OPENING REMARKS
ABI COMMISSION TO STUDY THE REFORM OF CHAPTER 11
FIELD HEARING-JUNE 4, 2013
NEW YORK, NEW YORK

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INTRODUCTION

Welcome. As Co-Chairs of the American Bankruptcy Institute's Commission to Study the Reform of Chapter 11, we thank the New York Institute of Credit for hosting this hearing today. Initially, we will hear from a number of witnesses today on certain critical and at times controversial topics: (1) the Bankruptcy Code's treatment of leases of nonresidential real property, including the effect of the provisions of BAPCPA limiting the time period for assuming or rejecting such leases on reorganizations; and (2) the Bankruptcy Code's treatment of licenses of intellectual property, including patent, copyright and trademark licenses, as to which the debtor is the licensor or licensee. In addition, we will also hear from a witness regarding the problems facing the middle-market and small business debtor. Al and I would like to begin with some brief remarks about the mission of the Commission and its activities to date, as well as about today's field hearing, and then we will hear from the witnesses, with additional inquiries by the Commissioners of each witness as appropriate.

WHY THE NEED FOR REFORM, AND WHY NOW?

It has been over thirty years since the current Bankruptcy Code was enacted, and a consensus has emerged that the current law needs an overhaul. The 1978 Bankruptcy Code, as it has been amended on numerous occasions, has served us well for years. Some would contend that the 1978 Bankruptcy Code offered a balance between creditor and debtor interests, establishing what was often described as a "level playing field" for restructurings. When first enacted, supporters of the 1978 Bankruptcy Code argued that it served the interests of all those impacted by a debtor in distress including employees, the surrounding community, the public

interest and creditor interests but did so in a flexible way that balanced all interests while meeting the debtor's goal of succeeding in saving its business.

Others did not see the balance. Detractors contended that the 1978 Code was too "debtor-friendly," that it lead to long and inefficient cases and that it provided too much discretion to bankruptcy judges. To the extent that the Code was amended after 1978, the detractors largely prevailed in the legislative battles. For better or worse, most of the changes to the Code since 1978 have (a) exempted categories of claimants or transactions from the reach of bankruptcy law; (b) added additional categories of administrative or priority claims, thus burdening the already strained liquidity of distressed companies; (c) limited or eliminated the discretion of the courts in administering chapter 11 cases; and (d) provided for shorter time periods and faster, more-truncated cases. Supporters of the 1978 Code contend that the many changes to the Code throughout the years have not helped further the goal of restructuring or have had unintended consequences.

However, arguing about who was right or wrong in terms of the recent history of the Code is, at this juncture, largely beside the point. Primarily, the world, including the financial environment and the operation of the markets, simply changed, and the Code, even as amended, was not designed to deal with these changes. For the most part, a series of "external" factors drive the need for a rethinking of chapter 11.

Since the Code's enactment, there has been a marked increase in the use of secured credit, placing secured debt at all levels of the capital structure. Many of the 1978 Code's provisions assume the presence of asset value above the secured debt, asset value that 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 intercreditor agreements. This is not to say that there is anything wrong with the growth of collateralized debt *per se*; indeed, that growth brought credit to many

companies who could not have obtained it otherwise. However, the 1978 Code's baseline assumption of value above the amount of liens on assets was challenged if not cast asunder.

The growth of distressed debt markets and claims trading introduced another factor not present when the 1978 Code was enacted, a factor which challenges certain other premises underlying the 1978 Code. Again, in many ways, this development was a net positive, providing creditors with a means of monetizing claims more quickly, rather than awaiting the outcome of sometimes lengthy cases. However, the rapidity of the development of these markets also created collateral consequences that the 1978 Code was simply not designed to deal with.

Many of today's companies are less dependent on "hard" assets (real estate, machinery and equipment or inventory), and more dependent on contracts and intellectual property as principal assets; the 1978 Code does not clearly provide for the efficient treatment of such assets and affected counterparties. Debtors are more often 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. The impacts of these changes on the efficacy of the current restructuring regime have been dramatic**.**

The way both courts and commentators discuss the purpose of chapter 11 has also changed. Early decisions (and the legislative history of the 1978 Code) emphasized that the primary purposes of the Code were the rehabilitation of businesses, and the preservation of jobs and tax bases at the state, local and federal level. As time passed, these purposes competed with "maximization of value" as an equal (and perhaps competing) goal. More recent discussions of the purpose of chapter 11 tend to emphasize value maximization to the exclusion of other goals and purposes. This development also calls for a fresh assessment of the purposes and goals of a U.S. restructuring regime.

Moreover, given the added complexity—and a statute that often does not have the tools or clear answers to deal with the problems that arise—even the cases that do reorganize seem to cost more; reorganization may be less efficient, more costly. Practitioners and the courts have achieved amazing and creative results despite the statute's shortcomings. However, recognition that the world has changed in significant ways since the enactment of the 1978 Code, and the related concerns, bring the restructuring community to consider the need for a prompt and thorough reevaluation of the Code in light of these changes. A better set of tools is required.

WHAT IS THE ABI COMMISSON, WHAT IS ITS MISSION AND HOW IS IT DOING ITS WORK?

The charge of the ABI Commission is nothing less than the study of the need for comprehensive chapter 11 reform. Accordingly, the commission's mission statement is equally ambitious:

> 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 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.

