III. BACKGROUND ON THE COMMISSION AND THE STUDY PROJECT

Congress historically has turned to U.S. bankruptcy laws to help stabilize the economy in times of crisis and, beginning in 1867, to provide both individuals and corporations a single forum to address multiple creditor claims.[5] Although the law has evolved significantly since the late 1800s, the law remains focused on strengthening the economy and society more generally and, in the process, instilling confidence in businesses and markets. These objectives require a delicate balance that encourages appropriate growth and innovation in business, but provides sufficient protection and certainty to creditors.[6] Chapter 11 of title 11 of the U.S. Code (the "***Bankruptcy Code***") can achieve this balance for U.S. companies and markets. This section reviews the historical development of the Bankruptcy Code, explains why it is important and necessary to consider reforms to the Bankruptcy Code at this point in time, and details the Commission's study process that generated this Report and Recommendations.

A. Brief History of U.S. Business Reorganization Laws

The United States has one of the strongest and most well developed business reorganization schemes in the world.[7] This business reorganization scheme has a rich history, stemming in large part from the railroad failures of the late 19th century.[8] The Bankruptcy Acts of 1867 and 1898 introduced the basic conceptual underpinnings of modern bankruptcy law, including business bankruptcy.[9] These laws, particularly the 1898 Bankruptcy Act, were grounded in a "rescue and rehabilitate" policy intended to allow the honest but unfortunate debtor, including the business debtor, to obtain a fresh start and a second chance at becoming a productive, contributing member of society.[10] As with all U.S. bankruptcy laws, the 1898 Bankruptcy Act sought to balance the need of the debtor

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5 *See, e.g.,* Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 Am. Bankr. Inst. L. Rev. 5, 18–23 (1995).

6 One commentator explained:

> The current U.S. bankruptcy system grew directly out of the United States' unique capitalist system, which rewards entrepreneurialism as well as extensive consumer spending. It makes sense that a society in which dollars rule would have a forgiving personal bankruptcy system in order to keep consumer spending high, and an equally forgiving business reorganization system to encourage risk taking and economic growth. Both systems are part of a larger scheme to keep economic players alive and active in the game of capitalism. U.S. bankruptcy systems are among the country's few social programs and they address many of society's ills. Thus, they are broad and form an integral part of the social system from which they sprung.

Nathalie Martin, *The Role of History and Culture in Developing Bankruptcy and Insolvency Systems: The Perils of Legal Transplantation*, 28 B.C. Int'l & Comp. L. Rev. 1, 3 (2005). *See also* Viral V. Acharya *et al.*, *Creditors Rights and Corporate Risk-Taking*, 102 J. Fin. Econ. 150, 150–66 (Oct. 2011) ("In cross-country analysis, we find that stronger creditor rights induce greater propensity of firms to engage in diversifying acquisitions that are value-reducing, to acquire targets whose assets have high recovery value in default, and to lower cash-flow risk. Also, corporate leverage declines when creditor rights are stronger.").

7 *See, e.g.,* Martin, *supra* note 6, at 4 ("[M]any countries have attempted to create a reorganization scheme for failing enterprises like Chapter 11 of the U.S. Bankruptcy Code (Chapter 11), in which existing management stays in place and manages the reorganizing company. These systems are perhaps the most common U.S. legal exports today.") (citations omitted).

8 Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distress Businesses for the Twenty-First Century?*, 78 Am. Bankr. L.J. 153, 160 (2004) ("The foundation of United States reorganization law is the equity receivership, also known as the federal consent receivership, that was fashioned in the late nineteenth century to resolve the financial distress and failures that permeated the railroad industry after the Civil War.").

9 For general discussions of the historical development of federal bankruptcy law, see, *e.g.*, David A. Skeel, Jr., Debt's Dominion 56–60 (2001) (explaining equity receivership process); Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 Am. Bankr. Inst. L. Rev. 5, 21–23 (1995) (same). *See also* Charles Warren, Bankruptcy in United States History (1935); Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 Colum. L. Rev. 717, 747–49 (1991); Stephen J. Lubben, *A New Understanding of the Bankruptcy Clause*, 64 Case W. Res. L. Rev. 319 (2014).

10 *See* Jason J. Kilborn, *Bankruptcy Law*, *in* Governing America: Major Decisions of Federal, State, and Local Governments from 1789 to the Present 41–49 (Paul J. Quirk & William Cunion eds., 2011) ("With the rise of private business corporations in the mid- to late-1800s, the rescue- and rehabilitation-oriented bankruptcy policy was extended to the 'big business' context."). The 1898 Bankruptcy Act initially permitted "[c]ompositions in lieu of liquidations," and then subsequent amendments, described below, enlarged rehabilitation alternatives for businesses. *See* Tabb, *supra* note 9, at 26–30.

to rehabilitate and the rights of creditors to recoveries. The basic notion that a business generally is more valuable to creditors and society as a whole if it rehabilitates rather than liquidates also emerged during this period.[11]

Bankruptcy law progressed in response to, among other things, the Great Depression of the 1930s,[12] and a more formalized process evolved that allowed distressed companies to remain in business while restructuring their obligations.[13] These developments produced Sections 77 and 77B of the Bankruptcy Act[14] and then the Bankruptcy Code's immediate predecessor, the Chandler Act,[15] which added three new chapters for reorganizing ongoing businesses (Chapters X and XI concentrated on businesses, and Chapter XII addressed real estate organizations).[16] Each iteration of the law focused on strengthening business reorganizations and seeking an appropriate balance between the rights and obligations of the debtor and its stakeholders.

