

STATEMENT OF  
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REFORM OF CHAPTER 11

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

FOR A HEARING ENTITLED:  
“SMALL BUSINESS BANKRUPTCY: ASSESSING THE SYSTEM”

PRESENTED  
MARCH 7, 2018

Chairman Sasse, Ranking Member Blumenthal and Members of the Subcommittee:

Thank you for the invitation today to represent the ABI Commission to Study the Reform of Chapter 11 (the “*Commission*”) in discussing the Commission’s proposed reforms addressing the restructuring under the Bankruptcy Code of small and medium-sized enterprises (“*SME’s*”). SME’s constitute the vast majority, in number and numbers of employees, of companies in this nation. However, when SME’s encounter financial headwinds, the current Bankruptcy Code offers little, if any, shelter or opportunity for reorganization, resulting in otherwise viable businesses facing liquidation, with resulting loss and disruption to their surrounding communities. Most financially-troubled SME’s simply avoid Chapter 11 altogether. The Commission’s proposed reforms, encompassed in the simple five (5)-page proposed bill attached to this statement, would, the Commission believes, reinstate reorganization under the Bankruptcy Code as a viable option for SME’s. The bill is not just a “small business” bankruptcy bill for the tiniest firms; the proposed restructuring option would apply to approximately 90% of all business filers by number. It would be chapter 11 for most businesses, other than the largest firms. Because of the jobs it will save, this is a jobs bill that is already paid for. The courts are there; the system is there, and it costs no more to make it work effectively to save companies.

Briefly, and as detailed below, the key Commission recommendations on SME’s would change the Bankruptcy Code to:

- Remove the unrealistic and artificial deadlines and allow SME’s to work with the court and their stakeholders to establish a sensible restructuring timeline.
- Reduce the amount, and limit the kinds, of information that a SME debtor must provide when filing a chapter 11 case.
- Reduce the reporting requirements imposed on SME’s.
- Not require the U.S. trustee to appoint a committee of unsecured creditors in a SME case, unless requested by a creditor or needed for other reasons.
- Allow a SME debtor or other stakeholder in the case to request the appointment of a professional with skills tailored to the particular problems facing that debtor—e.g., an accountant, financial advisor, operational expert in the debtor’s industry, etc. The Commission called this professional an “estate neutral,” which would be a new and valuable resource for debtors operating under the Bankruptcy Code.
- Include provisions that encourage the parties, and allow the court, to reduce or control the costs of a chapter 11 case by, for example, streamlining the plan of reorganization process, providing clear rules for the SME debtor’s reorganization (thereby reducing litigation), and structuring fees in the case (for example, fees of the estate neutral) to fit the size and resources of the particular SME debtor. *These steps would save time and money for all parties in the case.*
- Provide a plan of reorganization option (as a default if a deal is not reached) that allows a SME owner to maintain some ownership interest in the company while preserving the rights of secured creditors and seeking to repay unsecured creditors in full within a period

of four years or less. The Commission’s plan proposal also provides protections for creditors in the event that the SME debtor defaults under such a reorganization plan.

The ABI Commission to Study the Reform of Chapter 11.<sup>1</sup>

A robust, effective, and efficient bankruptcy system rebuilds companies, preserves jobs, and facilitates economic growth with dynamic financial markets and lower costs of capital. For more than 35 years, the U.S. Bankruptcy Code has served these purposes, and its innovative debtor in possession chapter 11 process, which allows a company to manage and direct its reorganization efforts, is emulated around the globe. As with any law or regulation, however, periodic review of U.S. bankruptcy laws is necessary to ensure their continued efficacy and relevance.

Whether by design or chance, efforts to review and assess U.S. business reorganization laws are undertaken approximately every 40 years. Such efforts have led to federal legislation effecting meaningful revisions to business reorganization laws in 1898, 1938, and 1978. It may be that four decades is the maximum amount of time that any financially driven regulation can remain relevant. Markets and financial products, as well as industry itself, often evolve far more quickly than the laws intended to govern them. It may be that significant economic crises tend to occur cyclically and encourage reevaluation of the federal bankruptcy laws. Regardless, the general consensus among restructuring professionals was that the time had come once again to evaluate U.S. business reorganization laws. Accordingly, in 2012, the American Bankruptcy Institute (the “**ABI**”) established the Commission for this precise purpose. The Commission’s work resulted in the Report.

The Commissioners are among the most prominent insolvency and restructuring practitioners in the United States, who have represented debtors, creditors, and other stakeholders, such as private equity investors, in the largest and most significant cases in U.S. history. The Commissioners included the then-current Chair and former Chair of the influential National Bankruptcy Conference, past Chair and former President of the prestigious American College of Bankruptcy, two past Chairs of the New York City Bar Committee on Bankruptcy and Reorganization, the former Chief Restructuring Officer of the United States Treasury, a past Chair of the Turnaround Management Association, three prominent turnaround consultants, a past member of the National Bankruptcy Review Commission, a former Chief Bankruptcy Judge of the Southern District of New York, the two principal draftsmen of the 1978 Bankruptcy Code, several past members of the Advisory Committee on Bankruptcy Rules of the Judicial Conference of the United States, the then-current President of INSOL International, the Director of the Executive Office for U.S. Trustees in the Department of Justice,<sup>2</sup> five past Presidents of

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<sup>1</sup> This statement is derived from Sections I, III and VII of the Commission’s Final Report and Recommendations found at [commission.abi.org/full-report](http://commission.abi.org/full-report) (the “**Report**”). For convenience and readability, this statement omits most of the footnotes contained in the extensively-sourced Report. Out of respect for those sources, and to readers of this statement who wish to access those sources, those sources can be found in the Report and are incorporated by reference.

<sup>2</sup> As a nonvoting member, Executive Director Cliff White took no position on legislative proposals. Mr. White provided institutional perspectives and technical assistance on issues considered by the Commission.

the American Bankruptcy Institute, and nine current and former global heads of the bankruptcy departments at major U.S. law firms. The Commission was geographically diverse, and balanced creditor and debtor interests.

In assembling those who would serve as Commissioners and as members of the topical advisory committees, special attention was paid to the fact that although large cases capture headlines, the overwhelming number of business bankruptcies are by small and medium-sized enterprises. Professionals with unique experiences in these kinds of cases lent their special expertise to the Commission process. As a result, the Report included recommendations focused on small and medium-sized enterprises that will materially improve the Bankruptcy Code for stakeholders in this broad market, and which we discuss today.

The Commission adopted a holistic and inclusive approach to its study and was guided by its mission statement, which reads:

In light of the expansion of the use of secured credit, the growth of distressed-debt markets and other externalities that have affected the effectiveness of the current Bankruptcy Code, the Commission will study and propose reforms to Chapter 11 and related statutory provisions that will better balance the goals of effectuating the effective reorganization of business debtors — with the attendant preservation and expansion of jobs — and the maximization and realization of asset values for all creditors and stakeholders.

In furtherance of its mission statement, the Commission undertook an in-depth three-year study process. The study focused exclusively on the resolution of financially distressed businesses under chapter 11 of the Bankruptcy Code. The Commission voted unanimously to adopt the Report on December 1, 2014.

### The Commission’s Three-Year Study and Its Context.

Congress historically has turned to U.S. bankruptcy laws to help stabilize the economy in times of crisis and, beginning in 1867, to provide both individuals and corporations a single forum to address multiple creditor claims. Although the law has evolved significantly since the late 1800s, the law remains focused on strengthening the economy and society more generally and, in the process, instilling confidence in businesses and markets. These objectives require a delicate balance that encourages appropriate growth and innovation in business, but provides sufficient protection and certainty to creditors. Chapter 11 of title 11 of the U.S. Code (the “*Bankruptcy Code*”) can achieve this balance for U.S. companies and markets.

#### (i) *A Brief History of U.S. Business Reorganization Laws*

The United States has historically had one of the strongest and most well developed business reorganization schemes in the world. This business reorganization scheme has a rich history, stemming in large part from the railroad failures of the late 19th century. The Bankruptcy Acts of 1867 and 1898 introduced the basic conceptual underpinnings of modern bankruptcy law,

including business bankruptcy. These laws, particularly the 1898 Bankruptcy Act, were grounded in a “rescue and rehabilitate” policy intended to allow the honest but unfortunate debtor, including the business debtor, to obtain a fresh start and a second chance at becoming a productive, contributing member of society. As with all U.S. bankruptcy laws, the 1898 Bankruptcy Act sought to balance the need of the debtor to rehabilitate and the rights of creditors to recoveries. The basic notion that a business generally is more valuable to creditors and society as a whole if it rehabilitates rather than liquidates also emerged during this period.

