Testimony of

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"Circuit City Unplugged: Why Did Chapter 11 Fail To Save 34,000 Jobs?"

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The National Bankruptcy Conference (the "Conference") appreciates the opportunity to participate in these oversight hearings on problems created by provisions of the 2005 Amendments to the Bankruptcy Code that adversely affect the reorganization of debtors under chapter 11 of the Bankruptcy Code. The Conference is a voluntary, non-

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profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws. Attached to this statement is a Fact Sheet about the Conference, including a list of its Conferees.

With a sharp downturn in the economy that seems to have no parallel since the Great Depression, many businesses and jobs are at risk. In this environment, the ability of chapter 11 to serve as a viable tool for the reorganization of business enterprises—both large and small—and for the preservation of jobs has assumed increased importance. The Conference believes that certain provisions of the 2005 Amendments unnecessarily impede the reorganization of debtors under chapter 11 and adversely affect the ability of chapter 11 to serve its rehabilitative purposes, preserve jobs, and preserve value for all constituencies in chapter 11 cases. Further, these same provisions create unwarranted "carve-outs" from the operation of generally applicable principles of bankruptcy law and grant unwarranted special treatment, for the benefit of certain economic constituencies, at the expense of chapter 11's rehabilitative function. We therefore commend the Subcommittee for focusing on these issues.

Three of the changes made by the 2005 Amendments, while generally applicable to all businesses in chapter 11, have particularly adverse implications for the ability of

retailers and other businesses with multiple locations that sell products to the public (such as restaurants) to reorganize under chapter 11. These three changes:

- provide vendors whose pre-chapter 11 claims against the debtor would otherwise be treated as general, unsecured claims, subject to modification under a plan, with: (x) first priority administrative claims that must be fully paid in cash in order for the debtor to emerge from chapter 11, for goods delivered within twenty (20) days before the chapter 11 filing, and (y) a substantially expanded right to reclaim goods delivered to the debtor before the chapter 11 filing (§§ 503(b)(9), 546(c));

- limit a debtor or trustee to a period of no more than 210 days from the date of the filing of a chapter 11 case to decide whether to assume (keep) or reject (abandon) a lease for an operating business location, unless the landlord agrees to a longer period (§ 365(d)(4)). This deadline substantially increases the risk of (i) improvident decisions to assume or reject leases based on insufficient operating data, and (ii) the premature closure of store locations (and elimination of related jobs);

- require a debtor to provide each utility from which it receives services with a deposit of cash or cash equivalents, no matter how good the debtor's pre-petition payment record, or how low the risk of non-payment, thereby placing further strains on the liquidity of already cash-constrained chapter 11 debtors (§ 366)).

To place the impact of erecting additional hurdles to the reorganization of retailers on the economy and on jobs in context, one need only review the accelerated pace of chapter 11 filings by substantial retailers over the last twelve months. Some of those chapter 11 filings are listed in Chart 1 on the next page.

CHART 1

Selected Retail Bankruptcy Filings for the period 1-1-2008 through 2-13-2009

No.	Name of Debtor	Date of Filing and Location	Annual Sales	Liabilities	No. of Locations	No. of Employees
1.	Circuit City Stores, Inc. (electronics)	11/10/2008 USBC – Eastern District of Virginia	$11.74 billion	$2.3 billion	721	39,600
2.	Mervyn's Holdings, LLC	07/29/2008 USBC – Delaware	$2.5 billion	$359 million	177	18,000
3.	Linens Holding Co. (home furnishing)	05/02/2008 USBC – Delaware	$2.8 billion	$1.4 billion	589	17,500
4.	KB Toys, Inc. (toys, games)	12/11/2008 USBC – Delaware	Figures unavailable	$192.5 million	461	10,850
5.	Goody's Family Clothing Inc. (clothing, shoes, accessories)	06/09/2008 USBC – Delaware 01/13/2009 USBC - Delaware	$1.1 billion	$443 million	355	9,868
6.	Steve & Barry's Manhattan LLC (clothing)	07/08/2008 USBC – Delaware	$656.6 million	$638 million	276	9,695
7.	Boscov's, Inc.	08/24/2008	$1.25 billion	$479 million	49	9,500

No.	Name of Debtor	Date of Filing and Location	Annual Sales	Liabilities	No. of Locations	No. of Employees
	(clothing, home-furnishings)	USBC – Delaware				
8.	Hoop Holdings, LLC (Disney stores)	03/26/2008 USBC – Delaware	Figures unavailable	$55 million	306	8,233
9.	Gottschalks, Inc. (clothing, make-up, shoes accessories)	01/14/2009 USBC - Delaware	$557 million	$112 million	62	5,282
10.	Value City Department Stores (clothing, accessories, electronics, home furnishing)	10/26/2008 USBC – Southern District of New York	$288,542,992.00	$101 million	64	4,500
11.	Friedman's, Inc. (jewelry)	01/22/2008 USBC – Delaware	Figures unavailable	$165 million	473	3,490
12.	Whitehall Jewelers Holdings, Inc. (jewelry)	06/23/2008 USBC – Delaware	$242.9 million	$112 million	373	2,852
13.	Sharper Image Corporation (personal electronic products)	02/19/2008 USBC Delaware	$211 million	$199 million	184	2,246
14.	Fortunoff Holdings, LLC (jewelry, gifts, home furnishing & housewares)	02/05/2009 USBC – Southern District of New York (purchased	$260 million	$139 million	20	1,780

