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ARTICLES

SMALL BUSINESS REORGANIZATION AND THE SABRE PROPOSALS

Karen M. Gebbia-Pinetti[*]

I. INTRODUCTION

A. The World of Small Business Reorganization[1]

Extensive anecdotal evidence[2] and the limited empirical data available[3] suggest that the majority of chapter 11 business

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[*] © 2002. Professor of Law, University of Hawai'i School of Law.

1. This Article focuses only on small businesses in reorganization, not those in liquidation.

2. *See, e.g.*, Brian A. Blum, *The Goals and Process of Reorganizing Small Businesses in Bankruptcy*, 4 J. SMALL & EMERGING BUS. L. 181, 185 (2000) (stating that small businesses "constitute the overwhelming majority of business bankruptcies"); Leif M. Clark, *Chapter 11 – Does One Size Fit All?*, 4 AM. BANKR. INST. L. REV. 167, 173 (1996) (criticizing the 1973 Bankruptcy Commission Report for failing to give proper attention to small or closely held businesses, which constituted a majority of bankruptcy cases at that time); Stephen J. Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509, 527 (2000) (stating "the bulk of the bankruptcy courts' caseload is comprised of [sic] personal and small business bankruptcies"); Bruce A. Markell, *LaSalle and the Little Guy: Some Initial Musings on the Ultimate Impact of* Bank of America, NT & SA v. 203 North LaSalle Street Partnership, 16 BANKR. DEV. J. 345, 346 (2000) (noting that many bankruptcy cases are filed by small businesses or individuals).

3. *See, e.g.*, Robert M. Lawless et al., *A Glimpse at Professional Fees and Other Direct Costs in Small Firm Bankruptcies*, 1994 U. ILL. L. REV. 847, 849 (1994) (finding that more than seventy-one percent of bankruptcy cases are small business cases); TERESA A. SULLIVAN ET AL., FINANCIAL DIFFICULTIES OF

reorganization cases are "small business" cases, however that phrase might be defined.[4]

SMALL BUSINESSES AND REASONS FOR THEIR FAILURE 3, 11, 12 (1998), *available at* http://www.sba.gov/ADVO/research/rs188tot.pdf (last visited Feb. 11, 2002) (stating "the great majority of companies in bankruptcy are small businesses" and "our data show that the business bankruptcy process is dominated by small businesses;" citing a 1994 study which found the median total assets of bankrupt businesses in fourteen districts was $94,757); Elizabeth Warren & Jay Lawrence Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L.J. 499, 500, 543 (1999) (finding that if Congress were to define small businesses to include businesses with non-contingent liabilities of five million dollars or less, more than ninety percent of current cases would be small business cases); *see also* NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS 609-60 (E. Warren, Rep., 1997) [hereinafter NBRC REPORT] (recommending reforms designed to reduce the time and cost of chapter 11 for small businesses); Alexander L. Paskay & Frances Pilaro Wolstenholme, *Chapter 11: A Growing Cash Cow, Some Thoughts on How to Rein in the System*, 1 AM. BANKR. INST. L. REV. 331, 346-46 (1993) (arguing the conclusion that most cases are small business "requires no empirical evidence . . . .").

4. *See, e.g.*, Blum, *supra* note 2, at 188-93 (evaluating various methods of defining "small business"); Joshua E. Husbands, *The Elusive Meaning of "Small Business,"* 2 J. SMALL & EMERGING BUS. L. 355 (1998) (noting the divergent definitions of "small business" in various statutes applicable to "small businesses," and noting that classification depends upon purpose and is based upon various factors including asset value, number of employees, and annual revenue); Linda Ekstrom Stanley, *Small Business Bankruptcy Reform: Codifying Our Best Practices*, 17 AM. BANKR. INST. L.J. 20, 20 (July/Aug. 1998) (noting that the National Bankruptcy Review Commission considered a proposal to define small business in terms of income, but adopted a debt-based definition; defining small business as one with non-contingent liabilities of five million dollars or less; noting that between eighty-five and ninety percent of chapter 11 cases would meet this definition); Lynn M. LoPucki, *The Trouble With Chapter 11*, 1993 WIS. L. REV. 729, 751 n.88 (1993) (noting that Judge Small selects small business cases for his fast track program "based upon the sizes of the debts [held by the debtor's] twenty largest creditors;" citing telephone interview with Judge Small); NBRC REPORT, *supra* note 3, at 68 (defining "small business" as having aggregate, non-contingent, liquidated, secured or unsecured debts as of the petition date of not more than five million dollars).

The 1994 amendments to the Bankruptcy Code defined "small business" as "a person engaged in commercial or business activities (but does not include a person whose primary activity is the business of owning or operating real property and activities incidental thereto) whose aggregate non-contingent liquidated secured and unsecured debts as of the date of the petition do not

Many bankruptcy experts suspect that the substantial costs and hurdles of reorganizing under chapter 11 are especially burdensome for small businesses and may significantly impair small businesses' ability to reorganize and survive.[5] Again, the

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exceed $2,000,000." 11 U.S.C. § 101(51C) (2000). This definition applies to those provisions of current bankruptcy law that apply only to small businesses. Bankruptcy Code section 1102 authorizes the court to order that a creditors' committee not be appointed in a small business case; Bankruptcy Rule 1020 allows a business that meets the small business definition to elect to be treated as a small business; Bankruptcy Code sections 1121(e) and 1125(f) and Bankruptcy Rule 3017.1 provide expedited plan and disclosure statement procedures for small businesses that take the election. *Id.* §§ 1102, 1121(e), 1125(f); FED. R. BANKR. P. 1020, 3017.1.

When bankruptcy experts speak of small businesses in bankruptcy, they often use the phrase generically to distinguish such cases from "large" or "mega" cases. For purposes of this Article, a business will be considered a small business if it meets any of the foregoing definitions.

5. *See, e.g.*, Clark, *supra* note 2, at 176-77 (arguing that the "one size fits all" approach of chapter 11 is generally effective; noting that Judge Small has simplified disclosure statements and expedited the confirmation process in a successful effort to reduce the costs of chapter 11 cases for small businesses); Christopher Frost, *The Theory, Reality and Pragmatism of Corporate Governance in Bankruptcy Reorganizations*, 72 AM. BANKR. L.J. 103, 104 (1998) (arguing that corporate governance problems of businesses in bankruptcy are exacerbated in small cases because creditors have so little at stake that traditional methods of controlling strategic behavior (creditors' committees, termination of debtor exclusivity, motions to convert or appoint a trustee) are impractical; arguing that in small cases no one has the time or incentive to monitor management); Karen L. Gilman, *Code Review Commission's Proposals Spark Controversy*, BANKR. STRATEGIST, Sept. 1997, at 4 (acknowledging that small businesses need a more cost effective system that would allow them to spend less time in bankruptcy; assessing the proposals in light of this goal); Donald R. Korobkin, *Vulnerability, Survival, and the Problem of Small Business Bankruptcy*, 23 CAP. U. L. REV. 413, 423-28, 431 (1994) (arguing that the small percentage - fifteen to twenty-five - of small businesses that emerge from bankruptcy as going concerns may arise from under-capitalization, high debt-to-equity ratio, heavy reliance on short-term financing, sensitivity to external changes such as economic recession, and being in desperate condition when the case is filed); Lawless et al., *supra* note 3, at 851-52 (finding that "the costs of small business bankruptcies do not follow the pattern of costs in large business bankruptcies" and explaining why the costs of chapter 11 are more burdensome for small businesses); Elliot D. Levin, *Comments and Responses to Small-Business Working Group Proposals*, 102 COM. L.J. 200, 204 (1997) (arguing that small businesses lack the financial resources and staff needed

to survive the lengthy and complicated chapter 11 process); LoPucki, *supra* note 4, at 728, 730 n.6, 749-52 (finding that between 1964 and 1997, the median time in chapter 11 increased by 150% for all entities, but did not increase for large, publicly held companies; concluding that the Bankruptcy Code decreased the time and cost of reorganization for the very largest entities but increased the time and cost of reorganization for most entities; recommending separate procedures for cases other than very large public companies; noting recurring problems in small business cases, including non-existent or inactive creditors' committees, difficulty retaining customers during bankruptcy and convincing suppliers to continue doing business with debtors); Paskay & Wolstenholme, *supra* note 3 at 335-41 (1993) (citing professional fees and litigation costs as reasons chapter 11 is so expensive); Stephen W. Rhodes, *Eight Statutory Causes of Delay and Expense in Chapter 11 Bankruptcy Cases*, 67 AM. BANKR. L.J. 287, 288-89, 307-15 (1993) (identifying causes of delay and expense in chapter 11 cases); Myron M. Scheinfeld, *Small Businesses and Single Asset Real Estate Bankruptcies*, 41 PRAC. LAW. 17, 18 (1995) (arguing that small business bankruptcy is too long, costly and complicated, that creditors are uninvolved, and that debtors are left to guide themselves through the process); A. Thomas Small, *Small Business Bankruptcy Cases*, 1 AM. BANKR. INST. L. REV. 305, 305-06, 317 (1993) (arguing that chapter 11 is "synonymous with unnecessary delay" and expense; arguing that less complex reorganizations should be expedited; arguing that delay harms creditors because time is money, harms debtors through uncertainty, expense, stigma, and court control over assets, and harms the system because languishing cases impair efficiency); Deborah L. Thorne, *The Bankruptcy Reform Act: For the General Practitioner*, CBA REC., Apr. 9, 1995, at 32 (arguing that the 1994 Bankruptcy Reform amendments increased the time and cost of chapter 11 for small businesses).

Small businesses have few reorganization options other than chapter 11. Out of bankruptcy workouts often are not feasible. *See* Stuart Gilson et al., *Troubled Debt Restructurings: An Empirical Study of Private Reorganization of Firms in Default*, 27 J. FIN. ECON. 315, 325 (1990); *see also* Korobkin, *supra* note 5, at 428 n.56 (noting that the limited evidence available suggests that "small businesses may be less successful than larger ones at relieving financial distress by means of out of court workouts"); Lynn M. LoPucki, *The Debtor in Full Control – Systems Failure Under Chapter 11 of the Bankruptcy Code?*, 57 AM. BANKR. L.J. 99, 99-101, 114-17 (1983) (finding, in an empirical study of chapter 11 cases filed in one district during the first year of the Bankruptcy Code, that out of court workouts played no part in any of the cases; concluding that workouts are too cumbersome or subject to control by dissenting minorities). Chapter 13 may provide an alternative to chapter 11 for some individuals engaged in business, but it is not available if the business is not an "individual" or if the business has unsecured debt exceeding $290,525 or secured debt exceeding $871,550 (as of Apr. 1, 2001).

See 11 U.S.C. § 109(e) (2000) (as adjusted by Notice Dated Feb. 20, 2001, Judicial limited empirical data available seem to support this notion.[6]

It should not be surprising, then, that bankruptcy practitioners, scholars, and judges agonize over the treatment of small businesses in reorganization;[7] conferences are organized to consider the particular problems of financially distressed small businesses;[8] Congress singled out small businesses for attention in the 1994 Bankruptcy Code amendments;[9] and the National Bankruptcy Review Commission recommended reforms applicable to small business reorganization cases.[10]

Conference of the United States, 66 F.R. 10910); *see also id.* § 104(b)(1) (providing for adjustment of dollar amounts).

6. *See, e.g.*, LoPucki, *supra* note 4, at 731-32, 744-46 (citing studies that indicate the adoption of chapter 11 has significantly increased the median length of reorganization cases, and small business reorganizations proceed at roughly the same pace as large ones).