Bankruptcy law progressed in response to, among other things, the Great Depression of the 1930s, and a more formalized process evolved that allowed distressed companies to remain in business while restructuring their obligations. These developments produced Sections 77 and 77B of the Bankruptcy Act and then the Bankruptcy Code’s immediate predecessor, the Chandler Act, which added three new chapters for reorganizing ongoing businesses (Chapters X and XI concentrated on businesses, and Chapter XII addressed real estate organizations). Each iteration of the law focused on strengthening business reorganizations and seeking an appropriate balance between the rights and obligations of the debtor and its stakeholders.

Under Chapter X of the Chandler Act, a trustee was appointed to replace the debtor’s management, and the Securities and Exchange Commission had a formal oversight role in the reorganization process. The large public companies subject to Chapter X did not embrace these two requirements. They worked to avoid a bankruptcy filing — even when arguably necessary or prudent under the circumstances — or tried to come within the provisions of Chapter XI of the Chandler Act. Chapter XI was intended for smaller, nonpublic companies and only addressed unsecured debt in the debtor’s capital structure. Nevertheless, companies generally preferred this chapter because it placed the reorganization largely in the hands of the debtor and its unsecured creditors’ committee and was premised on the efforts of these parties to structure a negotiated resolution to the debtor’s financial distress. After almost 40 years of restructuring experience under Chapter X and Chapter XI of the Chandler Act, policymakers and practitioners agreed that reform was needed.

Consequently, in 1970, Congress created the Commission on the Bankruptcy Laws of the United States (the “*Commission on Bankruptcy Laws*”) to “study, analyze, evaluate and recommend changes to the [1898] Act.” In 1973, the Commission on Bankruptcy Laws issued a report and a draft of proposed bankruptcy legislation. The National Conference of Bankruptcy Judges, excluded from the Commission on Bankruptcy Laws, submitted a competing legislative proposal. President Carter ultimately signed into law the 1978 Bankruptcy Code, which combined various concepts from both legislative proposals and merged Chapters X, XI, and XII of the 1898 Bankruptcy Act into a single business reorganization chapter (the current chapter 11). In passing the Bankruptcy Code, Congress believed that “the purpose of a business reorganization case [under chapter 11] . . . is to restructure a business’s finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders” with the understanding that “reorganization, in its fundamental aspects, involves the thankless task of determining who should share the losses incurred by an unsuccessful business and how the values of the estate should be apportioned among creditors

and stockholders.”

After its enactment, Congress amended the Bankruptcy Code on a periodic and piecemeal basis. In 1982, Congress broadened protections for the commodities and securities markets. In 1984, Congress clarified the jurisdiction of the bankruptcy courts, set the term and appointment procedures of bankruptcy judges, and enacted specialized rules for the treatment of collective bargaining agreements. In 1986, Congress created additional bankruptcy judgeships, expanded the U.S. Trustee pilot program to a nationwide program, and codified chapter 12 for family farmers. In 1988, Congress added protections for retirees and intellectual property licensees, and resolved conflicts between bankruptcy law and state laws. In 1990, Congress added various provisions, such as swap protections, making certain debts nondischargeable, and establishing bankruptcy appellate panels. In 1992, Congress added more provisions related to, among others, judgeships and chapter 12. In 1994, Congress again added various provisions, including changes in time limits, exemptions, and criminal penalties.

In 1994, Congress also created the National Bankruptcy Review Commission (the “*NBRC*”) to foster a more systemic look at studying and reforming the Bankruptcy Code. The NBRC issued its report in 1997, and several of its recommendations were addressed to varying degrees in the amendments to the Bankruptcy Code set forth in the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 (the “*BAPCPA Amendments*”). BAPCPA implemented an extensive overhaul of both the business and consumer provisions of the Bankruptcy Code.

BAPCPA and the prior amendments affecting chapter 11 tried to address perceived deficiencies in the Bankruptcy Code, but have in some respects altered the Bankruptcy Code’s original careful balance between a debtor’s need to rehabilitate and its creditors’ rights to recoveries on their claims against the debtor. In addition, the amendments have introduced perceived inequities among different creditor constituencies. These factors, combined with the changing economic environment and other externalities discussed below, have diluted the effectiveness of chapter 11 for many companies and their stakeholders. Reminiscent of the time preceding the work of the Commission on Bankruptcy Laws, companies once again are working to find alternatives to filing bankruptcy cases, potentially at the expense of their creditors, shareholders, and employees. Accordingly, after more than 35 years of experience under chapter 11, many practitioners and commentators agree that it is again time for reform.

(ii) *The Need for Reform*

Chapter 11 of the Bankruptcy Code has served us well for many years. Nevertheless, today’s financial markets, credit and derivative products, and corporate structures are very different than those existing in 1978 when Congress enacted the Bankruptcy Code. Companies’ capital structures are more complex and rely more heavily on leverage, which is secured under state enactments of the Uniform Commercial Code that encumber vastly more assets than in 1978; their asset values are driven less by hard assets (*e.g.*, real estate and machinery) and more by services, contracts, intellectual property, and other intangible assets; and both their internal business structures (*e.g.*, their affiliates and partners) and external business models are increasingly complex and multinational. In addition, claims trading and derivative products have changed the composition of creditor classes, even in small and middle market cases. Although

these developments are not unwelcome or unhealthy, the Bankruptcy Code was not originally designed to rehabilitate companies efficaciously in this complex environment.

Moreover, anecdotal evidence suggested, even before the Commission's work, that chapter 11 has become too expensive (particularly for small and medium-sized enterprises) and is no longer capable of achieving certain policy objectives such as stimulating economic growth, preserving jobs and tax bases at both the state and federal level, or helping to rehabilitate viable companies that cannot afford a chapter 11 reorganization. Many professionals suggested that more companies are liquidating or simply closing their doors without trying to rehabilitate under the federal bankruptcy laws. Commentators and professionals also suggested that companies are waiting too long to invoke the federal bankruptcy laws, which limits companies' restructuring alternatives and may lead to premature sales or liquidations.

### *(iii) The Commission's Study*

The Commission undertook a methodical study of chapter 11 of the Bankruptcy Code. Over 250 corporate insolvency professionals (including the Commissioners, committee members, and hearing witnesses) participated in this study. The Commission strived to include all perspectives, ideologies, and geographic and industry segments.

Notably, the Commission's process resembled that of the 1970 Commission on Bankruptcy Laws and, more recently, the 1994 NBRC in several respects. For example, the Commission used an advisory committee structure, described below, similar to the eight-topic committee structure invoked by the NBRC. Similar to the NBRC, the Commissioners retained authority for addressing and deciding each issue. Moreover, each of the field hearings hosted by the Commission and described below was open to the public, and the transcripts (and, in many cases, video recordings) are posted on the Commission's website at [www.commission.abi.org](http://www.commission.abi.org) (the "*Commission website*"). In addition, similar to the process followed by the NBRC, the Commissioners appeared at restructuring events throughout the country to discuss and publicize the Commission's work and to solicit feedback from affected constituents.

The Commission met on a regular basis after January 2012 and until issuance of the Report. During these meetings, the Commission has, among other things, discussed issues perceived as potential problems in chapter 11, reviewed recent developments in the case law and practice norms, and developed an effective process for identifying, researching, and analyzing chapter 11 as a whole. As explained below, the Commission used its advisory committees and numerous public field hearings to amass the information and research it required to critically analyze chapter 11 and consider any reform measures.

### **The Advisory Committees.**

To launch its study, the Commission identified 13 broad study topics to facilitate a detailed analysis of the various components of chapter 11. The Commission then enlisted the volunteer service of more than 150 of the insolvency profession's expert judges, lawyers, financial advisors, academics, and consultants to serve on advisory committees for each of these study

topics.

In forming the advisory committees, the Commission carefully vetted individuals who were qualified to address particular issues within any given advisory committee's charge. This vetting process considered not only the individual's knowledge and expertise in the area, but also whether the individual would be likely to add a particular perspective on the issues while still considering the overall integrity of the bankruptcy system. As such, each advisory committee received input from the perspective of the various chapter 11 constituents — *e.g.*, lenders, trade creditors, landlords, employees, etc. — on each of the issues they addressed and presented to the Commission. The diverse perspectives of the Commissioners and of the advisory committees added substantial value to the Commission's deliberations and decisions and the proposals encompassed in this Report.

