Harvey's Silence (Symposium: Letters to the Commission)

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COMMENT

Harvey’s Silence

by

James J. White*

Harvey Miller has a reputation as a leading bankruptcy lawyer, and he deserves it. As his criticism shows, he understands why and how the Code changed the Act in 1978 and how the drafters of Chapter 11 erred. Better than all but a handful of other lawyers, Harvey Miller knows how to manipulate Chapter 11 to serve his clients’ interests. He understands both the legal and practical intricacies of Chapter 11. Were I the CEO of a large and troubled company, I would hire Harvey Miller and gladly pay him twice what most other bankruptcy lawyers would charge. In short, Harvey Miller is a Chapter 11 virtuoso.

And for those same reasons, Harvey Miller cannot be a true critic of Chapter 11.

What is most notable about his article is its silence. Should Bradley and Rosenzweig’s proposal for the abolition of Chapter 11 be adopted? He is still. Should Michelle White’s ideas about foreign systems of liquidation be adopted? His article is still. Should any of the other radical or near-radical proposals for appointment of a trustee, auctions or the like be adopted? His article makes no mention of those. Like any virtuoso, Harvey Miller is incapable of condemning the institution that has allowed him to achieve virtuoso status. To ask him to do so would be like asking Itzhak Perlman to burn his violin or Mozart to destroy his best compositions. Replacing Chapter 11 with a provision for quick

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2See Michelle J. White, The Costs of Corporate Bankruptcy: A U.S.-European Comparison, reprinted in BANKRUPTCY: LEGAL AND ECONOMIC PERSPECTIVES 467 (Bhandari ed., 1995) (a bankruptcy system which favors liquidation over reorganization is more likely to be economically efficient).

3See Edward S. Adams, Governance in Chapter 11 Reorganizations: Reduced Costs, Improving Results, 73 B.U. L. Rev. 581, 621–35 (1993) (Adams proposed a two-pronged solution to reduce bankruptcy costs in Chapter 11 reorganizations: 1) use a bifurcated trustee system where an independent third party would be appointed to make fundamental bankruptcy decisions while the debtor could be retained to make business activity decisions; and 2) provide guidance to the trustee in order to recommend liquidation or reorganization); Barry E. Adler, Financial and Political Theories of American Corporate Bankruptcy, 45 STAN. L. REV. 311, 319–23 (1993) (discussing partial solutions such as market theories and proposals for ex-ante structuring); Douglas G. Baird, The Uneasy Case For Corporate Reorganisation, 15 J. LEGAL STUD. 127 (1986) (allow a court to auction the bankrupt and allow anyone to bid). See also Douglas G. Baird, Revisiting Auctions in Chapter 11, 36 J.L. & ECON. 633 (1993).
liquidation or sale would destroy the manifold possibilities that now exist for interpreting and manipulating the intricate provisions found in Chapter 11. It would minimize the possibilities for clever negotiation among the various parties under Chapter 11's umbrella and would drive half of the members of the National Bankruptcy Conference into retirement and the other half into the litigation or workout departments of their law firms.

For these reasons, the Bankruptcy Review Commission dares not listen to Harvey and his friends in deciding whether Chapter 11 needs substantial change. The Commission must recall that Chapter 11 is not an end in itself; it is not like a musical performance. Rather, it is part of the process by which the American economy cleanses itself of economic failure. It should therefore be measured by the efficiency with which it accomplishes that end, not by its inherent beauty.

The power of a market economy is its ability to renew itself by driving the inefficient out of business and fostering and enhancing the efficient. To the extent this process is inhibited by Chapter 11 or by any other state or federal law, a cost is imposed upon our society that must be borne in one way or another by us all. Carried to its unthinkable extreme, the inability to do away with inefficiency leads to the kind of dysfunction we have seen in the socialist economies of Eastern Europe where businesses continued to produce products that were inadequate, unwanted and unsalable on a free market. Chapter 11 can hardly induce the kind of inefficiencies in our economy that socialism induced in Eastern Europe, but its costs can be great and they should be considered by the Bankruptcy Review Commission.

