



## Future Of Ch. 11 Hinges On Long-Awaited Report

By Andrew Scurria

Law360, New York (December 04, 2014, 8:40 PM ET) -- The restructuring community is bracing for the release on Monday of a highly anticipated commission report on reforming Chapter 11, which attorneys expect to recommend sweeping alterations to the bankruptcy regime focused on the new commercial realities since its 1978 enactment.

After more than two years of study on what needs fixing, a task force from the American Bankruptcy Institute intends to publish hundreds of discrete recommendations on refurbishing the U.S. Bankruptcy Code that could forever change how distressed companies go about reorganizing.

The report, produced by 22 appointed commissioners and 13 advisory committees, will address topics that run the gamut of the bankruptcy universe, from modifying the rights of secured lenders in large corporate workouts to creating a viable restructuring path for small businesses.

While observers can only speculate about the commission's findings and conclusions, one thing is clear: The bankruptcy bar and the investment community will be furiously lobbying Congress and debating the proposals for years to come.

"It will get read quite broadly, and all of us will be busily at work writing alerts to our clients about all the bad things that are going to happen to them," Adam Harris of Schulte Roth & Zabel LLP said. "There are several tensions going on in the community, each one of which has its own lobbyists and separate interests."

Organized around topics like creditors' rights, labor and benefit issues, valuation disputes and safe harbors, the commission's work was a response to criticism that the U.S. bankruptcy regime has not kept pace with the world of 21st-century finance.

Chapter 11, with its focus on reorganizing debtors as a going concern, is the envy of many European and Latin American nations, where insolvency schemes can offer few choices outside a liquidation. But the overall number of U.S. bankruptcies [has been dropping](#) for some time now, and those companies that have taken on the expense of seeking court protection have enjoyed less control over the process.

Experts attribute that to the proliferation of secured lending since the 1980s, one of the primary [market forces](#) driving the commission's work. Companies' practice of granting collateral rights over their assets has let them borrow at lower interest rates but has also

diminished their ability to control their destiny once in Chapter 11.

When debtors enter bankruptcy with liens over their assets and cash, any move they make must go through secured lenders with veto rights, according to Keith Sambur of Richards Kibbe & Orbe LLP. At the same time, companies with loads of secured debt have fewer unencumbered assets to work with and to distribute to creditors.

The commission's report is widely expected to recommend diminishing the control that secured creditors can exert over a bankruptcy by virtue of their collateral position. Debtors that aren't beholden to one lending group, the thinking goes, will do a better job of restructuring their businesses from top to bottom for the benefit of all stakeholders.

"You have the members of the commission looking at this and saying, we can't reorganize a company anymore," Sambur said. "The committee's study is whether secured lending has led to decreases in recoveries for unsecured creditors and has led to reorganizations that are not real, true reorganizations — they're sales of assets or balance-sheet restructurings that are not preserving jobs."

Tamping down secured lender rights would be in line with recent decisions in the bankruptcies of [Fisker Automotive Holdings Inc.](#) and Free Lance-Star Publishing Co. that have thrown a curveball at creditors by limiting their right to credit-bid on assets. Hedge funds and debt buyers would have a tougher time following their [preferred course](#) of making deals outside of court before executing them through a quick prepackaged or prearranged bankruptcy.

On the other side of the debate are commercial lenders arguing that any such reforms would dry up the flow of capital by putting their recoveries in bankruptcy at risk.

Remember, the lending community is already [aghast](#) at the outcome of [Momentive Performance Materials Inc.](#)'s bankruptcy, where the company pushed through a restructuring plan that took away hundreds of millions of dollars in value from top-ranking bondholders.

"You will certainly see secured creditors eyes-wide-open as to how the commission proposes curtailing their ability to otherwise exercise control over Chapter 11 cases," Seth Lieberman of [Pryor Cashman LLP](#) said.

But the commission's mandate went far beyond secured lender rights. Among its other goals were enhancing a debtor's required disclosures, developing more flexible financing arrangements, revamping the asset-sale process and finding more value for junior creditors.

The final recommendations, which are not binding on any court or legislative body, are likely to be both procedural and substantive in nature. The federal judiciary itself adopts changes to the Federal Rules of Bankruptcy Procedure, which are then sent to Washington, D.C., where they are typically rubber-stamped.

“But given the attention that this is going to get, if anything moves beyond pure procedure and gets into substance, Congress is going to look very differently at what the judiciary would propose,” Sambur said.

Any alterations to the Bankruptcy Code, meanwhile, would have to come from the judiciary committees in Congress. The commission has fashioned the recommendations to make them amenable to piecemeal passage, but it remains to be seen if the new Republican-controlled Senate has an appetite for reform in 2015.

And there’s another wild card in the political calculus. The commission was conceived in the aftermath of the Great Recession and all that went with it: the banking crisis, the auto bailouts and bankruptcy courts chock-full of household names like [General Motors Co.](#)

With the economy slowly recovering and memories of the bad old days fading, Congress may not want to legislate for the worst times, Harris said.

“What you see is the things people complaining about ... harken back to the really dark days of late 2008, 2009, 2010 when there was no liquidity, companies were failing, and judges were faced with really tough choices,” he said. “That’s what’s left this bad taste in everybody’s mouth, but those days are gone.”

--Editing by Kat Laskowski and Edrienne Su.  
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