HEARING BEFORE THE UNITED STATES SENATE COMMITTEE ON THE JUDICIARY SUBCOMMITTEE ON OVERSIGHT, AGENCY ACTION, FEDERAL RIGHTS AND FEDERAL COURTS

March 7, 2018

Testimony of Craig Goldblatt
Partner, Wilmer Cutler Pickering Hale and Dorr, LLP
Washington, D.C.

Chairman Sasse, Ranking Member Blumenthal, and distinguished members of the Subcommittee, thank you for this opportunity to appear before you and address these important issues relating to small business bankruptcies. My name is Craig Goldblatt. I am a bankruptcy partner at WilmerHale here in Washington. I was involved in our firm's representation of the Loan Syndications Trading Association in connection with a report we prepared in 2015 on bankruptcy reform issues. I am also a Conferee of the National Bankruptcy Conference, which issued a report in 2010 (which was before I became a Conferee) addressed to small business bankruptcies. I am appearing today, however, not on behalf of any organization or client, but solely in my capacity as a bankruptcy practitioner who has given some thought to the issues that this Subcommittee is now considering.

There is a strong consensus in the bankruptcy community that the Bankruptcy Code in its current form is ill-suited for small business. The National Bankruptcy Conference observed in 2010 that chapter 11 "was designed for large corporations with extensive operations and complex capital structures, not small enterprises that depend critically on the skills of a single owner-manager and family owners. The model for Chapter 11 was the publicly-traded manufacturer, not the local diner."

I believe that as a general proposition, Chapter 11 of the Bankruptcy Code works quite well in the context for which it was designed – addressing financial distress faced by large corporations with complex capital structures. But the Chapter 11 process is complex, time-consuming, and costly. While that process serves a salutary purpose in a large and complex case – it operates to provide valuable creditor protections and generally works to maximize the value of the enterprise – it is ill suited to a small business that encounters financial distress. Indeed, this is an issue with which I have some first-hand experience. My parents ran a mid-sized catering business that, in its good years, put me through college and law school. But later on that business hit a speed bump, largely as a result larger economic forces. By that time, I knew something about bankruptcy, having been involved in the representation of debtors that had reorganized businesses with billions of dollars of debt. But after giving the matter careful thought, we concluded that the chapter 11 process, with all of its associated costs, simply would not work for the family business, whose assets were ultimately sold.

I believe that the basic approach proposed by the National Bankruptcy Conference in its proposed "Subchapter V" to chapter 11, a copy of which is attached, would be a material improvement to existing law. I say this not as an endorsement of every detail of the NBC proposal. I am certain there are issues that may warrant further consideration. To my mind, the central insight of the NBC approach – and these are my words, not theirs – is that it draws upon

the experience that has proven largely successful in individual debtor cases under chapter 13, as extended to family farm cases under chapter 12.

The basic bargain of chapter 13 is that, unlike a chapter 7 liquidation, the individual debtor is permitted to keep his or her assets in exchange for agreeing to pay his or her projected disposable income over the plan period (of up to five years) to his or her creditors. While I am not here to say that chapter 13 works perfectly, it has allowed many individual debtors who have fallen on hard times to craft an appropriate plan for repaying their creditors, while saving their homes or other assets.

The National Bankruptcy Conference proposal is, at bottom, premised on the notion that many small family businesses are much more like individuals trying to save their homes than they are like multi-national billion-dollar enterprises with complex capital structures. For this kind of small business, there is enormous value to simplicity. In addition, chapter 12 and 13 cases benefit enormously from the very good work of standing trustees, who are typically invaluable to debtors, creditors, and courts alike in keeping the cases on track and addressing problems when they arise.

The National Bankruptcy Conference proposal would eliminate many of the features typically associated with chapter 11 cases, such as the formation of a creditor's committee whose professionals need to be paid by the bankruptcy estate and an elaborate voting process triggered by a detailed disclosure statement that is separately approved by the bankruptcy court. At the same time, by limiting the Subchapter to businesses with indebtedness of less than $7.5 million, the proposal ensures that the more robust creditor protections associated with the chapter 11 process remain in place in the cases for which they are appropriate.

In other contexts, I have written and spoken about the importance of the absolute-priority rule in federal bankruptcy law – the notion that the owner of a business cannot receive value on account of his or her ownership interest unless creditors are paid in full. I continue to believe that this rule is critical to the sound operation of the lending markets, and therefore to the many businesses who access those markets to obtain necessary liquidity. It is true that the National Bankruptcy Conference proposal can be viewed as an exception to this foundational principle. But the simple reality of the situation is that it makes no sense to suggest that the equity of a local dry cleaning business or auto repair shop be distributed under a plan of reorganization to that business's creditors. These businesses typically depend on the individual or family that serves simultaneously as the entrepreneur, owner, operator, sales force and H.R. department. Saying to that individual or family – much like we do to the consumer debtor in chapter 13 – that you can retain possession of your business so long as you commit to pay your projected disposable income over a five-year period to the trustee, who will pay those funds over to your creditors, strikes me as very sensible public policy. It can allow struggling businesses to remain in business and afford a genuine fresh-start, while at the same time respecting the rights of those who lent money or provided goods or services to the business, and are entitled to repayment.

Again, I appreciate the opportunity to address this Subcommittee, and look forward to providing whatever assistance I may as Congress considers how to improve the bankruptcy process.