The costs of Chapter 11 have been the subject of a fulminating academic debate that started shortly after the Bankruptcy Reform Act of 1978 was adopted.4 There have been a few apologists for Chapter 11 in that debate (includ-

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ing the Commission’s Reporter, Professor Warren) but the weight of academic opinion is against Chapter 11. Most argue that Chapter 11 is inefficient, costly and wasteful. The most radical critics propose the abolition of Chapter 11. The other critics propose some form of sale, auction or speedy transfer of the assets out of the hands of the existing managers and into the hands of “residual holders” or others who have an interest in the debtor. Among other things, these critics note that mostly Chapter 11 does not operate as a reorganization procedure but as a procedure for slow liquidation. Only ten to fifteen percent of all Chapter 11’s ever result in a confirmed plan of reorganization. The others wind up in some sort of liquidation, either through Chapter 7 or through a liquidating Chapter 11 plan.

The academic critics have been joined by various business critics who make much the same argument but in different form. A leader of the parade of


horribles is Eastern Airlines. When Eastern Airlines filed its petition, it was thought that the unsecured creditors would receive payment in full had it liquidated at once. When the company liquidated twenty-two months later, the unsecured creditors received a pittance.\textsuperscript{10} Certain postpetition suppliers, the employees and managers of Eastern Airlines during the Chapter 11 proceedings received money that they would not have received on prompt liquidation. But not a single job was saved nor was a single long-term opportunity for suppliers made available by this Chapter 11. Arguably, this long and slow death was simply a means by which money that belonged to one set of creditors was taken from them and diverted to others.

Wherever one stands on this academic debate—and there are many positions and much disagreement—the debate should not be ignored by the Commission. To reexamine Chapter 11 without considering proposals for reform in the academic literature would be like considering proposals for the reform of the American aviation industry in 1950 by focusing exclusively on piston engines. Like the most talented piston engine engineers, the Harvey Millers and Ken Klees should be heard, but not to the exclusion of the jet propulsion advocates like Adler, Aghion, Baird, Bradley, Rasmussen, Roe, Rosenzweig and others. If the Bankruptcy Review Commission ignores the academic debate, its recommendations and its judgment should be questioned. Whatever its predilections or ultimate conclusion, the Commission must confront these serious challenges by economists, lawyers, and businesspersons. It, far better than hurried members of Congress, will be able to understand and possibly to implement some of the critics' proposals. Less affected by the pressures of lobbyists pushing for particular narrow interests, the Commission has a leisure that is not available to Congress. It would be regrettable if it did not use that opportunity.

I. THE COSTS OF CHAPTER 11

It is necessary first to identify the costs that are imposed upon society by Chapter 11.\textsuperscript{11} In the academic literature, these costs carry many names and they can be classified in many different ways. This Comment considers five

\textsuperscript{10}What Constitutes Success in Chapter 11? A Roundtable Discussion, 2 AM. BANKR. INST. L. REV. 229, 235-37 (1994) ("Was Eastern Airlines a Success?"); Michael H. Bradley & Michael Rosenzweig, Time to Scuttle Chapter 11, N.Y. TIMES, Mar. 8, 1992, § 3, at 13. David Epstein reports that, contrary to other reports, the unsecured creditors had received a ten percent dividend and that the dividend might eventually reach fifteen percent by the end of 1995.

separate costs, though some of them are interrelated.

A. TREATMENT OF MANAGERS IN CHAPTER 11

Managers of firms who might be driven into bankruptcy by financial distress are probably not indifferent to what will happen to them if their firms go into bankruptcy. One reason Congress and the Bankruptcy Commission of the 1970's allowed existing management to continue operation as debtors-in-possession and otherwise made Chapter 11 comparatively painless for the managers was to avoid one of the costs of a more harsh system. This is the cost that arises when a failing firm liquidates piecemeal or takes other actions to avoid bankruptcy even though bankruptcy reorganization would be the most sensible course. Put another way, leniency encourages early resort to bankruptcy, before the firm has become so deeply insolvent that it cannot be saved.

