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For Better or Worse: Chapter 11 in the Post-BAPCPA Downturn

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Jo Ann Brighton, Richard Mikels, and
Honorable Judge Joy Flowers Conti

JUDGE CONTI: First of all, I just want to say how pleased I am to be here in Chicago on this beautiful day. Both of my co-panelists are among the brightest lawyers that I have had the opportunity to meet. Jo Ann is at the firm where I started my career so we have that connection. Rick and I were adversaries many years ago. I think that's one of the best things about the bankruptcy practice because you are at loggerheads with others and fighting as aggressively as you can, then you turn around and become friends. I think it's a tribute to our profession that we're able to do that in the bankruptcy field. I want to bring you some news about things that are going on at the national level in my capacity on the Bankruptcy Administration Committee; that's the committee for the Judicial Conference that assesses the need for bankruptcy judges and how to deal with changes in bankruptcy administration and basically the overall workings of the bankruptcy courts in the country. In our meetings, we have an economist that generally comes to our meetings and helps us project into the future what's going to happen. At our most recent meeting in January, we were advised that looking into '09, they expected bankruptcy filings to be at about 1.3 million. I think we're on a track probably to surpass that from what I understand. In 2010 they're looking at an increase to 1.6 million filings, but they think it could go as high as 2 million filings.

The growth rate for the different chapters, I think this is interesting, they're anticipating a growth rate of about 30 percent for Chapter 7s, 31 percent for Chapter 13s and a 50 percent growth rate for Chapter 11s. I think we are starting to see that at least anecdotally. We don't have all the statistics in yet, but we're seeing a surge in Chapter 11 bankruptcies. You'll hear from my co-panelists that we're seeing a different mixture of the kinds of cases that are coming into Chapter

1. This is an edited version of the transcript from the first panel at the DePaul Business and Commercial Law Journal Symposium, Into the Sunset: Bankruptcy as Scriptwriter of the Dénouement of Financial Distress, *held on* April 16, 2009.

11s now. But that's sort of what we're anticipating. One of the things that we're undertaking is a long-range study plan. The Judicial Conference overall embarks about every ten years, give or take, a few years, on a major effort to do long-range planning, going out on a short-term basis, two or three years and then long-term, three years plus. So you may be getting inquiries over the course of the next year about where you see the issues going, what problems you're seeing. I urge you to keep attuned to these inquiries because you as practitioners and the young students who are going to go out and come into the practice of law are the ones that are on the ground and are best attuned now to see changes in your profession and what kind of changes we need to make in the court system to make it work. Another opportunity that I have is to be a liaison to the Bankruptcy Rules Committee and that committee just concluded a meeting in March. One thing to be on the lookout for is the national change in the civil rules on the time frame changes. You're going to see across the board changes in the time frame. They wanted to have everything uniform and to get away from the five days and seven days. They're stretching things out so that you're not going to have to count weekends and holidays. Those changes will be effective as I understand it at the end of this year. You'll need to be alert and understand that there are going to be some significant changes that you have to deal with.

One of the other projects that I'm involved with is a forms modernization project. The bankruptcy courts by and large are ahead of the game for all the other courts, and I can speak to that because I'm on a District Court and we generally look at what the bankruptcy courts are doing and try to play catch-up. The forms modernization project has been underway for about a year now and we're looking at another four years for the conclusion of the project. You will see from these sweeping changes in how the forms are handled in the bankruptcy system. I can't say for certain how it's actually going to come out because we're still in working group processes. But the envisioning is to have something maybe a little bit similar to what you see with the IRS. You use those forms where you just have a general sheet where you type out your information and then the system will spread that information everywhere it needs to go on whatever form you have.

So they're envisioning something like that and another way where you can keep track of the changes, so that if you want to see what the claims were initially for a certain category, there will be a way to track it on a report easily derived — this is what the judges are looking for — a way you can push a button and you can get a spreadsheet so you can see this claim was amended at this date and it changed from X to

Y or had this portion of the form changed. It will be easier to manipulate and I think that's what we're looking for to be totally electronic.

One of the problems that they've seen — and we're going to be talking about immediately after BAPCPA was enacted — a flurry of cases came into the bankruptcy system trying to beat the deadline for the implementation of the changes. After that, there was a dramatic drop-off in the number of case filings. But BAPCPA changed the way the courts internally function. It made it much more difficult, more intensive, more hearings — primarily in the consumer cases. So the work levels didn't really change. In fact, it grew because of the complexities that the BAPCPA world brought about to the court system. We're fortunate that we didn't have to have any dramatic layoffs in the court system because they were able to justify the changed workloads and that they needed to maintain the same level of staffs.

Those are some of the concerns we're seeing, but now we're going to have BAPCPA plus the increased filings. The courts are going to be facing very difficult choices because we don't have enough bankruptcy judges as it is. We have a proposal to add 50 new bankruptcy judges, but that has not been acted or moved upon. We're going to have staff problems because there are hiring freezes and different things like that. It's going to be a very challenging world for the bankruptcy courts going forward.

I just wanted to give you that sense of an overall and to speak a little bit about Chapter 11s and what we're really here to talk about today. The Chapter 11s are much more difficult. You're going to hear that from Rick and Jo Ann in terms of how to strategize and plan for them because BAPCPA did create a lot of impediments to what we used to deal with in terms of reorganizations. But it's not all negative. I think there's some bright hope that we're going to see and Rick's going to be speaking to that.

First of all, Jo Ann is going to address the first aspects of the challenges that we're seeing now in the BAPCPA area with exclusivity and 365[2] issues.

MS. BRIGHTON: I wasn't going to stand up, but I think I'm going to stand so you don't just hear this talking head. I'm going to stand up over here, so everybody can stay awake during the presentation.

One of the challenges when we planned this seminar about eight months ago was how the BAPCPA has made it easier or harder to restructure under Chapter 11. We're going to look at some of those provisions, and remember we're focusing on business Chapter 11s to-

2. 11 U.S.C. § 365 (2008).

day, not so much all the consumer cases that the judge was talking about, because BAPCPA made some substantial fee changes.

The hard part is the world as we know it has changed since BAPCPA, so it's kind of hard to sort of surgically remove what BAPCPA made more difficult or easy, and what has been made more difficult by the economic climate. I'm not sure that we can completely separate that out. But that's how we're going to break our presentation up today. We're going to talk about some specifics changes in BAPCPA that we think may have made changes with respect to how companies reorganize, but we all have to keep in mind that we have an incredibly different credit market right now. It's an incredibly tight credit market. We have complete changes in lender bases, we have bank mergers that we're dealing with, we have industries that are being decimated either by antiquated practices or just the evolution of those industries, and increasing complexity of the cases that we're seeing. A lot of cases, the auto cases are a good example, have of a lot unfunded pension plan problems and labor plan — labor issues. That makes it much more difficult to reorganize under Chapter 11. I don't think we can blame that on BAPCPA. So those are some of the things we're going to look at. Let's not forget the asset valuation volatility because that's a big issue too. The asset base is devalued so substantially that it has made it more difficult to restructure.

So we're going to break our presentation up into some of the changes we think BAPCPA may have had on the ability to reorganize under Chapter 11. Then we're going to take a look at changed economic conditions that we think also make it more difficult to restructure under what we would call a traditional restructuring in a Chapter 11 scenario.