The advisory committees began their work in April 2012. The Commission provided each advisory committee with a preliminary assessment containing initial study questions for its general topic area. Each advisory committee devoted significant time to researching and evaluating the study questions. The advisory committees met either in-person or telephonically on a frequent basis to review their research and debate the issues. The advisory committees engaged in this work for approximately 18 months before submitting research reports on most topics to the Commission in December 2013.

The Commission then held a three-day retreat in February 2014 to meet with each advisory committee and discuss the research reports. At the retreat, the advisory committees presented their reports and highlighted complex and nuanced issues for the Commission, and the Commissioners actively engaged in a direct dialogue with advisory committee members. The Commission also used the forum to begin integrating the study topics and reconciling overlapping issues. The retreat and the work of the advisory committees leading up to the retreat sessions were informative and very helpful to the Commission in this process. Following that, the Commission reviewed the entire body of work produced by the advisory committees and conducted follow-up research and analysis on a variety of issues.

### **The Field Hearings.**

The Commission held its first public hearing in April 2012 at the U.S. House of Representatives Committee on the Judiciary in the Rayburn House Office Building in Washington, D.C. Following that launch, the Commission held 16 public field hearings in 11 different cities: Boston, Las Vegas, Chicago, New York, Phoenix, San Diego, Tucson, Philadelphia, Austin, Atlanta, and Washington, D.C. Collectively, almost 90 individuals testified at these hearings. The testimony at each of these hearings was substantively rich and diverse. The hearings covered a variety of topics, including chapter 11 financing, general administrative and plan issues, governance, labor and benefits issues, priorities, sales, safe harbors, small and medium-sized enterprise cases, valuation, professionals' fees, executory contracts (including commercial leases and intellectual property licenses), trade creditor issues, and reform of avoiding powers. Transcripts and videos of the hearings, and the related witness statements, are available at the Commission website.



Several common themes emerged from the field hearings. Many witnesses acknowledged that chapter 11 cases have changed over time. These changes include: (1) a perceived increase in the number and speed of asset sales under section 363 of the Bankruptcy Code; (2) a perceived decrease in stand-alone reorganizations; (3) a perceived decrease in recoveries to unsecured creditors; and (4) a perceived increase in the costs associated with chapter 11. The witnesses who testified on issues relating to small and medium-sized enterprises generally opined that chapter 11 no longer works for these companies. Witnesses cited cost and procedural obstacles as common barriers. Finally, witnesses — even those who were highly critical of certain aspects of chapter 11 — all perceived value in the U.S. approach to corporate bankruptcies, including the debtor in possession model.

In addition, the Commission worked with the University of Illinois College of Law to organize and host an academic symposium on the role of secured credit in business bankruptcies in April 2014. Nineteen of the nation’s leading bankruptcy scholars contributed to the symposium. The symposium was open to the public, and both the scholarship presented and a video recording of the event are posted on the Commission website. Many of the scholarly papers from this symposium were published in the 2015 volume (No. 2) of the *Illinois Law Review*.

### **The Commission’s Deliberations**

Immediately following its February 2014 retreat, the Commission began its in-depth review of the advisory committees’ reports and recommendations, various issue-specific white papers prepared by the Commission’s Reporter with the assistance of the Commissioners and research fellows, the papers from the Illinois symposium, and testimony and papers submitted by hearing witnesses and restructuring professionals. The Commission then held five separate executive session retreats to deliberate, formulate, and vote on the content of the Report. The Commission also held numerous subcommittee meetings in between each of these executive session retreats.

At each of the executive sessions, the Commission reviewed issues raised by witness testimony or examined in the research materials prepared by the Reporter and the advisory committees, including the advisory committee’s recommendations on the initial study topics posed by the Commission. Moreover, the reports of the international working group informed many of the Commission’s deliberations. From these discussions, the Commissioners worked to identify areas of potential reform that would, among other things, improve case efficiencies, enhance business rehabilitations and creditors’ recoveries, and resolve uncertainty or ambiguity in the current law.

The recommended principles set forth in the Report are the result of the Commission’s study and deliberative process. The Commission believes that the Report achieves its core mission to “study and propose reforms to Chapter 11 and related statutory provisions that will better balance the goals of effectuating the effective reorganization of business debtors — with the attendant preservation and expansion of jobs — and the maximization and realization of asset values for all creditors and stakeholders.”

## Proposed Recommendations: Small and Medium-Sized Enterprise (SME) Cases

Most business bankruptcy cases filed in the United States involve small and middle-market enterprises. These businesses include family owned businesses, entrepreneurial ventures, and startup companies. They form the backbone of the American economy. As explained in one survey, “[a]ccording to the U.S. Economic Census, companies with 50 to 5,000 employees account for more employment than those with over 5,000.” This survey also noted that “in terms of output, the sheer number of mid-market firms accounts for the fact that, in aggregate, their revenues surpass those of the top 100 U.S. companies by capitalization and are equivalent to roughly 40 percent of the U.S. GDP.” Nevertheless, small and middle-market enterprises are prone to preliminary setbacks and initial failures, and they can be among the hardest hit in economic downturns.

In addition, established small and middle-market companies can experience failed acquisitions, underperforming product lines, overcapitalization, and other factors that contribute to financial distress and threaten their survival. Yet many commentators and practitioners assert that the Bankruptcy Code no longer works to help rehabilitate these companies. As one witness testified, “Chapter 11 is now viewed as too slow and too costly for the majority of middle-market companies to do anything other than sell its going concern assets in a 363 sale or to simply liquidate the company . . . [usually] almost exclusively for the sole benefit of the secured lender.”

The Commission heeded the concerns raised by several witnesses regarding the plight of small and middle-market enterprises in financial distress. The Commissioners solicited the testimony and input of practitioners and judges familiar with small and middle-market cases and thoroughly studied the issues identified as barriers to effective reorganizations in this space. They also, with the assistance of the Reporter and a report from the governance advisory committee, reviewed the literature and empirical evidence on small business cases in chapter 11.

The Commission strongly believes that the following set of reforms for small and middle-market enterprises, also embodied in the attached proposed bill, can have a significant and positive influence on the ability of these companies to effectively reorganize in and outside of chapter 11:

### **A. Definition of SME**

- **The term “*small or medium-sized enterprise*” (“SME”) means a business debtor with —**
  - (i) **No publicly traded securities in its capital structure or in the capital structure of any affiliated debtors whose cases are jointly administered with the debtor’s case; and**
  - (ii) **Less than \$10 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates as of the petition date.**

A debtor purporting to qualify as an SME under this definition must file a balance sheet reflecting a good faith estimate of its assets and liabilities as of the petition date with its chapter 11 petition.

- The court *sua sponte*, the U.S. Trustee, or a party in interest should be able to object to the debtor's indication in the petition that it satisfies subsections (i) and (ii) above and qualifies as an SME, but only on the grounds that the debtor does not in fact meet the definition of SME under the Bankruptcy Code. Such objection should be filed on or before 14 days after notice of the debtor's indication in the petition that it qualifies as an SME, and it should be heard on an expedited basis.
- In addition, if a business debtor satisfies subsection (i) above and has more than \$10 million but less than \$50 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates, the debtor may file a motion seeking to be treated as an SME in its chapter 11 case. Such motion must be filed with the debtor's voluntary petition or within seven days after the entry of the order for relief in an involuntary case. The court should grant such motion and classify the debtor as an SME only if the motion is timely filed and the court determines based on evidence presented at the hearing that treating the debtor as an SME in the chapter 11 case is in the best interest of the estate. Any objection to such motion should be filed on or before 14 days after the filing of the motion, and the motion and any objections should be heard on an expedited basis.
- The definition of SME does not include a "single asset real estate" case as defined in section 101(51B) of the Bankruptcy Code.
- The current "*small business case*" and "*small business debtor*" provisions of the Bankruptcy Code should be deleted in their entirety.