On the other hand, some have suggested that managers of failing companies should be punished in bankruptcy—that the treatment should be severe, not lenient. These critics of Chapter 11 suggest that managers will work harder, produce more and be more efficient managers of the firm if financial distress brings harsh consequences to them.

Even though the Congress in 1978 and some of the critics since then assume that the reception that awaits the managers in bankruptcy will influence their behavior, the two groups seem to come to opposite conclusions about the proper reception and about the incentives that should be offered—fear of bankruptcy or affinity to it.

In any event, some of the critics of Chapter 11 maintain that managers are not sufficiently punished, that the "punishment effect" is too low and thus that managers do not work as hard as they otherwise might to avoid financial distress. Professors Bradley and Rosenzweig argue that managers may even embrace Chapter 11 for strategic purposes that are contrary to the interests of others.

Among all existing bankruptcy regimes, Chapter 11 is perhaps the least

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1 H.R. REP. No. 595, 95th Cong., 1st Sess. 231 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6191 ("Proposed Chapter 11 recognizes the need for the debtor to remain in control to some degree, or else debtors will avoid the reorganization provisions in the bill until it would be too late for them to be an effective remedy.").

2 See, e.g., Philippe Aghion et al., The Economics of Bankruptcy Reform, 8 J.L. Econ. & Organ. 523 (1992) (arguing that punishment costs are minimized in a system that treats managers harshly, for example, quick liquidation or appointment of trustees. Conversely, the punishment effect is higher in a system that treats managers leniently); The Kindness of Chapter 11, The Economist, May 25, 1991, at 83 (U.K. edition) (Chapter 11 is too kind to a troubled company's existing managers and shareholders, and too harsh on creditors). See also Michelle J. White, The Costs of Corporate Bankruptcy: A U.S.-European Comparison, reprinted in Bankruptcy: Legal and Economic Perspectives 479-83 (Bhandari ed., 1995) (ex ante cost of bankruptcy and the costs associated with the punishment effect).

punishing. Because Chapter 11 turns existing management into the debtor-in-possession, there is minimal punishment. This is true despite the fact, as demonstrated by Professors Whitford and LoPucki, that by the end of most large Chapter 11's the principal managers lose their jobs. At least in the United States system many managers appear to keep their jobs throughout a Chapter 11 and those who eventually lose their jobs keep them for a year or possibly two years longer than they would under many other systems. Thus, the punishment imposed by Chapter 11 is less severe than the punishment that would be imposed by most foreign systems or by any system that automatically ousts management in favor of a trustee or that provides for swift sale or liquidation.

Of course, the hypothesis of the punishment effect—namely that those who face the prospect of punishment will work harder to keep from suffering and will thus cause their firms to be more successful than would otherwise be true—is itself subject to challenge. The company may go into bankruptcy for reasons beyond the control of the managers; even companies whose managers work long and hard may go into bankruptcy notwithstanding those efforts. Moreover, many managers may already be stimulated to work at their maximum potential by the incentives for success without regard to the punishment that will occur because of failure.

In short, the "punishment effect" is interesting but unconfirmed by empirical data. I believe that Congress erred in 1978 by minimizing punishment, but it is hard to make a persuasive empirical case for the efficacy of maximizing punishment.

B. OVER AND UNDERINVESTMENT

It is now cliche to note that an agent may make investments that disfavor shareholders and creditors if the agent's interests are not exactly aligned with the interests of shareholders and creditors. This divergence of interests may cause the managers of a distressed firm to invest in projects that are too risky, and fail to invest in more conservative projects that will benefit the creditors but not the managers.