No.	Name of Debtor	Date of Filing and Location	Annual Sales	Liabilities	No. of Locations	No. of Employees
		out of Case No. 08-10353 on 3/07/2008)				
15.	Wickes Holdings LLC (furniture)	02/03/2008 USBC – Delaware	$396 million	$208 million	48	1,459
16.	Shoe Pavilion, Inc.	0715/2008 USBC – Central District of California	$154 million	$11.2 million	117	1,400
17.	Uni-Marts, LLC (convenience stores/gas stations)	05/29/2008 USBC- Delaware	$550 million	$41.9 million	283	1,250
18.	Tweeter Opco, LLC (electronics)	11/05/2008 USBC – Delaware	Figures unavailable	$50.3 million	90	1,100
19.	S & K Famous Brands, Inc. (men's apparel)	02/09/2009 USBC – Eastern District of Virginia	$22 million net loss for 2008 $2.78 million income in 2007	$20 million	136	1,095
20.	Against All Odds USA, Inc. (clothing)	01/05/2009 USBC - New Jersey	$114,000,000	$35 million	64	1,038

No.	Name of Debtor	Date of Filing and Location	Annual Sales	Liabilities	No. of Locations	No. of Employees
21.	B. Moss Clothing Company, Ltd. (clothing)	12/02/2008 USBC – New Jersey	$50,678,000.00	$10.8 million	70	703
22.	Harold's Stores, Inc. (men's apparel)	11/07/2008 USBC – Western Dist of Oklahoma	$7,714,000 net loss prior to petition date	$39.4 million	43	559
23.	Shane Co. (jewelry)	01/12/2009 USBC – Colorado	$207 million	$79 million	23	542
24.	Mattress Discounters Corp. (mattresses and bed frames)	09/10/2008 USBC – Maryland	$125 million	$18.5 million	140	477
25.	Blue Tulip Corporation (gifts and personalized items)	01/05/2009 USBC – Delaware	Figures unavailable	$7.3 million	24	390
26.	Marty's Shoes Holdings, Inc. (shoes)	09/12/2008 USBC – Delaware	Figures unavailable	$23.2 million	47	250
	Totals provided for locations and employees				5,195	153,659

The information provided herein came from the Debtors' bankruptcy filings and other publicly available information. (which is identified in the Appendix hereto; copies of the underlying source material can be provided upon request)

Moreover, for reasons similar to those applicable to retailers, the provisions of the 2005 Amendments summarized above also adversely affect the ability of financially troubled restaurant chains--who employ thousands of workers—to reorganize. The listing of chapter 11 filings by substantial restaurant chains over the last twelve months in Chart 2 below helps place this impact in economic context.

CHART 2

Selected Restaurant Chapter 11 Filings for the period 1-1-2008 through 2-13-2009

No.	Name of Debtor	Date of Filing and Location	Annual Sales	Liabilities	No. of Locations	No. of Employees
1.	Buffets Holdings, Inc. (steak-buffet restaurants)	1/22/2008 USBC – Delaware	Figures unavailable	$898 million	642	36,000
2.	Steakhouse Partners Inc. (steakhouse restaurant chain)	05/15/2008 USBC – Southern District of California	$45 million	$26 million	21	1,325
3.	VI Acquisition Corp. VICORP Restaurants (Baker's Square and Village Inn)	04/03/2008 USBC – Delaware	$106 million	$42.7 million	306	12,750
	Totals provided for locations and employees				969	50,075

The information provided herein came from the Debtors' bankruptcy filings and other publicly available information. (which is identified in the Appendix hereto; copies of the underlying source material can be provided upon request)

In the aggregate, the retailers and restaurants listed in Charts 1 and 2 employed more than 200,000 individuals when they filed their chapter 11 cases. Thus, provisions of the 2005 Amendments that impede the ability of such businesses to reorganize are cause for concern.

We understand that the Subcommittee is also interested in our views on the effect of the 2005 Amendments in general, and not just those that affect retail debtors. In this regard, the Conference also believes that certain provisions included in the 2005 Amendments that are specific to chapter 11 cases for small businesses and individuals place unwarranted impediments on the ability of chapter 11 to accomplish its rehabilitative purposes for such businesses and individuals, and should be eliminated. Finally, the Conference believes that certain provisions of the Bankruptcy Code relating to the special treatment of financial contracts, while not enacted by the 2005 Amendments, merit focused revision.

A. Provisions of the 2005 Amendments that Adversely Affect the Reorganization of Retailers and Other Chapter 11 Debtors

1. The New Vendor Administrative Priority and Expanded Reclamation Rights.

Generally speaking, absent a specific statutory grant of priority, unsecured claims that arise against a debtor before it files its chapter 11 case ("pre-petition claims") are entitled to equal treatment. A chapter 11 plan can modify such claims in a variety of ways to accommodate the debtor's liquidity constraints and to comport with its enterprise value, so long as certain requirements for plan confirmation that are designated to protect creditors are satisfied. Thus, a chapter 11 plan can modify general unsecured claims by

changing debt maturities, amortization, and interest rates; converting debt to equity; satisfying claims at a discount; and eliminating junior classes of claims where there is insufficient enterprise value to leave any residual value for such claims.

