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RESPONSE: SMALL BUSINESS REORGANIZATION AND THE SABRE PROPOSALS

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When I first read the proposals of the Select Advisory Committee on Business Reorganization (“SABRE”),¹ I had two reactions. On the one hand, I was impressed, as one cannot fail to be, with the innovative and thoughtful proposals. At the same time I was puzzled. The SABRE proposals do not deal with what the proposals purportedly address: the time and expense of Chapter 11.² Instead, after listening to Professor Karen M. Gebbia-Pinnetti’s presentation at the Eugene P. and Delia S. Murphy Conference,³ rereading her article⁴ and the report of the committee,⁵ I have come to the conclusion that the proposals are intended to deal with the shortcomings of creditor representation in Chapter 11 cases.

My comments here do not address SABRE’s Proposal 1 for a “Federal Workout Proceeding,”⁶ which provides for a formal

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1. SABRE: The Select Advisory Committee on Business Reorganization (a special committee of the American Bar Association’s Section of Business Law - Business Bankruptcy Committee).

2. Karen M. Gebbia-Pinetti, *First Report on the Select Advisory Committee on Business Reorganization*, 57 BUS. LAW. 164, 169 (2001) [hereinafter SABRE Report].

3. Professor Karen M. Gebbia-Pinnetti, Address at the Fordham University School of Law Eugene P. and Delia S. Murphy Conference (Nov. 15, 2001).

4. Karen M. Gebbia-Pinnetti, *Small Business Reorganization and the SABRE Proposals*, 7 FORDHAM J. CORP. & FIN. L. 253 (2002).

5. SABRE Report, *supra* note 2.

6. *Id.* at 169-85.

procedure for workouts before the filing of a Chapter 11 case.⁷ My focus is on Proposals 2 and 3, which would apply once a Chapter 11 case has been filed. These proposals rest on a newly court-appointed independent facilitator and a neutral business expert (“neutrals”) to aid the Chapter 11 process. Proposal 2 recommends, among other things, the appointment of an independent facilitator to assist in plan negotiation during a Chapter 11 case.⁸ Proposal 3 suggests that neutrals provide objective analysis of the debtors’ financial information to all parties in interest.⁹

Past proposals for neutral facilitators of the bankruptcy process were attempts to reduce cases that languished in Chapter 11 without any reasonable prospect for reorganization.¹⁰ The drafters of the Bankruptcy Code of 1978 created the United States Trustee Program in part to address this problem.¹¹ The deliberations of the National Bankruptcy Review Commission considered a type of neutral expert in each Chapter 11 case who would evaluate the debtor at the early stages of a Chapter 11 case and report to the court on the debtor’s prospects for reorganization.¹²

Data from the past decade demonstrate that the average time per case spent in Chapter 11 has consistently declined.¹³ The SABRE Report states that its proposed reforms “specifically identified aspects of Chapter 11 practice that may unnecessarily

7. *Id.*

8. *Id.* at 169.

9. *Id.*; see also Gebbia-Pinetti, *Small Business Reorganization*, *supra* note 4, at 275-79 (providing a summary of SABRE’s Fourth Report).

10. See *infra* notes 11-12 (providing examples of proposals for independent monitoring agents).

11. For an explanation of the Bankruptcy Code of 1978, see H.R. REP. NO. 95-595, at 89, 91-93, 104-06 (1977).

12. For a discussion of “independent monitoring agent” for small business Chapter 11 cases, see Minutes, The National Bankruptcy Review Commission (Oct. 18-19, 1996), available at <http://www.abiworld.org/legis/review/minutes/oct96min.html> (last visited Mar. 11, 2002).

13. Gordon Bermant & Ed Flynn, *Outcomes of Chapter 11 Cases: U.S. Trustee Database Sheds New Light on Old Questions*, AM. BANKR. INST. J., Feb. 1998, at 28.

increase the cost and time of business reorganizations.”¹⁴ However, the report offers no empirical information or other support to suggest the extent to which “cost and time” is a problem. Perhaps, just as one can never be too thin or too rich, a Chapter 11 case can never be said to move too quickly or too cheaply.

Assuming the neutrals proposed by SABRE will be of assistance in particular cases, the proposal leaves unanswered the question of the systemic effect of these proposals. Overall, the time spent in Chapter 11 is down.¹⁵ Reforms like the SABRE proposals will at some point reach the point of diminishing returns. Further reductions in cost and expense of Chapter 11 cases may not be worth the cost of achieving these results. At this point any reform, from a systemic perspective, is inefficient.

I suggest that the SABRE proposals 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.

Over twenty-five years ago, the drafters of the Bankruptcy Code described the problem this way:

The practice in bankruptcy is different for several reasons. First, there is a public interest in the proper administration of bankruptcy cases. Bankruptcy is an area where there exists a significant potential for fraud, for self-dealing, and for diversion of funds. In contrast to general civil litigation, where cases affect only two or a few parties at most, bankruptcy cases may affect hundreds of scattered and ill-represented creditors. In general civil litigation, a default by one party is relatively insignificant, and though judges do attempt to protect parties' rights, they need not be active participants in the case for the protection of the public interest in seeing disputes fairly resolved. In bankruptcy cases, however, active supervision is essential. Bankruptcy affects too many people to allow it to proceed untended by an impartial supervisor.¹⁶

In other words, a bankruptcy case will pull into its vortex

14. SABRE Report, *supra* note 2, at 167-69.

15. Bermant & Flynn, *supra* note 13, at 32.

16. H.R. REP. NO. 95-595, at 88.

certain parties who do not have enough of an economic interest to pursue their claims against the debtor. Money owed to creditors, or that portion of the bankruptcy estate to which they might be entitled, is at risk unless the debtor's conduct is supervised.

The Bankruptcy Code addresses this problem in two ways. First, where certain general unsecured creditors have enough of a stake to pursue their claims, they represent the interests of all similarly situated creditors through the formation of a creditors' committee.¹⁷ While pursuing their own interests, they necessarily protect the interests of creditors who do not actively pursue their own claims.¹⁸ Second, when circumstances suggest that a trustee should be appointed to take over possession and management of the debtor's business, the United States Trustee is given authority to move for the appointment of a trustee.¹⁹

The SABRE proposals appear to be directed at cases where there is an active creditor constituency. Each of the proposed neutrals serves as some type of intermediary between the debtor and creditors who are involved in the negotiation, or are seeking to influence the reorganization. The proposal for a neutral plan facilitator and neutral business analysis assumes the existence of creditors who care enough, are active enough, and have enough at stake to be interested in the current and future financial condition of the debtor. Otherwise they will not participate in negotiation of a plan by the facilitator, and will have no interest in the information analyzed by the neutral expert.

If the object of the SABRE proposals were truly reduction of Chapter 11 delay and expense, they would raise questions of why an active creditor constituency does not work on its own behalf to minimize these problems. As noted above, the drafters of the Bankruptcy Code believed that active creditors, if their economic interest in the case were large enough, would work to minimize the expense and keep time of confirmation as short as possible because they would be playing with their own money.²⁰ The SABRE

17. 11 U.S.C. § 1102 (2000).

18. H.R. REP. NO. 95-595, at 104.

19. *Id.*

20. *See generally* H.R. REP. NO. 95-595 (1977) (noting the expected behavior of reasonable creditors).

proposal calls this belief into question. The need for neutral facilitators to reduce time and expense suggests that economic interests of an active creditor constituency are not, by themselves, sufficient to minimize the time and expense of a Chapter 11 case. More than the terms of the proposals themselves, this suggestion has profound implications for bankruptcy policy, and calls into question many of the assumptions about the reorganization process.

Notes & Observations