Assume a company in financial distress that is insolvent but has not filed for bankruptcy relief. Assume that the managers are major shareholders and

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16Lynn M. LoPucki & William C. Whitford, Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies, 141 U. Pa. L. Rev. 669, 723 (1993) (in ninety-one percent of the forty-three public companies studied, there was a least one change in CEOs).
17Professors LoPucki and Whitford note that the allegiance of managers of large public companies may shift with the solvency of the company. See Lynn M. LoPucki & William C. Whitford, Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies, 141 U. Pa. L. Rev. 669, 751 (1993) ("Management's orientation was clearly a function of the company's solvency. The management of solvent companies never aligned with creditors, while the management of insolvent companies did so frequently.").
that they, together with the other shareholders, will reap the benefits from an investment only to the extent of the increase of the firm's net worth above zero and not to the extent of an increase that reaches only to zero. If assets are 500 and liabilities are 1,000, the first 500 of profits will go to creditors; shareholders will profit from investments only after the assets stand at 1,000 and so equal the liabilities. In those circumstances, the managers, concerned only with their own interests and not with the interests of creditors, might decline to invest in projects where the positive projected value could be expected to raise the firm only to solvency but not above. On the contrary, their selfish interests might cause them to invest in quite risky transactions whose aggregate projected value is negative but which promise a large profit in a minority of circumstances.

Assume that an investment of 500 could be expected to produce a return of only 100 in eight out of ten cases but a return of 1500 in two out of ten. This would be a losing proposition, for the expected return—summing all ten possibilities and dividing by ten—from the investment of 500 would be only 380. On the other hand, if the managers were to take everything above a return of 1000, yet no part of the first 1000, it might be in their interest to make such an investment. The managers and shareholders reap a large part of the upside, but the creditors suffer the entire downside. This problem, of course, exists in and out of bankruptcy; it is minimized by aligning the managers' interests with the interests of others who have an interest in the firm.

While the theory about over and underinvestment by managers of distressed firms is plausible, there is no empirical evidence that confirms the theory with respect to financially distressed firms. Until confirmed, it is difficult to see how the theory can be the basis for amendments of the existing bankruptcy law.

C. DELAY

I believe that the largest and most palpable costs of Chapter 11 arise from delay. These costs arise in and outside of bankruptcy anytime a firm that is inefficient continues to operate and experience losses. By hypothesis these losses..."
are waste. Society would be better served by causing the company to invest in other and more efficient activities. Chapter 11—at least as practiced in large cases—appears to condone and even exaggerate delay and the attendant costs. For example, Eastern Airlines lost $600 million during the twenty-two months it lingered in Chapter 11. LTV continued in bankruptcy from July, 1986, to May, 1993, and during most of that time incurred losses. Countless other smaller and nameless Chapter 11’s—as many as ninety percent—have this attribute; namely, they are businesses that must ultimately be liquidated, but it takes as long as eighteen months on average to accomplish liquidation. And during every one of those 550 days in bankruptcy, many, perhaps most, of these firms are experiencing losses and postponing the day when their assets can be allocated to better and more efficient purposes. The costs of delay are palpable and indisputable. The Commission should address them.

D. DIRECT COSTS

The most easily measurable costs of bankruptcy are the so-called direct costs, the costs of lawyers, accountants, investment bankers and the like and the costs that are necessarily associated with the operation of the business under court supervision. Because these costs are so obvious, they are most frequently mentioned in the press and most commonly cited by creditors. Surely they are important, but it is unclear exactly how one avoids them if one is to have a reorganization proceeding. Of course, to the extent that they are folded into the cost of delay discussed above, they should be minimized. If a reorganization that should take two months takes two years, the delay has magnified the direct costs of bank-