Under Chapter X of the Chandler Act, a trustee was appointed to replace the debtor's management, and the Securities and Exchange Commission had a formal oversight role in the reorganization process.[17] The large public companies subject to Chapter X did not embrace these two requirements.[18] They worked to avoid a bankruptcy filing — even when arguably necessary or prudent under the circumstances — or tried to come within the provisions of Chapter XI of the Chandler Act.[19] Chapter XI was intended for smaller, nonpublic companies and only addressed unsecured debt in the debtor's capital structure. Nevertheless, companies generally preferred this chapter because it

11 *See, e.g.,* Charles J. Tabb, *The Future of Chapter 11*, 44 S.C. L. Rev. 791, 803 (1993) ("This idea that the preservation of a business as a going concern is better for everyone — creditors, stockholders, bondholders, employees, and the public generally — is not a new one. It has been around for at least a century, really ever since the Industrial Revolution reached full flower."). James Madison was a proponent of early recognition of bankruptcy laws, "[t]he power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different states, that the expediency of it seems not likely to be drawn into question." Miller & Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distress Businesses for the Twenty-First Century?*, *supra* note 8, at 159 & n. 4 (quoting The Federalist No. 42, at 271 (James Madison) (Clinton Rossiter ed., 1961)).

12 *See, e.g.,* Tabb, *supra* note 9, at 22.

13 "One of the primary purposes of the Bankruptcy Act is to 'relieve the honest debtor from the weight of oppressive indebtedness, and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934). *See also* David S. Kennedy & R. Spencer Clift III, *An Historical Analysis of Insolvency Laws and Their Impact on the Role, Power, and Jurisdiction of Today's United States Bankruptcy Court and Its Judicial Officers*, 9 Norton J. Bankr. L. & Prac. 165, 176 (2000) ("The Chandler Act was the Congressional response to the depression and was modeled after the emergency legislation of the early 1930's. Since 1938, there has existed in America a Congressional policy favoring reorganization over liquidation, where possible.").

14 Sections 77 and 77B of the 1898 Bankruptcy Act adopted various features of the equity receivership model of reorganization historically used for railroads and applied those features to railroads and other business entities. *See, e.g.,* Skeel, *supra* note 9, at 54, 106; Bussel, *infra* note 17, at 1555–56.

15 "[The Chandler Act] was far-reaching in its scope and purpose. The Act comprised 15 chapters; the first seven chapters dealt with the liquidation provisions substantially based upon the original 1898 Act while chapters eight through fifteen dealt primarily with the rehabilitation of various classes of debtors." Kennedy & Clift, *supra* note 13, at 176. For a detailed history and analysis of the Chandler Act, see Vincent L. Leibell, Jr., *The Chandler Act — Its Effect Upon the Law of Bankruptcy*, 9 Fordham L. Rev. 380, 385–409 (1940).

16 *See, e.g.,* Alexander L. Paskay & Frances Pilaro Wolstenholme, *Chapter 11: A Growing Cash Cow Some Thoughts on How to Rein in the System*, 1 Am. Bankr. Inst. L. Rev. 331, 331 nn. 3 & 4 (briefly explaining Chapters X, XI, and XII).

17 *See, e.g.,* SEC v. Am. Trailer Rentals Co., 379 U.S. 594, 603–06 (1965) (explaining development of the Chandler Act); Daniel J. Bussel, *Coalition-Building Through Bankruptcy Creditors' Committees*, 43 UCLA L. Rev. 1547, 1557–58 (1996) (explaining key elements of Chapter X).

18 *See* Skeel, *supra* note 9, at 123–27 (explaining the general negative corporate reaction to Chapter X and noting that "[t]he independent trustee requirement discouraged the managers of large firms from filing for bankruptcy if there was any way to avoid it").

19 *See id.* at 125–27. *See also* A. Mechele Dickerson, *Privatizing Ethics in Corporate Reorganizations*, 93 Minn. L. Rev. 875, 890 (2009) ("The harsh treatment managers received in Chapter X discouraged managers from using that Chapter and ultimately caused Chapter XI to become the dominant reorganization vehicle for even large, publicly traded companies that ostensibly should have filed under the trustee-controlled Chapter X."). See Harvey R. Miller, *Bankruptcy and Reorganization Through the Looking Glass of 50 Years (1960–2010)*, 19 Norton J. Bankr. L. & Prac. 3 Art. 1 (1993) for a brief comparison about the treatment of debtors and their management under Chapter X versus Chapter XI). For example, one source suggests that only a minor portion of business bankruptcies were in fact commenced through Chapter X (*e.g.*, 0.6 percent of total filings in 1971). David T. Stanley & Marjorie Girth, The Brookings Inst., Bankruptcy: Problems, Process, and Reform (1971).

placed the reorganization largely in the hands of the debtor and its unsecured creditors' committee and was premised on the efforts of these parties to structure a negotiated resolution to the debtor's financial distress.[20] After almost 40 years of restructuring experience under Chapter X and Chapter XI of the Chandler Act, policymakers and practitioners agreed that reform was needed.[21]