## **B. General Application to SME's**

- A debtor that satisfies the definition of an SME should be subject to the principles set forth herein for SME cases without further action by the court, trustee, or debtor in possession.
- If an objection is timely filed to the debtor's indication in the petition that it qualifies as an SME under the Bankruptcy Code definition, such debtor should be treated as an SME unless and until the entry of an order of the court sustaining any such objection.
- If a debtor timely files a motion seeking to be treated as an SME, such debtor should be treated as an SME only upon the entry of an order of the court overruling any objections thereto and authorizing the debtor's designation as an SME.
- If a debtor qualifies or is designated as an SME, the court may for cause, after notice and a hearing, permit the SME debtor to use good

faith estimates in compiling its valuation information package, as required by the principles, if audited or unaudited financial statements are not readily available. The court also may set a deadline by which the SME debtor should turn over its valuation information package, to a requesting party in interest.<sup>3</sup>

- The general recommended principles proposed for chapter 11 cases (in the Report) apply to SME cases, unless the principles expressly exclude SME cases or would otherwise conflict with the SME principles.

### C. Oversight of SME Cases

- The debtor should be permitted to operate as a debtor in possession with all rights, powers, and duties set forth in section 1107 of the Bankruptcy Code and subject to the appointment of a chapter 11 trustee for cause under section 1104.
- A committee of unsecured creditors under section 1102(a) should not be appointed in an SME case unless an unsecured creditor or the U.S. Trustee files a motion with the court requesting the appointment of a committee and the court, after notice and a hearing, determines that the appointment is necessary to protect the interests of unsecured creditors in the case.
- If the debtor does not satisfy the Bankruptcy Code definition of SME but files a timely motion to be treated as an SME in the chapter 11 case, the U.S. Trustee should not appoint a committee of unsecured creditors unless the court denies the debtor's motion. The U.S. Trustee should suspend its ordinary appointment process pending resolution of the debtor's motion.
- If the debtor qualifies as an SME or is designated an SME by the court, the notice of the chapter 11 case served upon creditors should explain that the U.S. Trustee will not appoint a committee of unsecured creditors in the case unless such committee is requested by an unsecured creditor or the U.S. Trustee and the court orders such appointment. If the debtor indicates in its petition that it qualifies as an SME, such notice also should explain that parties in interest have 14 days from the date of such notice to object to the debtor's treatment as an SME.
- The court *sua sponte*, the U.S. Trustee, the debtor in possession, or a party in interest should be able to request the appointment of an estate neutral that also has the authority to advise the debtor in possession on operational and financial matters, as well as the

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<sup>3</sup> See Report at Section IV.A.6, *Valuation Information Packages*.

content and negotiation of its plan. The standard for approval of an estate neutral and the U.S. Trustee's authority to appoint the estate neutral, if ordered by the court, should be governed by the general principles on estate neutrals.<sup>4</sup>

- Any estate neutral should represent the interests of the estate and be paid by the estate. The Bankruptcy Code could establish a fee structure available for the estate neutral in an SME case to control costs and increase certainty. Such structure could be based on the size of the case or the amount of creditor distributions.

#### **D. Plan Timeline in SME Cases**

- Within 60 days of the entry of the order for relief, the SME debtor should develop and file with the court a timeline for filing and soliciting acceptances of its plan.
- If an estate neutral or a committee is appointed, the SME debtor should consult with such estate neutral or committee in developing its timeline.
- After the SME debtor files its timeline for filing and soliciting acceptances of its plan, the court should enter an order setting the deadlines for the SME debtor's plan process.
- The SME debtor should be subject to the exclusivity periods provided in Bankruptcy Code section 1121.

#### **E. Plan Content and Confirmation in SME Cases**

- A chapter 11 plan in an SME case should provide for the following treatment of allowed claims and interests in the case:
  - Payment of all administrative and priority claims in accordance with section 1129(a)(9) of the Bankruptcy Code.
  - Bifurcation of each undersecured claim into an allowed secured claim in accordance with section 506 and a general unsecured claim for any deficiency claim; neither section 1111(b) nor section 1129(a)(7)(B) should apply in an SME case.
  - Distributions to secured creditors (i) as provided in the plan and accepted by each class of secured creditors; or (ii) in accordance with section 1129(b)(2)(A).
  - Distributions to unsecured creditors (i) as provided in the plan and accepted by each class of unsecured creditors; (ii) in accordance with section 1129(b)(2)(B) (subject to the recommended principles in the Report codifying the new value corollary); or (iii) as provided below

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<sup>4</sup> See Report Section IV.A.3, *The Estate Neutral*.

for an *SME Equity Retention Plan*.

- Prepetition equity interests may receive voting common stock or ownership units in the reorganized debtor, provided that (i) all impaired classes have accepted the plan; (ii) the plan complies with section 1129(b) (subject to the recommended principles in the Report codifying the new value corollary); or (iii) the plan complies with section 1129(b)(2)(A) and provides impaired classes of unsecured creditors that have rejected the plan with preferred stock, or similar economic interests, in the reorganized debtor as described below (an “*SME Equity Retention Plan*”).
- The court should confirm an SME Equity Retention Plan that is not accepted by any class of unsecured claims only if:
  - (i) The prepetition equity security holders will continue to support the debtor’s successful emergence from chapter 11 by remaining involved, on a basis reasonably comparable to their prepetition involvement, in the ongoing operations of the reorganized debtor; and (ii) the reorganized debtor will pay to the holders of unsecured claims, no less often than annually, its excess cash flow calculated in a manner reasonable in relation to the company’s operating cash flow for each of the three full fiscal years following the effective date of the chapter 11 plan. The debtor should file a budget with its disclosure statement and chapter 11 plan that describes the excess cash flow calculation method and includes projections of excess cash flow for the three fiscal years following the effective date of the plan.
  - The prepetition equity security holders receive or retain 100 percent of the common stock, or similar ownership interests, issued or outstanding as of the effective date entitling the holders as a class to receive 15 percent of any economic distributions from the reorganized debtor, including dividends, liquidation or sale proceeds, merger or acquisition consideration, or other consideration distributed to the economic owners of the reorganized debtor.
  - The prepetition unsecured creditors as a class receive 100 percent of a class of preferred stock, similar preferred interests, or payment obligations issued by the reorganized debtor on the effective date in accordance with the chapter 11 plan with the following features (referred to as the “*creditors’ preferred interests*”): (i) *pro rata* voting rights, limited to voting only on the extraordinary transactions identified in these principles; and (ii) entitlement as a class to receive 85 percent of any economic distributions from the reorganized debtor, including dividends, liquidation or sale proceeds, merger or acquisition consideration, or other consideration distributed to the economic owners of the reorganized debtor.
  - The creditors’ preferred interests mature on the fourth anniversary of the effective date, at which time the interests should convert into 85 percent of the common stock, or similar ownership interests, of the reorganized debtor, unless redeemed in cash on or before the maturity date for their full face amount. The face amount of the

creditors' preferred interests should equal the amount of the allowed unsecured claims held by those creditors receiving the creditors' preferred interests and established under the plan or confirmation order. Any cash or other distributions received by the holders of the creditors' preferred interests (whether under the plan on account of their unsecured claims or on account of the creditors' preferred interests) prior to the maturity date should reduce the redemption or conversion value of such interests.

- The following kinds of post-effective date transactions are deemed “*extraordinary transactions*” subject to the vote of holders of creditors' preferred interests: (i) any change to the compensation of, or payments to, insiders of the reorganized debtor as set forth in the chapter 11 plan, including any compensation or payments to or for the benefit of relatives or affiliates of such insiders; (ii) dividends or other distributions of value to equity security holders of the reorganized debtor; (iii) decisions to forego or roll over any dividends or other distributions of value required to be paid under the organizational documents on account of the economic ownership interests held by holders of creditors' preferred interests; (iv) the sale of all or substantially all of the assets of the reorganized debtor, dissolution of the reorganized debtor, or merger of the reorganized debtor with or its acquisition of another entity; and (v) any amendments to the organizational documents that would modify, alter, or otherwise affect the rights of holders of creditors' preferred interests. An extraordinary transaction should require at least an absolute majority vote of the holders of creditors' preferred interest, but the chapter 11 plan may require a higher level of approval. Whether an extraordinary transaction has been approved by the requisite majority vote (or such higher level as required by the plan) should be determined in accordance with applicable state entity governance law.
- The consummation of an extraordinary transaction without the requisite approval should constitute a default under the chapter 11 plan, and holders of creditors' preferred interests should have the ability to request appropriate relief for such breach from the court that confirmed the plan. In addition, upon any such default, the creditors' preferred interests should be entitled to a liquidation preference over the common stock in the full face amount of the creditors' preferred interests, reduced by any cash or other distributions received by the holders of the creditors' preferred interests (whether under the plan on account of their unsecured claims or on account of the creditors' preferred interests) prior to liquidation.
- The general recommended principles proposed in the Report for chapter 11 plans apply to SME cases, unless the principles expressly exclude SME cases or would otherwise conflict with the SME principles.