22Michelle J. White, Bankruptcy Costs and the New Bankruptcy Code, 38 J. FIN. 477, 484 (1983) (finding direct costs of large reorganization cases average six percent of disbursements to all creditors); Lawrence A. Weiss, Bankruptcy Resolution: Direct Costs and Violation of Priority Claims, 27 J. FIN. ECON. 283, 289 (1990) (finding direct costs in large reorganizations to be 20.6 percent of market value of equity, 3.1 percent of book value of debt plus market value of equity, and 2.8 percent of book value of total assets); Edward I. Altman, A Further Empirical Investigation of the Bankruptcy Cost Question, 39 J. FIN. 1067, 1075–77 (1984) (finding direct costs of large reorganization cases to average six percent of total value); Barry E. Adler, Bankruptcy and Risk Allocation, 77 CORNELL L. REV. 439 (1992) (discussing empirical studies that have addressed the various costs of bankruptcy); Robert Lawless et al., A Glimpse at Professional Fees and Other Direct Costs in Small Firm Bankruptcies, 1994 U. ILL. L. REV. 847 (1994) (a study of fifty-seven small firm bankruptcies filed in Memphis found that professional fees accounted for twenty percent of distributions. These figures were "vastly" greater than those found in previous studies of direct costs of large firms); Claudia MacLachlan, Anger Rises Over Bankruptcy Fees, NAT'L L.J., Mar. 9 1992, at 1; Jagdeep S. Bhandari & Lawrence A. Weiss, The Untenable Case for Chapter 11: A Review of the Evidence, 67 AM. BANKR. L.J. 131, 134 n.10 (1993) (discussing a number of empirical studies).
ruptcy by ten times or more. Therefore, one way to attack the direct costs of bankruptcy is to treat them as a cost of delay and to work to reduce that delay.

E. Selection Error

If one assumes that certain firms—namely the inefficient and distressed—should be liquidated while others—namely the efficient but distressed—should be reorganized, one must pay the cost of determining whether a particular firm is a sheep or a goat and a further and wasteful cost if the process does not correctly identify those who should be liquidated as goats and those who should be saved as sheep. These are Professor Michelle White’s “type I” and “type II” errors that keep alive the inefficient (type I) but kill the efficient (type II).23 It is the implicit hypothesis of her writing, and one that I share, that Chapter 11’s generosity encourages error on the side of reorganization.24 One datum that arguably supports that proposition is the fact that as many as ninety percent of all firms that file for “reorganization” in Chapter 11 ultimately liquidate. Their lingering death in Chapter 11 takes on average as long as eighteen months.25 This is really no more than a feature of the cost of delay described above and it seems that it should be treated as such. That is to say, there are inevitable costs associated with distinguishing between firms that should be liquidated and those that should be saved. Those costs should be minimized. To the extent they are not minimized and to the extent incentives are granted to managers to exaggerate them, there is waste.

There does not appear to be any system in Europe or elsewhere that is less likely than Chapter 11 to commit the error of liquidation of a company that should be reorganized.26 I, therefore, urge the Commission to ignore type II

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23See Michelle J. White, Corporate Bankruptcy as a Filtering Device: Chapter 11 Reorganization and Out-of-Court Debt Restructurings, 10 J.L. ECON. & Organ. 268 (1994).

24See Michelle J. White, The Costs of Corporate Bankruptcy: A U.S.-European Comparison, reprinted in Bankruptcy: Legal and Economic Perspectives 470 (Bhandari ed., 1995) (“as will be seen, the approach in the United States is to encourage early bankruptcy filing by treating managers more leniently in bankruptcy.”). See also Philippe Aghion et al., The Economics of Bankruptcy Reform, 8 J.L. Econ. & Organ. 523 (1992); Michael H. Bradley & Michael Rosenzweig, The Untenable Case for Chapter 11, 101 YALE L.J. 1043 (1992).


26Foreign jurisdictions tend to screen potential bankrupt debtors at the outset to determine if reorganization is a worthwhile cause. For example, French insolvency laws appoint an administrator during an initial observation period to determine if the debtor should be reorganized or liquidated. Barthelemy Mercadal, France, 26 Int’l Law 531 (1992). The Canadian insolvency laws also screen potential debtors early in the reorganization process and allow creditors and the courts to evaluate the debtors proposed plan. D. J. Kee & Elizabeth A. Scott, Canada, 27 Int’l Law 215 (1993). This screening process is more likely to deny a debtor bankruptcy protection for the purpose of reorganization and is more likely to terminate reorganization proceedings at an earlier stage than the system in the United States. In either case, the Canadian system favors liquidation over reorganization in questionable cases. George G. Triantis, The Interplay of Liquidation and Reorganization in Bankruptcy: The Role of Screens, Gatekeepers, and Guillotines, working paper on file with author, at 21.
errors and concentrate on the delay associated with type I errors—trying to save the unsavable.

