Comparative study assists reform of Chapter 11

Bob Wessels reports on the ABI Commission to study the reform of Chapter 11

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Introduction

Chapter 11 has been a leading US "export" in the last 10 years, with countries around the world modernising their insolvency laws, many using Chapter 11 as an example. Since its enactment in 1978, the US Bankruptcy Code has become an essential business tool for distressed companies in the US.

In the last few years, however, mega-cases such as Lehman Brothers, General Motors and Chrysler have caused some observers to question whether Chapter 11 has been strained and can adequately protect the interests of all stakeholders. In addition, the overall decline in asset values globally, the increased control of secured creditors, the globalisation of commerce, finance and capital markets, the advent of non-traditional financial products and the development of an active market in buying and selling bankruptcy claims have all changed the dynamic among stakeholders in Chapter 11 cases.

In light of these changes, and the cross-border implications of many if not most business insolvencies today, a healthy review of Chapter 11 is in order. Here you will find Bob Wessels' excellent report on the American Bankruptcy Institute Commission to Study the Reform of Chapter 11.

David Conaway

Comparative study assists reform of Chapter 11 US Bankruptcy Code

Over a year ago in the USA the American Bankruptcy Institute ("**ABI**") has established an "*ABI Commission To Study The Reform Of Chapter 11*". Chapter 11 US Bankruptcy Code has been a source of inspiration for insolvency and reorganisation laws throughout the world. In the last two decades several Eastern-European insolvency systems have been inspired by it and more recently Western-European countries followed, such as Spain, Italy and Germany. In the USA itself, however, there is consensus that the time has come to study whether Chapter 11 is in need of reform.

The basic model of Chapter 11 has been introduced in 1978. Since the Code's enactment, however, there has been a marked increase in the use of secured credit, placing secured debt at all levels of the capital structure. Chapter 11 assumes the presence of asset value above the secured debt, but asset value is often not present in many of today's Chapter 11 cases. The debt and capital structures of most debtor companies are more complex, with multiple levels of secured and unsecured debt, often governed by equally complex inter-creditor agreements. Also the market has changed.

It is acknowledged that the growth of distressed debt markets and claims trading introduced another factor not present when the 1978 Code was enacted. The nature of businesses has changed. Chapter 11 was developed in an era when the biggest employers were manufacturers with domestic operations. However, many of the biggest employers today are service companies. Many of the remaining American manufacturers are less dependent on hard assets, and more dependent on contracts and intellectual property as principal assets.

The US Bankruptcy Code does not clearly provide for the treatment of such assets and affected counterparties. And of course, debtors are much more often then 35 years ago multinational companies, with the means of production and other operations offshore, bringing international law and choice of law implications. Today's "debtor" is likely to be a group of related, often interdependent, entities. For instance in Chrysler the "debtor" was a group of some 25 companies.

And finally, the original intention of Chapter 11, being the rehabilitation of businesses, and the preservation of jobs and tax bases at the state, local and federal level, is eroded. Presently the emphasis is "*maximisation of value*" as an equal, sometimes competing or even exclusive goal, e.g. "fire sales" in the meaning of Section 365.

All these developments call for a fresh assessment of the purposes and goals of a US restructuring regime. The current thinking is summarised in the ABI Commission's mission statement. It states: "*In light of the expansion of the use of secured credit, the growth of distressed-debt markets and other externalities that have affected the effectiveness of the current Bankruptcy Code, the*

commission will study and propose reforms to chapter 11 and related statutory provisions that will better balance the goals of effectuating the effective reorganisation of business debtors – with the attendant preservation and expansion of jobs – and the maximisation and realisation of asset values for all creditors and stakeholders."

ABI is the organisation of choice to undertake such an effort. It has some 13,000 members coming form all parts of the legal world. The ABI Commission itself is composed of some twenty members. It is co-chaired by Bob Keach and Albert Togut, whilst prof. Michelle Harner (University of Maryland) serves as the primary investigator. The ambitions of the Commission are not small: "… *the study of the need for comprehensive chapter 11 reform, by which we mean consideration of starting from scratch and re-inventing the statute*."

The ABI Commission has identified 13 substantive topics of study and has composed 13 Advisory Committees to study and discuss these issues. These Advisory Committees are studying and will be reporting on:

1. Financing Chapter 11;
2. Governance and Supervision of Chapter 11 Cases and Companies;
3. Multiple Enterprise Cases/Issues;
4. Financial Contracts, Derivatives and safe Harbours;
5. Executory Contracts and Leases;
6. Administrative Claim Expansion, Critical Vendors and Other Pressures on Liquidity; Creation and/ r Preservation of reorganization Capital;
7. Labor and Benefit Issues;
8. Avoidance Powers;
9. Sales of Substantially All of the Debtor's Assets, Including Going-Concern Sales;
10. Plan Issues: Procedure and Structure;
11. Plan Issues: Distributional Issues;
12. Bankruptcy Remote Entities, Bankruptcy-Proofing and Public Policy; and
13. The Role of Valuation in Chapter 11.

The ABI Commission sees it as a great value to learn in what way certain countries have addressed topics relevant to these issues in their legislation. It has therefore been suggested to also establish an Advisory Committee on Comparative Law with the task to address questions raised by the Commission and the other Advisory Committees regarding how particular issues are addressed in several countries, where the country's approach may be relevant to the Chapter 11 model. The countries identified of importance are Austria, Australia, Belgium, Canada, France, Germany, Italy, Japan, Korea, Netherlands, PR of China, Spain, South Africa and UK (England & Wales). In each of those countries two or three persons have been selected and invited to assist in the work of the Advisory Committee on Comparative Law. These are all experienced scholars or practitioners, well known for their scholarly work and/or their reputation in practice. Some of them are members of INSOL Europe.

The 13 US-law Advisory Committees are now up and running and recently the process of soliciting input from various bar organizations and interest groups across the USA has started. This includes holding hearings and taking testimony from numerous parties on how Chapter 11 might be improved. During the early stages of their work, several of the Advisory Committees have wondered whether matters of comparative law may play a role in their deliberations. Where the views of the issues are being refined through this early stage of the process, the ABI Commission has started soliciting comparative law input.

As Chair of the Advisory Committee on Comparative Law I am happy to receive any matters of importance, especially form countries not mentioned above, relating to one of the topics mentioned. These could be certain concepts of Chapter 11 that have been used in existing legislation of are in consideration in drafts that are underway. Also certain solutions chosen in reorganisations or contractual plans used, inspired by a US model, would be helpful.

Furthermore, during INSOL Europe conferences I have spoken to several practitioners telling me about their experiences in using Chapter 11 for parties they represented. I would appreciate to receive a short note to have your experiences filter into the renewal process in the USA.

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In the course of the year I intend to report about the developments at the other side of the Atlantic.

I believe the comparative views to Chapter 11 renewals is a unique project and promises to become a significant step to further convergence of insolvency laws all over the globe.

Bob Wessels

THE ABI COMMISSION SEES IT AS A GREAT VALUE TO LEARN IN WHAT WAY CERTAIN COUNTRIES HAVE ADDRESSED TOPICS RELEVANT TO THESE ISSUES IN THEIR LEGISLATION

Make a comment!