The Commission's deliberations and reasoning as to each of these reforms was as follows:

## *Definition of SME*

The utility of chapter 11 for smaller companies is not a new concern. Shortly after the enactment of the Bankruptcy Code, commentators raised concerns regarding the ability of smaller debtors to confirm chapter 11 plans. Congress attempted to address these concerns in 1994 by introducing a small business election provision in chapter 11. The 1994 amendments defined “small business” as “a person engaged in commercial or business activities (but does not include a person whose primary activity is the business of owning or operating real property and activities incidental thereto) whose aggregate noncontingent liquidated secured and unsecured debts as of the date of the petition do not exceed \$2,000,000.” A person qualifying as a small business could elect themselves into a fast-track chapter 11 plan process that allowed the court, among other things, to conditionally approve the debtor’s disclosure statement and to combine the hearing on the adequacy of the disclosure statement and the approval of the plan. The amendments also allowed the court to order that a committee of unsecured creditors not be appointed in a small business case.

Congress further amended the small business provisions of chapter 11 in 2005 in response, at least in part, to the ongoing issues with small business cases identified by the National Bankruptcy Review Commission’s (the “*NBRC*”) study and report (the “*NBRC report*”). The NBRC report concluded that small business debtors fell into two categories: (i) a small number with a reasonable likelihood of reorganizing and succeeding as a going concern; and (ii) a larger number with no reasonable prospect of rehabilitation. The NBRC suggested that reform focus on increasing the likelihood of success for those debtors who might succeed and reducing the amount of time a likely-to-fail debtor spends in chapter 11.

The NBRC report concentrated to some extent on those small business debtors that were unlikely to rehabilitate. The NBRC report indicated that small businesses benefited from the protections of chapter 11 — the automatic stay, retention of control of the business, ability to delay payments to creditors, and ability to delay formulating a chapter 11 plan — while administrative costs increased, even though there was no realistic prospect of rehabilitation. Chapter 11 arguably only prolonged these debtors’ imminent demise and reduced recoveries for creditors. The NBRC proposed reforms to address these likely-to-fail debtors and to try to reduce overall cost and delay for small business debtors. These changes included establishing presumptive plan filing and plan confirmation deadlines, additional postpetition documentation requirements, more reporting, and changes to the burden of proof for small business debtors. In adopting these provisions, Congress also removed the elective nature of the small business provisions and amended the definition of the “small business debtor” that would be subject to these mandatory provisions.

At that time, some commentators testified before the NBRC that the reduced deadlines would provide too little time and shifting the burden of proof would be too onerous, and that these provisions would deprive debtors of a fair opportunity to reorganize in chapter 11. Others commented that the system was working relatively well and that bankruptcy judges were doing a good job of filtering failing firms from viable ones. Unfortunately, time has proven those commentators right to some extent. Witnesses before the Commission generally testified that chapter 11 is not working for small and middle-market debtors, and several of these witnesses suggested that certain of the deadlines imposed by the BAPCPA amendments were particularly challenging and counterproductive for small business debtors.

Moreover, several witnesses and commentators have observed an increasing use of state and federal law insolvency alternatives by small and middle-market enterprises in lieu of a chapter 11 filing. These alternatives include state and federal receiverships and assignments for the benefit of creditors (“*ABCs*”) under state law.



In a receivership, a person — the receiver — is appointed by a court to take property into custody and preserve it; receiverships are often used as a method for liquidating entire businesses. Commentators argue that receiverships are attractive for several reasons: Receivers may be granted powers that are broader and more flexible than those under the Bankruptcy Code; nonbankruptcy courts are able to use summary remedies to allow, disallow, and subordinate the claims of creditors which promotes judicial efficiency and reduces litigation costs; lack of certainty in chapter 11 due to divergent case law; and lastly, receiverships are less time-consuming and costly than chapter 11 to liquidate property. Receivership has traditionally been considered an extraordinary remedy and may only be available in specific circumstances, particularly when statutory authority for the receivership is lacking.

An ABC involves a consensual transfer of assets by the debtor to an assignee who holds them in trust for the benefit of creditors. ABCs are a function of state law, with many states requiring court supervision of the ABC and with other states not requiring such oversight. The law governing ABCs, like the law covering receiverships, is often a mixture of common law and statutory law and varies significantly by state.

These state law alternatives are subpar remedies in many circumstances and present their own problems. For example, some debate a receiver's ability to sell property free and clear of liens without the consent of all lienholders. Case law is inconsistent as well. In an ABC, any nonconsenting creditors are not bound by any conditions contained in the assignment and the ABC does not displace even the consenting creditors' original claims, unless there is a release. And even though these nonbankruptcy procedures are generally faster and cheaper, they are also more private and generally less transparent. This may hide insider self-dealing or preferential treatment of certain creditors. Nevertheless, the prevailing perception that chapter 11 no longer works for small and middle-market enterprises has forced many companies to consider these alternatives.

The Commission reviewed the history of the small business debtor provisions and the various proposals to address small business chapter 11 issues that have been proposed in the past, including the NBRC report discussed above and proposals by the Honorable A. Thomas Small of the U.S. Bankruptcy Court for the Eastern District of North Carolina and the American Bar Association's Select Advisory Committee on Business Reorganizations. It also considered empirical data, including thoughtful studies by Professor Anne Lawton and Professor Edward Morrison, and the industry and academic literature analyzing the financial distress of, and restructuring options for, small and middle-market enterprises. Finally, the Commission was aided in its deliberations by witness testimony.

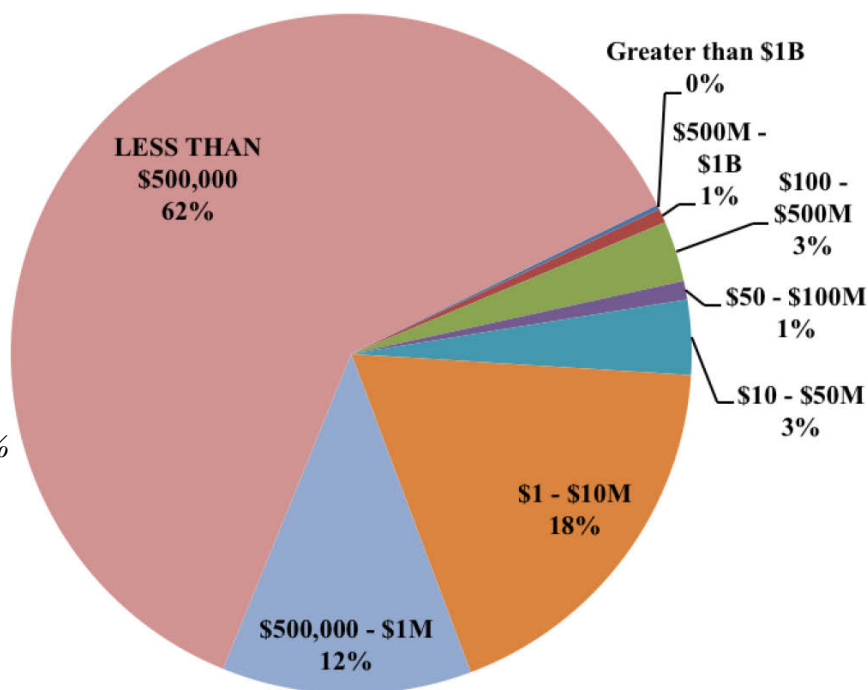
The first question raised by the Commissioners concerned the need for, and the value of, separate chapter 11 provisions for different types of debtors. The Commissioners discussed the very large — or “mega” — chapter 11 cases that often dominated the media headlines. These cases certainly would benefit from the general reform principles proposed by the Commission, but the Commission did not believe that targeted chapter 11 provisions would further assist these debtors. The Commissioners also observed the relatively small number of mega cases filed on an annual basis and that many jurisdictions had adopted special local rules to address certain administrative and procedural issues that commonly arise in those cases.

The Commissioners did not generally believe, however, that a “one-size-fits-all” approach to chapter 11 is the best approach. In addition to the mega cases, the Commissioners found that the general reform principles being proposed identified and responded to key issues for the more established, upper-middle-market and larger company cases. These cases often struggled with liquidity early in the process, timing issues surrounding their exit strategy and value allocation, and case-specific investigations, litigation, or negotiations. These debtors also typically benefit from the advice and counsel of restructuring professionals and have more experienced management teams.