The first thing is the changes to the exclusivity provisions. Just to give you a very brief background, the exclusive period after you file for bankruptcy is a significant control factor for the debtor. It's the time at which only the debtor can file a plan of reorganization, and that is a significant sort of safe harbor for the debtor during that period, when it has the ability to negotiate with its creditors and to put forth a plan.

Well, BAPCPA changed, under BAPCPA 1121(b)(c)[3] you had the ability to file a plan for 120 days and then seek an additional 60 days to solicit acceptances or rejections of the plan, then you were able to get extensions for cause and they were frequently granted. It wasn't unusual to see cases like Eastern Airlines that were in bankruptcy for

3. 11 U.S.C. § 1121(b) (2008).

six years, or Adelphia which was in bankruptcy for four years. So that gave companies a substantial amount of time to put together a plan or to analyze what their options were, and maybe even wait out an economic downturn. While you still can get extensions for cause, post-BAPCPA you cannot get an extension which is greater than 18 months after the date the petition for relief is filed with respect to filing a plan, or 20 months with respect to soliciting acceptance or rejections of the plan.

That is significant because it has put the debtor on the defensive and has made them have to react a lot more quickly. We're going to talk later about the cases and the change in the lending bases cases, but when you're dealing with 20 or 40 lenders that you're having to restructure with, or lenders' groups, that's a difficult thing to do in that time period. That has made a very big shift in control for the debtor.

JUDGE CONTI: Jo Ann, you do primarily representation of lenders.

MS. BRIGHTON: Correct. So I state my bias for the record.

JUDGE CONTI: Do the lenders like the change? Have they been happy with it or is this something that's driven by the unsecured creditors?

MS. BRIGHTON: I'll let Rick comment on this. The lenders like the change because it shortens the time period on one hand. On the other hand, it really ties the debtor's hands and sometimes you need the bankruptcy court form in order to be able to what I call herd all the sheep in the lender community, and sometimes it's not possible to do it. We'll talk about this a little later, but this is also very significant when you combine 365[4] retail bankruptcy cases, they have a short exclusivity period and a shortened time period to assume or reject your nonresidential leases, and it's very difficult to do in that timeframe. So sometimes the lenders like it in bankruptcy because we can monitor things more closely and we can work with the debtor and have judicial oversight to do it. So it's a mixed bag.

I actually think it's a negative for the debtor because if you don't go in with a substantial amount of your plan pre-negotiated, it's very hard to accomplish in this time frame.

MR. MIKELS: I think what you've got to think about is when people walk into your office, and let's not take Lehman or General Motors, let's take a middle market company, maybe even a family-owned company, and they think that you're there to help them, you have to

4. 11 U.S.C. § 365 (2008).

explain that they're a separate entity from the debtor; their control of the debtor if we file a Chapter 11, is going to go away within a fairly brief period of time if we don't have everything all resolved, and the creditors can wait you out and take over your company, and then sell it to somebody else or do something else, notwithstanding the company's been in your family for the last 108 years. The response to that is what can we do out of court? So it is diminishing Chapter 11 as a real viable resolution for a lot of middle market companies. That doesn't mean that nobody files, but what it means is quite often they wait so long to file to get their ducks in a row out of court, and that by the time they file, the only thing left to do is sell the company for the benefit of the band. That trend is just aided substantially by this change in the exclusivity provisions.

MS. BRIGHTON: Clearly the intent of Congress was to create a much more expeditious process, and they have, but by imposing those times also has a negative component. I will note just, so you know, for small business debtors under 1121(e)[5], it's an even shorter time period. It's 180 days to file a plan and you can still have an extension, but it's an absolute drop dead 300 days from the date you file in order to file a plan. And there's a case in Florida called *Florida Coastal*[6] if you're interested, where a court had said that even though the plan was filed 317 days after, even though it related back to the original plan, they let a competing creditor who actually brought claims just for the purposes of proposing a competing plan, propose their plan and take over the debtor. So just keep that in the back of your mind. The bottom line is that it changes the balance of power in a short period of time.

The next very significant change with BAPCPA was section 365, which has to do with the period of time when a debtor can assume or reject its contracts or leases in bankruptcy. It's a very important component of the debtor's ability to restructure its business and it is supposed to give the debtor breathing room in order to figure out whether these leases for your project make sense, they're profitable, they're beneficial to the estate.

What happened is prior to the amendment under 365(d)(4)[7] the debtor had 60 days from the petition date to assume or reject leases of nonresidential property. And like this period, like exclusivity, this period could be extended for cause. The assumption or rejection in this time period is critical because at this point the debtor's got to make a

5. 11 U.S.C. § 1121(e) (2008).
6. In re Florida Coastal Airlines, Inc., 361 B.R. 286 (Bankr.S.D.Fla. 2007).
7. 11 U.S.C. § 365(d)(4) (2008).

decision very quickly about whether or not this is a profitable contract or lease.

BAPCPA created a very hard deadline under 365(d)(4)[8] to assume or reject commercial leases, and the leases are deemed rejected, if the debtor does not assume or reject upon the earlier of 120 days or the filing of a claim. Further, you can only get an additional 90-day extension if the lender consents in advance, in writing. So what this provision has done is clearly shift the negotiating power to the landlord, and the debtors are forced to negotiate with the landlord much quicker and than we would have you do in the past.

JUDGE CONTI: Would this impact what we heard today, that General Growth Properties just filed and they own I think 200 malls across the country, Faneuil Hall in Boston; Oak Brook, Illinois; one of the properties across the street here; Tyson Galleries, huge malls across the country. How is it going to affect the landlord? I mean they would be the landlord.

MS. BRIGHTON: Retail cases are the ones that are most hardly hit by this provision because it used to be that the debtors had time, and they would work with the lenders and the landlords, and figure out whether this location made sense, whether it was profitable.

To be able to do that in this 2010 time frame is very difficult. And what I think may happen is debtors will learn to err on the side of assuming contracts just so they don't have to assume or reject. Then what happens if they ultimately reject them, they've created an additional cost for the estate because now you have a rejection claim which is entitled to a higher priority under 503(b)(7).[9]

MR. MIKELS: The other thing about this is this particular change is very bad for lenders; it's bad for lenders because how do you lend to a retailer? Where are you going to sell your collateral if the lease is rejected so quickly and you can't get to court to extend that?

MS. BRIGHTON: Especially if you're planning a going out of business sale and it's a cooperative effort, but you generally need more time than that to do an orderly GOB sale.

MR. MIKELS: And that of course is bad for lenders, but it's also bad for the landlords who are supposed to benefit from this. They got their first. Congress as best they quite effectively to get this, but now they're finding that lot of the retailers that could have reorganized in Chapter 11 aren't going to be able to reorganize in Chapter 11 be-

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8. *Id.*

9. 11 U.S.C. § 503(b)(7) (2008).

cause of this financing issue that this has caused and hence, companies like General Growth are filing for Chapter 11.

MS. BRIGHTON: You look at cases like K-Mart where they had a determined pre-petition, a substantial number of leases, and the leases were really their largest asset because they were under market leases. They determined pre-petition that they were going to reject a whole slew. But it takes time to figure out with your new business model whether or not you're going to keep leases in certain places or not.