The ability to effect such modifications is not, however, unbridled; the plan must comply with statutory plan confirmation requirements that protect general unsecured creditors, including the following:

- A creditor who rejects a plan must receive at least as much value as it would receive in a liquidation under chapter 7 of the Bankruptcy Code (the "straight bankruptcy" provisions). 11 U.S.C.§ 1129(a)(7).

- Where a class of claims does not accept a plan by a majority in number and two-thirds in amount of the claims actually voted on the plan, the plan must be "fair and equitable" to the dissenting creditor class, and may "not discriminate unfairly" against that class. *Id.* § 1129(b).

- The plan must provide the "same treatment" for each claim in a creditor class, unless a particular creditor agrees to less favorable treatment. *Id.* § 1123(a)(4).

- The plan must be "feasible" (*id.* § 1129(a)(11)), i.e., the court must conclude that the plan has a reasonable chance of success, considering such factors as the earning power of the business, the adequacy of its capital structure, economic conditions and the competency of management.

Taken together, these provisions help ensure that general unsecured creditors are treated fairly and equally in the context of the available liquidity and enterprise value. Importantly, however, the debtor is not required to pay all pre-petition claims in full immediately after a confirmed plan of reorganization becomes effective – ordinarily, an impossible task, given the economic difficulties that propelled the debtor into chapter 11 in the first place.

In contrast, claims which are granted priority as costs of administration ("administrative claims") must be paid *in full*, *in cash*, no later than on the effective date of a plan of reorganization, unless a particular creditor agrees to different treatment. There is no mechanism for the non-consensual treatment or modification of an administrative claim under a chapter 11 plan. Thus, as a practical matter, a substantial increase in the administrative claims against the debtor will produce a corresponding increase in the demands on the debtor's already-constrained cash and cash flow. The debtor will have substantially less cash available to fund operations, address deferred maintenance (a not uncommon problem of financially distressed debtors) and make improvements; will have to borrow substantial additional funds at high interest rates and emerge from chapter 11 with more debt and leverage to cover the additional administrative claims (assuming that financing is even available); or will have to resort to some combination of both. The 2005 Amendments provided for just such a substantial increase in administrative claims, with just such consequences.

Prior to the 2005 Amendments, pre-petition claims of vendors for goods sold to a debtor ordinarily constituted general, unsecured claims which, as indicated, do not have

to be paid in full in cash in a chapter 11 reorganization, and can be modified under a plan. The 2005 Amendments, however, elevated, to the status of an administration claim, any claim of a vendor for goods delivered to the debtor in the ordinary course of business during the twenty days before bankruptcy. The effect of this change, in the case of a large retailer, is that tens or hundreds of millions of dollars in pre-petition unsecured claims that could otherwise have been modified under a plan, without being paid in full, must instead be paid in full and in cash—this, by a debtor whose very liquidity problems led to the chapter 11 filing in the first place. If the debtor cannot pay those claims in full or obtain the new financing necessary to do so, it will have to shut its doors and liquidate.

To illustrate the problem, if a chapter 11 debtor has $250 million of pre-petition vendor claims for goods sold that are treated as general unsecured claims, the chapter 11 plan can modify those claims without the debtor having to come up with $250 million in immediate cash payments to reorganize and emerge from chapter 11. In contrast, if these same pre-petition vendor claims are treated as administrative claims because of the 2005 Amendments, the debtor will have to pay $250 million to those creditors to emerge from chapter 11. If the debtor cannot do so, it will have to liquidate. Even if the debtor can do so, it will have to divert funds from operations, maintenance and improvements and/or borrow additional funds, incur additional financing costs and add to its leverage. Moreover, to the extent that such post-2005 Amendment administrative vendor claims for pre-petition deliveries are paid earlier in the case—for example, because the bankruptcy court may require such payment of such administrative vendor claims on a parity with the administrative claims of vendors for the post-petition delivery of goods which are

typically paid in the ordinary course of business--such additional claims can place additional cash constraints on the debtor's operations early in the case.

The 2005 Amendments further increased the cost of resolving pre-petition vendor claims by greatly expending the reclamation rights of vendors of goods.[2] Prior to the 2005 Amendments, a vendor who sold goods to the debtor in the ordinary course of business while the debtor was insolvent could, if the a vendor had a legal right of reclamation under non-bankruptcy law, exercise that right with respect to goods delivered to the debtor up to *ten* days before the bankruptcy filing. The 2005 Amendments more than quadrupled the reclamation "reach-back" period to *forty-five days* before the bankruptcy filing, and arguably created a new "federal" right of reclamation which may exist even if the seller would not have been entitled to reclaim its goods under state law. These new, post-2005 Amendment reclamation rights can create still further demands on the cash flow of a struggling retail debtor, while imposing on the debtor the administrative burden and cost of responding to such claims.

In sum, the special, preferential treatment accorded to the claims of vendors of goods by the 2005 Amendments can substantially impede the successful reorganization of retailers, restaurants, and other businesses that purchase and sell goods. The Conference believes that these changes should be repealed.