On the other hand, the Commissioners identified significant and troubling issues for small and lower-to-middle-market enterprises. (These principles refer to these companies as “small and medium-sized enterprises (SMEs).”) In working to develop the parameters of companies in this space, the Commissioners discussed companies that have less experienced management teams, relatively smaller pools of assets and liabilities, relatively smaller revenue streams, challenges with understanding the nature of their financial issues or the potential tools available to help them address those issues, and vested equity owners who likely either founded the company or help manage the company. The Commissioners also stressed the importance of these companies possessing viable business models, recognizing that chapter 11 should not be used to delay the inevitable failure of a company. The Commissioners firmly believed, however, that many of these SMEs were failing not because of fatally flawed business models, but because they were not receiving the assistance they needed in the context of a financial restructuring. This belief has been supported by witness testimony and some of the related literature.

To assess the types of companies within the SME category, the Commission reviewed historical data regarding the types of companies filing for bankruptcy. The Commissioners analyzed data prepared from a database of all business bankruptcy filings (both chapter 7 and chapter 11) maintained by New Generation Research. This data included annual revenue for all but 670 of the 11,261 businesses that filed for chapter 7 or chapter 11 bankruptcy in 2013. This revenue data break down as follows:<sup>5</sup>

### Revenue of Debtors Filing for Bankruptcy in 2013



*Note:*  
Based on the New Generation data, 74% of companies that filed bankruptcies in 2013 had revenue below \$1 million. In addition, based on this same dataset, 90% of the companies that filed bankruptcy in 2013 had 50 or fewer employees.

<sup>5</sup> This chart was prepared for the Commission based on data from the New Generation’s Business Bankruptcy Filing Database. Accordingly, it was limited to public and large private companies.

The Commissioners found the revenue and employee information very informative, but they acknowledged that these data points were not readily available on the petition date for any particular debtor. Accordingly, using these measures to define SMEs would be administratively difficult and, although feasible prospectively, such measures would not have the benefit of precedent in terms of interpretation and scope.

The Commissioners then reviewed data points more readily available for chapter 11 debtors: assets and liabilities. All debtors list these data points in a general manner in the bankruptcy petition and in a more specific manner in the schedules of assets and liabilities. Although also subject to definitional and interpretational issues, courts and practitioners have dealt with these concepts since the inception of the Bankruptcy Code and are more familiar with their application. The Commission asked Professor Anne Lawton to prepare several analyses of chapter 11 debtors' assets and liabilities based on the datasets she built for chapter 11 filings in 2004 and 2007. The data in Professor Lawton's dataset are taken from a random sample drawn from the population of chapter 11 cases filed in calendar year 2007. The population includes all chapter 11 cases filed in each of the 94 judicial districts in the United States. *Individual and business filers* alike are included, as are both voluntary and involuntary cases. The asset and liability data are summarized in the following charts:

<b>Debtors' Assets Based On Schedules</b>			
<b>Asset Ranges</b>	<b>Number of Cases</b>	<b>Percent of Total Number of Cases</b>	<b>Cumulative Percent of Cases</b>
\$0 – \$ 100,000	111	17.4%	17.4%
\$100,001 – \$500,000	119	18.6%	36.0%
\$500,001 – \$1 million	91	14.2%	50.2%
\$1,000,001 – \$2.19 million	117	18.3%	68.5%
\$2,190,001 – \$5 million	99	15.5%	84.0%
\$5,000,001 – \$10 million	47	7.4%	91.4%
\$10,000,001 – \$50 million	44	6.9%	98.3%
\$50,000,001 – \$100 million	4	0.6%	98.9%
Over \$100 million	7	1.1%	100%
<b>Total</b>	<b>639</b>	<b>100%</b>	

<b>Debtors' Liabilities Based On Schedules</b>			
<b>Liability Ranges</b>	<b>Number of Cases</b>	<b>Percent of Total Number of Cases</b>	<b>Cumulative Percent of Cases</b>
\$0 – \$100,000	34	5.3%	5.3%
\$100,001 – \$500,000	111	17.3%	22.6%
\$500,001 – \$1 million	80	12.5%	35.1%
\$1,000,001 – \$2.19 million	149	23.2%	58.3%
\$2,190,001 – \$5 million	126	19.7%	78.0%

\$5,000,001 – \$10 million	56	8.7%	86.7%
\$10,000,001 – \$50 million	66	10.3%	97.0%
\$50,000,001 – \$100 million	8	1.2%	98.3%
Over \$100 million	11	1.7%	100%
<b>Total</b>	<b>641</b>	<b>100%</b>	

The Commissioners carefully analyzed Professor Lawton’s data and discussed its implications. They observed a natural breaking point in the data at the \$10 million threshold.<sup>6</sup> They examined the types of companies that might be captured by a definition that included companies with \$10 million or less in assets or liabilities. They considered this question based on industry and geographic region, methodically walking through the different companies that could be captured by such a definition. Through this analysis, the Commissioners agreed that public companies (*i.e.*, those with publicly issued debt or equity securities) should be excluded from any SME designation in all instances. Moreover, at the end of these deliberations, the Commissioners determined that the \$10 million or less in assets or liabilities standard corresponded with the characteristics identified above of SMEs that are not being well served by current law.

The Commissioners recognized that this standard would capture around 85 percent to 90 percent of the chapter 11 filings, at least based on Professor Lawton’s datasets and adjustments to exclude *individual* chapter 11 filings (the overwhelming majority of which fall under the \$10 million threshold) and any small *public* companies.<sup>7</sup> As previously noted, the Commission did not consider reform proposals for individual chapter 11 debtors, and it did not intend individuals to be covered by the recommended principles for SME debtors.

The Commissioners also discussed whether to include any of the factors or qualifications in the current definition of small business debtor. The Commission rejected making the definition overcomplicated and, as such, declined to require liabilities to be “noncontingent” or “liquidated,” for example. It also agreed that a debtor should be able to qualify as an SME based on either assets or liabilities. Nevertheless, the Commission determined that the asset and liability calculations should be performed on a consolidated basis with any affiliates to ensure that smaller businesses within a larger, more complex corporate family were excluded. It further concluded that single asset real estate cases should be excluded from the definition of SME, but that such determinations should be based solely on the single asset real estate definition in section 101(51B) of the Bankruptcy Code.<sup>8</sup>

Several Commissioners raised two related points: (i) nonpublic companies that do not qualify under this standard based solely on an asset or liability basis may have a very simple business and capital structure that could benefit from the tools and process proposed for small and middle-market enterprises, but (ii) a standard that allowed larger nonpublic companies to qualify for the process also could capture companies with very complex business and capital structures that need

<sup>6</sup> Professor Lawton’s 2004 dataset suggests that for *all* chapter 11 filings, 91.6 percent of the debtors had assets (based on schedules) of \$10 million or less, and 88.2 percent had liabilities (based on schedules) of \$10 million or less.

<sup>7</sup> For example, in the 2007 dataset, Professor Lawton was able to identify 171 individual chapter 11 filings with liabilities of \$10 million or less. Removing these individual filers (and the four individual filers with more than \$10 million in liabilities) from the dataset reduced the percentage of business chapter 11 filings with \$10 million or less in liabilities (based on schedules) to 83 percent. Similarly, in the 2004 dataset, the percentage of business chapter 11 filings with \$10 million or less in liabilities (based on schedules) drops to 86 percent.

<sup>8</sup> The Commissioners did not recommend maintaining the current qualifier in the definition of “small business debtor” in section 101(51D) that the debtor be involved in “commercial or business activities (including any affiliate of such person that is also a debtor under this title and *excluding a person whose primary activity is the business of owning or operating real property or activities incidental thereto*).” 11 U.S.C. § 101(51D) (emphasis added).

to filter through the general chapter 11 process. The Commissioners acknowledged the validity of both scenarios and examined alternatives to appropriately address each. The Commission agreed that nonpublic companies with assets or liabilities in excess of \$10 million but less than \$50 million should be able to request to be treated as an SME, but that the U.S. Trustee and parties in interest should have the ability to challenge the designation. The Commission also agreed that the court should only grant the request if it is in the best interests of the estate.

The Commissioners used this definition of SMEs and the underlying objectives to develop a comprehensive set of principles to guide and facilitate more effective chapter 11 cases for SMEs. Accordingly, the Commission voted to recommend the adoption of the SME principles and the deletion of the small business debtor and small business case provisions from the Bankruptcy Code.