And I use Circuit City as an example because Circuit City's unheard of in the sense that because of these deadlines, they started a liquidation sale even before the Christmas season and normally when you're representing retailers, you always have that one more Christmas season that you want to get through because everybody always thinks that's going to be the season. Circuit City was really blazing trails in that regard. So if you add in, just from the provisions that I went over, if you add in the shortened exclusivity period —and Rick is going to talk about the increased reclamation rights — increase in utility deposit requirements under BAPCPA, increase in unsecured priority claims and now this shortened period to assume or reject your leases, I think this all adds up at least just looking at the BAPCPA provision to make it a little bit more difficult for debtors to reorganize under the traditional Chapter 11 model. I'm sorry. I wanted to talk about curing claims. Before BAPCPA, in order to assume a lease you had to cure your defaults and then in addition, you had to provide adequate assurance of future performance. There was this issue out there about how do you cure non-monetary defaults? For example, if you're a car dealership and you're not allowed to go dark and you go dark and now you want to assume the lease, how do you undo going dark? Well, you couldn't.

I think you have the provision. BAPCPA with 365(b)(1)(A),[10] Congress attempted to clarify with respect to nonresidential real property leases that you don't have to cure these non-monetary defaults, but you do have to reimburse the landlords for any pecuniary loss that they incurred because of that default. That makes sense because you can't undue something like going dark.

The problem is they provided a solution in that one scenario and in other cases such as franchise agreements, leases of personal property and all other leases for contracts, that issue is still out there and has basically given the non-debtor party almost the ability to block the assumption of any leases. I'll just give you one quick example. In the

10. 11 U.S.C. § 365(b)(1)(A) (2008).

Eagle Creek[11] case, you had a debtor who had to build out, a building developer had to build out 50 lots by a certain date. Couldn't do it, filed for bankruptcy, wanted to assume that contract, and how do you undue not being able to meet that deadline. The court basically said, "Sorry, you can't cure that default and you can't assume that contract." That also shifts the power to the non-debtor party to be able to block, what may be the assumption of a beneficial contract for the debtor. You want to talk about reclamation?

MR. MIKELS: Sure. I just want to say we appreciate all of you being here, but especially DePaul students. It's really wonderful to see so many young lawyers that are interested in our field and we thank you for that. That's where the field gets its vibrancy.

Reclamation. Reclamation is where creditors can get goods back that it sold to the debtor. Obviously not good for the debtor, obviously very good for the reclaiming creditor. The bankruptcy court provisions are loosely based on Uniform Commercial Code section 2-702,[12] which says that under state law, sellers can reclaim goods by sending a written demand within a reasonable time after the buyer has receipt of the goods, but it must be done while the debtor is insolvent and the creditor must have discovered the insolvency after shipping the goods. The right to reclaim is subject to buyers in the ordinary course, and other good faith purchases returned in the UCC includes secured lenders.

So you can see there are some pretty tight restrictions, and the goods have to be on hand at the time that the demand is made. If the debtor sold the goods, the goods aren't there, and 2-702 is a remedy that looks specifically to the goods themselves.

Now, prior to BAPCPA, a seller's goods under section 546,[13] were allowed to be reclaimed much like under 2-702.[14] I tried to do that and I lost it too, the seller of goods had days from the receipt of goods by the buyer to send this demand notice. Again, the goods had to be there at the time. Now, if there was a bankruptcy that came during the 10-day period, then there was an extra 20 days for filing in which to issue the notice. BAPCPA made an enormous change in this, in that the 10-day period was extended to 45 days. Although, if the 45 days runs out after the commencement of the case, then it is extended until 20 days after the commencement of the case. What's interesting is you can see that 546 was specifically designed to incorporate 2-702

11. In re Eagle Creek Subdivision, LLC, 397 B.R. 758 (Bankr. E.D.N.C. 2008).
12. U.C.C. § 2-702 (1992).
13. 11 U.S.C. § 546 (2008).
14. U.C.C. § 2-702 (1992).

as you can see where the amendments crossed out any statutory or common law. So the reference to 2-702 was deleted by BAPCPA, but the courts, including *Dana Corp.*

I think that's the major case, Judge Liflin in New York, indicated that was somewhat meaningless, that they still looked to all the provisions under 2-702.

But the big change is that the 10-day period is now 45 days which brings a lot more goods in, particularly in a retailer where goods are flowing on a regular basis.

Now, on top of that, there is another remedy that was provided by the amendments, and that is 503(b)(9),[15] which allows a 20-day period during which, if you sold goods to the debtor, you have a priority administrative expense. This is extremely important because there's no insolvency requirements like there are under 546;[16] there's no requirement to send a notice. All that you have to do is sell goods. Now, unlike 546, it does not look to the goods themselves. What this looks to is the creation of an administrative expense in the case.

This raises some interesting questions. First of all, you can see that it makes it more difficult to do a Chapter 11 because any time you increase a priority, any time you allow people an administrative expense of something like this, that's a determination by Congress that the rights of these people to their contractual expectancy is more important than the debtor's ability to reorganize. If you look at each of these things and you expand them, it makes a successful reorganization less likely, but the determination was made the rights of these people were superior to that and deserved protection.

It also comes up as a problem in situations where a bank wants to foreclose through the use of a Chapter 363[17] sale, and we will talk more about this later, but quite often Chapter 11 today is used as a sale process primarily for the benefit of the banks. The company goes into Chapter 11, it sells its assets within a brief period of time, it's funded by the bank in the meanwhile, and the bank generally agrees it will pay the administrative expenses.

Now what they mean to say, and what they're probably saying is that what we're going to pay are those expenses that are incurred during the course of preparation for the sale if it's for the bank's benefit. However, we ran into a case where the bank was going to fund the administrative expenses, and at the end of the day they paid all the

15. 11 U.S.C. § 503(b)(9) (2008).
16. 11 U.S.C. § 546 (2008).
17. 11 U.S.C. § 363 (2008).

administrative expenses, but the judge allowed them to delay the payment of these 503(b)(9)[18] claims, and when the case was converted, all the administrative expenses were paid, but not those; that issue was still being litigated whether the bank was supposed to pay those as well. Because the difference is these were incurred prior, they didn't add to the bankruptcy estate. They were added prior to the bankruptcy and that's not something that you usually would expect the bank to have to pay.

JUDGE CONTI: Basically you're saying if the bank has the lien on the inventory and these goods are coming in, the bank lien trumps whatever right of reclamation there may be?

MR. MIKELS: The bank lien trumps the right of reclamation under 546.[19] The administrative expense under 503(b)(9)[20] exists anyway and if the bank agrees that for the benefit of having the bankruptcy process to sell its assets, for the debtor to sell its collateral as a going concern rather than a liquidation, it will pay the administrative expenses. Nobody ever contemplated this as one of those administrative expenses because what you want the bank to do is do no harm. Wherever we are now, we are. But if we're going to sell for your benefit, you've got to cover every angle going forward or we're not doing it.

JUDGE CONTI: Is this like a discrimination issue that's come up now that you're paying one class of administrative claims and not another?