2. Limitation on the Time Within Which a Debtor or Trustee May Assume or Reject a Lease of Non-Residential Real Property to 210 Days From the Petition Date

One of the important powers granted to a chapter 11 debtor or trustee is the right to assume or reject an executory contract or unexpired lease. Generally speaking, the "assumption" of a contract enables the debtor or trustee to retain the benefits of the contract and bind the other party to continued performance, but requires that the debtor or trustee cure defaults and provide adequate assurance of future performance. Upon assumption, the contract becomes an administrative (i.e., first priority) liability of the chapter 11 estate and, following confirmation of a plan, will remain an ongoing liability of the reorganized debtor. In contrast, if the debtor rejects an executory contract, the debtor will no longer be entitled to the other party's performance, or be obliged to perform, under the contract, and the other contract party will (except to the extent of any security deposit) have a pre-petition, general unsecured claim for damages for breach of contract that may be modified under a plan of reorganization in the same manner as the other general unsecured claims.

Recognizing the importance of allowing a chapter 11 debtor—particularly, a large enterprise that may have thousands of contracts—to make an informed decision on the assumption or rejection of each executory contract or unexpired lease, the Bankruptcy Code generally allows a debtor until the confirmation of a plan of reorganization to assume or reject an executory contract or unexpired lease, subject to the power of the

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[2] In essence, a reclamation right is a right of a vendor to "reclaim" the goods, rather than simply having a general, unsecured claim for the price of the goods.

bankruptcy court to shorten the time for assumption or rejection of a particular contract or lease for "cause."

Prior to the 2005 Amendments, the rule governing the period to assume or reject an unexpired lease of non-residential real property under which the debtor is the tenant was somewhat different, but still gave the court considerable flexibility. Specifically, Bankruptcy Code § 365(d)(4) required the trustee or debtor to assume or reject such a real property lease within sixty days after the bankruptcy filing; but this period could be extended "for cause," and typically was extended, particularly in large chapter 11 cases.

The 2005 Amendments amended Bankruptcy Code § 365(d)(4) to (i) extend the initial period to assume or reject nonresidential real property leases from 60 to 120 days after the chapter 11 filing, but (ii) limit any extension of the 120-day period to 90 additional days, thus giving the trustee or debtor in possession a maximum of 210 days after the chapter 11 filing to assume or reject every one of its nonresidential real property leases, except where the landlord agrees to a longer extension.

It is critical to note that even before the 2005 Amendments, the Bankruptcy Code already protected (and still protects) the landlord during the period prior to assumption or rejection of a lease by requiring, in Section 365(d)(3), that the trustee or debtor in possession must timely perform all of the obligations of the debtor under a real estate lease arising from the time the bankruptcy petition is filed, until that lease is assumed or rejected (except for "ipso facto" bankruptcy termination clauses and covenants relating to the debtor's insolvency or financial condition). Thus, the debtor is already required to pay all post-petition rent and perform all other post-petition obligations under the lease

until the lease is assumed or rejected. It is because of this statutory protection accorded to landlords that courts were flexible in extending the assume/reject period for real estate leases prior to the 2005 Amendments. Despite this protection, the 2005 Amendments took away the court's flexibility to extend the assume/reject period beyond the new 210-day limit.

The adverse impact of this 210-day limitation is best understood in the context of the cost to a debtor of the premature assumption or rejection of a lease. If the debtor assumes a lease, then any claim for a subsequent breach or abandonment of the lease constitutes a first priority administrative claim, which must be paid in full in cash on the effective date of a plan unless the landlord agrees otherwise; or, if the claim arises after the confirmation of a plan, constitutes a post-confirmation liability of the reorganized debtor that is not discharged. Although the Bankruptcy Code generally limits the administrative claim for breach of an assumed real property lease to two years' worth of monetary obligations under the assumed lease, *see* 11 U.S.C. § 503(b)(7), such an administrative claim can still require a substantial cash outlay. Moreover, once the debtor confirms a plan and emerges from chapter 11, the two-year "cap" will not apply to any subsequent claim by the landlord for breach or abandonment of the assumed lease. Faced with the potential cost of a premature and improvident lease assumption, the debtor may be forced to err on the side of rejecting leases for locations that might have proved profitable (and firing all the employees who work at such locations), once the 210-day deadline is impending.

The 210-day time limit to assume or reject leases can be particularly problematic in the case of retailers with highly seasonal businesses, because such retailers and their creditors may be forced to commit to a business plan involving the closure of certain locations before they have had a fair opportunity to evaluate whether operational turnaround efforts to improve underperforming locations have succeeded. For example, if a retailer files a chapter 11 case right after the Christmas holiday season (which is not uncommon), the 210-day time limit will force it to decide which locations to retain and which to close *before* the next holiday season. This is a significant obstacle to informed decision-making, because the last quarter of the year (with the holiday season) is typically the most profitable quarter for a retailer (indeed, the first nine months may be break even at best). Thus, the debtor will have to make its "close - do not close" decision without the benefit of any information regarding the impact of its business and operating changes on operating results during the most important quarter of the year.

Moreover, the 210-day limitation on the time to assume or reject contracts also creates incentives and precipitates lender demands (via post-petition debtor in possession financing arrangements) for the liquidation of retailers if they are not refinanced or a buyer of the debtor's business obtained within the first 30 or 60 days of a chapter 11 case. Generally, the lender has a lien on the inventory and recognizes that the inventory has to be liquidated in place or it will lose substantial value. As a result, the lender imposes onerous conditions as part of its debtor in possession financing that force liquidations, because the lender wants the inventory liquidated before the leases have to be rejected, the premises vacated and the inventory moved elsewhere. This is an absolute condition

weighed by every secured lender to a retail organization, and it is a major precipitating factor in the chapter 11 liquidation of retailer debtors.

