risk in bankruptcy will raise the cost of credit across the economy. But Keach said he was "very confident" that the proposals, if enacted, would not hurt the capital markets.

"The advocates for secured credit were very active and persuasive on the commission," Keach said.

The report says to let debtors seek confirmation of a plan without any support from impaired creditors, which Keach said would incentivize negotiated resolutions and discourage tactical maneuvering, such as when debtors or creditors manipulate voting classes.

Another proposal is the creation of a nimble "estate neutral" with the power to scrutinize fees, manage contested asset sales and handle other oversight work in lieu of pricey examiners or trustees.

Of particular interest to many brick-and-mortar retailers eyeing bankruptcy, the commission proposed extending the deadline for debtors to keep or reject commercial property leases. A set of 2005 amendments to Chapter 11 has given debtors a 210-day window to decide on their leases, a tall order for retailers with many struggling locations.

The commission also suggested that private investors should not keep windfalls from bad leveraged buyouts when the companies that were sold later file for bankruptcy. Current safe harbor laws have been interpreted broadly to protect some private stockholders from giving back profits from LBO deals in bankruptcy.

Commission leaders hope to present their findings to Congress. They estimate that it could be until 2018 before any bills are ready for congressional action — 40 years after the Bankruptcy Code's enactment.

The previous regime, passed just before the Great Depression, was also in place for exactly 40 years.

--Editing by Rebecca Flanagan.

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