MR. MIKELS: Yes. It creates a problem. The other issue and I'll be very brief on this because I really don't think this change is as significant as the others in terms of Chapter 11s being successful. But as you can see, one of the defenses to the preferences is that a payment, if it's a payment of a debt incurred by the debtor in the ordinary course of business of financial affairs and made in the ordinary course of business of financial affairs the debtor and the transferee, which was always the rule. You had to have both to have the preference defense. So that if it was in the ordinary course of your industry but not in the ordinary course of the affairs between this particular debtor and this particular creditor, you couldn't have the defense.

Now they've made it so it's either or. If you have either one of those prongs, then you have defense preferences. This of course

18. 11 U.S.C. § 503(b)(9) (2008).

19. 11 U.S.C. § 546 (2008).

20. 11 U.S.C. § 503(b)(9) (2008).

makes preferences harder to collect, but I don't think these changes are as significant to the topic as the others.

JUDGE CONTI: This would be a big issue in the Bernie Madoff situation where certain investors got paid and others didn't prior to the bankruptcy.

MR. MIKELS: That is correct and is a long-standing issue in many of the Ponzi scheme cases that came across our desks over the years because who are you trying to help? People who got their money out by happenstance are now being forced to return part of it in some of these cases and some of the judges are finding some defenses, but in others, they actually have to pay money back. On the surface that sounds terrible because here they are the victims again. But on the other hand, shouldn't they be made to share equally with all of the other victims?

JUDGE CONTI: This will be probably litigated in that case to some extent.

MR. MIKELS: Quite possibly, yeah.

MS. BRIGHTON: Another change which I don't think is going to take a lot of time is the change in the fraudulent transfer statute of limitations. Under section 548,[21] if there is a transfer by the debtor and it was either for less than reasonably equivalent value, which is constructively fraudulent, or if it was the actual intent to hinder, delay or defraud creditors, the statute under the bankruptcy code was a one-year reach-back. That has been changed to a two-year reach-back and that is something that we can say is good because that is something that benefits the debtor, it gives them a longer period to bring money into the estate. That's all I have to say about fraudulent transfer.

Another change to the code, and we don't have these on the slides, is with respect to single asset real estate cases. I'll refer to them as SAR cases. In SAR cases, the secured creditor's automatically entitled to relief from stay unless the debtor does two things, and the first hurdle you have to get over in order to be a SAR case is either the debtor can voluntarily check it on the box that they qualify as a SAR case, or you have to litigate whether it's a SAR case, and I've had to do that frequently recently.

It's not as straightforward as you think. The definition is a case in which substantially all the debtor's income is generated by a single property or project and no other business is conducted by the debtor other than the business of operating the real property.

21. 11 U.S.C. § 548 (2008).

Let's take a golf course. One property, that's all you do is operate the golf course, but what happens when you start to sell golf shirts and clubs in the clubhouse? That's not so clear. I think there are cases that have said that's not a single asset real estate case. Carol Holmes is a business — a builder that has filed and that was determined not to be a SAR case because it's a building developer, but they also wrote mortgages and they also did research and other construction type activities. So that's the first hurdle you have to get through.

If you get through the hurdle then it's a SAR case, it's nice to be the lender because you know in 90 days you're getting automatic relief from the state without having to litigate it, but that means that the debtor has to file a plan within 90 days that shows a reasonable possibility of being confirmed within a reasonable time, and commence monthly payments in the amount of the interest of the non-default rates based on the value of competitive interest.

Problem: How do we determine if the plan is feasible? How do we determine if we had to make the monthly payment? You need a valuation. It is very hard to do a valuation hearing in 90 days. The other thing I'll say on this is as a lender we're running into, does that mean we just have to sit and wait on our hands for 90 days because it's unclear whether or not we can file a claim that the case was filed in bad faith? Prior to these SAR cases some judges said well, what better time to file than on the eve of foreclosure. Other judges said well, filing on the eve of foreclosure is bad faith. Is it worth litigating when in 90 days we're going to get relief from the state? How do I show the judge it's a dissipating asset, and I am in fact being harmed over the next 90 days because by the time we litigate, I'll have relief from the state? So that's one issue that's out there. The other is can I move for a motion for traditional reasons such as cause? Yes, you can, but again, since they have 90 days to come up with a plan, you know, if it's cause, maybe it's a dissipating asset or the wind's blowing the dirt all over the place, but it's very difficult in a single asset real estate case to prove that there's cause that you can't wait for 90 days. And then the second part is to show whether or not it's not necessary for an effective plan of reorganization. Yes, it is, it's the only asset they have and look, Congress intended to give them 90 days to figure this out.

So that is just one issue that I think that we wanted to highlight. I think the next issue is employee wage claims.

MR. MIKELS: Playing tag like this is sort of fun. This is a determination Congress had to make about what's more important and it decided to substantially increase the amount of priority for wage earners, not only an amount, but you can see it went up to 10,950, but also in time, it's now wages earned within 180 days before the bankruptcy as opposed to just 90 and once again, this change is probably bad for debtors, it's good for the employees.

MR. MIKELS: It's probably bad for the banks and it is probably very good for the debtor's principals because they usually are personally liable for these things and if they can't get it made a priority, in many states they have to go into their pocket to get these items paid. The next item is KERPS, which are Key Employee Retention Plans. Now, as Chapter 11 became more and more oriented to doing 363[22] sales for the benefit of the secured lenders and possibly other creditors, in other words, these fast Chapter 11s in which over the course of two or three months all the profit is sold, one of the questions is what happens to the company if everybody leaves? Don't we really want people to stay? This is actually sort of interesting because when I started practicing, the issue was how much of a decrease in compensation were the principals going to take? The judges would grill them and make them cut their pay now or at least up until these changes. The issue was how much are these people going to get for hanging around until they can sell the company? And huge multi-million dollar awards were going out to principals of companies if they would stay and make the situation work.

Now, cynically I would say that what had happened is that banks in some cases wanted to make sure that the assets could be sold because if they sell in a Chapter 11; they get very close to the going consumer value. If they sell it in a Chapter 7 or a foreclosure, they get liquidation value and the difference can be quite major.

So as a result, how in the world do you get the principals of a company to just lie down, let the bank go through this process, hold everything together? How in the world do you convince people to do that? The way they did it was through KERPS, so this became an important part and really misunderstood if you're a cynic part of the Chapter 11 process.

Congress was beginning to find it offensive that these huge amounts were going out to the principals when the creditors weren't being paid very much. And so they passed this law that effectively makes it impossible for KERPS to be approved. As you can see, the tests that we have here and our next slide, if you take a look at them, they're almost impossible to meet. I'm not going to spend your time repeating what's on there, but these are designed to be virtually impossible to meet.

22. 11 U.S.C. § 363 (2008).

JUDGE CONTI: I think the key one is that if you're the judge and you're sitting there, you have to show that the employee has another legitimate offer so that there's a reason to keep them. In this day and age, it's pretty hard to find another job. So you have to have that in hand and that's just unrealistic.