7. *See supra* notes 2-5 and accompanying text; *see also* Lawrence Ponoroff, *The Dubious Role of Precedent in the Quest for First Principles in the Reform of the Bankruptcy Code: Some Lessons from the Civil Law and Realist Traditions*, 74 AM. BANKR. L.J. 173, 219-20 (2000) (advocating individual case management by judges to accommodate the needs of small businesses in chapter 11); A. Thomas Small, *Suggestions for the National Bankruptcy Review Commission: Small Business Reorganization Chapter*, 4 AM. BANKR. INST. L. REV. 550, 550 (1996) (advocating a separate reorganization chapter for small businesses).

8. *See, e.g.*, U.S. SMALL BUSINESS ADMINISTRATION, BUILDING THE FOUNDATION FOR A NEW CENTURY, FIRST ANNUAL REPORT OF IMPLEMENTATION OF THE RECOMMENDATION OF THE 1995 WHITE HOUSE CONFERENCE ON SMALL BUSINESS (1996), *available at* http://www.whcsb.org/fropen.htm (last visited Feb. 26, 2002).

9. *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 217, 108 Stat. 4106, 4127, codified at 11 U.S.C. §§ 101, 1121, 1125 (2000); *see also* sources cited *supra* note 5 (discussing the small business provisions added by the 1994 amendments).

The legislation that passed both houses of Congress this session (107th Congress, first session, 2001) is focused predominantly (although far from exclusively) on consumer bankruptcy and does little to target small business reorganization per se. *See* The Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. (2001); The Bankruptcy Reform Act of 2001, S. 420, 107th Cong. (2001).

10. *See* NBRC REPORT, *supra* note 3, at 609-60. The National Bankruptcy Conference also considered (but rejected) proposals for separate treatment of small businesses. *See* NATIONAL BANKRUPTCY CONFERENCE, REFORMING THE BANKRUPTCY CODE: FINAL REPORT (1994), *available at*

Much of the debate concerning the treatment of small businesses in bankruptcy swirls around the decision embraced by the drafters of the 1978 Bankruptcy Code to unite diverse business relief chapters into the current chapter 11.[11] As a consequence of this one-size-fits-all approach, small, closely-held businesses face the same complicated reorganization processes as large, publicly held businesses.[12] Although few would openly advocate a return to the type of strategic behavior that characterized the superceded Bankruptcy Act's segregation of "corporate reorganizations" and "arrangements" under former chapters X and XI,[13] many would

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http://www.law.uchicago.edu/NBC/ (last visited Feb. 26, 2002).

11. *See, e.g.*, Clark, *supra* note 2, at 170-75 (describing the evolution of bankruptcy reorganization from two chapters into a single unified chapter for all sizes and types of businesses); Lynn M. LoPucki, *Chapter 11: An Agenda for Reform*, 69 AM. BANKR. L.J. 573, 574 (1995) (arguing that the drafters of the Bankruptcy Code erred in adopting a "one size fits all" approach to business reorganization); Paskay & Wolstenholme, *supra* note 5, at 332 (noting that, with chapter 11, Congress established a single chapter for all reorganizations); David A. Skeel, Jr., *Markets, Courts, and the Brave New World of Bankruptcy Theory*, 1993 WIS. L. REV. 465, 510-20 (1993) (arguing that the existence of separate reorganization chapters under the Bankruptcy Act was a "colossal failure;" noting that chapter 11 did not distinguish between different types of debtors; advocating separate chapters for closely held and non-closely held businesses to alleviate the burdens on small businesses in bankruptcy); Charles J. Tabb, *The Future of Chapter 11*, 44 S.C. L. REV. 791, 815-16 (1993) (noting that the debate over establishing a separate chapter for small businesses suggests a return to the old two-chapter system for business bankruptcy).

For a discussion of the changes implemented by the 1978 Bankruptcy Code, see generally Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DEPAUL L. REV. 941 (1979); Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5 (1995).

12. *See* LoPucki, *supra* note 11, at 573-78. Because there is only one reorganization chapter, it follows that every business files under that chapter.

13. Congress intended that small debtors would file reorganization proceedings under chapter XI and large, publicly held debtors would file under chapter X. *See* Linda J. Rusch, *Single Asset Cases and Chapter 11: The Classification Quandary*, 1 AM. BANKR. INST. L. REV. 43, 54 (1993). Because chapter X required the appointment of a trustee while chapter XI permitted the debtor to remain in possession, even large businesses chose to reorganize under chapter XI in order to avoid relinquishing control of the business to a trustee. *See* COLLIER ON BANKRUPTCY § 7-1104 (2000) (noting that

> [s]ince the appointment of a receiver was the exception rather than the rule

advocate reforms that modify the one-size-fits-all treatment of small businesses.[14]

Reform proposals range from (i) doing nothing and allowing chapter 11's elegant flexibility to accommodate the needs of small businesses in reorganization,[15] (ii) encouraging bankruptcy courts to accommodate small business cases through specialized case management procedures, and amend the Bankruptcy Rules and Bankruptcy Code in minor ways if necessary to facilitate these procedures,[16] (iii) creating a separate reorganization chapter for

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> under chapter XI, while appointment of a trustee was mandated by chapter X, management of insolvent corporations, even those with outstanding publicly held debt or equity securities, sought to avoid chapter X and to instead bring their cases under chapter XI.);

Susan Jensen-Conklin, *Financial Reporting by Chapter 11 Debtors: An Introduction to Statement of Position 90-7*, 66 AM. BANKR. L.J. 1, 16-17 (1992) (noting that a debtor had little control under chapter X of the former Bankruptcy Act because a trustee was appointed in every case and only the trustee could propose a plan; stating that administration of chapter X cases was time-consuming and complicated); Harvey R. Miller, *The Changing Face of Chapter 11: A Reemergence of the Bankruptcy Judge as Producer, Director, and Sometimes Star of the Reorganization Passion Play*, 69 AM. BANKR. L.J. 431 (1995) (comparing Bankruptcy Act chapter X, in which a trustee was appointed in every case to operate the business and formulate a plan, to chapter XI, in which the debtor in possession generally retained control of the business; noting that debtors avoided filing Chapter X and that even large, publicly held businesses reorganized under chapter XI, which was meant for small, closely-held businesses, in order to avoid the appointment of a trustee under chapter X; finding that less than ten percent of business reorganizations occurred under chapter X; noting that chapter XI's debtor in possession concept carried over to the current Bankruptcy Code, which maintains a strong presumption that the debtor should remain in control of the business).

14. *See* David B. Young & Jeff Bohm, *Small Business and Single Asset Real Estate Reorganization Issues*, 788 PLI/COMM. 447, 453-59 (1999).

15. *See, e.g.*, NATIONAL BANKRUPTCY CONFERENCE, *supra* note 10, at 307-11 (arguing that a separate reorganization chapter for small businesses is not warranted because there is insufficient evidence that chapter 11 is too confusing, costly, and time consuming and because a separate reorganization chapter will not resolve the problems of small businesses in chapter 11).

16. *See, e.g.*, Clark, *supra* note 2, at 189-200 (recommending retaining one-size-fits-all chapter 11 with improved judicial training and judicial control of small business cases to maintain flexibility); Small, *supra* note 5, at 305 (proposing "fast track" judicially implemented case management processes for certain cases, particularly small business cases; explaining how the then-current Bankruptcy

small businesses, or otherwise amending the Bankruptcy Code in significant ways to make chapter 11 easier for small businesses,[17] and (iv) amending the Bankruptcy Code to make chapter 11 harder for small businesses in order to force the liquidation of businesses that are not viable.[18]

B. SABRE: The Select Advisory Committee on Business Reorganization

In March 2000, Mike Sigal, Chair of the American Bar Association Business Bankruptcy Committee, appointed Gerald K. Smith to chair a special committee of the Section of Business Law, Business Bankruptcy Committee, to be known as the Select Advisory Committee on Business Reorganization ("SABRE").[19] SABRE's mission is to consider the perception that chapter 11 business reorganizations take too long and cost too much and, if appropriate, to develop legislative solutions to reduce the time and cost of business reorganizations.[20] Although SABRE was

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Code and Bankruptcy Rules permitted such procedures).

17. *See, e.g.*, Bankruptcy Amendments Act of 1993, S. 540, 103d Cong. (1993) (proposing an experimental chapter 10, in which a plan could be confirmed without a creditor vote and a case could proceed without a creditors' committee for small businesses with debts of $2.5 million or less); Paskay & Wolstenholme, *supra* note 5, at 342-45 (discussing "fast-track" process and proposed chapter 10 for small businesses; recommending legislative reforms rather than simple judicial case management procedures); Small, *supra* note 5, at 319-20 (recommending amendments to chapter 11 to accommodate small businesses, or separate chapter 10 for small businesses); *cf.* Skeel, *supra* note 11, at 465 (recommending separate reorganization chapters for closely held and non-closely held businesses).

18. NBRC REPORT, *supra* note 3, at 610, 623 (suggesting that the court, upon request of a party in interest or the U.S. Trustee, after notice and hearing, and for cause shown, convert or dismiss a small business case, whatever is in the best interest of the parties); *see also* Business Bankruptcy Reform Act of 1998, S. 1914, 105th Cong. (1998) (introduced Apr. 2, 1998) (proposing, essentially, adoption of the NBRC proposals).

19. Messrs. Smith and Sigal appointed the author of this Article as SABRE Reporter and member, and appointed SABRE members Hon. Burton Lifland, Hon. Ralph Mabey, Hon. Joseph (Jerry) Patchan, Michael St. Patrick Baxter, and G. Eric Brunstad. Mr. Sigal and Hugh Ray are ex officio members.

20. SABRE's proposals do not directly address questions concerning the

organized to examine the time and cost of reorganization under chapter 11 generally, it has carefully considered how its proposals might affect businesses of varying sizes and types, including small businesses.[21]

In March 2001, following extensive investigation and analysis, and consultation with the members of the Business Bankruptcy Committee Council and other bankruptcy experts, SABRE issued its First Report.[22] The First Report elaborates three specific reform proposals designed to address specifically identified aspects of chapter 11 practice that may unnecessarily increase the cost and time of business reorganizations.[23] The proposals are targeted toward underlying problems as to which SABRE identified accord among bankruptcy experts.[24]

The elaboration and analysis of these proposals, which is set forth in the First Report, is not repeated here. Rather, this Article (i) briefly considers how the proposals set forth in SABRE's First Report might affect small business reorganizations, and (ii) introduces a draft proposal under consideration by SABRE that may be of particular application in small business reorganization cases. For each of these proposals, this Article considers the extent to which bankruptcy judges and practitioners might implement the SABRE proposals even in the absence of new legislation or rules.

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efficacy of chapter 11, including topics such as confirmation rates, re-filing rates, or differences in chapter 11 statistics among judicial districts.

21. SELECT ADVISORY COMMITTEE ON BUSINESS REORGANIZATION, FIRST REPORT OF THE SELECT ADVISORY COMMITTEE ON BUSINESS REORGANIZATION, 57 BUS. LAW. 163, 166-69, 213-14 (Karen M. Gebbia-Pinetti, Reporter, 2001) [hereinafter FIRST REPORT].

22. *Id.*; *see also* SELECT ADVISORY COMMITTEE ON BUSINESS REORGANIZATION, ANNOTATED LIST OF RESOURCES, 57 BUS. LAW. 245 (Karen M. Gebbia-Pinetti, Reporter, 2001).

23. *See* FIRST REPORT, *supra* note 21.

24. *Id.* at 166-69. SABRE avoided topics on which bankruptcy experts disagree concerning the underlying causes.