Consequently, in 1970, Congress created the Commission on the Bankruptcy Laws of the United States (the "***Commission on Bankruptcy Laws***") to "study, analyze, evaluate and recommend changes to the [1898] Act."[22] In 1973, the Commission on Bankruptcy Laws issued a report and a draft of proposed bankruptcy legislation.[23] The National Conference of Bankruptcy Judges, excluded from the Commission on Bankruptcy Laws, submitted a competing legislative proposal.[24] President Carter ultimately signed into law the 1978 Bankruptcy Code, which combined various concepts from both legislative proposals and merged Chapters X, XI, and XII of the 1898 Bankruptcy Act into a single business reorganization chapter (the current chapter 11).[25] In passing the Bankruptcy Code, Congress believed that "the purpose of a business reorganization case [under chapter 11] . . . 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"[26] with the understanding that "reorganization, in its fundamental aspects, involves the thankless task of determining who should share the losses incurred by an unsuccessful business and how the values of the estate should be apportioned among creditors and stockholders."[27]

After its enactment, Congress amended the Bankruptcy Code on a periodic and piecemeal basis. In 1982, Congress broadened protections for the commodities and securities markets.[28] In 1984, Congress clarified the jurisdiction of the bankruptcy courts, set the term and appointment procedures of bankruptcy judges, and enacted specialized rules for the treatment of collective bargaining agreements.[29] In 1986, Congress created additional bankruptcy judgeships, expanded the U.S. Trustee pilot program to a nationwide program,[30] and codified chapter 12 for family farmers.[31] In 1988, Congress added protections for retirees and intellectual property licensees, and resolved conflicts between bankruptcy law and state laws.[32] In 1990, Congress added various provisions, such as swap protections, making certain debts nondischargeable, and establishing bankruptcy appellate panels.[33] In 1992, Congress added more provisions related to, among others, judgeships and chapter

20 *See* Bussel, *supra* note 17, at 1557–58 (explaining key elements of Chapter XI).
21 Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 Mich. L. Rev. 336, 371–73 (1993) ("One of the key reasons for the adoption of the 1978 Code was the widespread perception that the old Code was unworkable.").
22 Act of July 24, 1970 Establishing a Commission on the Bankruptcy Laws of the United States, Pub. L. No. 91-354, 84 Stat. 468 (1970). For further discussion about the Commission on Bankruptcy Laws and its composition, see *Report of the Commission on the Bankruptcy Laws of the United States*, 29 Bus. Law. 75, 75–76 (1973).
23 Report of the Commission on the Bankruptcy Laws of the United States, H.R. Doc. No. 93-137 (1st Sess. 1973). *See also Report*, *supra* note 22; Frank R. Kennedy, *The Report of the Bankruptcy Commission: The First Five Chapters of the Proposed New Bankruptcy Act*, 49 Ind. L.J. 422 (1974).
24 *See* Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DePaul L. Rev. 941, 943–44 (1979).
25 *See* Tabb, *supra* note 9, at 35.
26 Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. Rev. 129, 181 (2005) (quoting H.R. Rep. No. 95-595, at 220 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6179).
27 *Id.* (quoting S. Rep. No. 95-989, at 10 (1978), *reprinted in* U.S.C.C.A.N. 5787, 5796).
28 *See* 1 Norton Bankr. L. & Prac. 3d § 2:11.
29 *See id.* § 2:12.
30 The U.S. Trustee Program was piloted in certain judicial districts prior to the 1986 legislation. The 1986 legislation made the program permanent nationwide, with the exception of North Carolina and Alabama. Bankruptcy cases in Alabama and North Carolina are not under the jurisdiction of the U.S. Trustee, but rather are administrated by Bankruptcy Administrators in those jurisdictions.
31 *See* 1 Norton Bankr. L. & Prac. 3d § 2:13.
32 *See id.* § 2:14.
33 *See id.* § 2:15.

12.[34] In 1994, Congress again added various provisions, including changes in time limits, exemptions, and criminal penalties.[35]

In 1994, Congress also created the National Bankruptcy Review Commission (the "***NBRC***") to foster a more systemic look at studying and reforming the Bankruptcy Code.[36] The NBRC issued its report in 1997,[37] and several of its recommendations were addressed to varying degrees in the amendments to the Bankruptcy Code set forth in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the "***BAPCPA Amendments***").[38] BAPCPA implemented an extensive overhaul of both the business and consumer provisions of the Bankruptcy Code.[39]

BAPCPA and the prior amendments affecting chapter 11 tried to address perceived deficiencies in the Bankruptcy Code, but have in some respects altered the Bankruptcy Code's original careful balance between a debtor's need to rehabilitate and its creditors' rights to recoveries on their claims against the debtor. In addition, the amendments have introduced perceived inequities among different creditor constituencies. These factors, combined with the changing economic environment and other externalities discussed below, have diluted the effectiveness of chapter 11 for many companies and their stakeholders. Reminiscent of the time preceding the work of the Commission on Bankruptcy Laws, companies once again are working to find alternatives to filing bankruptcy cases, potentially at the expense of their creditors, shareholders, and employees.[40] Accordingly, after more than 35 years of experience under chapter 11, many practitioners and commentators agree that it is again time for reform.[41]

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34 *See id.* § 2:16.

35 *See id.* § 2:17.

36 National Bankruptcy Review Comm'n Act, Pub. L. No. 103-394 §§ 601–702, 108 Stat. 4147 (codified at 11 U.S.C. § 101 (1994)). For more information about the NBRC and its composition, see http://govinfo.library.unt.edu/nbrc/index.html.