For all of these reasons, the Conference believes that the inflexibility of the 210-day time limit is unwarranted and that this fixed time limit for the assumption or rejection of non-residential real property leases should be eliminated.

3. The Imposition of Stringent Cash Deposit Requirements In Favor of Utilities.

Bankruptcy Code § 366 requires that a chapter 11 debtor afford providers of utility services with "adequate assurance of payment." The 2005 Amendments modified Section 366 so that it virtually compels a debtor or trustee to provide each utility with a deposit of cash or cash equivalents satisfactory to the utility. In the case of a retailer or other debtor with many locations, this requirement can impose substantial additional cash requirements on an already cash-strapped debtor, and divert cash from operations and/or impose additional financing costs on the debtor, early in the case.

Prior to the 2005 Amendments, a utility was entitled to "adequate assurance of payment;" but, the term was not defined; and a court could find that a first priority administrative claim for post-petition utility services constituted "adequate assurance of payment," without requiring a cash deposit, and could be more flexible in the case of a debtor that had a good record of paying its utility bills. Moreover, there was no presumption in favor of the form of "adequate assurance" demanded by the utility.

The 2005 Amendments changed these rules. An administrative expense priority can no longer constitute "adequate assurance of payment"—the utility can demand cash

or a cash equivalent. Section 366 now provides explicitly that "an administrative expense priority shall not constitute an assurance of payment" and now defines "assurance of payment" to mean a cash deposit; letter of credit; certificate of deposit; surety bond; prepayment; or "other form of security that is mutually agreed on between the utility and the debtor or the trustee." Moreover, a utility is given the right to discontinue service if "the utility does not receive from the debtor or the trustee adequate assurance of payment for utility service that is satisfactory to the utility" within thirty days of the chapter 11 filing. Although the court is given the power to modify the amount of the assurance of payment demanded by the utility, the court may not, in so doing, consider the debtor's timely payment for utility service before the chapter 11 filing; the fact that no security was required before the chapter 11 filing; or the availability of an administrative expense priority.

There are certainly cases where an administrative claim alone may not be sufficient to provide a utility with "adequate assurance of payment" because of the risk of an administratively insolvent estate. In its current form, however, Section 366 does not permit the court to consider any option other than a security deposit of cash or cash equivalents. For example, in its current form, the statute would not permit a court to consider a combination of an administrative claim plus utility-friendly provisions in the secured debtor in possession financing facility (such as a "carve-out" of some sort), to function as "adequate assurance of payment" in lieu of a security deposit. This is simply too inflexible a construct.

Taken together, these provisions now enable utilities to impose substantial cash demands on a debtor at the outset of a chapter 11 case, thereby limiting the cash available for operations in the critical early months of a chapter 11 case. The Conference believes that these changes should be repealed.

B. 45-Day Confirmation Time Limit in Small Business Chapter 11 Cases

In a chapter 11 "small business case" (defined in § 101(51C)), Section 1129(e) requires that plan confirmation be "not later than 45 days after the plan is filed unless the time for confirmation is extended in accordance with Section 1121(e)(3)." The 45-day limit has proven to be difficult and, in some situations impossible, to satisfy. *See Caring Heart Home Health Corp., Inc.*, 380 B.R. 908 (Bankr. S.D. Fla. 2008) (case dismissed because court set disclosure statement hearing beyond the 45-day limit). An extension of the 45-day time limit is possible under Section 1121(e)(3), but requires a cumbersome, time consuming and expensive hearing at which the debtor must demonstrate by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time. An easy solution to the problem is to extend the time limit to a more realistic 90 days.

After a chapter 11 plan is filed, a lot must occur before a plan can be confirmed. The court must approve a disclosure statement; notice of the confirmation hearing must be sent to all creditors; ballots accepting or rejecting the plan must be filed; a confirmation hearing must be held; and the court must enter a confirmation order. Under the best of circumstances it is difficult to accomplish all of this within 45 days.

Rule 2002(b)(2) of the Federal Rules of Bankruptcy Procedure requires that parties in interest, including all creditors, be given not less that 25 days notice of the time fixed for filing objections and the hearing to consider confirmation. Several things must happen before the 25-day notice can be given, including the approval by the court of a disclosure statement. Rule 2002(b)(1) requires a 25-day notice to parties in interest of the time fixed for filing objections and the hearing to consider approval of the disclosure statement. Taken together, the 25-day notice regarding the disclosure statement hearing and the 25-day notice regarding the confirmation hearing exceed the 45-day confirmation limit. Bankruptcy judges have the discretion in small business cases to (1) conditionally approve the disclosure statement (§ 1125(f)(3)(A)) and combine the disclosure statement hearing with the confirmation hearing (§ 1125(f)(3)(D)), (2) determine that the plan itself contains adequate information and that a separate disclosure statement is not necessary (§ 1125(f)(1)), and (3) approve a disclosure statement on a court approved form or an Official Form, but unless the court adopts one of these options, meeting the 45-day confirmation deadline is impossible.