II. THE FIRST REPORT OF THE SELECT ADVISORY COMMITTEE ON BUSINESS REORGANIZATION

A. Small Businesses and Federal Workout Proceedings

> SABRE Proposal:
>
> FEDERAL WORKOUT PROCEEDING. Foster out of bankruptcy resolutions of some business and economic difficulties by establishing a federal statutory mechanism that stays creditors from enforcing their claims and prevents the debtor from making extraordinary asset transfers during a short workout period.[25]

A federal workout proceeding ("FWP") is commenced[26] when the debtor and substantial, unaffiliated creditors jointly file a workout petition in federal bankruptcy court. An FWP embodies three essential elements:

> (i) It provides a federally imposed stay that prevents enforcement actions by creditors (similar to the automatic stay in bankruptcy) and prevents dissipation of assets by the debtor, for a short period, to permit negotiation so that business solutions rather than judicial intervention might solve business and financial problems. The stay, including any extensions, may not exceed 120 days.
>
> (ii) In order to validate the debtor's intention to attempt an out of bankruptcy workout, prevent abuse, and verify that at least some substantial creditors are willing to work with the debtor toward a workout, an FWP may be commenced only by the debtor plus some substantial, unaffiliated creditors.
>
> (iii) The FWP provides a vehicle for consensual debt restructuring. As with out of court workouts, the debtor and

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25. *Id.* at 169-85.

26. For simplicity, this Article discusses the proposals in the present tense, as if enacted, rather than in the future tense.

> individual creditors may modify the terms of their contracts by agreement. The FWP does not, however, allow the debtor to impose terms on dissenting creditors and it does not provide a mechanism by which a majority can bind the minority. If a debtor wishes to modify a particular creditor's claim or contract without that creditor's consent, the debtor must file a bankruptcy case and attempt to modify the claim or contract under the strictures of the Bankruptcy Code.[27]

This Proposal, elaborated in the First Report, is designed to "foster out of bankruptcy resolutions of some business and economic difficulties and avoid a bankruptcy filing by establishing a federal statutory mechanism that stays creditors from enforcement and the debtor from out-of-the-ordinary course asset transfers during a short workout period."[28]

The FWP is expected to be particularly useful in cases in which the debtor and substantial creditors are on the verge of achieving an out of court restructuring, but a single creditor or small number of creditors threatens to take precipitous action that would make such an agreement impossible.[29] For example, foreclosure or the imposition of a lien could thwart negotiations that contemplate new secured credit sufficient to allow the debtor to satisfy or refinance the dissenter's underlying claim, pay other creditors under agreed (perhaps extended) terms, and remain in operation.

Although SABRE expects both large and small businesses to file FWPs, and the FWP certainly holds great promise for large businesses, it may be especially useful to small businesses. The essential characteristics of the FWP – its simplicity, short duration, flexibility, and reduced costs in comparison to chapter 11[30] – are critically valuable to small businesses, which often lack the resources and resiliency that might allow larger businesses to weather a lengthy chapter 11 case.

Moreover, even if the FWP does not result in a consensual workout, it nevertheless might be a critical precursor to a pre-

27. FIRST REPORT, *supra* note 21, at 169-70. The description of the FWP to this point is drawn virtually word for word from the FIRST REPORT. *Id.*

28. *See id.* at 169.

29. *Id.* at 171.

30. *Id.* at 179.

packaged or pre-negotiated[31] chapter 11 filing. Many analysts believe that pre-packaged chapter 11 cases can dramatically reduce the time and cost of chapter 11, in particular, and of restructuring, in general.[32] To date, however, few, if any, small business debtors

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31. The FWP may provide an adequate opportunity to negotiate terms, even if it does not provide sufficient time for disclosure and voting. In that case, a pre-petition negotiated, post-petition voted plan may still dramatically increase the small business's chances for success in chapter 11. *Cf.* Elizabeth Tashjian et al., *Prepacks: An Empirical Analysis of Prepackaged Bankruptcies*, 40 J. FIN. ECON. 135 (1996) (including both pre-petition voted and post-petition voted plans in an analysis of "pre-packaged" chapter 11 cases).

32. *See* GORDON BERMANT ET AL., FEDERAL JUDICIAL CENTER, CHAPTER 11 VENUE CHOICE BY LARGE PUBLIC COMPANIES 39-40 (1997) (concluding that the "academic consensus" is that pre-packaged cases cost more than out of court workouts but less than full chapter 11 cases); *see also* David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 DEL. L. REV. 1, 27-29 (1998) (arguing that Delaware venue solves the delay problem because cases are resolved faster there (many are pre-packs)); Conrad B. Duberstein, *Out-of-Court Workouts*, 1 AM. BANKR. INST. L. REV. 347, 347-48, 352-53 (1993) (arguing that an out of court workout can avoid the costs, delay, and aggravation of a litigious chapter 11; suggesting that the lower cost of an out of court workout increases the potential "slice-of-pie" available for creditors); Gilson et al., *supra* note 5, at 319 (citing SOLSTEIN, A FEAST FOR LAWYERS: INSIDE CHAPTER 11: AN EXPOSE (1989)) (noting that it is widely believed that the direct costs of chapter 11 are higher than the direct costs of private negotiation because the complexity and procedural demands of chapter 11 increase attorneys' fees; adding that chapter 11 may also increase indirect costs such as management time devoted to restructuring); Randolph J. Haines, *Defense, Discipline, Debtors: Bankrupting the Opposition*, LITIG., Summer 1995, at 38, 40 (arguing that out of court workouts are beneficial to creditors because "out of court workouts, even if they mean accepting pennies on the dollar, are usually quicker and cheaper than any bankruptcy, and therefore likely to return more to creditors"); Bettina M. Whyte & Patricia D. Tilton, *Turnarounds: Pursuing A Dual Path*, 14 AM. BANKR. INST. J. 28, 28 (1995) (stating that generally, "an out of court workout is preferable to reorganizing under the Code due to the cost, image, drain on resources, impact on morale, etc. of a bankruptcy"); *cf.* Tashjian, *supra* note 31, at 153-55 (concluding that creditors were more willing to accept a pre-packaged filing on the same terms as an out of court workout because all other creditors would be bound in a pre-packaged filing but not in the workout). *But see* Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom,"* 54 VAND. L. REV. 231, 251-53, 264 (2001) (noting that pre-packaged cases are faster to confirm and entail lower direct costs

have filed pre-packaged chapter 11 cases.[33] By providing a setting in which the debtor and its creditors can negotiate a pre-packaged plan without concern that any party will take precipitous action, the FWP may enable small business debtors and their creditors to take advantage of a potentially useful restructuring process rarely used by small businesses today.

Finally, because an FWP cannot be filed without substantial creditor consent,[34] the FWP may benefit all parties in both large and small business cases by promptly informing them whether the debtor has a realistic prospect of achieving a viable plan likely to garner adequate support among and acceptance by creditors. This realism is particularly important in small business situations in which creditors often lose time, money, and effort when small business debtors optimistically file a reorganization case that ultimately is dismissed or converted to liquidation.[35]

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chapter 11 but cases confirmed in Delaware and New York, fail at much higher rates than cases confirmed in other jurisdictions (thirty-three percent re-filing rate in Delaware and New York as compared to seven percent in other jurisdictions); stating that Delaware courts have a tendency to abdicate statutory obligations to gauge the feasibility of a pre-packaged plan and instead approve them "no questions asked").

Despite possible abuses of the pre-packaged reorganization process, it seems that pre-packaged reorganization cases, when used properly and in good faith, can dramatically reduce the time and cost of bankruptcy. *See generally* Tashjian, *supra* note 31, at 141-46, 155 (providing the results of an empirical study analyzing "the attributes and outcomes of the restructuring process for a sample of forty-nine financially distressed firms that restructured by means of a prepackaged bankruptcy"). *But see* Brian L. Betker, *An Empirical Examination of Prepackaged Bankruptcy,* FIN. MGMT., Mar. 1, 1995, at 3 (suggesting that there is little actual difference between pre-packs and traditional chapter 11 cases when the pre- and post-petition time and cost are taken into account); *see also* Lubben, *supra* note 2, at 516 (comparing the Tashjian, Weise, and Betker studies); Karen E. Wagner, *Representing a Business Debtor,* 633 PLI/COMM. 7, 50-51 (1992) (arguing, without empirical data, that pre-packaged reorganization can take years and may increase costs).

33. *See* Gilson et al., *supra* note 5, at 324-25.

34. *See* FIRST REPORT, *supra* note 21, at 169-70, 173 (stating that the term "substantial" is to be "measured, in the court's discretion, by reference to the number, percentage, and nature of the creditors, including whether the debtor's major creditor(s) support or oppose the filing").

35. *See* Korobkin, *supra* note 5, at 423-25 (arguing that management failure

The FWP is a new, unique, and unparalleled mechanism. Its fundamental concept – a stay of out-of-the-ordinary course actions by both creditors and the debtor – is unprecedented.[36] Consequently, unlike some of the other proposals discussed herein, it cannot be implemented without new, federal legislation.[37]

Even in the absence of legislation, however, a small business might draw upon the essential principles of the FWP in an effort to gain some measure of the FWP's benefits. A business could do so through negotiation by proposing that the holdout creditors agree to a short moratorium on enforcement if the debtor agrees to a coterminous moratorium on out-of-the-ordinary course transfers.[38]

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to file chapter 11 until the business is too distressed to be saved may explain why only fifteen to twenty-five percent of small businesses emerge successfully from chapter 11); Levin, *supra* note 5, at 200 (stating:

> [T]he principal reason for the low success rate in small chapter 11 cases is that many debtors' businesses have no realistic prospects for reorganization from the moment they are filed, and that many remain in chapter 11 for extended periods of time even though the debtor has not filed a plan of reorganization and even though the debtor is unlikely to be able to confirm a plan of reorganization.).

36. FIRST REPORT, *supra* note 21, at 169. There is currently no federal mechanism other than the automatic stay that allows a debtor to impose a moratorium on creditors' collection activities. Similarly, no federal statute allows creditors to prevent a debtor from dissipating assets during the course of negotiations. Indeed, the Supreme Court recently held that a federal court could not use its equitable powers to prevent a debtor from dissipating assets in the absence of a federal statute. *See* Grupo Mexicano de Desarrollo, S.A. v. Alliance Bond Fund, Inc., 527 U.S. 308, 333 (1999) (concluding that federal courts' equity power does not extend to granting an injunction preventing a debtor from disposing of assets pending adjudication of an unsecured creditor's contract claim; reasoning that "[t]he debate concerning this formidable power over debtors should be conducted and resolved where such issues belong in our democracy: in the Congress"); *see also* FIRST REPORT, *supra* note 21, at 169-85.

37. SABRE is in the process of drafting such legislation for consideration and comment by interested persons prior to submission to Congress.

38. FIRST REPORT, *supra* note 21, at 169-85. The FIRST REPORT indicates that a definition distinguishing between ordinary course and of out-of-the-ordinary course transactions will be provided in the statute. For example, the grant of security for extensions of new credit and the payment of employee wages and other operating expenses would constitute ordinary course transactions, but the grant of security for antecedent debt would not. *Id.* at 170.