37 National Bankruptcy Review Commission Final Report: Bankruptcy: The Next Twenty Years, Oct. 20, 1997, *available at* http://govinfo.library.unt.edu/nbrc/reporttitlepg.html [hereinafter NBRC Report].

38 *See* Susan Jensen, *A Legislative History of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 Am. Bankr. L.J. 485, 487–88 (2005).

39 Lubben, *supra* note 9, at 407–08.

40 A restructuring law that companies seek to avoid at all costs can exasperate companies' financial distress and negatively impact the overall economy. It can cause companies to increase leverage beyond sustainable levels in the hopes of buying time to find out-of-court solutions. It can encourage companies to engage in speculative projects, undertake precipitous reductions in workforce, and delay payments to vendors and suppliers who in turn may experience financial difficulties. This was the state of U.S. business bankruptcy laws in 1978 when Congress enacted the Bankruptcy Code to overhaul Chapters X and XI of the 1898 Bankruptcy Act. It is again the state of U.S. business bankruptcy laws, with companies — particularly small and medium-sized enterprises — avoiding a chapter 11 filing whenever possible because of inefficiencies, uncertainty, and costs associated with the chapter 11 process. *See, e.g., infra* note 60; *Exploring Chapter 11 Reform: Corporate And Financial Institution Insolvencies; Treatment of Derivatives: Hearing Before the Subcomm. on Regulatory Reform, Commercial and Antitrust Law of the H. Comm. on the Judiciary*, 113th Cong. (Mar. 26, 2014) (written testimony of Professor Michelle M. Harner, Co-Director, Business Law Program, University of Maryland Francis King Carey School of Law), at 2 & nn. 7–9 (noting that chapter 11 has become too expensive for businesses and causes companies to close rather than timely file for bankruptcy, which has adverse consequences for the companies, their employees, and the economy) (citations omitted), *available at* http://judiciary.house.gov/index.cfm/2014/3/hearing-exploring-chapter-11-reform-corporate-and-financial-institution-insolvencies-treatment-of-derivatives.

41 *See* Richard Levin & Kenneth Klee, *Rethinking Chapter 11*, Int'l Insolvency Inst., Twelfth Annual Int'l Insolvency Conf. (June 21–22, 2012), *available at* http://www.iiiglobal.org/component/jdownloads/finish/337/5966.html. *See also* Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 Stan. L. Rev. 673 (2003); Stephen J. Lubben, *Some Realism About Reorganization: Explaining the Failure of Chapter 11 Theory*, 106 Dick. L. Rev. 267 (2001); Harvey R. Miller, *Chapter 11 in Transition — From Boom to Bust and into the Future*, 81 Am. Bankr. L.J. 375 (2007); Miller & Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, *supra* note 8; Miller & Waisman, *Is Chapter 11 Bankrupt?*, *supra* note 26; James H. M. Sprayregen et al., *Chapter 11: Not Perfect, but Better than the Alternative*, Am. Bankr. Inst. J., Oct. 2005, at 1; *Written Statement of Bettina M. Whyte: ASM Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (Apr. 19, 2012) (providing an intriguing narrative story of how times have changed and the Bankruptcy Code has not), *available at* Commission website, *infra* note 55.

B. The Need for Reform

Chapter 11 of the Bankruptcy Code has served us well for many years. Nevertheless, today's financial markets, credit and derivative products, and corporate structures are very different than those existing in 1978 when Congress enacted the Bankruptcy Code. Companies' capital structures are more complex and rely more heavily on leverage, which is secured under state enactments of the Uniform Commercial Code that encumber vastly more assets than in 1978;[42] their asset values are driven less by hard assets (*e.g.*, real estate and machinery) and more by services, contracts, intellectual property, and other intangible assets; and both their internal business structures (*e.g.*, their affiliates and partners) and external business models are increasingly multinational. In addition, claims trading and derivative products have changed the composition of creditor classes. Although these developments are not unwelcome or unhealthy, the Bankruptcy Code was not originally designed to rehabilitate companies efficaciously in this complex environment.[43]

Moreover, anecdotal evidence suggests that chapter 11 has become too expensive (particularly for small and medium-sized enterprises) and is no longer capable of achieving certain policy objectives such as stimulating economic growth, preserving jobs and tax bases at both the state and federal level, or helping to rehabilitate viable companies that cannot afford a chapter 11 reorganization.[44] Some professionals suggest that more companies are liquidating or simply closing their doors without trying to rehabilitate under the federal bankruptcy laws.[45] Commentators and professionals also suggest that companies are waiting too long to invoke the federal bankruptcy laws, which limits companies' restructuring alternatives and may lead to premature sales or liquidations.[46]

42 *See, e.g.,* Mark Jenkins & David C. Smith, *Creditor Conflict and the Efficiency of Corporate Reorganization*, (paper presented at April 2014 symposium) (draft on file with Commission) ("Secured debt represented less than 45 percent of the debt of Moody's-rated firms filing for bankruptcy in 1991; by 2012, secured debt accounted for more than 70 percent of the debt of Moody's-rated bankruptcy filers."), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2444700. For a discussion of the amendments to the Uniform Commercial Code and their potential impact on secured creditors' collateral packages, see Section VI.C.4, *Section 552(b) and Equities of the Case*.