Bankruptcy judges often conditionally approve disclosure statements in small business cases, but still, meeting the 45-day confirmation limit requires resourcefulness by the clerk's office and some scheduling good fortune. Typically, the 25-day notice of the confirmation hearing is not given for several days after the plan is filed, which reduces the time in which a confirmation hearing can be held and a decision made to a period of 10 to 15 days. If amendments to the disclosure statement are required or if extensive modifications to the plan are needed, confirmation within the 45-day limit cannot be achieved.

As previously mentioned, the 45-day time limit may be extended, but only after it has been shown by a preponderance of the evidence that it is more likely than not that the court will confirm a plan within a reasonable period of time. Most small business debtors have limited resources that could be better used to pay creditors than to fund an expensive hearing to prove that an unduly restrictive time limit should be extended.

The Conference recommends that the confirmation time limit in small business cases be expanded from 45 days to 90 days.

C. Discharges for Individuals Who Are Chapter 11 Debtors

The 2005 Amendments made significant changes with respect to individuals who are chapter 11 debtors, one of which repeatedly proves to be an impediment to their reorganization. Section 1141(d)(5)(A), in most cases, postpones an individual debtor's discharge until all plan payments have been completed, thus treating individual chapter 11 debtors very differently from business chapter 11 debtors and increasing the costs to these individual debtors. To address this problem, the Conference recommends that chapter 11 debtors who are individuals receive a discharge upon confirmation of their plans pursuant to Section 1141(d)(1)(A), as do chapter 11 debtors who are not individuals.

There are three types of discharges that are possible for an individual who is a debtor in a chapter 11 case. First, there is the discharge that is granted by the court "on completion of all payments under the plan" pursuant to Section 1141(d)(5)(A). The second type is the post-confirmation "early discharge" pursuant to Section 1141(d)(5)(B), which is similar to the chapter 13 "hardship discharge" under Section 1328(b), but

requires no hardship. Finally, there is the discharge that is granted pursuant to Section 1141(d)(5)(A) at a time other than when all payments are completed: The discharge is instead granted when "after notice and a hearing the court orders otherwise for cause."

Early post-confirmation discharges under Section 1141(d)(5)(B) are rare, and although courts occasionally allow a discharge to occur "for cause" prior to completion of plan payments, *see In re Sheridan*, 391 B.R. 287 (Bankr. E.D.N.C. 2008) (court allowed discharge upon confirmation where debtors gave conspicuous notice of the request for discharge, established the likelihood that all plan payments would be made, and provided assurance in the form of collateral that creditors would receive the amount promised even if all plan payments weren't made), most debtors who are individuals receive their chapter 11 discharge only after all payments have been made.

Granting a discharge upon completion of a plan works well in chapter 13 cases where, pursuant to Section 1322(d), a confirmed plan can not last longer than five years. In contrast, in chapter 11, plans may be for much longer durations. In addition to the administrative burden imposed on courts to attend to the case and determine when it may be closed, the larger difficulty is that as long as a case remains open, a chapter 11 debtor must continue to pay the quarterly fee required by 28 U.S.C. § 1930. The obligation to pay these fees is significant.

The amount of the quarterly fees is based on all disbursements made by the reorganized debtor, "including ordinary operating expenses." *Walton v. Jamko, Inc. (In re Jamko, Inc.)*, 240 F.3d 1312, 1313 (11th Cir. 2001); *In re Danny's Markets, Inc.*, 266

F.3d 523 (6th Cir. 2001). Even if a debtor has a very low net income, the fee will be calculated on the chapter 11 debtor's day to day operating expenses, and will range from a minimum of $325 per quarter for any debtor to as much as $30,000 per quarter in a very high disbursement case. The operating expenses for individuals who run businesses can be quite high, and payment of the quarterly fee over many years imposes an onerous and unfair burden on chapter 11 debtors who are individuals.

The Conference recommends that individual debtors in chapter 11 cases be granted a discharge pursuant to Section 1141(d)(1)(A) like other reorganized debtors in chapter 11. Alternatively, the discharge could be granted prior to the payment of all plan payments but after the payment of all plan payments required for a specified period of time, such as one year. This alternative serves the purpose of ensuring that the individual chapter 11 debtor establishes the likelihood of continued payment and protects creditors, without imposing excessively costly burdens on the individual debtors. Even this alternative, though, would result in quarterly fee payments totaling at least $1,400 by a chapter 11 debtor who is an individual. In the view of the Conference, the better plan is to grant discharges to individual debtors in chapter 11 cases under Section 1141(d)(1)(A).

D. Provisions Relating to the Treatment of Financial Market Contracts

1. Background

Commencement of a case under the Bankruptcy Code results in the imposition of an automatic stay of the exercise of most creditor remedies and collection efforts with respect to prepetition claims and contracts. In particular, the automatic stay generally blocks a non-debtor counterparty to prepetition contracts with the debtor from

(a) terminating the prepetition contracts notwithstanding the debtor's default,

(b) exercising its rights as a secured creditor to realize on any property of the debtor pledged to secure the obligations owing to it by the debtor under such contracts, and

(c) exercising any rights of setoff that it may have to recover amounts owing to it by the debtor by netting them against amounts that it owes to the debtor. Additionally, the Bankruptcy Code contains powerful avoidance provisions that generally permit a debtor to recover preferential transfers – prepetition amounts paid by an insolvent debtor on its debts that allowed some creditors to receive a higher recovery than other similarly situated creditors – and fraudulent transfers – prepetition transfers made with actual intent to hinder, delay or defraud creditors or by an insolvent debtor without receiving reasonably equivalent value in exchange.