MR. MIKELS: And it never was going to happen. And then the economic test that you see, I mean, if you can understand it, you can apply it, you won't meet it. So that looked like it was going to be a problem. But the creativity of lawyers always comes to the fore in critical times and now incentive plans have been developed. Not what my Senator Ted Kennedy had in mind when he squashed KERPS I'm sure, but now they do incentive plans so that now people pay not for hanging around, but people are paid for the benefit if they get such and such a price, you can get such and such a bonus. And that apparently is flying unless and there have been a couple of cases that have allowed this to occur, some were *Dana Corp.*,[23] *Global Homes*,[24] *Nelson* and in those cases the courts — well, *Dana* was interesting. *Dana* first said you know what; the terms of this are going to be met. It's so obvious it's going to be met. This is nothing more than a KERPS. And if it walks like a KERP and it quacks like a KERP, I know it's a KERP. And then they went back and amended it so there were at least some hurdles to meet so it wasn't quite so obviously a KERP. Generally if it's not being objected to, they tend to be allowed and even if they are being objected to, they may be altered but they are still being allowed.

MS. BRIGHTON: Now we're going to switch gears. Has BAPCPA made some things about Chapter 11 more difficult? Absolutely. Has BAPCPA made a few things easier? Probably. Can we tell exactly what the sole effect of BAPCPA is? Absolutely not because things have changed so substantially since it was enacted I don't know that we can pull it up. So what we wanted to do was also just have an economic discussion about what's going on and why those economic factors may also make it more difficult at this time to have a successful Chapter 11 reorganization.

The first thing I wanted to talk about was DIP loans, Debtor in Possession financing is traditionally afforded under the code. You're allowed if you can demonstrate that there isn't another more beneficial arrangement out there at a better price. Generally it was used to keep the company going during the restructuring period, give them

23. *In re Dana Corp.*, 351 B.R. 96.

24. *In re Global Home Prods., LLC*, 369 B.R. 778 (Bankr. D. Del. 2007).

that breathing room and allow them to come up with a restructuring plan.

The problem is there's no DIP financing right now. There's nobody willing to lend. Maybe that's too broad of a statement because there is DIP financing at a very, very steep price. I'll give you the line. Dell case is a recent example. It was largest DIP loan ever extended, that's $8 billion. It was charged out at 13 percent plus 7 percent in fees and then a dollar-for-dollar roll-up which allowed the lenders who had a pre-petition amount to roll-up for each dollar they extended, roll-up another dollar to elevate that pre-petition amount into a post-petition priority claim, because what happens when a DIP is approved is you're allowed to prime the other liens and that's why you have to demonstrate to the court that you can't get more favorable financing elsewhere or more favorable terms elsewhere.

Right now I would say there are a number of issues, obviously the tight capital market and the lack of liquidity is an issue why DIP loans are not being made. Also I stated my bias earlier. All I do is represent banks. But there are just some industries the banks don't want to be part of anymore and they're really deep into it, and there are some industries that are just facing very difficult economic times, obviously the auto cases come to mind, airlines, hospitality, and retail, but also publishing. Publishing is changing. The face of publishing is changing. If you're a lender in you're in deep because you've loaned pre-petition to a publishing company, and we've seen just in the headlines to *The Globe* and *The Tribune* are suffering financially, do you want to go out and extend further financing? Probably not.

At a certain price it looks like some people will still enter into DIP loans, but they are much more difficult to obtain. What we're seeing though is DIP loans changed in their face rather than funding when they are made and when they are advanced, rather than funding this period of time to allow the debtor to restructure, there are some significant controls that are placed.

In the *GI Joe Holdings* case which is a sports retailer named Joe's Sports, they made a DIP loan $51.2 million, but as a part of the DIP loan they essentially said you have to come up with a stocking house bid in 16 days and sell the company 10 days after that. So yeah, we'll give you a DIP loan, but we'll give a DIP loan so that you can sell it for our benefit.

We don't have time to get into whether that makes sense and whether that's fair, but that was never the intention I think of Debtor in Possession financing. I also think that puts a great onus on the bankruptcy judges because there's no committee formed at that point.

If you have the DIP loan lined up even before you go in and you have these terms where things have to move at such a fast pace, no committee is formed and you're going to tell me the bankruptcy judge is going to be responsible to read through all the first day orders including the DIP financing, that's the traditional committee role. I'm not sure what the answer is, but I just want to highlight that issue.

Another case is *Fluid Routing Systems*[25] where there was DIP financing from Sun Capitol and they gave them 35 days to sell the business. So essentially it's not DIP financing to fund your business and see if we can come up with a better plan; it's just financing, and even with my bias I feel it's a little self-serving, sell it for our benefit. It's a way to fund a foreclosure in the context of bankruptcy. Did you want to add anything?

JUDGE CONTI: But isn't that the trend that you're seeing; that the Chapter 11s are no longer really reorganizations, they're just either for a sale purpose or an outright liquidation?

MS. BRIGHTON: And I think that some of that is true and some of it is fueled by what we discussed with BAPCPA. When you're looking at some of the 365[26] limitations perhaps, especially if it's a retailer, you as the DIP lender say look, I don't want to get any deeper in this, but if you're going to give me a great price, I'm going to make some money off of this. I'll fund the admin costs, but we're going to get out of this and we're going to get out of it quick. That's one way to look at it.

I did see a recent panel at a distressed investment conference and they were talking about they didn't see the DIP financing market opening up and the liquidity opening up until about 2010. I don't know if that's true.

MR. MIKELS: The reason for DIP financing, and it's only recently that you had DIP finances that came in from outside and wanted to do DIP financing. When I say recent I'm talking about 10 or 15 years. Before that, the people that did the DIP financing were the people that had the loans in the first place and either they'd be made to continue to loan through arguments over use of cash collateral, or they would in fact do DIP financing and when they do DIP financing, they had more leverage because they were putting more money in. If a debtor couldn't survive just on the cash collateral, then the DIP financing is critical and the lenders had even more leverage.

25. *In re Fluid Routing Solutions Intermediate Holding. Corp., Case No. 09-10384* (Bankr. D. *Del.* Feb. 2009).

26. 11 U.S.C. § 365 (2008).

So what happened over the course of time is some of the provisions that go into the DIP financing are just really becoming more and more extreme, which we'll talk about a little bit later. But the problem right now is the solicitive financing is drying up and many of the lenders even that have — they just don't see a going concern value is so much higher than the liquidation value that they're willing to take the risk and then throw more money in to realize the difference.

MS. BRIGHTON: This leads us to our next point. That was when you generally had one lender or two lenders and that the composition of the lenders has changed substantially and you may have several tranches of lenders, several levels of lenders and they're trading so from day-to-day you're not even sure who that lender may exist and some may want to participate in the DIP and may not want to participate in the DIP.

JUDGE CONTI: Are they having a more difficult time selling off these loans today so they're not seeing as much change as they had in the past?

MS. BRIGHTON: I think that that's true in the last six months. I think before that, when we met to represent lenders' groups, you never knew who was going to be on your conference call because it changed on a daily basis. The other thing I would add to Rick's comment is the reason the DIP market opened up, it got very competitive. There was a lot of money out there and it was very lucrative because you get prime plus 5 percent on a DIP loan, plus a priority payment.

And one thing that I was reading about recently is there's not a lot of historical data on default rates for DIPS because DIPS, before this cycle hadn't historically been defaulted on. And Moody's is looking at now going into a rating service for DIPS trying to incentivize people to participate in DIPS and have a ratings issue.