More than a year ago, then ABI President Geoff Berman tasked us to assist him in assembling a working group of the "best and the brightest" from among chapter 11 practitioners, academics, bankers, and congress, to study possible business bankruptcy law reforms. With the ABI Commission, we feel we have accomplished that task. The commission members are:

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The commission is also ably assisted by its reporter, an eminent bankruptcy scholar in her own right, Michelle M. Harner, Professor of Law and Co-Director of the Business Law Program at the University of Maryland Francis King Carey School Of Law. Professor Harner oversees the work of the advisory committees, provides critical research assistance, records the deliberations of the commission, and will assist in the production of the commission's final work product. The work of the commission is also underwritten by grants from the ABI Anthony H.N. Schnelling Endowment Fund and the ABI. We must also acknowledge the tireless and dedicated efforts of ABI Executive Director Sam Gerdano in assisting the commission.

The commission, in a series of meetings, selected a number of topics for initial study. For each topic, the commission has selected an advisory committee of distinguished judges, academics, and practitioners to assist the commission in the study of the topic, research the topic and possible reforms, and, where warranted, to develop the arguments for reform alternatives. Over 150 of the best minds from the judiciary, academia, the bar, financial advisory services, and the worlds of finance and banking have agreed to serve on the committees. These committees are organized and now in the midst their important work. The various topics, and the advisory committees, are as follows:

i. Financing Chapter 11

ii. Governance and Supervision of Chapter 11 Cases and Companies

iii. Multiple Enterprise Cases/Issues

iv. Financial Contracts, Derivatives, and Safe Harbors

v. Executory Contracts and Leases

vi. Administrative Claim Expansion, Critical Vendors and Other Pressures on Liquidity; Creation and/or Preservation of Reorganization Capital

vii. Labor and Benefits Issues

viii. Avoiding Powers

ix. Sales of Substantially All of the Debtor's Assets, Including Going Concern Sales

x. Plan Issues: Procedure and Structure

xi. Plan Issues: Distributional Issues

xii. Bankruptcy Remote Entities, Bankruptcy-Proofing and Public Policy

xiii. Valuation

The ABI Commission may also address other issues at the commission level as well.

THE FIELD HEARINGS

The commission realized that, despite the breadth of knowledge and experience on the commission and its advisory committees, many others around the country—from the bar, the judiciary, academia, the financial professions, business and elsewhere--have critical information, experience, knowledge, data and ideas to contribute to this important process. Accordingly, to access this wealth of knowledge, information, data, ideas and experience, the commission decided to hold field hearings around the country to hear and collect testimony on various issues.

The ABI Commission held six public field hearings in 2012, in Washington, D.C., New York, San Diego, Boston, Phoenix and Tucson. In those hearings, the commissioners heard testimony, and asked questions of, more than twenty witnesses from various organizations and industries affected by potential restructuring reform. The witness testimony covered various topics, including secured lending, the effect of reform on the credit markets, claims trading, the

interface of procedural rules and substantive restructuring reform, sales of businesses via chapter 11, debtor-in-possession lending, credit bidding, the role of creditors' committees, middle-market and small business issues, and governance of restructuring companies.

The testimony has been illuminating on a number of fronts. Among many other insights, the ABI Commission has heard that it must consider the impact of reforms on the broader market for credit, both for distressed and healthy companies. The Commission is fully mindful of that guidance.

THE PATH FORWARD.

The ABI Commission will hold at least eight field hearings in 2013. The commission has already conducted hearings this year addressing valuation; labor and benefits issues; fees and costs of restructurings; middle market companies; the complex issues surrounding derivatives and financial contracts, such as repurchase agreements, swaps, and like agreements; and trade credit issues, including section 503(b)(9), reclamation and preference reform. In addition to today's hearing, additional hearings are scheduled for Chicago, Atlanta and Austin, Texas. Future hearings will cover governance, sales in chapter 11, and plan issues. The commission is also soliciting and accepting written submissions on all issues. We hope to hear from every interest affected by potential restructuring reform. Throughout 2013, the commission will also receive the work of its various advisory committees on a host of topics and subtopics.

Armed with this information, the commissioners will discuss each topic, debate and search for consensus for reform. The final result will be a comprehensive report, part blueprint for reform and part catalog of open issues and current options, to be considered in updating chapter 11. At the end of the day, the commission's work may lead to consideration of reform legislation, but legislation fully informed by the careful and thorough process of the commission, and the input of the entire insolvency community. We could not be more excited and energized

about both the quality and the quantity of the contributions of that community to date, and the future of this study.

TODAY'S HEARING.

The BAPCPA provision providing for a maximum time period for the assumption or rejection of commercial leases has been controversial since its initial passage. Some have blamed the provision for the demise of both the "designation rights" market and retail reorganizations (with those two events being perhaps connected). Others contend that the provision brought needed certainty for landlords, preventing a contagion of failures within shopping centers, and that the perceived decline in retail restructurings is the product of externalities, rather than the statutory change. Years of practice under the Code have exposed other ambiguities affecting commercial leases, with courts split over the issue of so-called "stub rent" and issues of the process for, and the standard for, measuring adequate assurance of future performance when a lease is assumed and assigned. We will examine these topics and more today.

No category of contracts has generated more controversy than licenses of intellectual property, including licenses of patents, copyrights and trademarks. The circuits have been split for years over whether a debtor-in-possession may assume such contracts (even when it will not attempt to assign the contract), leading to forum-shopping around this issue. Recent decisions have also created a circuit split over the effect of a debtor-licensor's rejection of a license on the rights of the non-debtor licensee, both in areas covered by section 363(n) and not expressly covered by that provision. A number of other ambiguities and issues abound in this crucial area for modern reorganizations that often center on such "intangible" assets. We will hear from witnesses on these critical and complex issues.

Concern has been raised in prior hearings on the increasing costs of reorganizations, and the impact of such costs on the continuing viability of chapter 11 for small and middle market companies. We will also briefly revisit that topic today.

With that by way of introduction, we turn to our first panel of witnesses. We will hear from all of the witnesses on the panel first, and then ask the witnesses to take questions from the Commission before moving to the next panel and repeating that process.