Congress has determined on several occasions that the application of the foregoing provisions presents systemic risk to certain key financial markets, and therefore has added provisions to the Bankruptcy Code affording special protections to several types of financial market contracts: securities contracts; commodities contract; forward contracts; repurchase agreements; swap agreements; and master netting agreements. Each of these terms is separately defined in the Bankruptcy Code. Among other things, the special protections permit most non-debtor counterparties to protected contracts to:

(a) Exercise contractual rights triggered by the debtor's bankruptcy to terminate, liquidate and accelerate protected contracts, free from the automatic stay and most other stays.

(b) Exercise contractual rights to realize against collateral and set off obligations to recover amounts owing to them under protected contracts.

(c) Retain most amounts transferred to them under or in connection with protected contracts free from the Bankruptcy Code's avoidance provisions, except in cases of actual fraud related to such transfer.

These protections can be enormously valuable to a non-debtor counterparty to such a protected contract but are not available with respect to other prepetition contracts, such as loan agreements and normal commercial agreements. Over time, Congress has expanded these protections and the types of protected contracts covered by them. Important business practices have developed to take advantage of the special protections in ways that were taken into consideration by Congress when crafting the legislation. For example, "mortgage warehouse financing" – secured lending arrangements collateralized by mortgage loans – have largely been replaced by mortgage repo arrangements – repurchase agreements for the financing of mortgage loans. However, the potential exists for straightforward lending or commercial arrangements to be "disguised" or reconfigured in ways not contemplated by Congress to fit within the parameters of the Bankruptcy Code's definitions of repurchase agreements, swap agreements or other types of protected contracts. Indeed, in view of the current broad definitions of such terms, it takes very little imagination to reconfigure any loan and many types of commercial arrangements into what is facially a protected contract, even though such contract is unrelated to the markets sought to be protected by Congress. The potential for abuse is compounded by the fact that, in order to afford certainty to the markets, the courts are

afforded little or no discretion by the language of the Bankruptcy Code to weed out such abusive transactions.

2. Limitation of Types of Collateral Subject to Special Protections

The current special protections contain no limitation on the types of collateral against which a non-debtor counterparty may exercise contractual rights. Therefore, a non-debtor counterparty to a protected contract, such as a swap agreement, may exercise its secured party rights against the collateral posted for such agreement free from any bankruptcy stay, regardless of whether such collateral is cash or securities (as would be common for a swap agreement) or the debtor's principal plants, equipment and other operating assets (which would be quite uncommon for a legitimate swap agreement). Indeed, the use of uncommon collateral in what is otherwise facially a protected contract may be a strong indicator that the transaction is, in fact, a secured loan or commercial arrangement that has been documented to appear to be a protected contract.

The unfettered exercise of secured party rights against operating assets could end the debtor's prospects for reorganization, and thus likely lead to the termination of its employees and the loss of going concern values to other creditors and stakeholders. Where collateral is cash, securities or other fungible financial assets not used in the operation of the debtor's business, affording a non-debtor counterparty the right to realize on such collateral free from a stay, should not deprive the debtor of its reorganization prospects. In contrast, where the collateral is operating assets – which can often be unique or practically irreplaceable – not only does the type of collateral raise serious issues as to the bona fides of the transaction as a protected contract, but the loss of the

stay can be fatal to the debtor's reorganization prospects. Therefore, the Conference has been focusing on limiting the special protections related to the exercise of contractual rights against collateral to financial assets of types that are usual for legitimate protected contracts and whose loss does not present as high a level of risk to reorganization prospects. In particular, the Conference has been considering:

(a) limiting the stay exemption protections contained in Bankruptcy Code §§ 362(b), (6), (7), (17) and (27) for the exercise of secured party contractual rights under protected contracts to "financial collateral";

(b) defining "financial collateral" as:

(i) cash, cash equivalents, securities, instruments, certificates of deposit, mortgage loans, interest in a protected contract or property sold or to be sold in the performance of a protected contract, excluding any security or instrument issued or executed by the debtor or a person under common control with the debtor;

(ii) any other property not used in the operation of any business owned or conducted by the debtor or a person under common control with the debtor; and

(iii) any letter of credit, guarantee, reimbursement agreement or other credit enhancement issued or provided by a person other than the debtor for the obligations under such contracts;

(c) expressly excluding from "financial collateral" any receivable arising in the ordinary course of the business of the debtor or a person under common control with the debtor, any property that was not of a kind constituting financial collateral at the time of the filing of the petition, and the proceeds of such property.

The Conference has not completed its work with respect to the foregoing proposal as to financial collateral, but the work has sufficiently progressed that it was deemed appropriate to present at this time.

3. Distributions on Securities

Bankruptcy Code § 546(e) was designed to protect prepetition transfers under securities contracts from avoidance as preferential transfers or fraudulent transfers. For example, a mark-to-market margin payment under a securities purchase agreement, securities loan, margin loan, clearing advance or other securities contract might be subject to avoidance as a preferential transfer absent Section 546(e) protection. Similarly, Section 546(e) protects intermediaries in the national securities clearance process from avoidance exposure with respect to the transfers for which they act as intermediaries.