43 *See, e.g.,* Ralph Brubaker, *The Post-RadLAX Ghosts of* Pacific Lumber *and* Philly News *(Part II): Limiting Credit Bidding*, Bankr. L. Letter, July 2014, at 4 ("Two monumental developments in Chapter 11 practice that the Code drafters likely did not anticipate, though, have skewed negotiations over allocation of reorganization surplus decisively in favor of senior secured creditors, in a manner that the Code drafters also likely did not anticipate. The first is the ascendancy of secured credit in Chapter 11 debtors' capital structures, such that it is now common that a dominant secured lender has blanket liens on substantially all of the debtor's assets securing debts vastly exceeding the value of the debtor's business and assets. The second, related phenomenon is the rise of 'relatively expeditious going-concern sales of the debtor's business and assets to a third-party purchaser' as a prominent means of realizing the debtor's going-concern value in Chapter 11.") (citations omitted).

44 *See, e.g., Oral Testimony of Joseph McNamara: NACM Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (May 21, 2013) ("In my experience, over the last half decade, companies have had a harder and harder time successfully reorganizing their debt and using the chapter 11 process, and thus are more prone to either fold their reorganization procedure into a liquidation or successfully exit and then re-enter bankruptcy a few short years later."), *available at* Commission website, *infra* note 55. *See also* Stephen J. Lubben, *What We "Know" About Chapter 11 Cost is Wrong*, 17 Fordham J. Corp. & Fin. L. 1 (2012) (reviewing literature and presenting empirical data to contradict common perceptions of bankruptcy costs); *Written Statement of John Haggerty, Argus Management Corp.: ASM Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (Apr. 19, 2013) (describing an increase in the use of nonbankruptcy alternatives, including increased unsupervised winddowns, as a result of the costs and loss of control associated with chapter 11), *available at* Commission website, *infra* note 55; *Oral Testimony of John Haggerty, Argus Management Corp.: ASM Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 36 (Apr. 19, 2013) (ASM Transcript) (describing how the DIP budget for professionals' fees has ballooned and noting that such costs keep small businesses out of chapter 11), *available at* Commission website, *infra* note 55.

45 *See, e.g.,* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 Stan. L. Rev. 751, 777–85 (2002) (discussing decrease in traditional stand-alone reorganizations). *See also Oral Testimony of Dan Dooley: ASM Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 37 (Apr. 19, 2013) (ASM Transcript) (describing increased use of state and local receiverships and ABCs in lieu of chapter 11 or chapter 7 because of the reduced costs and reduced delay), *available at* Commission website, *infra* note 55.

46 *See, e.g.,* Michelle M. Harner & Jamie Marincic Griffin, *Facilitating Successful Failures,* 66 Fla. L. Rev. 205 (2014) (analyzing literature and presenting results of empirical survey on, among other things, timing of bankruptcy filings). *See generally infra* note 66 and accompanying text (generally discussing limitations of chapter 11 empirical studies).

Not all commentators agree that significant reform to chapter 11 is necessary. Some suggest that any changes could have unintended consequences or negatively impact credit markets. Others simply suggest that the system continues to work well enough.[47]

These issues are at the heart of the Commission's study. As explained below, the Commission's process was designed to explore the new environment in which financially distressed companies operate and to determine what aspects of the current system are — and are not — working as well as possible.

C. The Commission's Study

The Commission has undertaken a methodical study of chapter 11 of the Bankruptcy Code. Over 250 corporate insolvency professionals (including the Commissioners, committee members, and hearing witnesses) participated in this study. The Commission has strived to include all perspectives, ideologies, and geographic and industry segments.

Notably, the Commission's process resembles that of the 1970 Commission on Bankruptcy Laws and, more recently, the 1994 NBRC in several respects. For example, the Commission used an advisory committee structure, described below, similar to the eight-topic committee structure invoked by the NBRC.[48] Similar to the NBRC, the Commissioners retained authority for addressing and deciding each issue.[49] Moreover, each of the field hearings hosted by the Commission and described below was open to the public, and the transcripts (and, in many cases, video recordings) are posted on the Commission's website at www.commission.abi.org (the "***Commission website***"). In addition, similar to the process followed by the NBRC, the Commissioners appeared at restructuring events throughout the country to discuss and publicize the Commission's work and to solicit feedback from affected constituents.[50]

The Commission has met on a regular basis since January 2012. During these meetings, the Commission has, among other things, discussed issues perceived as potential problems in chapter 11, reviewed recent developments in the case law and practice norms, and developed an effective process for identifying, researching, and analyzing chapter 11 as a whole. As explained below, the Commission used its advisory committees and numerous public field hearings to amass the information and research it required to critically analyze chapter 11 and consider any reform measures.