II. PROPOSALS FOR CHANGE IN CHAPTER 11

What can and should the Bankruptcy Review Commission learn from these costs and what can and should the Commission do? The Commission should focus on the costs of delay and on the related direct costs of bankruptcy. As noted above, reducing delay once a debtor is in bankruptcy may itself have a greater impact on the direct costs than anything else that can be done.

The simple-minded way to attack delay and the direct costs of bankruptcy is to do what Congress did to a limited extent in 1994; namely, to attempt to limit the exclusivity period by shortening the 120 days in § 1121(b) and by restricting the judges’ power to extend that period. While limits of that sort may be desirable, much more subtle tools are necessary to defeat the likes of Harvey Miller when it is in the interest of Harvey’s client to slow down a Chapter 11. What could be done? Consider some possibilities.

A. PAY TRUE COSTS

First, the Commission should consider the reversal of United Savings Association v. Timbers of Inwood Forest Associates, Ltd. Recall that in Timbers, the Supreme Court held that protection was “adequate” even though it did not protect the secured creditor’s lost opportunities. Section 361 could require that the debtor not only accrue but actually pay an amount equal to a fair return on the value of the secured creditor’s collateral. Thus, if the creditor had a $1 million loan secured by a $1 million asset and ten percent were the appropriate rate of return, the debtor would be obliged to pay $8,300 each month to the secured creditor. Payments of that sort might discipline not only the debtor, but also the unsecured creditors, and the counsel of both. Moreover, it would end a subsidy now given by the secured creditors to the unsecured creditors and others during the pendency of a Chapter 11 proceeding.

B. CUT OFF FUNDING

Second, the Commission might gradually diminish the level of payment, even to zero, to lawyers, accountants and investment bankers. Thus, one might

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27 11 U.S.C. § 1121(c)(1), (2), (3) (1994). Where the debtor decides to be treated as a small business, the exclusivity period is 100 days. This period may be extended only on a showing of circumstances beyond the debtor’s control. Id. § 1121(c)(3)(B).


29 11 U.S.C. §§ 503(b)(1)(A), 507(a)(1), 1129(a)(9) (1994). Any change to the treatment of administrative expenses may modify behavior of the participants in strategic and unintended ways; for example, fees might be front-loaded to avoid restrictions on fees later. The law could also give bonuses for speedy proceedings.
provide that a judge who is setting fees should normally make no payments for services rendered more than six months after the petition is filed and should scale down the payments for services made more than ninety days after the filing of the bankruptcy petition. If such limitations were properly applied, they would reverse the current incentives of the Chapter 11 agents. The selfish interest of lawyers, accountants and investment bankers now favors delay; how much more wonderful if their incentives favored a hasty conclusion.  

C. INITIATE EARLY ASSESSMENT BY A NEUTRAL  

Third, one might adopt a variant of the French\(^3\) or Canadian\(^2\) system.

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30Debtors might even be encouraged to solicit competitive bids from potential agents. See, e.g., In re Oracle Sec. Litig., 132 F.R.D. 538 (N.D. Cal. 1990) (the court relied upon a competitive bidding process to select class counsel in securities litigation), reconsideration denied, 136 F.R.D. 639 (N.D. Cal. 1991).

31French law is designed to provide failing firms assistance before the need for bankruptcy arises. This "preventive maintenance" involves the use of business experts who monitor the financial statements of member firms and offer help at the first sign of trouble. Debtors may also seek court help when it is apparent that the debtor will be in need of funds. In such cases, the court may appoint a conciliator who will assist the company in workouts with its creditors. If these measures fail, any party may file for the debtor's bankruptcy (technically only when the debtor cannot pay its debts).