What this leads us to is the over leverage of cases. As I said, it's not unusual to have multi-layers of debt with many lenders in each layer. And what happens is now in these cases and what's making it more difficult to restructure, there's nothing left.

JUDGE CONTI: You're saying pre-petition they've layered?

MS. BRIGHTON: They've layered it to the point where there are just no unencumbered assets. You might have some creditors trust you to create and incentivize something to go after. You may have your avoidance action, but the hard value of the assets doesn't support the value of the first level or the second or third. And we just restructured a publishing case and it was clear the hard assets couldn't even support the first and at that point how do you restructure it? You're an industry that's dying and sometimes you offer rights offerings because another sub-issue of this is exit financing is just as dried up as DIP financing. You may have warrants or rights offerings or something along those lines, but all that does is increase the debt layer of the company. It doesn't throw any new equity in.

So this multi-layer issue and I know Rick's going to talk about it a little bit is really significant and a great impediment to restructuring the companies because there's just nothing left. And then you get to the exit, why are we even thinking about Chapter 11 because all we're serving is the first lien lenders. We can't even support the second lien lenders, we'll wipe out the equity, we'll probably cram down the second and maybe as a group of first lien lenders we'll create some sort of *de minimis* amount in a trust to throw to the unsecured creditors so that it doesn't look like we're only going into this bankruptcy in order to serve ourselves.

So I know you're going to talk a little bit more globally on these issues. Those are the economic issues that I think are significant and maybe in combination with some of the BAPCPA issues that have made it more difficult to restructure.

MR. MIKELS: I just want to tell you that if you're interested in the last topic that Jo Ann spoke about, which is the multiple layers of debt and the confusion in cases that are causing, Jo Ann wrote an incredible series of articles in the ABI journal a couple of years ago that cover that, and they're the best I've seen on these very, very difficult issues. Her co-author was Mark Berman.

Now, we're talking about all the problems and I think in terms of Chapter 11 as a vehicle for debtors that has been added to by BAPCPA. But the reality is that the amendments in 2005 are not where the problem stems from, they're just one continuing part of this issue.

Now, it may that Chapter 11s as a tool for debtors is something good for society. It may be that Chapter 11s for the benefit of debtors is bad for society. I don't take a position on those points. I used to represent banks all the time like Jo Ann does and I've reformed and now I represent mostly debtors so I understand all these different sides.

But what has happened is actually relatively simple to understand although almost nobody agrees with me on this, but just look at that chart. Could it be more simple? You have a liquidation value of $30 million and a going concern value of $60 million. That's fairly realistic, right? Everybody can live with those numbers. Nice little difference, maybe a doubling of value.

Now everybody knows that the first $30 million is going to go to who? It's going to go to the creditors. Everybody knows that. That's theirs, even if they went off and foreclosed whatever the company or liquidated in Chapter 7, that $30 million goes to the creditors. But what about the next $30 million, who does that go to? Does that continue to go to the secured lenders, does it go to the unsecured creditors, does it go to the stockholders? That is the issue that Congress sets up Chapter 11 to decide.

Before 1978 there were two methods of reorganizing, one was a Chapter XI and one was a Chapter X. X was devised for large publicly held corporations. It had an absolute priority rule so the creditors had to be paid in order which answered that question. It had a trustee come in at the beginning so that the management might be out; the stockholders were pretty much out right at the beginning of the case.

And then for more modest sized companies that weren't public companies, you had a Chapter XI. Chapter XI looked at this problem and dealt with it differently. First of all, there was no absolute priority rule. Creditors didn't have to be paid in order. Second of all, and most important, only the debtor could file a plan. Exclusivity was throughout the case. So the creditors' choice was do we take what the debtor offers, or do we take the liquidation value? This is overly simplistic, but what would happen is the debtor would say, okay, I'm going to give you creditors $45 million. And that's $15 million more than your liquidation value. And the creditors would say, wait a minute, that's not fair. There's $60 million of value. We're the creditors. Why should we leave $15 million behind for the stockholders? And the answer to the question was well, we understand that, but your choice is $45 million or $30 million. You don't have a choice of $60 million. Would you like the $45 or do you want to take the $30?

MS. BRIGHTON: The difference here is now that you have this simple explanation but then you have a debt of $150 million so there's nothing left. I mean you've lost that cushion.

MR. MIKELS: But it's the same — it's still the same problem because even then the bank doesn't want $30 which is all they'd get left to their own devices.

MS. BRIGHTON: You're not leaving any incremental value for the unsecured creditors.

MR. MIKELS: First of all, Chapter 11 is not supposed to deal with secured creditors. However, I'll tell you the secret of how that worked. The courts did not grant relief from stay. So either you'd watch your collateral rot or you'd make a deal with the debtor. Now, it doesn't matter for this purpose and for this purpose it doesn't matter whether there are unsecured creditors or secured creditors in that case because still there's $45 million available for creditors and $15 million that's available for stockholders. Now that's not how it worked out in every case, but this is the concept.

JUDGE CONTI: You're talking about giving leverage to the debtor to make things happen?

MR. MIKELS: Yes, give leverage to the debtor and we came out of Chapter 11, you didn't have a lot of Chapter XXIIs or XXXIIIs because you left equity in the company for the stockholders. And if you had a family business for 180 years, you had a family business likely for another 180 years because nobody could come in and take it away from you. Now, what happened was, what do you think debtors like? Do you think they like Chapter 11 or Chapter 10? Eleven looks a lot better. So as a result by the time 1978 came, nobody filed Chapter 11. It had fallen into almost disuse. There were a couple of them floating around.

JUDGE CONTI: Those were the big railroad reorganization cases that you've all read about in the case books.

MR. MIKELS: But most of the big cases that took place in the middle and late '70's went to Chapter 11 even though they were public and even though they were large because look at this, why wouldn't you go into Chapter 11? Well, people found this somewhat offensive because why should you leave $15 million for the stockholders? Well, Number 1 it works, number 2, the company is restructured, and number 3, it provides a fresh start to people. However, on the other hand, you have this conundrum because there are two competing policies for what Chapter should accomplish. One is that Chapter 11 should provide people with a real opportunity to restructure their businesses and to keep them.

And the other is you should maximize the return for creditors. Well, you can't have this, you can't do both. Either the creditors get $60 because it's an absolute priority rule or the stockholders are getting $15 because restructuring it and a fresh start is important.

So this was the conundrum. In 1978 Congress decided to pass Chapter 11, which had limited exclusivity and which is the debtor's major leverage. Worse, in the amendments of 2005, you now have an absolute priority rule unlike Chapter 10. I call it the new Chapter 11 only because it's newer than the old Chapter 10. In the old Chapter 10, the absolute priority rule was absolute. You couldn't agree to get out of it.

Under Chapter 11, they were trying to bring the best of both Chapter XI and Chapter X into the new Chapter 11 and therefore, there was exclusivity; there was a limited period the judge could extend it. No longer can the judge extend it forever and the absolute priority rule was negotiable. Creditors could agree that they didn't have to be treated in the absolute priority rule.