### ***General Application to SME's***

As noted above, Congress introduced the small business provisions into the Bankruptcy Code as an elective process. Debtors who satisfied the original definition of “small business” could elect to proceed with the fast-track plan confirmation procedures. Congress removed the elective nature of the small business provisions in 2005 pursuant to the BAPCPA Amendments. The current provisions mandate small business treatment if, among other things, the debtor has less than \$2,190,000 in total secured and unsecured debts and there is no active unsecured creditors’ committee in the case.

Although the current small business provisions are mandatory and self-executing, several commentators have suggested that small business debtors are not self-reporting and may not be proceeding as small business cases. For example, Professor Robert Lawless observed that “there were 2,299 chapter 11s filed in 2007 where (i) the debtor was not an individual, (ii) [the debtor] said they had predominately business debts, and (iii) the total liabilities were between \$50,000 and \$1,000,000. Because very few small chapter 11 cases have unsecured creditors’ committees, almost every one of these 2,299 cases should have identified as small business debtor, but only 36.8 percent did so.” Now, the failure to self-identify as a small business debtor may be an oversight, it may be the result of the somewhat complicated definition of “small business debtor” described above, or it may be a desire to avoid the obligations and deadlines imposed on small business debtors under current law. Regardless of the reason, however, the consequences can be significant, including a determination that the small business debtor deadlines apply from the petition date, even if the non-designation is not corrected or is not deemed incorrect by the court until much later in the case.

The three primary objectives underlying the Commission’s approach to the SME principles were (i) simplifying the process; (ii) reducing costs and barriers; and (iii) providing tools to facilitate effective reorganizations for viable companies. With these objectives in mind, the Commission determined that a hybrid approach to the application of the SME principles would work best. Accordingly, if the debtor is a nonpublic company that satisfies the asset or liability standard, it automatically invokes the SME principles. If the debtor is a nonpublic company that does not qualify, but it has assets or liabilities less than \$50 million and believes that the SME principles would better serve its estate and stakeholders, it can make a request to be treated as an SME debtor.

The Commissioners were mindful that some companies might try to manipulate the standard or self-identify as an SME when the standard is not satisfied, but they believed that those concerns are appropriately addressed by allowing the U.S. Trustee and parties in interest to object to the designation in the petition or a debtor’s request to be treated as an SME. In both instances, however, the Commissioners understood the importance of these matters being resolved quickly to allow the debtor either the full benefit of the SME principles or appropriate time to consider proceeding under the general chapter 11 principles. They believed that any delay in these

determinations could significantly prejudice both the debtor and its stakeholders. The Commission also considered whether debtors would fail to self-report, as some commentators have suggested might be the case under the current law. Again, the Commissioners recognized that this was a possibility, but it believed that the SME principles incorporated appropriate incentives for the debtor and its estate so as to mitigate that risk.

### *Oversight of SME Cases*

As discussed above, the debtor in possession model used in chapter 11 cases makes oversight of the case particularly important. In most cases, the Bankruptcy Code establishes the U.S. Trustee and the committee of unsecured creditors as the statutory watchdogs in the case. Both of these parties have the ability to oversee and investigate certain aspects of the case and to appear and be heard with respect to matters pending in the case. (In addition, other creditors and equity security holders have standing to appear and be heard in the case under section 1109 of the Bankruptcy Code.) Nevertheless, in many SME cases, the U.S. Trustee may not be able to appoint a committee of unsecured creditors typically because of a lack of creditor interest in serving on the committee.

The lack of creditor engagement was one reason cited by Congress in using the absence of a committee as a defining feature of a small business case. The legislative history of the BAPCPA Amendments explains:

Most chapter 11 cases are filed by small business debtors. Although the Bankruptcy Code envisions that creditors should play a major role in the oversight of chapter 11 cases, this often does not occur with respect to small business debtors. The main reason is that creditors in these smaller cases do not have claims large enough to warrant the time and money to participate actively in these cases.

If an unsecured creditors' committee is not appointed in the small business debtor case, the debtor may drift in its case, achieving little, or it may cede to the desires of its secured creditors, even if those objectives do not align with the best interests of the estate. Accordingly, although the absence of a committee or creditor engagement may correspond to the size of the debtor or the complexity of the case, it does not mean that the debtor does not need oversight or assistance in the case.

The Commission viewed the administrative and oversight functions in an SME case as critical to the utility and effectiveness of the SME principles. The Commissioners wanted to develop principles that encouraged SMEs to file chapter 11 cases when appropriate, which meant reducing costs, simplifying disclosures and the process, and providing a way for the prepetition managers to stay in control of the business with some financial guidance and counseling when needed. These factors allowed the Commissioners to reflect on various alternatives for structuring the SME principles, including a chapter 13-like process for SMEs.

Some Commissioners suggested that the best oversight for SME cases was a standing trustee system similar to that used in the chapter 13 context. In chapter 13 cases, the U.S. Trustee appoints a standing trustee in each jurisdiction. The trustee represents the estate, and he or she oversees the administration of the case, including the confirmation of, and distributions under, the debtor's rehabilitation plan. The trustee does not represent the debtor, but he or she may consult with the debtor, including with respect to issues in the proposed rehabilitation plan. A few Commissioners even suggested either raising the chapter 13 debt limits to permit small businesses to file under chapter 13 or incorporating a more chapter 13-like process into chapter 11 for small businesses.

Most Commissioners strongly rejected the notion of either a standing trustee for SMEs or a chapter 13-like process for SME cases. These Commissioners noted that small business cases are not simply big chapter 13 cases. They highlighted the structural differences in business cases, including the debtor's contractual relationships with vendors and suppliers and its obligations to customers. SMEs also have employees to consider and operational issues that may complicate their restructuring

alternatives. Finally, these Commissioners highlighted the likely reluctance of SMEs to file bankruptcy cases if the administration of their cases and perhaps their businesses would be turned over to a standing trustee.

The Commissioners then considered whether the traditional unsecured creditors' committee structure was an effective oversight mechanism for SME cases. They reflected on the witness testimony concerning the costs associated with unsecured creditors' committees, particularly in smaller cases. They also noted the creditor apathy that might prevent the formation of a committee in the first instance in SME cases. Most Commissioners agreed that committees could be effective in SME cases if creditors were engaged and representative of the general unsecured creditor body, and if costs could be contained. They also agreed, however, that satisfying both of these criteria in an SME case was likely the exception rather than the rule.

The Commissioners analyzed whether an estate neutral might provide appropriate oversight in SME cases when a committee was not appointed and when the SME debtor needed monitoring or assistance. They reviewed the witness testimony on the types of tools that witnesses believed would be helpful to SME debtors. For example, the Honorable Barbara J. Houser of the U.S. Bankruptcy Court for the Northern District of Texas suggested that "a third party who is more of a financial person, who could come in and evaluate the viability of the business," may be of assistance to both the court and the debtor in possession in assessing the debtor's prospects for reorganization. Several Commissioners observed that the estate-neutral concept might apply particularly well in SME cases. The court could appoint an estate neutral for specific purposes, including a financial review of the debtor, consulting with the debtor concerning its finances and restructuring options, or investigating the debtor's affairs when necessary or appropriate. The estate neutral, with court authority, also could assist the SME debtor in developing its chapter 11 plan, which would provide oversight of the debtor in possession and a counterbalance to any particular individual creditor influence in the case. Although the estate neutral would impose an additional cost on the estate, the Commissioners believed that the courts could and should closely monitor the fees and expenses of the estate neutral and could even use caps or budgets to protect the estate.

On balance, the Commission voted to recommend the use of estate neutrals to assist SME debtors achieve effective outcomes in appropriate cases. The Commissioners underscored the case-by-case nature of this inquiry and, accordingly, declined to make it a mandatory appointment. They specifically found, however, that if the court orders the appointment of an estate neutral, the U.S. Trustee should be the party responsible for the appointment of the neutral to ensure objectivity and fairness in the process. The Commission also determined that the U.S. Trustee and parties in interest should be able to request the appointment of a committee in an SME case. As noted above, if there is creditor interest, a committee may be very valuable in an SME case. Nevertheless, the Commissioners found no basis for the existence (or non-existence) of a committee to affect an SME designation. They also believed that the cost of, and the historical issues with, appointing a committee in smaller cases supported a default rule of no committee appointment.