In 1986, the French bankruptcy laws where reformed to save failing firms and maintain employment. Satisfaction of the creditors' claims is no longer the primary priority of bankruptcy, although it is still a significant consideration. Creditors are protected in other ways, such as the ability to pursue corporate management for the debts of the corporation.

Bankruptcy begins with a screening process where the debtor's financial statements are reviewed to determine if a plan should be proposed or whether liquidation should be commenced. This period of review has been shortened with the 1986 reforms in order to reduce costs and to simplify the procedure (no more than eighteen months). An Administrator may be appointed at the outset of bankruptcy to supervise the process and propose a plan, or the debtor may retain these functions. Employee committees are given a greater role in rehabilitation proceedings. After the screening process, the court will determine if a proposed plan should be adopted or liquidation of the company would be best.

The Canadian legislature enacted a new federal Bankruptcy and Insolvency Act ("Act") in 1992 because prior insolvency laws were not binding upon secured creditors. The Act provides the debtor a "waiting period" from all claims, including those of secured creditors.

A debtor can initiate a reorganization by filing a notice of intention to make a proposal or by filing the actual proposal it wishes to make to its creditors. The Act provides the debtor a "waiting period" from all claims, including those of secured creditors.

A debtor can initiate a reorganization by filing a notice of intention to make a proposal or by filing the actual proposal it wishes to make to its creditors. However, the timetable under which the debtor must act is more demanding than the United States counterpart. If the debtor files a notice of intention, it has thirty days to file the proposal. The time period may be extended for additional periods of up to forty-five days, but the debtor is limited to a total of five months in extensions. A creditor may oppose an extension on various grounds, including that the creditor's agreement to a proposal will not happen within the time limits, or at all. Within ten days after filing a notice of intention to make a proposal, the debtor must file a projected cash flow with its own report and a report from the trustee on the reasonableness of the projected cash flow. These reports will assist creditors and the court in assessing the viability of the proposed reorganization.

The Act also provides guidelines for creditors to follow in evaluating a proposal. Further, the Act does not allow parties to alter or terminate an agreement with the debtor, or to claim an accelerated payment simply because the debtor has filed a petition. The new Act, however, does not prevent a supplier from requiring payments on a C.O.D. basis, nor does it require that anyone make further advances of money or credit to the debtor after the filing. D. J. Kee & Elizabeth A. Scott, Canada, 27 INT'L LAW. 215 (1993); George O. Triantis, The Interplay of Liquidation and Reorganization in Bankruptcy: The Role of Screens, Gatekeepers, and Guillotines, working paper on file with author. See supra note 26.
Under the French reorganization system, an official is appointed to determine whether the firm can and should be reorganized or whether it should be liquidated. Chapter 11 might be amended to provide either that the United States trustee or an appointed trustee make a finding not more than 120 days after the petition whether the debtor should be liquidated or reorganized. Upon the former conclusion, the debtor would be put into Chapter 7. If one could find trustees capable and tough enough to make this decision, and if adequate standards could be established concerning which firms should be reorganized and which should be liquidated, these rules might have a substantial impact on the time the debtor spends in bankruptcy.

D. APPOINT A TRUSTEE

Fourth, one might replace the debtor-in-possession with a trustee if no plan has been confirmed within six months after the filing of the bankruptcy petition. This would stimulate both the debtor-in-possession and the debtor-in-possession’s agents (who might be replaced if a trustee were appointed) to prepare and present a plan of reorganization.

E. REDUCE INCENTIVES

Fifth, the Commission should consider the incentives buried in and associated with the administrative rules such as those found in §§ 361, 363 and 364 and make Chapter 11 less inviting to those who should not be there. If, for example, creditors who lend to debtors in Chapter 11 were not automatically elevated under §§ 364(a) and 503(b)(1) to administrative expense status, and if others could not so readily attain even higher status under the other subsections of § 364, creditors themselves would have to distinguish between the sheep and the goats.