B. Plan Facilitators in Small Business Reorganization Cases

> SABRE Proposal:
>
> INDEPENDENT FACILITATOR. In appropriate circumstances, after a reasonable period of time has passed during which the parties are unable to reach consensus on a plan, the court may appoint an independent facilitator to foster consensus. If facilitated negotiations fail to produce a plan, the court may permit the facilitator to file a plan, subject to the usual voting and confirmation requirements, and to parties' objections and requests to modify.[39]

In appropriate circumstances, at any time after 120 days after the commencement of a case (without regard to whether the debtor's exclusive period to file a plan has expired or been enlarged), the court, *sua sponte* or at the request of any party in interest, may order the appointment of a plan facilitator to foster consensus.[40] If facilitated negotiations fail, the facilitator, with court approval, may develop and file a plan.[41]

Appropriate circumstances include any or all of the following, without limitation:

- appointment is in the best interests of the debtor and the creditors
- appointment may facilitate or expedite reorganization
- the parties are at impasse
- passage of time since filing
- no plan has been filed
- no plan is likely to be confirmed soon.[42]

This Proposal, elaborated in the First Report, is designed to address the difficulty of achieving consensus in a litigious

39. FIRST REPORT, *supra* note 21, at 185.
40. *Id.* at 185-86.
41. *Id.*
42. *Id.* The description of the Independent Facilitator to this point is drawn, virtually word for word, from the FIRST REPORT.

environment.[43] It employs a neutral facilitator to foster consensus and break through impasse if the parties are unable to agree on the essential structure of a plan within a reasonable period.[44]

Traditional mediators have been employed in several large chapter 11 cases to foster consensus and resolve impasse in plan negotiations.[45] The facilitator proposal differs from traditional mediation primarily in its contemplation that a neutral facilitator may be granted the ability to file a plan.[46] The rationale for this extraordinary power is discussed in the First Report.[47]

Not surprisingly, this proposal was inspired by several large, drawn out, acrimonious chapter 11 cases in which high profile mediators were appointed to reconcile the parties' intractable disagreements.[48] The proposal is expected to expand and enhance the use of facilitation in large cases. Yet, the prospects of facilitation for small business cases are particularly enticing.

Legitimate disputes over issues such as valuation, distribution, and management certainly can and do cause lengthy negotiations in any chapter 11 case.[49] Because small businesses tend to have fewer resources and less flexibility than large businesses, however, small businesses may collapse under the cost of sustaining the administrative costs and business stresses of an unnecessarily protracted chapter 11 case. Thus, the consequences of protracted negotiations may be more severe for small businesses. Moreover, small businesses are particularly vulnerable to rancorous negotiations spurred by a single creditor (or a small number of creditors) whose position is founded more on animosity toward the debtor and its principals than on objective economics. Small businesses are also often plagued by the need to negotiate with multiple creditors separately because of the absence of an

43. *Id.*

44. *Id.* at 167.

45. For examples, see *id.* at 188-89.

46. *See id.* at 185.

47. *See id.* at 188-202 (arguing that the policy reasons underlying the 1978 Bankruptcy Code decision to eliminate trustees and allow debtors to continue to run their businesses, do not necessarily also justify giving the debtor full control of the reorganization process).

48. For examples, see FIRST REPORT, *supra* note 21, at 188-89.

49. *See id.* at 185-93.

organized, functioning, creditors' committee. The absence of an organized, thoughtfully advised creditor voice may create perverse incentives in which both debtor and creditors engage in a game of "chicken" by threatening potentially fatal delay in an effort to force the other party to accept concessions. For all of these reasons, small business cases may be particularly well suited to facilitation.

Small business chapter 11 presents unique hurdles, however, in identifying appropriate facilitators. The facilitator's ability to garner the respect of the parties is a significant factor in the success of chapter 11 mediation or facilitation.[50] In the mega-chapter 11 cases in which mediation has grabbed headlines,[51] this respect has flowed from the mediator's national prominence.[52] A moderately

50. *See In re* R.H. Macy & Co., 152 B.R. 869 (Bankr. S.D.N.Y. 1993); *see also* Carole Silver, *Models of Quality for Third Parties in Alternative Dispute Resolution*, 12 OHIO ST. J. DISP. RESOL. 37, 68 (1996); Cyrus Vance, *Final Report of Cyrus R. Vance, As Mediator, Pursuant to the Standing Mediation Order and the Mediation Order Entered in the Macy's Reorganization Cases* (Dec. 8, 1994) (on file with Fordham Journal of Corporate & Financial Law); Hugh M. Ray, Jr., *Mediators, Egos and Common Courtesy*, TEX. LAW., Mar. 14, 1994, at 22; *Eurotunnel Joue la Carte Des Mandataires Ad Hoc et des Actionnaires*, LES ECHOS, 13 Fevrier, 1996; *Eurotunnel S'en Remet a Deux Arbitres de Poids*, LES ECHOS, 13 Fevrier, 1996.

51. *See, e.g.*, Terry Brennan, *Judge Approves Indesco Plan*, DAILY DEAL, Jan. 10, 2002 (discussing use of mediation in Indesco bankruptcy); *McDermott International Reports Fourth Quarter and Year-End Earnings for 2000*, BUS. WIRE, Feb. 23, 2001 (discussing appointment of a mediator in the Babcock & Wilcox Company bankruptcy); *Southern Northern States Accept Plan to Buy Cajan Electric*, BLOOMBERG NEWS, June 4, 1999 ("U.S. Bankruptcy Judge Steven Felsenthal of Dallas, who has acted as mediator in the [Cajan Electric Cooperative] case, made the proposal to allow Cajan to emerge from chapter 11 bankruptcy after five years in court. The case is believed to be one of the longest running in bankruptcy court history."); *see also In re* R.H. Macy & Co., 152 B.R. 869.

52. In *In re* R.H. Macy & Co., 152 B.R. 869, a large, complex, chapter 11 case, Judge Burton R. Lifland appointed former Secretary of State, Cyrus Vance, to mediate plan negotiations. Mr. Vance succeeded in mediating a plan that was confirmed. Although Mr. Vance filed a report concerning the ultimate settlement, the negotiation process remained confidential. *See* Vance, *supra* note 50; *see also* Ray, *supra* note 50, at 22 ("A mediator of powerful stature signals, 'You must respect me because you must care what I think about you. I cannot issue a binding decision, but if you behave in such a way that you dishonor me,

sized, but still relatively large, chapter 11 debtor may be unable to attract a nationally prominent facilitator, but may be able to attract a highly respected local figure to serve as facilitator. In contrast, although a small business's financial distress may occasionally have a significant enough role in the local community to attract the interest of a prominent local figure, most small businesses will fail to pique the interest of prominent national or local facilitators. Consequently, a modified approach will be necessary to identify appropriate facilitators.

First, an approach worth serious study would be the use of established mediation experts. These mediators are often lawyers and, if not chapter 11 experts, could perhaps be trained to mediate the financial and legal issues that are likely to arise in plan negotiations. Perhaps the United States Trustee ("U.S. Trustee") could serve as a neutral advisor to the facilitator. Second, courts might establish a panel of bankruptcy experts, who would undergo mediation training, to serve as facilitators in small business cases.

Either of these approaches should be structured to recognize that the success of facilitation depends not only on the parties' respect for the mediator, but also on the facilitator's regard for his or her own reputation. In prominent mega-cases, the facilitator's success or failure is headline news.[53] In small, no-news cases, special care must be taken to ensure that facilitators have incentives to succeed. One advantage of using professional mediators is that maintaining a reputation for efficiency and neutrality is already essential to professional mediators.[54] Any panel experts should be chosen carefully to ensure their

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because of my standing, you dishonor yourself.'"); *Eurotunnel Joue la Carte*, *supra* note 50, at 13; *Eurotunnel S'en Remet*, *supra* note 50, at 7F (noting that, at the request of Eurotunnel, the President of the Tribunal de Commerce appointed two prominent people, Robert Badinter and Lord Wakeham, as "mandataires ad hoc" to mediate an accord among the parties (banks and 750,000 "actionaires"); their mission and strategy are confidential).

53. *See In re* R.H. Macy & Co., 152 B.R. 869; *see also* Vance, *supra* note 50; Ray, *supra* note 52; *Eurotunnel Joue la Carte*, *supra* note 50; *Eurotunnel S'en Remet*; *supra* note 50.

54. *See generally The Cardozo Outline Journal of Conflict Resolution (COJCR): The National Center for State Courts (NCSC): The Policy Consensus Initiative (PCI)*, 1 CARDOZO ONLINE J. CONFLICT RESOL. 4 (1999/2000).

seriousness of purpose and regard for these same values. It will be essential to avoid employing persons whose primary concern is financial compensation and whose incentives may be inconsistent with the objectives of facilitation.

Small businesses and their creditors can obtain some, but far from all, of the benefits of the facilitator proposal under current law. The legal tools exist for small businesses (or their creditors) to request, and courts to appoint, mediators in chapter 11 cases pending today.[55] As previously noted, several bankruptcy courts have appointed mediators to facilitate plan negotiations, as well as to resolve claims disputes.[56] The debtor, or other party, need simply request and justify the appointment under the applicable mediation-authorizing procedures in the district (assuming bankruptcy mediation is authorized).[57] The request may be met with greater enthusiasm by the court if it comes jointly from the debtor and some substantial creditor or group of creditors.

A small business whose chapter 11 case is pending today, or is filed tomorrow, can obtain all the benefits of mediation without any changes in law. Parties in interest in chapter 11 cases cannot, however, obtain all the benefits of the neutral facilitator proposal without amendments to the Bankruptcy Code or Bankruptcy Rules. SABRE urges legislation or rule changes to implement this proposal for several reasons, including to make the use of facilitators a regular and favored practice rather than an oddity, enhance the clarity and uniformity of rules governing the appointment of facilitators in bankruptcy cases, reduce the cost of district-by-district and case-by-case rulemaking, and give courts authority to grant facilitators power to file plans.[58]

The current chapter 11 scheme does not allow a court to grant a neutral entity authority to file a plan.[59] The parties can obviate

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55. FIRST REPORT, *supra* note 21, at 188-202.

56. *See id.* at 188-89.

57. The scope and authority for bankruptcy mediation and other forms of bankruptcy ADR are well beyond the scope of this Article. For illumination, see the sources and authors cited in FIRST REPORT, *supra* note 21, at 190-93 nn.46-51; FEDERAL JUDICIAL CENTER, GUIDE TO JUDICIAL MANAGEMENT OF CASES IN ADR (2001).

58. *See* FIRST REPORT, *supra* note 21, at 188-202.

59. *See* 11 U.S.C. § 1121 (2000). The court's broad equitable and case

this limitation to some degree by allowing one party to "sponsor" a plan drafted by the facilitator (i.e., file the facilitator's plan in its own name).[60] This would, of course, undermine a significant aspect of the facilitator's leverage over all parties, but nothing more is possible without new legislation.

C. Shared and Court Appointed Experts in Small Business Reorganization Cases

> SABRE Proposal:
>
> NEUTRAL BUSINESS INFORMATION. Foster access to neutral business information by requiring that the debtor and its professionals share financial information with parties in interest, and by enabling the court to appoint one (or more) neutral business experts to conduct financial and other analyses at estate expense. Parties in interest would be permitted to engage separate experts at their own expense or, if such parties satisfy the "substantial contribution" standard, at estate expense.[61]

This Proposal is designed to reduce the proliferation of conflicting business experts by (i) ensuring that the debtor and its professionals share neutral financial and business information with all parties in interest, and (ii) replacing multiple, partisan, business experts with court appointed, independent, business experts who will generate neutral business and financial analyses that all parties in interest may share.

The fundamental objective is that neutral, financial, and

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management powers under section 105 would not appear to permit such action because section 105 does not grant power inconsistent with express provisions of the Bankruptcy Code. *See, e.g., In re* PHM Credit Corp., 110 B.R. 284 (Bankr. E.D. Mich. 1990); Fed. Land Bank of Omaha v. Fishbach, 72 B.R. 245 (Bankr. D.S.D. 1987); *In re* Sec. & Energy Sys., Inc., 62 B.R. 676 (Bankr. W.D.N.Y. 1986); *In re* Pirsig Farms, Inc., 46 B.R. 237 (Bankr. D. Minn. 1985); *In re* Sec. & Energy Sys., Inc., 62 B.R. 676 (Bankr. W.D.N.Y. 1986).