But under those terms, you could wait out exclusivity and you have the absolute priority rule if you want to. So therefore, why would you have ever leave anything for the debtor? And therefore, even if you have a real reorganization, aren't you likely to have a company that's going to come out that's going to be overleveraged.

We talk about overleverage in society. It's even overleveraged in the Chapter XXIIs that came out and went back in because the creditors have more leverage and they could get the full 60 million. The shareholders were usually out and as a result, you'd have overleveraged companies coming out. Again not all the time, but we're talking about trends here and why it's more difficult and why Chapter 11s aren't really working.

In any event when this happened by the late '80's, I don't mean to sound obnoxious about this, but I was arguing to people that this was going to cause us to be administering corpses some day because people were going to catch onto this. For the first ten years under the Bankruptcy Act everybody was practicing like it was still the Bankruptcy Act because that's all we'd ever done. Then all of a sudden somebody, probably some lawyer that wasn't a bankruptcy lawyer, said wait a minute, what do you mean? We don't have to do this. Everybody said eureka, he's right. As a result almost nobody agrees with me on this, but I don't see how you can't, as a result section 363 sales are very prevalent today because all we're administering is corpses because companies do not want to go into Chapter 11 because for the management and for the principals for these stockholders, it's a death knell. Why would you commit financial suicide by going into a Chapter 11 where the whole $60 million of value is going to go to the creditors? If you want to save your company, your best shot is to try to work it out outside of a Chapter 11 and you keep working it out and working out until you have no other choice, at which point there's nothing to save and all you have is liquidation.

So in my way of thinking, that is pretty much what happened. And once again, like the landlords who are now filing bankruptcy because of this change that they wanted, I'm not sure that in each case it is much fairer to give the creditors 60 million. But I think you're going to find that what the creditors are actually getting in cases, may turn out to be less than they used to get in the old Chapter 11 because people are filing.

JUDGE CONTI: You're saying it's really not realistic, they're being promised something as part of this plan process, but then when they're set up to fail so they'd wind up getting less.

MR. MIKELS: No, I'm saying case by case, they may get a little bit more, and they may get a lot more, but I'm saying in the aggregate, with Chapter 11 not being there to save companies, in the aggregate people are ending up with less than they'd get if people were willing to file Chapter 11 sooner and pay before the companies have been diminished.

MS. BRIGHTON: Isn't one of the problems, the equity holders are the people making the decision whether to file the bankruptcy? A lot of times the opposition directors are also equity holders and they're the ones that have to make the decision, so it's self-preservation as well.

MR. MIKELS: Absolutely. That's the whole point. Who makes the decisions for the corporation, the management and stockholders? That's our system. The banks don't own the businesses. All they are is creditors. The law keeps changing to give them more and more rights in that regard. And also, you know, there was a time, maybe in the '80's, where if you mentioned the word control or lender liability, goose bumps would break out on the lenders all over their entire bodies. So terrified.

Well, you know, today you don't have issues of control. First of all, a lot of the hedge funds weren't around in the 1980's and second of all, it's just a different market. People aren't as afraid of taking control in situations and you can see that, for example, in these DIP, the banks take — or the lenders, not just banks, take almost total control of the situation.

If there's a default, there's an automatic relief from stay and that was unheard of in the old days. If you know a plan has to be filed by X date or a sale has to be executed by X date or we're not lending and that is a massive change.

Now, there are other factors that go into this and one is items like BAPCPA which have made it more difficult as we discussed in the first part of this program. And so you've got an orientation of Congress, and recently there's a case that came down just in the last couple of weeks where the PBGC now has a right once a company is discharged or comes out of Chapter 11; they have a right to receive, if a pension is terminated, they have a right to receive, I think it's $1,250 per individual each year for three years. What happens if General

Motors goes into Chapter 11 and decides to terminate its pension plan? So once again, Congress made a decision that PBGC's insolvency problems were more important than companies being able to reorganize, because for companies like GM this could be a real problem in their ability to reorganize I would think.

Jo Ann talked about new lenders filling up the balance sheet. Now, many people think this is how the capital markets evolved, and therefore, bankruptcy had to adjust itself to the capital markets which are why things are as they are. I would contend that it's just the opposite or there's a little truth to both sides. But look at our example again. If you have a $60 million company and you knew that only the debtor could file a plan to get out of Chapter 11 and you knew you were only going to get $45 million or there was a likelihood of that, an uncertainty, how many people would be putting in mezzanine debt into these companies? I mean, it wouldn't have happened to the same degree.

Concepts of fiduciary duties have changed in ways that you have extra protections for creditors. In the *Chawla*[27] case it's been cut back, but still these are concepts that didn't exist before that Boards of Directors had to be concerned about the interests of the creditors which make things more difficult.

There has been an onslaught of new professionals. When I started practicing, there were bankruptcy lawyers and that was it. We didn't have financial advisors and the investment bankers wouldn't pay much attention to bankruptcy cases. But now there are new professionals and what happened is the debtor needs these professionals — let's start with the first one to come on the scene, which were the financial advisors. The debtors need financial advisors. They have their financial problems. They have their operational problems and they need some help with it. Then the banks caught on and they started saying well, here are three financial advisors, why don't you pick one of these? And the reason for that is they wanted to have credibility, which by the way also helps the debtor if the debtor has more credibility because of the financial advisor. The financial advisors would put out numbers to the bank. The bank knew that a financial advisor wouldn't be allowed to put up numbers that were fraudulent or misleading and the banks had some ability to have confidence in what they were receiving.

It also meant that the — there was somebody on the inside who knew where the bodies were buried and where the bodies were buried

27. In Re Chawla, 46 F.3d 1185 (D.C. Cir. 1995).

included what's going to happen if we have to liquidate. Banks didn't want to liquidate. If you gave banks the keys in those days, again they'd get a rash, unlike today. Part of the difference is today there's somebody on the inside that tells them where the bodies are buried and has a plan. They can make up a plan; know what they're going to find when they get there to liquidate. So they're more likely to push toward that because there's not the uncertainty that was involved years ago.

So the financial advisors became more involved. Then investment banks came on the scene which once again was able to give the lenders a sensible insight into could this company be sold as a going concern, what we are going to get if it is, and how do we go about doing it. Again the uncertainty was reduced.

MS. BRIGHTON: But they also add costs because their fees are at the top of being paid in the priority scheme.

MR. MIKELS: Right.

JUDGE CONTI: And everybody needs them. Once one party has them in the case everybody gets one.

MR. MIKELS: Absolutely. Which is another problem with Chapter 11; it's so expensive which means it's harder to come out successfully. I don't talk as much about the costs being that I am one.

Now we have chief restructuring officers. This means that the debtor brings somebody in who reports to the Board and to the bank separately and who absolutely runs the restructuring process. And in case after case after case, the lending group will want a chief restructuring officer because that chief restructuring officer, like the financial advisor who is in the group of three, is somebody that the banks deal with time and time again. So on the one hand there's a wonderful credibility. On the other hand, if you want to be cynical, it's really a show for the banks right on the inside of the company. So this has taken these control issues and turned them on their heads. And again, much better for the lenders, much worse for the debtors.

Given all of these changes, I found a quote that some author wrote, this is I would say four years ago and commenting on the very changes that we have been talking about. And if you'll forgive me, I'm going to read this. It says, "In reality, all of these changes have been good"[28] the issue was whether these things are good or bad? As I told you at the beginning I wasn't taking a position on whether they're good or bad. They're just different.