The Advisory Committees. To launch its study, the Commission identified 13 broad study topics to facilitate a detailed analysis of the various components of chapter 11. These study topics are: (1) administrative claims and other pressures on liquidity; (2) avoiding powers (*e.g.*, preferences and fraudulent conveyances); (3) bankruptcy-remote and bankruptcy-proof entities; (4) distributional issues under plans; (5) executory contracts and unexpired leases; (6) financial contracts, derivatives,

47 *See, e.g.,* Stuart C. Gilson, *Coming Through a Crisis: How Chapter 11 and the Debt Restructuring Industry Are Helping to Revive the U.S. Economy*, 24 J. Applied Corp. Fin. 23 (2012).
48 *See* NBRC Report, *supra* note 37, at 60–61.
49 *See id.* at 61.
50 *See id.* at 63.

and safe harbors; (7) financing issues; (8) governance and supervision of cases; (9) labor and benefits issues; (10) multiple entities and corporate groups; (11) procedural and structural issues under plans; (12) role of valuation; and (13) asset sales in chapter 11.[51] The Commission then enlisted the volunteer service of more than 150 of the insolvency profession's expert judges, lawyers, financial advisors, academics, and consultants to serve on advisory committees for each of these study topics.[52]

In forming the advisory committees, the Commission carefully vetted individuals who were qualified to address particular issues within any given advisory committee's charge. This vetting process considered not only the individual's knowledge and expertise in the area, but also whether the individual would be likely to add a particular perspective on the issues while still considering the overall integrity of the bankruptcy system. As such, each advisory committee received input from the perspective of the various chapter 11 constituents — *e.g.*, lenders, trade creditors, landlords, employees, etc. — on each of the issues they addressed and presented to the Commission. The diverse perspectives of the Commissioners and of the advisory committees added substantial value to the Commission's deliberations and decisions and the proposals encompassed in this Report.

The advisory committees began their work in April 2012. The Commission provided each advisory committee with a preliminary assessment containing initial study questions for its general topic area. Each advisory committee devoted significant time to researching and evaluating the study questions. The advisory committees met either in-person or telephonically on a frequent basis to review their research and debate the issues. The advisory committees engaged in this work for approximately 18 months before submitting research reports on most topics to the Commission in December 2013.

The Commission then held a three-day retreat in February 2014 to meet with each advisory committee and discuss the research reports. At the retreat, the advisory committees presented their reports and highlighted complex and nuanced issues for the Commission, and the Commissioners actively engaged in a direct dialogue with advisory committee members. The Commission also used the forum to begin integrating the study topics and reconciling overlapping issues. The retreat and the work of the advisory committees leading up to the retreat sessions were informative and very helpful to the Commission in this process. Since then, the Commission has reviewed the entire body of work produced by the advisory committees and conducted follow-up research and analysis on a variety of issues.

The Commission also formed an international working group consisting of leading practitioners and academics from 13 different countries.[53] The working group has studied targeted questions posed

51 The Commission deferred the work of the advisory committee on multiple entities and corporate groups; in the end, many of the study questions initially assigned to that committee overlapped with and were addressed by other committees or the Commission as a whole.

52 As noted above, *supra* note 3, the names and affiliations of members of the advisory committees are listed at Appendix C. In addition, several of the advisory committees identified, and the Commission appointed, research fellows to provide research and other support for the work of those advisory committees. The Commission is grateful for the service and contributions of the advisory committee research fellows.

53 Members of the international working group are: Dr. A. Klauser and L. Weber, from Austria; S. Atkins and Professor R. Mason, from Australia; Professor M. Vanmeenen and N. Wouters, from Belgium; S. Golick, from Canada; J-L. Vallens, M. André and R. Dammann, from France; Professor R. Bork, Professor S. Madaus and A. Tashiro, from Germany; Professor S. Bariatti and G. Corno, from Italy; H. Sakai, from Japan; Professor P.M. Veder and R.J. van Galen, from the Netherlands; Professor Wang Weigo and Professor Li Shuguang, from the People's Republic of China; Professor F. Garcimartín and A. Núñez-Lagos, from Spain; Professor A. Boraine and A. Harris, from South Africa; Professor I.F. Fletcher, I. Williams, S. Bewick and R. Heis, from England and Wales; and G. Stewart and M. Robinson from INSOL International, and Professor B. Wessels and R.J. de Weijs, from the Netherlands as organizing members. Further contributions were made by E. Dellit, L. Farley, T. Hamilton, L. McCarthy and D.

by the Commission and the advisory committees to provide a comparative analysis of the relevant issues. These questions generally involved the following broader topics: (i) the use of surcharges in sales; (ii) the treatment of intellectual property licenses in insolvency; (iii) financing options for insolvent companies; (iv) the role of administrators and monitors; (v) plan issues (presenting, voting, plans variations, and allocation rules); (vi) creditors' or stakeholders' committees; and (vii) claims trading.

The Field Hearings. The Commission held its first public hearing in April 2012 at the U.S. House of Representatives Committee on the Judiciary in the Rayburn House Office Building in Washington, D.C. Since that time, the Commission has held 16 public field hearings in 11 different cities: Boston, Las Vegas, Chicago, New York, Phoenix, San Diego, Tucson, Philadelphia, Austin, Atlanta, and Washington, D.C. Collectively, almost 90 individuals testified at these hearings.[54] The testimony at each of these hearings was substantively rich and diverse. The hearings covered a variety of topics, including chapter 11 financing, general administrative and plan issues, governance, labor and benefits issues, priorities, sales, safe harbors, small and medium-sized enterprise cases, valuation, professionals' fees, executory contracts (including commercial leases and intellectual property licenses), trade creditor issues, and reform of avoiding powers. Transcripts and videos of the hearings, and the related witness statements, are available at the Commission website.[55] A summary of the hearing topics is attached at ***Appendix E***.