60. This assumes, of course, that a party would agree to accept the responsibility of diligence, etc., imposed by Bankruptcy Code sections 1125 and 1129. *See* 11 U.S.C. §§ 1125, 1129 (2000).

61. FIRST REPORT, *supra* note 21, at 202.

business data and analyses that are relevant to the reorganization should be available to all parties in interest. This objective must be balanced, however, against the need to preserve the parties' ability to retain separate experts when necessary to protect their interests. The court is in the best position to determine how best to achieve these objectives in each case.

In some cases, it may be necessary only to require that the debtor provide to any official and unofficial committees, and any party in interest who requests, all material, historical, current, and projected financial data and analyses prepared by or for the debtor, including by its accountants and other financial and business experts and advisors.[62]

In other cases, it may be necessary to appoint one or more neutral, independent, disinterested experts to generate data and analyses. Independent business experts may be particularly

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62. The Bankruptcy Code, Bankruptcy Rules, and U.S. Trustee's Office impose various financial reporting requirements on the debtor. *See* FED. R. BANKR. P. 1007, 2015, 4002; *see also* 11 U.S.C. §§ 704(7), (8), 1106(a)(1), 1107(a) (2000); U.S. Trustee Operating Manual, § 3-3.3, *available at* http://www.usdoj.gov/ust/ustp_manual/vol3ch03.htm (last visited Feb. 11, 2002). The parties in bankruptcy cases typically generate a great deal of additional business and financial information that they typically do not share with other parties. Financial and business analyses and recommendations that may be required or useful in a case might include, without limitation: (i) financial projections, (ii) industry analyses, (iii) market analyses, (iv) profit and loss analyses, (v) whether the business is viable, (vi) whether the business should be liquidated or reorganized, (vii) valuation analyses and development of methodologies for valuation, (viii) analysis of financial information relevant to whether related entities should be substantively consolidated, (ix) analysis and valuation of assets and liabilities, (x) analysis of major claims that may impact allocation of reorganization values, (xi) analysis of the debtor's business plan, and (xii) analysis of the debtor's prospects for feasible reorganization.. This proposal targets this additional information.

To implement this Proposal, Congress might direct the U.S. Trustee (with input from bankruptcy practitioners, judges, academics, and financial and business experts) to develop national guidelines, criteria, and schedules concerning the types of historical, current, and projected factual information that should be made available to all parties. If the court so directs, the U.S. Trustee could work with the parties in interest to develop specific schedules and requirements in each case. The court would become involved if the parties were unable to reach an accord on scheduling and disclosure.

appropriate when the data are subject to interpretation, including on issues such as valuation, feasibility, prospects for reorganization, and the recommendation to liquidate or reorganize. In such cases, the court, with the advice and recommendations of the debtor, any creditors' committee or creditors' representative, and other parties in interest, may appoint one (or more) neutral, independent, disinterested, business experts to generate financial and other business analyses that all parties in interest will share.

This Proposal, elaborated in the First Report, is designed to address the proliferation of conflicting business experts by fostering the shared use of neutral financial and business analyses prepared by the debtor's experts and neutral, court-appointed experts.[63]

In large and "mega" cases, the court is likely to consider the neutral expert concept primarily in the context of requests by the debtor and one or more committees for authority to hire multiple, estate-reimbursed accountants, investment bankers, consultants, and other experts.

In small business cases, the frequent absence of an organized, active creditors' committee, combined with the often considerable expense of individual creditors hiring and paying their own separate experts, may create an imbalance in which the only "expert" analysis is provided by the debtor's potentially partisan experts. In such cases, the need for open, generous sharing of financial and other business analysis is critical. Such cases may benefit greatly from the appointment of a single, neutral, non-partisan, court-appointed expert.

Although SABRE recommends legislation or rulemaking to provide clear standards and uniformity in the appointment of neutral experts, and to make the appointment of neutral experts the norm rather than the exception, most of the recommendations of this proposal can be implemented under Bankruptcy Code section 327,[64] Bankruptcy Code section 105,[65] Federal Rule of

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63. *See* FIRST REPORT, *supra* note 21, at 167, 202-03. The description of Neutral Business Information to this point is drawn virtually word for word from the FIRST REPORT.

64. 11 U.S.C. § 327(a) (2000) (allowing the trustee, with court approval, to employ professionals to assist the court in its duties).

Evidence 706,[66] and Federal Rule of Bankruptcy Procedure 9017,[67] without new legislation or rules.[68]

III. A DRAFT PROPOSAL UNDER CONSIDERATION: CREDITOR PARTICIPATION[69]

A. Introduction

As part of SABRE's analysis preceding the First Report, SABRE examined several issues relating to creditor participation and the effectiveness of committees in chapter 11 cases. It developed the following preliminary draft proposal that addresses (i) the frequent absence of an organized creditor voice in small business cases, and (ii) the potential for duplication and other mischief in large cases with multiple committees. In the First Report, SABRE deferred these issues for further analysis and to determine whether additional empirical data might be forthcoming.[70] SABRE believed, however, that the first component of this preliminary draft proposal[71] could be of particular importance in small business cases in which committees often are not appointed, do not retain professionals, or otherwise do not operate.

SABRE continues to evaluate the following draft proposal as part of its ongoing project.

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65. *Id.* § 105(a) ("The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.").

66. FED. R. EVID. 706 (allowing federal courts to appoint expert witnesses).

67. FED. R. BANKR. P. 9017 (incorporating the Federal Rules of Evidence in Bankruptcy Code cases).

68. *See* FIRST REPORT, *supra* note 21, at 206-10 and accompanying notes.

69. This Section provides an overview of a draft of one proposal SABRE is considering. If adopted, in this form or a modified form, this proposal may appear in a subsequent SABRE report. This proposal is not yet complete and is unpublished. The author is the SABRE Reporter, and therefore is able to provide this overview.

70. *See* FIRST REPORT, *supra* note 21, at 168.

71. *See infra* Part III.B.

B. The Draft Creditors' Representative Proposal[72]

> At the outset of each chapter 11 case, the U.S. Trustee shall determine and advise the court whether there is sufficient creditor interest in forming a committee and whether a committee is likely to be active and effective.
>
> In cases in which no committee is appointed, the U.S. Trustee, with court approval, shall appoint a creditors' representative to monitor the case and negotiate plan and payment terms on behalf of unsecured creditors, unless the court, for cause, orders that a creditors' representative not be appointed.

1. Overview of Draft Proposal

This proposal addresses a distinct problem concerning the effectiveness of committees in chapter 11 cases: the absence or inactivity of committees in many, typically smaller, cases.

a. Overview: Will There Be a Committee?

At the outset of each chapter 11 case, the U.S. Trustee shall determine and advise the court whether there is sufficient creditor interest in forming a committee and whether a committee is likely to be active and effective. This should obviate the current problem of cases in which no creditors' interest monitors the debtor, and will allow the court to determine, in each case, whether a creditors' representative or a creditors' committee should be appointed.

b. Overview: Creditors' Representative

In cases in which no committee is appointed, the U.S. Trustee, with court approval, shall[73] appoint a creditors' representative to

72. SABRE welcomes comments on this proposal to Karen M. Gebbia-Pinetti, Reporter, University of Hawai'i School of Law.

73. If no committee or creditors' representative is appointed, some might suggest appointing the U.S. Trustee to perform the functions of a committee under section 1103. Concerns would be raised, however, regarding how the U.S.

perform some of the duties assigned to committees under Bankruptcy Code section 1103(c) as are appropriate in the particular case, unless the court for cause orders that no creditors' representative be appointed. The creditors' representative shall monitor the debtor to prevent abuses, mediate among divergent creditor constituencies, protect the interests of creditors, negotiate and/or draft a plan on behalf of creditors, be the creditors' spokesperson, and if the court requests recommend whether the case should be liquidated.[74] The creditors' representative shall not have an affirmative duty to investigate the debtor's conduct, assets, liabilities, or financial condition. The order appointing the creditors' representative shall specify the representative's specific duties.

The U.S. Trustee shall establish a panel of qualified persons to serve as creditors' representatives in chapter 11 cases. The U.S. Trustee, with input from bankruptcy practitioners, judges, and other bankruptcy professionals, shall establish and publish qualifications for creditors' representatives and shall solicit applicants. Criteria should include chapter 11 experience, financial acumen, legal training, business experience, and other skills. The panel should contain persons experienced in varied industries. The creditors' representatives could be lawyers, accountants, or

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Trustee could perform these functions without compromising its neutrality. It would seem necessary to appoint a third party.

74. Proposed chapter 10, S. 540, discussed *supra* note 17, would have eliminated the committee in small business cases and appointed a supervisory trustee. *Cf.* Skeel, *Markets, Courts*, *supra* note 11, at 511-12 (recommending separate chapters for closely and non-closely held businesses; proposing that a creditor, rather than a neutral, should act as a representative of all creditors in the same class in closely held business cases). In contrast, Bankruptcy Code section 1102(a)(3), added in 1994, authorizes the court to dispense with the committee in small business bankruptcy cases, but contains no provision for the appointment of an alternative debtor monitor or creditor representative. 11 U.S.C. § 1102 (2000).

The U.S. Trustee might develop guidelines, with input from the bench, trustees, practitioners and academics, concerning functions appropriate for creditors' representatives, but allow the court flexibility in each case. For example, the creditors' representative might monitor the case, arrive at conclusions, inform its constituency, and negotiate to consensus, but be relieved of the duty to investigate and take affirmative action. *See id.* § 1103(c)(2).

business people. The selection process should favor multi-skilled professionals with chapter 11 experience who may be able to represent creditors' interests without retaining separate professionals.

The appointment process will be similar, procedurally, to the process for appointing a trustee.[75] The creditor's representative panel shall be separate and distinct from the chapter 7 trustee and chapter 13 trustee panels; however, an individual may qualify to serve on more than one such panel. If an individual is appointed to serve as chapter 11 creditors' representative in a case that subsequently is converted to chapter 7, however, that individual may not serve as the chapter 7 trustee.

In cases in which no committee is appointed, the U.S. Trustee, with court approval shall select a creditors' representative for each case from the creditors' representative panel. The court shall have discretion, however, based upon the needs of the case and the best interests of creditors and the debtor, to approve the appointment of a person who is not on the panel, if the appointee meets the qualifications established for creditors' representatives.

The court shall determine, based upon the scope of the representative's duties and the circumstances of each case, whether the creditors' representative will be allowed to retain counsel and other professionals. The court may require the representative or its professionals, if any, to present a budget to the U.S. Trustee before commencing work. A program for the compensation of the creditors' representative and its professionals (if appointed) shall be developed by the U.S. Trustee with input from bankruptcy practitioners, judges, and other bankruptcy professionals. If appropriate, the U.S. Trustee might develop two or more pilot programs that employ divergent payment programs, each of which is implemented in several districts, in order to gather data and determine the comparative effectiveness of the divergent programs in enhancing representation of creditors and monitoring of the debtor without unwarranted cost. The creditors' representative's fees and expenses, and those of its court-appointed professionals, if any, will be paid as an administrative expense on the same priority

75. *Id.* §§ 321-323 (outlining the eligibility, qualifications, and role of court appointed trustees).

as the fees of professionals hired under Bankruptcy Code section 327.[76]

The U.S. Trustee shall gather and publicly report appropriate data concerning the effectiveness of the creditors' representative program, in each judicial district and nationwide. This report shall compile and compare data from cases in which creditors' representatives and committees are appointed, and might include factors such as: the number of cases in which creditors' representatives and committees are appointed; the size of cases in which creditors' representatives and committees are appointed; the relative fees and other costs associated with creditors' representatives and committees; the time to confirmation; the percentage of cases confirmed, dismissed, and converted; the circumstances in which creditors' representatives and committees are appointed; factors that contribute to the lack of creditor interest in forming committees; composition and experience of creditors' representative panels; number of cases in which creditors' representatives are selected other than from the panel; circumstances that warrant appointing representatives other than from the panel, etc.