28. Richard E. Mikels & Charles W. Azano, *"The More Things Change. . ." Reflections on 34 Years of Practice*, 25 Oct. Am. Bankr. Inst. J. at 72 (2006).

And this author says, "In reality, all these changes have been good for someone and bad for someone else. For example, as a Chapter 11 administration becomes less flexible and therefore more predictable, that tends to be a good thing for lenders and a bad thing for debtors. Lenders are able to make better underwriting decisions if there is more certainty as to the disposition of the loan in the event the debtor faces financial difficulty."[29]

As has happened in the real world in such circumstances, lenders as well as equity investors, comforted by additional certainty, are willing to make loans into increasingly risky opportunities and by the way, deeper and deeper into the balance sheet. Further advance rates tend to increase so that more debt can be placed on the same assets. This is of course good in the sense that the aggressive lending stimulates the economy.

However, when the inevitable recession occurs, the more aggressive lending may well transform itself into layers of risk which the economy cannot absorb leading to a deeper recession.

MS. BRIGHTON: I'd actually like to make one comment on that because there are no unencumbered assets and there's nothing left in the bankruptcy when you hit the bankruptcy, the banks are the first line of fire. There's never been a greater incentive to be more creative or aggressive with respect to lender liability litigation. And what you're seeing now is the banks are being sued. We would never call the material adverse change clause because I might as well just say please sue me and serve me at this address, even though that's something we negotiated for.

I've seen lawsuits recently that say it is bad faith. We were performing under this loan, you didn't renew it and in a different economic time you would renew it and since you're not renewing it, you knew or should have known that it was going to put us under. Or you knew or should have known nobody can repay their debt so how dare you come after us to enforce the obligation. Or the great Obama defense, which is Obama promised us you were not going to be coming after us with this new economy.

In defense to that, yes, lenders are getting more aggressive but lenders are first ones that receive the deep pockets and you're going to see a lot more the lenders being sued and the lenders suing each other because there's no other place people can go to get any sort of recovery.

JUDGE CONTI: That's good fodder for the litigators.

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29. *Id.*

MR. MIKELS: I think Jo Ann is absolutely right on that. All of the things we've talked about are trends. In the depression there was a trend toward debtor orientation and that's why you had a Chapter X and XI. That was a depression era statute because it was really important to help people in their troubles. As time went on, sanctity of contract became more important as a role because in a capitalist society, you have to know the people who are contracting with are going to perform and Chapter 11 is antithesis of that.

So that becomes prevalent and you'll see all of these things swinging back and forth in part with the economy and in part with other changes in the society. But one of the things that have changed significantly is that in 1980 there were a huge number of lender liability suits. Then there were almost none for a very long period of time and then there was the issue of deepening insolvency and that looked like that was the beginning of a new trend toward lender liability even though the deepening insolvency was cut back as a viable theory, it looked like people were looking to lender liability. What Jo Ann said is absolutely correct, we've now moved back into a period where all of these trends have gotten so far, and these balance sheets so stuffed up with debt that Jo Ann is absolutely right, we are going to see more and more lender liability.

MS. BRIGHTON: What I call kitchen sink complaints filed by the creditors' committees where they just throw everything up against the wall. But now the great one is aiding and abetting breach of fiduciary duties. The directors and officers didn't do what they were supposed to do and now you, the bank or lender group knew or should have known that this was going to happen and you're somehow responsible.

In the *Trump* case, I think it was here in Chicago, with the Trump Tower here in Chicago, he sued the bank group because he said they sent so many first lien lenders into the first lien group, and there was a requirement for unanimous consent that they knew or should have known that they would never be able to gain unanimous consent, so therefore they were liable. He sought like $650 million in punitive damages. Those are the kinds of things we're going to see because there's nobody else left to sue. There are no assets to go after. And I think while the banks are getting more aggressive, and I agree they're getting more aggressive with DIP funding and some of the other methods, they're the ones who are on the line of fire in defending all these suits.

You're going also going to see because of the multi tranches and the different layers of debt, everybody's going to be suing each other. The first and seconds are each suing other trying to gain one up on each other under the creditor agreement.

JUDGE CONTI: I think that's where we're going to see these cases winding up in district court as opposed to bankruptcy court. What you need to look for — I'm just going to leave you with three thoughts in terms of the tactics that the — that are our litigation tools. One is a Supreme Court decision within the last two years called *Bell Atlantic v. Twombly*.[30] It is a change in pleading, the rule that when you plead a complaint, if there's any conceivable set of facts in which a claim can be stated it's going to pass muster, that's gone. The Supreme Court retired that.

MS. BRIGHTON: Hence the kitchen sink complaint.

JUDGE CONTI: The kitchen sink complaint is out and any decent district court judge is going to read the complaint and if it's filled with mere conclusions, it's gone. You'll have a right to amend, but that claim will be gone unless you have some factual underpinnings. It still doesn't haven't to be a fact specific complaint like you might need in some state courts, but there has to be — the standard is there has to be enough facts there so that the court can discern that there's a plausible claim. That's your standard. So you have to be careful about that. If you're the pleader, be careful about that if you are going to attack the complaint. Rule 26,[31] really big, any time I talk to a bankruptcy lawyer, and I used to be one. If you say Rule 26,[32] they don't even know what you're talking about. They say, "What's that? Well, we never follow that."

Rule 26[33] is very important and if you're going to be in a district court, read the rules. You should even read it if you're in bankruptcy court. Basically you must disclose. On day one you're supposed to have the documents that support your claim, the witnesses that you have who are critical to your claim. You've got to turn that all over to the other side. If you fail to do that, down the road, you could lose your claim. That's a sanction that can be imposed. There are changes coming which you're going to see implemented over the course of the next two years. E-discovery is a big issue.

MS. BRIGHTON: And expensive, expensive.

JUDGE CONTI: But it's big and you've got to be up to speed on e-discovery because there are few paper document trails anymore. It's all electronic trails and you've got to be on top of e-discovery im-

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30. *Bell Atl. Corp. v. Twombly*, 550 U.S. 544 (U.S. 2007).
31. Fed. R. Civ. P. 26.
32. *Id.*
33. *Id.*

mediately when a case files. If you want to see what's in that lender's files, because that's where you're going to find the information, and the lender's going to want to know what's in the debtor's file, you've got to be immediately talking about preservation. There's a duty to preserve. You have to be on that immediately. There's been huge sanctions involved in some cases, huge sanctions if you fail to comply with the duties. Those are the just the three thoughts I want to leave you with.

MR. MIKELS: By the way, for the students, you should know the Judge that still holds the record for the highest GPA in history at Duquesne Law School, which I find very impressive.

JUDGE CONTI: He was invited to my swearing in and that's how he knows that. We have time for maybe one question or two if anybody has a question that they want to ask. I think there's a lot of business to be had out there for lawyers. We have to reinvent ourselves today as we had to do going into the '80's. I think we're going to see other changes in bankruptcy and we need to envision how to work through these changes.

MR. MIKELS: I think the trends will change and we need — in this society we need Chapter 11 as a viable option for companies.