If the Commission is persuaded that too many linger in Chapter 11 before they suffer the inevitable liquidation, it seems that the solution to that problem does not lie in harsher timetables under § 1121 but, rather, in the manipulation of the administrative powers such as §§ 361, 362 and 364 in ways that directly affect the incentives of Chapter 11 agents, suppliers, postpetition lenders and others. Doubtless there are more subtle incentives that I have not thought of, but in general the Commission should work on the incentives of the Chapter 11 participants. It should not attempt to solve delay simply by timetables that can be waived.


F. Encourage Liquidation

My proposals and those of all the Chapter 11 critics reject the subtext found in Chapter 11 by many courts, namely that one should err on the side of reorganization as opposed to liquidation and spare no expense in the search for a way to reorganize. The revised statute should rectify that mistake; it should encourage not just liquidation or sale, but quick liquidation or sale. Few Chapter 11's ever produce a successful reorganization plan; that datum should spawn skepticism not optimism about the prospects for reorganization in Chapter 11. Congress should tell the courts that they have served just as well—or better—when there is a quick liquidation or sale as when there is a reorganization.

G. Consider Radical Proposals

Finally, the Commission should consider at least some part of the comparatively radical proposals that have been made in the academic debate during the last ten years. Most of these proposals have not been worked out in careful detail; many of them would require amendment to dozens of sections in Chapter 11. To authorize the form of buyout contemplated by Adler, successions contemplated by Bradley and Rosenzweig, or sales of slices of equity of the kind suggested by Roe would require complicated and detailed drafting. New sections would have to be integrated with existing law. These new sections would interact with existing law in ways that cannot readily be anticipated. It may be beyond reason to believe that the Commission in two years' time could fully

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35See United Sav. Ass'n v. Timbers of Inwood Forest Assocs. Ltd. (In re Timbers of Inwood Forest Assocs. Ltd.), 793 F.2d 1380, 1408 (5th Cir. 1986) (“In many Chapter 11 cases ... the likely result of orders requiring periodic postpetition interest payments to undersecured creditors will be the immediate conversion to Chapter 7—a result which seems inconsistent with the congressional policy favoring attempts at reorganization.”); Bonner Mall Partnership v. U.S. Bancorp Mortgage Co. (In re Bonner Mall Partnership), 2 F.3d 899, 914 (9th Cir. 1993) (in determining that the new value exception survived the Code’s enactment, the Ninth Circuit observed that “the new Chapter 11 shifted bargaining power away from creditors and in favor of debtors. Consequently, it made plan confirmation easier. ... [W]e believe that the structural changes to the reorganization process made by the Code are in harmony with the pro-confirmation principle underlying the new value exception.”), cert. granted, 114 S. Ct. 681, motion to vacate denied & dismissed as moot, 115 S. Ct. 386 (1994); Rochman v. Northeast Utilities Serv. Group (In re Public Serv. Co.), 963 F.2d 469, 471–72 (1st Cir.) (recognizing the public policy favoring orderly reorganizations and settlement of the debtors’ estate in bankruptcy proceedings), cert. denied, 113 S. Ct. 304 (1992); In re Ford Business Forms, Inc. v. Sure Card, Inc., 180 B.R. 294, 299 (Bankr. S.D. Fla. 1994) (“Whereas the aim of a Chapter 7 liquidation is the prompt closure and distribution of the debtor’s estate, Chapter 11 provides for reorganization with the aim of rehabilitating the debtor and avoiding forfeitures by creditors”); In re AV.B.I., Inc., 143 B.R. 738, 739 (Bankr. C.D. Cal. 1992) (“Chapter 11 is designed to foster consensual plans of reorganization.”).

36See supra note 8.


incorporate any of those in a detailed way. Nevertheless, small parts of these radical suggestions might be picked out and enacted. The suggestions made above—appointing a trustee or authorizing the United States Trustee or the court to order a liquidation or sale of a company on relatively short notice—is not beyond the power of the Commission.

CONCLUSION

Let us hope that the Bankruptcy Review Commission does not condemn the next generation to drone through the weather at 10,000 feet and 200 knots when that generation could be cruising high above in the clear at 450 knots.