2. Analysis of Draft Proposal

The 1978 Bankruptcy Code[77] fundamentally altered pre-Code reorganization practice by reducing the need for judicial intervention and implementing a private bargaining system in which the parties' agreement to the terms of the plan, supplemented by a few, critical, minimum treatment standards, largely governs the reorganization process.[78] The official creditors'

76. *See id.* § 327.

77. Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended primarily at 11 U.S.C.).

78. *See* H.R. REP. NO. 95-595, at 88 (1978), *reprinted in* 1978 U.S.C.A.A.N. 5963, 6049 (stating that bankruptcy judges would no longer perform a supervisory function over cases but would concentrate on judicial duties); *see also* Marta G. Andrews, *The Chapter 11 Creditors' Committee: Statutory Watchdog?*, 2 BANKR. DEV. J. 247, 264 (1985) (stating that a "major legislative goal of the Code was to decrease the administrative responsibilities of bankruptcy judges so that they

could function as impartial arbiters of disputes between the debtor and its creditors"); Mark J. Krudys, *Insider Trading by Members of Creditors' Committees – Actionable!*, 44 DEPAUL L. REV. 99, 103 n.12 (1994) (noting that the Bankruptcy Code "significantly altered the function of creditors' committees from that enumerated under the provisions of the Bankruptcy Act of 1898," primarily by shifting the burden of overseeing the debtor from the bankruptcy judge to the creditors' committee); Dennis S. Meir & Theodore Brown, Jr., *Representing Creditors' Committees under Chapter 11 of the Bankruptcy Code*, 56 AM. BANKR. L.J. 217, 217 (1982) (noting that the Bankruptcy Code reflects Congress's intention that bankruptcy judges serve a strictly judicial role, and that creditors' committees monitor debtors' activities; also suggesting that active and aggressive creditors' committees can significantly impact the course of a chapter 11 case); Harvey R. Miller, *The Changing Face of Chapter 11: A Reemergence of the Bankruptcy Judge as Producer, Director, and Sometimes Star of the Reorganization Passion Play*, 69 AM. BANKR. L.J. 431, 431-32, 439 (1995) (noting that the 1978 Bankruptcy Code gave power and responsibility for formulating a reorganization plan to the debtor with appropriate oversight and input from the creditors' committee; suggesting a recent trend in which bankruptcy judges have exercised increasing oversight, but arguing that leaving negotiations to creditors and debtors is better); Stephen A. Stripp, *An Analysis of the Role of the Bankruptcy Judge and the Use of Judicial Time*, 23 SETON HALL L. REV. 1329, 1339-41 (1993) (noting that, under the Bankruptcy Code, judges no longer take an active role supervising cases but delegate this responsibility to creditors and a U.S. Trustee); Tabb, *The History of Bankruptcy Law*, *supra* note 11, at 35 (noting that the enactment of the 1978 Bankruptcy Code relegated judges to a strictly judicial role and prohibited them from attending the first meeting of creditors); *see also* 11 U.S.C. §§ 1126, 1129(a) (2000); First Merchs. Acceptance Corp. v. J.C. Bradford & Co., 198 F.3d 395, 403 (3d Cir. 1999) (discussing committee's role in negotiating the plan and monitoring the debtor); *In re* Western Pacific Airlines, Inc., 219 B.R. 575, 577-78 (Bankr. D. Colo. 1998) (discussing committee's "watchdog" role); Phar-Mor, Inc. v. Coopers & Lybrand, 22 F.3d 1228, 1240 (3d Cir. 1994), *reh'g and suggestion for reh'g en banc denied* (1994) ("Under the 1978 Act, the courts have been relieved of most administrative matters, and the responsibility for monitoring the operations of the debtor and its compliance with appropriate bankruptcy procedures has fallen largely to the creditors' committee (although the U.S. Trustee has some role)."); *In re* Structurlite Plastics Corp., 91 B.R. 813, 818 (Bankr. S.D. Ohio 1988) ("The drafters of the Bankruptcy Code clearly envisioned a prominent role for creditors' committees in the reorganization process."); *In re* Marin Motor Oil, Inc., 689 F.2d 445, 455-56 (W.D. Pa. 1982) (discussing committee's broad role); *In re* Daig Corp., 17 B.R. 41, 43 (Bankr. D. Minn. 1981) (stating:

> The creditors' committee is not merely a conduit through whom the debtor speaks to and negotiates with creditors generally. On the contrary, it is purposely intended to represent the necessarily different interests and concerns

committee is a critical component of this structure. Under the Bankruptcy Code, the committee is designed to counterbalance the power conferred on the debtor,[79] to consolidate creditors' multiple voices into one strong bargaining force, and to ensure adequate creditor representation.[80] The existence of an official committee gives creditors a sense of participation as well as a real opportunity to participate in the progress of the case and the formulation of the plan, either directly by committee membership, or indirectly by communicating with committee members.[81]

> of the creditors it represents. It must necessarily be adversarial in a sense, though its relation with the debtor may be supportive and friendly. There is simply no other entity established by the Code to guard those interests. The committee as the sum of its members is not intended to be merely an arbiter but a partisan which will aid, assist, and monitor the debtor pursuant to its own self-interest.);

In re Penn-Dixie Indus., Inc., 9 B.R. 941, 944 (Bankr. S.D.N.Y. 1981) (noting the committee has a "wide and important array of authority and responsibility . . . the Bankruptcy Code contemplates a significant and central role for the committee in the scheme of a business reorganization"); GEORGE M. TRIESTER ET AL., FUNDAMENTALS OF BANKRUPTCY LAW 397 (1996).

79. This power includes the presumption that the debtor will remain in possession and will have an exclusive period in which to propose a plan. *See* 11 U.S.C. §§ 1107, 1108, 1121 (2000).

80. *See* H.R. REP. NO. 95-595, at 401 (1977) (legislative history of section 1102) (stating:

> This section provides for the appointment of creditors' and equity holders' committees, which will be the primary negotiating bodies for the formulation of the plan of reorganization. They will represent the various classes of creditors and equity security holders from which they are selected. They will also provide supervision of the debtor in possession and the trustee, and will protect their constituents' interests.);

see also supra note 78 and accompanying text.

81. Andrews, *supra* note 78, at 248-49 (arguing that, through the creditors' committee, creditors have an opportunity to play "consultative, investigatory, participatory, supervisory, and service-oriented" roles); *see also* Andrew DeNatale et al., *Powers, Functions and Duties of Creditors' Committees*, 767 PLI/COMM. 791, 802 (1998) (arguing that, through the creditors' committee, "the interests of all constituents can be represented, and each constituent can enjoy the benefits of an active, organized, and official advocate, without actively participating in the process," which allows participation by creditors who would otherwise be unable to have a voice in the process); J. Bradley Johnston, *The Bankruptcy Bargain*, 65 AM. BANKR. L.J. 213, 270 (1991) (arguing that the creditors' committee facilitates, rather than discourages, coalition building, and

The Bankruptcy Code contemplates that a committee shall be appointed in every chapter 11 case (unless, as amended in 1994, the debtor is a small business and the court, on request of a party in interest, finds "cause" not to appoint a committee).[82]

The idealized vision of self-monitoring chapter 11 cases in which active yet restrained committees serve as an equal counter-balance to the debtor has not been realized. Instead, committees frequently play an insignificant or non-existent role in small chapter 11 cases. Consequently, if the drafters' vision is to be achieved, it will be necessary to address the problems that arise from the absence of committees in many cases. This will require that the current committees either be reformed or replaced by an entity that can perform the critical roles expected of committees. This proposal seeks to accomplish this objective by filling the gap in cases in which committees are not active.

a. Analysis: Will There Be a Committee?

The essential first step is the development of a simple process by which the court, with input from a neutral entity (the U.S. Trustee), can determine in which cases a committee is likely to be formed and to serve effectively.

This proposal seeks to accomplish this goal by building upon the existing structure, under which the U.S. Trustee appoints

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enables unsecured creditors to speak with one voice; "[b]y using creditors' committees, the bargaining difficulties inherent in consolidating the interests of numerous unsecured creditors is simplified, and the unsecured creditors' bargaining power enhanced, by effectively treating unsecured creditors as one bargaining entity with a single bargaining agenda"); Meir & Brown, *supra* note 78, at 217 (noting that the Bankruptcy Code reflects Congress' intent that bankruptcy judges serve a strictly judicial role and that creditors' committees monitor the debtor's activities; suggesting that active and aggressive creditors' committees can significantly impact the course of a chapter 11 case); Miller, *supra* note 78, at 448-49 (arguing that creditors' committees provide representation for both sophisticated lenders and small trade and individual creditors); *see also* H.R. REP. NO. 95-595, at 401 (1977) (legislative history of section 1102 quoted *supra* note 80).

82. 11 U.S.C. § 1102(a)(3) (2000); *cf. In re* Haskell-Dawes, Inc., 188 B.R. 515, 520-21 (Bankr. E.D. Pa. 1995) (finding no "cause" to forego committee appointment).

members of creditors' committees. At the outset of each chapter 11 case, the U.S. Trustee will determine and advise the court whether a committee is likely to be effective in the case.

b. Analysis: Creditors' Representative

Although the Bankruptcy Code contemplates that active committees will monitor the debtor, negotiate a plan, and serve other roles in chapter 11 cases, there are many (typically smaller) cases in which committees are not appointed, do not operate or participate in the case, or do not hire counsel or other professionals.[83]

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83. *See, e.g.*, *In re* ABC Auto. Prods. Corp., 210 B.R. 437, 442-43 (Bankr. E.D. Pa. 1997) (discussing why creditors are not interested in serving on committees; "as court and commentators alike have noted, in many cases creditors' committees are inactive or ineffectual"); *In re* Aspen Limousine Serv., Inc., 187 B.R. 989, 994 n.6 (Bankr. D. Colo. 1995) (noting that "[i]n practice, a committee is rarely appointed in a smaller case"); *In re* Spruill, 78 B.R. 766, 772 n.14 (Bankr. E.D.N.C. 1987) ("[M]ost creditors' committees in this district are totally inactive and ineffective"); *In re* B&W Tractor, 38 B.R. 613, 615 n.4 (Bankr. E.D.N.C. 1984) (noting that less than five percent of cases in the district have active creditors' committees); *In re* Coast Carloading Co., 34 B.R. 855, 859 n.3 (Bankr. C.D. Cal. 1983) ("Indeed, the Code seems to mandate the appointment of a committee, although in practice it is sometimes impossible to get people to serve."); *In re* Gusam Rest. Corp., 32 B.R. 832, 834 n.1 (Bankr. E.D.N.Y. 1983) ("[I]n too many cases where creditors' committees are formed, the creditors' committees exist in name only and are completely ineffectual" (quoting *In re Nikron, Inc.*, 27 B.R. 773, 776 (Bankr. E.D. Mich. 1983)), *rev'd on other grounds*, 737 F.2d 274 (2d Cir. 1984); *see also* RICHARD I. AARON, BANKRUPTCY LAW FUNDAMENTALS § 4.06 (1992) (noting that there is little incentive for creditors to participate on a committee); Robert C. Aronoff, *Appointing and Organizing Official Creditors' Committees with Model By-Laws*, 20 CAL. BANKR. J. 289, 290 (1992) ("[S]tudies have shown the Creditors' Committees are often ineffective."); Peter C. Blain & Diane Harrison O'Gawa, *Creditors' Committees Under Chapter 11 of the United States Bankruptcy Code: Creation, Composition, Powers and Duties*, 73 MARQ. L. REV. 581, 581-82 (1990) ("[I]n the majority of chapter 11 cases, creditors' committees have fallen short of Congress' initial expectations and have failed to utilize the broad powers available to them."); Blum, *supra* note 2, at 200 (noting that:

> because unsecured creditors in smaller cases typically have too small a stake in the case to make it worthwhile to incur the expense and trouble of participating in a creditors' committee, they tend to be apathetic and uninvolved. Even

The absence of active committees in these cases may lead to a gap or vacuum in monitoring, inadequate creditor input in the plan process, excessive debtor control and leverage, increased delay and

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> where they do make the effort to participate in the committee, lack of financing may make the committee ineffective in controlling the debtor. As a result, this check on the debtors' actions has proven to be largely ornamental.);

Arthur B. Federman, *The Bankruptcy Reform Act of 1994*, 51 J. MO. B. 105, 107 (1995) (questioning whether the power to dispense with creditors' committees in small business cases under section 1102 will have much impact because committees are rarely appointed in small cases anyway); Joseph Guzinski & Lynn M. LoPucki, *Study of Rates of Formation of Committees* (unpublished manuscript, on file with the Fordham Journal of Corporate & Financial Law) (reporting results of a study based upon Executive Office of the U.S. Trustee data and a questionnaire circulated to all U.S. Trustee's Offices seeking data for the period July 1996 to June 1997; finding low committee formation rate); Michael J. Herbert, *Business Reorganizations under Chapter 13: Some Second Thoughts*, 10 OKLA. CITY U. L. REV. 603, 630 (1985) (stating that:

> it is often difficult to get creditors to agree to serve on a creditors' committee if the case is small. The reason is simple. The claims themselves are generally small and the time and effort required for effective creditor committee service is rarely determined worthwhile. This apathy may also make it relatively easy for the plan to be approved, since most creditors who bother to vote on it are likely to take whatever they can get.);

Jerome R. Kerkman, *The Debtor in Full Control: A Case for Adoption of the Trustee System*, 70 MARQ. L. REV. 159, 165, 174, 183, 191 (1987) (reporting the results of a study of forty-eight cases in the Eastern District of Wisconsin during 1982 that showed a correlation between the size of cases and opposition by creditors; arguing that the reasons for inadequate creditor control include: (1) creditors' committees failed to operate; (2) creditor opposition flourished in cases that were likely to succeed but creditors did not effectively organize to close non-viable business; (3) non-debtor plans provided no realistic control; (4) trustees and examiners were seldom used to investigate viability; and (5) preferences were not attacked); Miller, *supra* note 13, at 450 (noting that creditors' committees are either not appointed or not active in many cases; noting that there is little oversight of the debtor in cases with no active committee and no active secured creditor or other large creditor; stating that the committee "often fails to live up to its role"); Stephen J. Rhodes, *Eight Statutory Causes of Delay and Expense in Chapter 11*, 67 AM. BANKR. L.J. 287, 309-11 (1993) (arguing that "inactive and ineffectual" creditors' committees fail to perform any management function in chapter 11 cases and contribute to delay); Small, *supra* note 5, at 320-21 (noting that, "in most cases, unsecured creditors are apathetic and creditors' committees ineffective, particularly in smaller chapter 11 cases."); Young & Bohm, *supra* note 14, at 470-72 (noting that creditors' committees are rarely appointed in small business cases).

costs that flow from the debtor being forced to negotiate with individual creditors rather than with a single, organized group of creditors, and increased time and cost of chapter 11 that flow from the debtor engaging in delay tactics. Finally, inadequate creditor input may allow the debtor to confirm a plan that provides creditors with less than they would have received with more vigorous representation.[84]

If no committee is appointed, the Bankruptcy Code provides no alternative monitor or organized creditor voice. The bankruptcy laws do give the U.S. Trustee some role in monitoring the debtor and the case;[85] however, in practice, the U.S. Trustee tends to be a monitor of last resort.[86] It rarely steps in to seek conversion or dismissal unless the debtor has failed to file required reports or the case has languished for a lengthy period and shows no prospect of confirmation.[87] The U.S. Trustee's role does not replicate the committee's role because the U.S. Trustee is a neutral observer, not an advocate for creditors.[88] Moreover, neither the U.S. Trustee nor any other entity is designated to fulfill the committee's duties when there is no committee. The U.S. Trustee plays a more

84. *See* J. Bradley Johnston, *The Bankruptcy Bargain*, 65 AM. BANKR. L.J. 213, 270 (1991) (arguing that the creditors' committee facilitates coalition building, and enables unsecured creditors to speak with one voice "[b]y using creditors' committees, the bargaining difficulties inherent in consolidating the interests of numerous unsecured creditors is simplified, and the unsecured creditors' bargaining power enhanced, by effectively treating unsecured creditors as one bargaining entity with a single bargaining agenda"); *see also* Raymond T. Nimmer & Richard B. Feinberg, *Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity*, 6 BANKR. DEV. J. 1 (1989) (arguing that unsecured creditors committees "can play an active, advisory role and influence the direction of the case").

85. *See* 28 U.S.C. § 586 (2000) (imposing on the U.S. Trustee the duties to review fee applications, monitor plans and disclosure statements in chapter 11 cases, ensure that reports and schedules are timely filed, monitor creditors' committees, notify the United States Attorney of acts that may constitute crimes, monitor cases, and take action to avoid delay, among other duties).

86. *Accord* Joseph Guzinski, Comments at the Eugene P. and Delia S. Murphy Conference of Corporate Law, Fordham University School of Law (Nov. 15, 2001); Joseph Guzinski, *Response: Small Business Reorganization and the SABRE Proposals*, 7 FORDHAM J. CORP. & FIN. L., 295 (2002).

87. *Accord* Comments of Joseph Guzinski, *supra* note 86.

88. 28 U.S.C. § 586(a)(2).

substantive monitoring role only when the U.S. Trustee serves as trustee, not when the case lacks a committee.[89]

The reasons committees do not operate in many chapter 11 cases probably vary from case to case and involve some combination of apathy, creditors having little at stake, the debtor having few unencumbered assets from which to make distributions or compensate committee professionals, creditor interests being highly fragmented, and individual creditor claims being so small that few unsecured creditors can justify the time and expense of serving on a committee.[90]

If payment of the committee's expenses by the estate was designed to ensure creditor participation, it has not worked. The percentage of cases in which committees are formed is small and probably has declined since the early years of the Bankruptcy Code.[91] In small cases, the creditors may be less able to pay the expenses of monitoring the case. Even if they are wealthy creditors, they may be unwilling to monitor a small case in which their stake is small and their chances of receiving a distribution are low. Consequently, it is not clear whether the incentive of compensation by the estate affects creditors' determination to be actively involved in a case. Data are not readily available on these questions.

This proposal contemplates that the creditors' representative would be appointed to perform the monitoring, plan negotiating, and fulfill certain other roles of the committee in certain cases in which no committee is appointed.[92] Under this proposal, the court

89. *Id.*

90. *See, e.g., In re* ABC Auto. Prods. Corp., 210 B.R. 437, 442-43 (Bankr. E.D. Pa. 1997) (discussing reasons for creditors' decisions not to serve on committees); Karen Gross & Patricia Redmond, *In Defense of Debtor Exclusivity: Assessing Four of the 1994 Amendments to the Bankruptcy Code*, 69 AM. BANKR. L.J. 287, 292-304, 308 (1995) (arguing that the main cause of delay and cost is not exclusivity but creditor apathy, especially in medium and small cases).

91. *See* sources cited *supra* note 83.

92. For example, the creditors' representative might assist the court in determining, early in a case, whether the business should be liquidated or reorganized. *Cf.* Edward S. Adams, *Governance in Chapter 11 Reorganization: Reducing Costs, Improving Results*, 73 B.U. L. REV. 581, 584-92, 621-34, 611-21 (1993) (citing studies regarding low confirmation rates (Stripp, *supra* note 78 and

would determine in each case whether the circumstances of the case warrant the appointment of a creditors' representative or whether some other method of monitoring the debtor and protecting creditors would be appropriate (such as an active major creditor, or the appointment of a neutral business and financial expert).

In recent years, several bankruptcy experts have recommended reforms designed to enhance the effectiveness of committees or fill the gap in cases in which committees are not active or effective.[93] For example, the NBRC has proposed giving the court more oversight and control over committee membership

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Jensen-Conklin, *supra* note 13); arguing that filings by companies that will eventually liquidate drive up the costs of bankruptcy; advocating replacing debtor in possession managers with trustees and establishing a methodology to help the trustee determine whether a company should continue in chapter 11 or be liquidated; proposing that management continue to make "business activity decisions" such as the use of assets and day-to-day business operations, but that the trustee make "fundamental bankruptcy decisions" such as mediating plan negotiations, shaping the tone and character of settlement discussions, allocating losses, and assessing the viability and validity of the reorganization; suggesting that the U.S. Trustee choose the trustee from a panel of qualified applicants with experience in the debtor's industry or business; recommending that the main task of the trustee would be to determine whether to liquidate or reorganize the company and that the U.S. Trustee and court would review the trustee's decisions to ensure that the trustee is not continuing the business simply out of self-interest; proposing a methodology to assist the trustee in making the decision to liquidate or reorganize; considers and compares value-based and process-based approaches; reviewing history of chapter 11, including allocation of control and decision-making, as context for the proposal, and discussing existing balances in the Bankruptcy Code and how these would be affected by the proposal); Tabb, *The Future of Chapter 11*, *supra* note 11, at 859 (arguing that time and money are lost in cases before hopeless debtors are eventually liquidated, that an independent third party should be brought in to analyze feasibility of the debtor, that such a person can make an objective assessment that many of these cases should be liquidated earlier rather than later, and that the cost savings derived from earlier termination would offset the cost outlay involved in hiring the independent party); *see also* Kerkman, *supra* note 83, at 165, 183, 191 (showing a correlation between size of cases and opposition by creditors; concluding that creditors are unable to close non-viable businesses, creditors can rarely change management, debtors can dictate terms of plan, and debtors can obtain significant delays).

93. *See infra* notes 94-99.

to ensure adequate representation.[94] Professor Edward Adams has suggested that the debtor remain in possession to operate the business, but a non-operating trustee be appointed in every chapter 11 case to make "fundamental bankruptcy decisions" such as an assessment of plan feasibility and of the debtor's viability.[95] Professor Tabb and others have proposed the appointment of an independent monitor in chapter 11 cases.[96] Messrs. Blain and O'Gawa have recommended that the U.S. Trustee develop guidelines to help committees perform their duties more effectively.[97] Professor Gross and Messrs. Curtin and Togut have proposed that the U.S. Trustee assist bankruptcy professionals in developing effective monitoring techniques, the Bankruptcy Code be amended to embody an early testing of feasibility or viability, and additional studies be undertaken.[98] Judge Paskay has

94. *See* NBRC REPORT, *supra* note 3, at 455, 492-501.

95. *See* Adams, *supra* note 92, at 621-24.

96. *See* Evan D. Flaschen, *Independent Monitors in Chapter 11*, 4 AM. BANKR. INST. L. REV. 514, 515 (1996) (proposing that the court appoint an independent monitor in all chapter 11 cases); Jerome R. Kerkman, *The Debtor in Full Control: A Case for Adoption of the Trustee System*, 70 MARQ. L. REV. 159, 197 (1987) (arguing for greater use of examiners and trustees to investigate the debtor and reduce debtor control); Gerald K. Smith, *Reorganizations*, 1995 ANN. SURV. BANKR. L. 605, 622-30 (1995) (discussing appointment of an independent trustee); Tabb, *The Future of Chapter 11*, *supra* note 11, at 854-59 (considering whether courts should appoint a trustee or independent examiner in every case); Barry L. Zaretsky, *Trustees and Examiners in Chapter 11*, 44 S.C. L. REV. 907, 907-42 (1993) (arguing that the appointment of an independent third party provides a benefit from intervention without incurring the costs, or creating the disruption, of a trustee, and that the third party may defuse tensions by mediating plan negotiations or other disputes, assist the debtor with management or reorganization decisions, or perform other tasks that can best be accomplished by a party unconnected with any of the constituencies in the case).