Several common themes emerged from the field hearings. First, many witnesses acknowledged that chapter 11 cases have changed over time.[56] These changes include: (1) a perceived increase in the number and speed of asset sales under section 363 of the Bankruptcy Code;[57] (2) a perceived decrease in stand-alone reorganizations; (3) a perceived decrease in recoveries to unsecured creditors;[58] and (4) a perceived increase in the costs associated with chapter 11.[59] Second, the witnesses who testified on issues relating to small and medium-sized enterprises generally opined that chapter 11 no longer

Elliott (Australia), C. Fell, M. Rochkin, S. Obal and Professor J. Sarra (Canada), L. Valentovish (Japan), L. Harms (South Africa) and C. E. Poolis (England).

54 The names and affiliations of these witnesses are listed at ***Appendix D***.

55 All testimony and statements related to the Commission's study from 2012 through 2014 that are cited in the Report are available at the Commission website at www.commission.abi.org [hereinafter Commission website].

56 *See Oral Testimony of Bryan Marsal: NCBJ Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 15–19 (Oct. 26, 2012) (NCBJ Transcript) ("There is a gradual erosion of the underlying public principle of the Code which was to preserve jobs and maximize value through rehabilitation."), *available at* Commission website, *supra* note 55; *First Report of the Commercial Fin. Ass'n to the ABI Comm'n to Study the Reform of Chapter 11: Field Hearing at Commercial Fin. Ass'n Annual Meeting*, at 2 (Nov. 15, 2012) ("[A] principal criterion for evaluating any proposed amendments to the Code is the extent to which they maximize the value of companies as going concerns (thereby preserving jobs and maximizing value for creditors), either through a reorganization in those situations where reorganization is a realistic option, or through a sale or liquidation where reorganization is not a realistic option."), *available at* Commission website, *supra* note 55.

57 *See Oral Testimony of Gerald Buccino: TMA Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 19 (Nov. 3, 2012) (TMA Transcript) ("When sales occur too quickly before the rehabilitative process, the yield to prepetition creditors is diminished."), *available at* Commission website, *supra* note 55; *Oral Testimony of Michael Richman: NCBJ Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 20 (Oct. 26, 2012) (NCBJ Transcript) (recommending that section 363 sales should be modified so that courts can restrain hasty sales and better monitor expedited sales), *available at* Commission website, *supra* note 55.

58 *See Written Statement of Paul Calahan: NACM Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (May 21, 2013) ("The Code and the economic environment have made it more difficult for unsecured creditors to realize fair payment of their claims . . . A voice for unsecured creditors is clearly needed and provides valuable insight to the court and other parties."), *available at* Commission website, *supra* note 55; *Written Statement of Joseph McNamara: NACM Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (May 21, 2013) ("A tremendous disparity remains between payment of secured and unsecured claims and some evidence suggests secured creditors with first liens experienced outstanding recoveries, while unsecured recoveries were around 20%, with the median recovery set at 10%."), *available at* Commission website, *supra* note 55.

59 *See Written Statement of John Haggerty, Argus Management Corp.: ASM Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (Apr. 19, 2013) (recommending that the level of professionals should be rationalized at the onset of a case and fees and billing should be more transparent and have greater oversight during the process to keep overall costs down), *available at* Commission website, *supra* note 55.

works for these companies. Witnesses cited cost and procedural obstacles as common barriers.[60] Third, the witnesses who testified on financial contracts and derivatives generally agreed that the safe harbor protections have been extended to contracts and situations beyond the original intent of the legislation.[61] They did not necessarily agree, however, on appropriate limitations or revisions to the relevant sections of the Bankruptcy Code.[62] Finally, witnesses — even those who were highly critical of certain aspects of chapter 11 — all perceived value in the U.S. approach to corporate bankruptcies, including the debtor in possession model.[63]

In addition, the Commission worked with the University of Illinois College of Law to organize and host an academic symposium on the role of secured credit in business bankruptcies in April 2014. Nineteen of the nation's leading bankruptcy scholars contributed to the symposium.[64] The symposium was open to the public, and both the scholarship presented and a video recording of the event are posted on the Commission website. Many of the scholarly papers from this symposium will also be published in a forthcoming issue in the 2015 volume of the *Illinois Law Review*.

D. The Commission's Deliberations

Immediately following its February 2014 retreat, the Commission began its in-depth review of the advisory committees' reports and recommendations, various issue-specific white papers prepared by the Commission's Reporter with the assistance of the Commissioners and research fellows, the papers from the Illinois symposium, and testimony and papers submitted by hearing witnesses and restructuring professionals.[65] The Commission then held five separate executive session retreats to deliberate, formulate, and vote on the content of this Report. Two of these retreats were held in

60 *See Written Statement of the Honorable Dennis Dow: Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (Apr. 19, 2013) (noting that the complexity, time, and costs of the chapter 11 process impose obstacles that small business debtors often cannot overcome), *available at* Commission website, *supra* note 55; *Written Statement of Professor Anne Lawton: NCBJ13 Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (Nov. 1, 2013) ("The Code's small business debtor definition should be simplified."), *available at* Commission website, *supra* note 55; *Oral Testimony of Gerald Buccino: TMA Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 7, 15 (Nov. 3, 2012) (TMA Transcript) ("A one-size-fits-all approach for the Code does not work because smaller businesses have special needs."), *available at* Commission website, *supra* note 55; *Oral Testimony of Jeff Wurst: NYIC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 28 (June 4, 2013) (NYIC Transcript) (stating smaller companies can no longer afford to seek protection under chapter 11), *available at* Commission website, *supra* note 55.