There has been disagreement among the courts as to the scope of the Section 546(e) protection with respect to payments to shareholders in connection with leveraged buyouts and similar transactions. Absent Section 546(e), shareholders who received payouts for their stock in connection with a leveraged buyout that rendered the target company insolvent may be vulnerable to recovery of their payouts as constructive fraudulent transfers by the target company's bankruptcy estate. The recovered amounts would be available to repay the target company's unpaid creditors. Some (but not all) courts have interpreted Section 546(e) sufficiently broadly as to immunize shareholders from such recoveries if they received their payouts through the national securities clearance or payment system, even though no securities contract was implicated and they are not themselves securities intermediaries. The Conference believes that this result is unfair and unnecessary to protect the securities markets.

To address this issue, the Conference suggests that:

(a) Section 546(e) be amended to exclude from its protection redemption payments, principal payments, dividend payments, interest payments or other distributions on or in respect of a security, made for the benefit of the beneficial holder of the security, by or on behalf of the issuer of the security or another entity obligated with respect to the security; and

(b) a new section be added to Bankruptcy Code § 550, which deals with the persons from whom an avoidable transfer may be recovered, to provide that payments so excluded from Section 546(e) can be recovered solely from the beneficial holder of the relevant security.

In this way, securities intermediaries would be protected from liability for any such payments that may pass through them, while preserving the ability for the bankruptcy estate to recover preferential or fraudulent transfers from the beneficial holders who receive them.

Appendix

Electronic resources

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1. In re Against All Odds, USA, Inc., Ch. 11 Case No. 09-10117 –DHS No. 1 and No. 13 (Bankr. D.N.J.)

2. In re B. Moss Clothing Company, Ltd. Ch. 11 Case No. 09-33980-NLW No. 1 and No. 17 (Bankr. D.N.J.)

3. In re Blue Tulip Corporation, Ch. 11 Case No. 09-10015-KG No. 1 and No. 3 (Bankr. Del.)

4. In re BSCV, Inc. et al., Ch. 11 Case No. 08-11637-KG No. 1 and No. 2 (Bankr. Del.)

5. In re Circuit City Stores, Inc. et al., Case No. 08-35653-KRH No. 1 and No. 22 (Bankr. E.D. Va.)

6. In re Fortunoff Holdings, LLC, Case No. 09-10497-RDD No. 1 and No. 14 (Bankr. S.D.N.Y.)

7. In re Friedman's, Inc., Case No. 08-10161-CSS No. 32 (Bankr. Del.)

8. In re Goody's Family Clothing, Inc. Case No. 08-11133-CSS No. 1 and No. 2. (Bankr. Del)

9. In re Gottschalks Inc., Case No. 09-10157-KJC, No. 1 and No. 14 (Bankr. Del)

10. In re Harold's Stores, Inc., Case No. 08-15027-TMW, No. 1 and No. 4 (Bankr. W.D. Ok.)

11. In re Hoop Holdings, LLC, Case No. 08-10544-BLS, No 1 and No. 3 (Bankr. Del.)

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14. In re Marty Shoes Holdings, Inc., Case No. 08-12129-KJC, No. 1 and No. 4 (Bankr. Del.)

15. In re Mattress Discounters Corp., Case No. 08-21642 No. 1 and No. 20 (Bankr. D. Md.)

16. In re Mervyn's Holdings, LLC, Case No. 08-11586-KG No. 1 and No. 2 (Bankr C.D. Cal.)

17. In re Shane Co., Case No. 09-10367-HRT, No. 1 and No. 22 (Bankr. Co.)

18. In re TSIC, Inc. Case No. 08-10322-KG, No. 1 and No. 3 (Bankr. Del.)

19. In re Shoe Pavilion, Inc. Case No. 08-14939-MT, No. 1 and No. 7 (Bankr C.D. Cal.)

20. In re S & K Famous Brands, Inc., Case No. 09-30805-KRH, No. 1 and No. 16 (Bankr. E.D. Va.)

21. In re Stone Barn Manhattan, LLC, Case No. 08-12579-alg, No. 1 and No. 14 (Bankr. S.D.N.Y.)

22. In re Tweeter Opco, LLC, Case No. 08-12646-MFW, No. 1 and No. 20 (Bankr. Del.)

23. In re Uni-Marts, LLC, et al., Case No. 08-11037-MFW, No. 1 and No. 5 (Bankr. Del)

24. In re Value City Holdings, Inc., et al., Case N0. 08-14197-jmp, No. 1 and No. 2 (Bankr. S.D.N.Y.)

25. In re Wickes Holdings, LLC, et al., Case No. 08-10212-KJC, No. 1 and No. 3 (Bankr. Del)

26. In re Whitehall Jewelers Holdings, Inc., et al., Case No. 08-11261-KG, No. 1 and No. 5 (Bankr. Del.)

27. In Buffets Holdings, Inc., et al. Case No. 08-10141-MFW, No. 1 and No.

28. In re Steakhouse Partners, Inc., Case No. 08-04147-JM11, No. 1 and No. 12 (Bankr. S.D. Cal.)

29. In re VI Acquisition Corp., Case No. 08-10623-KG, No. 1 and No. 22 (Bankr. Del.)