97. Blain & O'Gawa, *supra* note 83, at 581 (noting that Congress relieved the court of administrative burdens in the hopes that creditors' committees would take a more active role in the day to day administration and monitoring of chapter 11 cases, but finding that, in the majority of cases, the committees have failed; suggesting that the U.S. Trustee system and the increasing awareness by creditors of the role and power of committees might alter this, and developing guidelines for committees to follow so their statutory powers are used effectively).

98. Timothy J. Curtin et al., *Debtors Out-of-Control: A Look at Chapter 11's Check and Balance System*, 1988 ANN. SURV. BANKR. L. 87, 87-89, 91-94

recommended eliminating the committee requirement and disclosure requirement in small business cases.[99]

Earlier studies have also recommended that some sort of independent monitor oversee chapter 11 cases, such that the creditors' committee is not responsible for all aspects of monitoring the debtor.[100] For example, The Brookings Institute Study recommended that an administrative agency, rather than the bankruptcy judges, oversee administration and monitoring.[101] The 1973 Commission on the Administration of the Bankruptcy Laws also urged the development of a bankruptcy administrative agency.[102]

(reporting the results of a survey of bankruptcy judges; noting that the "ideal" chapter 11 envisioned by the drafters "was an expeditious proceeding in which relatively evenly-matched parties, the debtor and its creditors, strove to reorganize an ailing business in a manner that would fairly recognize the competing interests of all;" concluding that the bifurcation of administrative and judicial functions had led to gaps in monitoring; finding that members of the bankruptcy community perceive a problem relating to abuses made possible due to the limited role of committees and excessive control by the debtor).

99. *See* Alexander L. Paskay, *Reorganizing Single Asset Real Estate*, 4 AM. BANKR. INST. L. REV. 538, 540 (1996) (proposing the elimination of (1) the requirement that an unsecured creditors' committee be appointed in single asset cases, and (2) the requirement that the debtor file a disclosure statement in small and single asset cases). The small business amendments passed by Congress in 1994 adopted a similar approach. *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 217, 108 Stat. 4106, codified at 11 U.S.C. § 1102 (authorizing the court to forego appointing a creditors' committee in a small business case); § 1121(e) (shortening the exclusivity period in small business cases); § 1125(f) (providing for conditional approval of disclosure statement in small business cases); *see also* FED. R. BANKR. P. 1020 (allowing a business that meets the small business definition to elect small business treatment).

100. *See infra* notes 101-102.

101. DAVID T. STANLEY & MARJORIE GIRTH, BANKRUPTCY: PROBLEMS, PROCESS, REFORM 199 (1971) (proposing the creation of a bankruptcy agency in the executive branch to perform certain functions then performed by the court, trustees, receivers, appraisers, accountants, auctioneers, and auxiliary personnel; arguing that a separate agency would increase efficiency because it would receive pressure from the executive offices and would be aided by such executive offices as the Office of Management and Budget and the Civil Service Commission).

102. COMMISSION ON BANKRUPTCY ADMINISTRATION, 1973 REPORT 2-3, 19-21, 115, 132-33 (1973) (proposing that Congress create a Bankruptcy Administration, primarily to oversee liquidations and provide consumer

Although their recommendations vary, the authors of these proposals generally recognize two goals: the need for adequate monitoring of the debtor and the desire for a private system in which debtor and creditors actively negotiate and solve their restructuring disputes with little governmental regulatory interference. The creditors' representative proposal captures the essence of these concepts in its recommendation that a creditors' representative perform the committee's role in many of the large number of case in which no committee is active.

The creditor's representative may add nominal costs to the case. These costs should be offset, however, by cost savings accrued from reducing the number of creditors with whom the debtor must negotiate, and reducing the potential for delay and abuse that can occur when the debtor has unchecked control over the case.[103]

C. Implementation

Under the current Bankruptcy Code, there is no provision that expressly permits the court to appoint a creditors' representative. Although a court might attempt to achieve the same types of benefits through a carefully defined appointment of an examiner, expert, or consultant, and the U.S. Trustee can play a monitoring role, each of these entities is designed to serve as a neutral voice. None can provide a legitimate, creditor-oriented, debtor-balancing voice in the case. Amendments to the Bankruptcy Code will be

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counseling; noting that the bankruptcy judges would resolve controversies; suggesting the system would require either federal funding or funding through bankruptcy fees; arguing that an administrator is required because there is no real creditor control; noting that this results in excessive costs and serious abuses; noting that the Donovan Report in 1929 identified these same problems, and that this proposal is somewhat similar to the Donovan Report proposal; noting similar concepts in other countries; noting that the Brookings Institute Report argued that the use of a judicial mechanism to solve administrative matters raised costs and delay and did not promote the objectives of bankruptcy).

103. *See* Tabb, *The Future of Chapter 11*, *supra* note 11, at 854-61 (arguing that an independent trustee may add costs but these costs would be offset by reducing delay attributable to extensive debtor exclusivity and reducing unwarranted reallocations between different categories of claimants; noting that an independent trustee has only one goal, to maximize the value of the estate).

required to implement this proposal.

IV. REPLY TO MR. GUZINSKI RESPONSE

In his thoughtful *Response: Small Business Reorganization and the SABRE Proposals*,[104] Mr. Guzinski[105] suggests that SABRE's proposals to employ Plan Facilitators and Neutral Business Experts[106] in chapter 11 cases[107] "do not deal with . . . the time and expense of Chapter 11"[108] but "aim at another, more deep-seated problem in chapter 11. This problem is often described in terms of 'time and expense,' but is something more fundamental: the fact that our adversarial model of litigation in some ways does not serve the reorganization process."[109] Mr. Guzinski correctly concludes that the Plan Facilitator and Neutral Business Expert proposals address deficiencies in the adversarial process, as it functions in chapter 11 cases with active creditors.

The drafters of the Bankruptcy Code[110] vested creditors with extensive rights to monitor and counterbalance powerful debtors.[111] SABRE and others have concluded, however, that the powers

104. Guzinski, *supra* note 86.

105. Joseph A. Guzinski, Acting General Counsel, Executive Office for U.S. Trustees.

106. *See* FIRST REPORT, *supra* note 21, at 167, 185-210.

107. 11 U.S.C. §§ 1101-1174 (2000).

108. Guzinski, *supra* note 86, at 295. Mr. Guzinski also suggests that the SABRE First Report does not present evidence that time and cost is a problem. *Id.* at 296-97. In fact, the SABRE First Report sets forth extensive discussion of the debate concerning the extent to which time and cost are a concern in chapter 11 cases. *See* FIRST REPORT, *supra* note 21, at 211-41. Moreover, although there is some evidence that the time businesses spend in chapter 11 has decreased Guzinski, *supra* note 86, at 296 & n.13, there is also evidence that the time in chapter 11 for all but the very largest cases has increased. *See* FIRST REPORT, *supra* note 21, at 216 (citing Professor LoPucki's study of time in chapter 11).

109. Guzinski, *supra* note 86, at 297.

110. The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, codified at 11 U.S.C. §§ 101- 1330 (2000).

111. *See* FIRST REPORT, *supra* note 21, at 196-97; *see also* 11 U.S.C. § 1109 (granting creditors extensive rights to appear and be heard as parties in interest); § 1107 (setting forth the rights, powers and duties of the debtor in possession); § 1121 (granting the debtor an exclusive period in which to file and obtain confirmation of a plan of reorganization).

granted to both debtor and creditors may increase cost and delay in chapter 11 by establishing an overly adversarial atmosphere that discourages parties from sharing neutral business information, encourages unnecessary litigation of routine matters, and fosters strategic behavior in plan negotiations.[112] The Plan Facilitator and Neutral Business Expert proposals seek to moderate this atmosphere by adapting to the chapter 11 bargaining process the same types of neutrals that other courts traditionally employ (i.e., independent experts and mediators). As in other courts, the use of neutrals is designed to reduce the cost and delay associated with unnecessary litigation.[113]

Mr. Guzinski also suggests that the Plan Facilitator and Neutral Business Expert are "intended to deal with the shortcomings of creditor representation in Chapter 11 cases."[114] This conclusion is misplaced. The Plan Facilitator and Neutral Business Expert are not designed to solve shortcomings of creditor representation. Rather, they address the problems that arise from undesirable adversarial incentives of all parties, including debtor, creditors, and equity holders. They are designed to maintain the current system in which both the debtor and creditor have extensive powers to protect their interests, but to make that system more cooperative and less adversarial.

Although the Plan Facilitator and Neutral Business Expert are not designed to address deficiencies in creditor representation, SABRE has identified certain failures of creditor representation in chapter 11 cases, and is analyzing means of addressing those failures.[115] Particularly, the available empirical and anecdotal evidence suggests that, despite Congress's intent that active

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112. *See* FIRST REPORT, *supra* note 21, at 199-200.

113. SABRE is continuing to analyze the extent to which the burdens and duties that the Bankruptcy Code places upon creditors' committees (*see* 11 U.S.C. § 1102) may foster unnecessary litigation by compelling committees to analyze and litigate routine motions in order to prevent accusations that the committee is failing to represent its constituencies' interests zealously. Additional proposed reforms addressing this problem may appear in a subsequent SABRE Report.

114. Guzinski, *supra* note 86, at 295.

115. Any proposals to address these deficiencies would appear in a subsequent SABRE report.

committees would monitor and counterbalance the debtor in chapter 11 cases, committees are not active in most chapter 11 cases.[116] The preliminary draft Creditors' Representative proposal, set forth in the Article, may provide a means of addressing this concern.[117] Under this proposal, the U.S. Trustee, with court approval, would appoint a Creditor's Representative to negotiate on behalf of unsecured creditors in many cases in which no committee is active.[118] As noted in the SABRE First Report[119] and the draft Proposal,[120] SABRE continues to analyze the available data and refine this proposal for possible inclusion in a subsequent SABRE report.

Mr. Guzinski correctly notes that the U.S. Trustee may play a role in reducing time and cost in cases in which creditors are not active.[121] If the case is languishing without any prospect for reorganization, and there is no active creditor voice, the U.S. Trustee can move for dismissal or the appointment of a trustee.[122] The U.S. Trustee cannot, however, negotiate a plan on behalf of creditors in such cases. Similarly, in cases in which creditors are active, the U.S. Trustee cannot mediate plan negotiations or generate neutral business and financial data. The Creditors' Representative, neutral Plan Facilitator, and Neutral Business Expert are designed to fill these gaps, which are not filled by the U.S. Trustee.

SABRE believes that the cost savings associated with the Federal Workout Proceeding, Plan Facilitator and Neutral Business Experts, together with the incidental improvements these reforms will make to the bankruptcy system, will exceed any costs associated with implementing these proposals.

116. *See* FIRST REPORT, *supra* note 21, at 231.

117. *See supra* Part III.

118. *See id.*

119. *See* FIRST REPORT, *supra* note 21, at 233.

120. *See supra* pp. 283-90.

121. Guzinski, *supra* note 86, at 298; *see also* 28 U.S.C. § 586(a)(3)(G) (2000).

122. 11 U.S.C. §§ 1104, 1112 (2000).