61 *See Written Statement of Daniel Kamensky on behalf of Managed Funds Association: LSTA Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (Oct. 17, 2012) (asserting that the breadth of safe harbors has had unintended consequences and some courts have held that safe harbors extend to protect one-off private transactions that do not affect financial institutions), *available at* Commission website, *supra* note 55; *Oral Testimony of Jane Vris on behalf of the National Bankruptcy Conference: NYCBC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 9 (May 15, 2013) (NYCBC Transcript) ("The original purpose of the safe harbors was to preserve the clearing of payments and delivery within a fair closed system, the protections have now expanded beyond that."), *available at* Commission website, *supra* note 55; *Written Statement of Jane Vris on behalf of the National Bankruptcy Conference: NYCBC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (May 15, 2013), *available at* Commission website, *supra* note 55.

62 *See Oral Testimony of the Honorable James Peck: NYCBC Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11*, at 31–32 (May 15, 2013) (NYCBC Transcript) (recommending that judges should have more discretion to determine whether contracts fit the criteria for protection under the safe harbors), *available at* Commission website, *supra* note 55.

63 *See Written Statement of William Greendyke: UT Field Hearing Before the ABI Comm'n to Study the Reform of Chapter 11* (Nov. 22, 2013) (reporting that the membership of the Bankruptcy Law Section of the State Bar of Texas noted that the chapter 11 process still worked, but found it to be more expensive and "faster" than 10 years ago), *available at* Commission website, *supra* note 55.

64 The names and affiliations of the academics who presented at this symposium are listed at ***Appendix F***.

65 Certain of the materials that the Commission reviewed and discussed during the three-year study and deliberative process are identified in the footnotes in this Report. These citations capture but a fraction of the materials collected and reviewed by the Commissioners during this process. It simply was not feasible to cite all relevant sources and materials. The absence of a citation to a particular court opinion, empirical study, law review article, or witness's testimony does not mean that such material was not considered and analyzed by the Commissioners.

Virginia, two in New York, and one in Chicago. The Commission also held numerous subcommittee meetings in between each of these executive session retreats.

At each of the executive sessions, the Commission reviewed issues raised by witness testimony or examined in the research materials prepared by the Reporter and the advisory committees, including the advisory committee's recommendations on the initial study topics posed by the Commission. Moreover, the reports of the international working group informed many of the Commission's deliberations. From these discussions, the Commissioners worked to identify areas of potential reform that would, among other things, improve case efficiencies, enhance business rehabilitations and creditors' recoveries, and resolve uncertainty or ambiguity in the current law.

During the three-year study process, and in connection with its deliberations, the Commission compiled and reviewed, among other materials, an extensive database of empirically based articles and working papers concerning different aspects of chapter 11 of the Bankruptcy Code. In reviewing *all* empirical data, including the data cited in this Report, the Commissioners were aware of the limitations that frequently impact chapter 11 data, including the following. First, endogeneity bias often is a problem in chapter 11 studies: (i) to the extent that omitted or unattainable information affects results (*e.g.*, off-docket activity and negotiations; makeup of creditor body; talent or dynamics of management team; financial condition of debtor prior to and on petition date; impact of prepetition management decisions on company's case; and, in some instances, economic or industry cycles), omitted variable bias occurs; and (ii) when the causal direction between two variables cannot be determined, simultaneity bias might occur (*e.g.*, does the presence of private funds in a case make it more successful or do private funds invest in cases that are better positioned to be more successful).[66] Second, selection bias can occur when subsets of available data sources are not randomly sampled or the pool from which the sample is drawn is not representative of the entire population (self-selection bias can also limit empirical survey studies). Third, coder bias and intercoder reliability can skew interpretation or results (*e.g.*, if more than one coder is involved in the project, each may interpret the often subjective items on a chapter 11 docket in different ways, despite efforts to achieve an acceptable intercoder reliability rate). Fourth, data are limited and subjective: for example, it is difficult to define "success" in chapter 11; it is difficult to determine if a plan is a traditional stand-alone reorganization or a merger or a third party sale — they are all change of control events, and many datasets do not capture these nuances; and outside of public bondholders, it is difficult to determine recoveries in chapter 11 cases, particularly for smaller cases. Finally, because of the biases and limitations noted above, as well as others not discussed here, it might be difficult to establish strong claims of causality in empirical studies of chapter 11 cases. Nevertheless, the Commission reviewed empirical data from numerous sources and supporting a variety of different positions on the issues before it; it found all of the data informative, and it used the data in its overall consideration of all relevant factors.

The recommended principles set forth in this Report are the result of the Commission's study and deliberative process. The Commissioners voted on each principle, and a principle was adopted as a Commission recommendation if it received support from two-thirds of the Commissioners voting, with 11 favorable votes being the minimum required for a principle being reported as a

66 *See generally* Michael R. Roberts & Toni M. Whited, *Endogeneity in Empirical Corporate Finance*, *in* Handbook of the Economics of Finance (2014) (discussing these issues with endogeniety, as well as measurement errors in that context).

recommendation. If the requisite level of support was not obtained, this Report includes a description of the issue, a summary of the factors considered by the Commission in connection with the issue, and a notation that no consensus emerged. The Commission believed that this Report achieves its core mission to "study and propose reforms to Chapter 11 and related statutory provisions that will better balance the goals of effectuating the effective reorganization of business debtors — with the attendant preservation and expansion of jobs — and the maximization and realization of asset values for all creditors and stakeholders."[67]

67 *See* Commission's mission statement, *supra* at 3.