### ***Plan Timeline in SME Cases***

The Bankruptcy Code, as amended in 2005, requires that a debtor's chapter 11 plan be confirmed within 45 days of its filing. Several witnesses before the Commission testified that this is nearly impossible for small business debtors to achieve. Although it is possible to obtain a continuance, one witness noted that the burden for doing so is quite high, and that there is confusion regarding what the court must find and how it must make the necessary determinations, given the tight timelines and significant requirements. Thus, practically speaking, even viable small business debtors face considerable challenges to confirming a plan.

The Bankruptcy Code also provides that a small business debtor *must* file the chapter 11 plan within 300 days of the petition date. One witness noted that the 300-day deadline creates interpretive and practical problems similar to those identified above for the 45-day deadline, plus

gives rise to additional concerns. For example, confusion exists regarding the application of the provision to parties other than the debtor, and the Bankruptcy Code does not specify the effect of an amended plan. The Bankruptcy Code also does not address the consequences for failure to submit a plan by the 300-day deadline.

The Commissioners debated the utility of firm deadlines in the context of SME cases. They understood the need to assess the viability of a debtor earlier rather than later in the case; no party benefits from prolonging a dismissal and incurring additional costs and expenses that cannot be paid. They also discussed the danger of handcuffing debtors to artificial deadlines that might not facilitate the debtor's reorganization or serve the interests of the estate in the particular case.

The Commission reviewed the recommendations of the advisory committee, which focused on helping both viable and nonviable debtors reach their fate efficiently. The advisory committee's recommendations included simplifying the definition of "small business debtor," and eliminating the 300-day plan proposal and 45-day plan confirmation deadlines for small business cases. The Commission also considered reforms suggested by witnesses, including more discretion for bankruptcy judges concerning the procedures in small business cases, and additional clarification regarding the standard of review and procedural requirements if the current 45- and 300-day confirmation and plan deadlines remain in place.

The Commissioners worked to develop a process striking an appropriate balance between the need to assess the viability of an SME debtor case early while still allowing viable SME cases a reasonable opportunity to succeed. The Commission voted to recommend a mandatory requirement that the SME debtor file a timeline for filing and soliciting acceptances of its chapter 11 plan within 60 days of the petition date. It set this deadline to allow time for the SME debtor to settle into the chapter 11 case, resolve any issues relating to its SME designation, and consult with any committee or estate neutral appointed in the case, but still allow the court time to develop deadlines for the filing and solicitation of a chapter 11 plan consistent with other provisions of the Bankruptcy Code, such as the debtor's exclusivity periods under section 1121. The Commission determined that section 105(d)(2)(B) adequately authorizes the court to establish these deadlines, and that the Bankruptcy Code should be amended to simply require the court to exercise this authority in SME cases.

### ***Plan Content and Confirmation in SME Cases***

Many commentators agree that chapter 11 is failing for small business debtors, but they disagree on both the cause and solution to this problem. As discussed above, some suggest that the deadlines concerning the plan process pose significant barriers. Others suggest that the plan process itself and the confirmation standards make emergence from chapter 11 almost impossible for small business debtors. Still, others have posited that reorganization is simply not feasible for small business debtors, benefits only the business owner, and that going concern sales may be a more effective restructuring option for these debtors.

The Commission received testimony from several witnesses arguing that the absolute priority rule and courts' disparate treatment of the new value corollary doom many small business debtors' plans. As Judge Houser explained:

So, where a small to mid-sized business debtor cannot pay its unsecured claims in full with a market rate of interest over the life of the plan (a common occurrence), the junior class of interest holders may not receive or retain any property under the plan "on account of" their former interests. This is because of the application of what we call the absolute priority rule. The application of this rule and the so-called "new value exception" to it in small to mid-size Chapter 11 cases proves problematic.

Witnesses suggested that this uncertainty in the plan process can cause delay and expense, and can even deter filings in the first instance.



A debtor's emergence from chapter 11 frequently turns on its ability to confirm a chapter 11 plan. Although it may consider a sale of all or substantially all of its assets under section 363 as an exit strategy, a debtor — particularly an SME who likely has founders or managers as part of its prepetition ownership structure — strives to reorganize and emerge from chapter 11 as a stronger and more efficient version of its prepetition business.

The Commission considered at length the interests of an SME's prepetition stakeholders and the challenges to confirmable plans for SME debtors. The Commissioners acknowledged that many SMEs are family-owned businesses or businesses in which the founders are still actively involved. For this reason, many SMEs find the common result of plan confirmation extinguishing prepetition equity interests in their entirety unsatisfactory or completely unworkable. The Commissioners discussed the tension created by these expectations: prepetition equity views their contributions and continued participation as necessary to the reorganization, but stakeholders may hold a very different perspective. Prepetition equity or managers may be considered part of the problem or ineffective.

The Commissioners debated how best to mitigate this tension and foster a meaningful reorganization process for SMEs. Most Commissioners agreed that the SME principles should include some option for prepetition equity security holders to retain or receive the equity of the reorganized debtor, beyond that currently permitted under the new value corollary. These Commissioners asserted that SMEs needed a reorganization path that encouraged founders and prepetition equity not only to invoke chapter 11, but also to devote all of their efforts to the debtor's successful reorganization. Indeed, for many SMEs — whether stakeholders like them or not — the prepetition founders or managers often possess the knowhow and relationships necessary to facilitate a successful restructuring of the business.

The Commissioners determined that the SME principles should create an equity retention option that would appropriately align the interests of prepetition management and equity with the debtor's reorganization and protect the interests of unsecured creditors, despite noncompliance with the traditional absolute priority rule. The basic elements of this structure include:

- A reorganized capital structure that (i) permits prepetition equity to retain or receive 100 percent of the voting interests in the reorganized debtor, subject to the limited voting rights of the creditors' preferred interests, and no more than 15 percent of the economic ownership interests in the reorganized debtor (akin to common stock ownership with limited economic rights); and (ii) grants preferred ownership interests to general unsecured creditors that include limited voting rights on extraordinary transactions and at least 85 percent of the economic ownership interests in the reorganized debtor (creditors' preferred interests).
- A provision in the plan that directs the reorganized debtor to pay to the holders of unsecured claims, no less often than annually, its excess cash flow calculated in a manner reasonable in relation to the company's operating cash flow for each of the three full fiscal years following the effective date of the chapter 11 plan. This provision is intended to provide cash dividends to unsecured creditors prior to maturity of the preferred interests and to fairly allocate the reorganized debtor's excess cash to claims impaired by the chapter 11 plan.
- The creditors' preferred interests mature on the fourth anniversary of the effective date of the chapter 11 plan, at which time the interests should convert into 85 percent of the common stock, or similar ownership interests, of the reorganized debtor, unless redeemed in cash on or before the maturity date for their full face amount. The face amount of the creditors' preferred interests

should equal the amount of the allowed unsecured claims held by those creditors receiving the creditors' preferred interests and established under the plan or confirmation order. Any cash or other distributions received by the holders of the creditors' preferred interests (whether under the plan on account of their unsecured claims or on account of the creditors' preferred interests) prior to the maturity date should reduce the redemption or conversion value of such interests.

- The holders of creditors' preferred interests are entitled to vote on any and all of the following extraordinary transactions: (i) any change to the compensation of, or payments to, insiders of the reorganized debtor as set forth in the chapter 11 plan, including any compensation or payments to or for the benefit of relatives or affiliates of such insiders; (ii) dividends or other distributions of value to equity security holders of the reorganized debtor; (iii) decisions to forego or roll over any dividends or other distributions of value required to be paid under the organizational documents on account of the economic ownership interests held by holders of creditors' preferred interests; (iv) sale of all or substantially all of the assets of the reorganized debtor, dissolution of the reorganized debtor, or merger of the reorganized debtor with or its acquisition of another entity; and (v) any amendments to the organizational documents that would modify, alter, or otherwise affect the rights of holders of creditors' preferred interests. This provision is intended to protect the value of, and entitlement to, the cash, creditors' preferred interests, and other distributions allocated to unsecured creditors under the plan from diminution or impairment by the postconfirmation actions of common interest-holders, managers, or insiders. The failure to adhere to the voting or other rights granted to holders of creditors' preferred interests under or in connection with the plan constitutes a default under the plan that may be enforced in the bankruptcy court. In addition, upon any such default, the creditors' preferred interests should be entitled to a liquidation preference over the common stock in the full face amount of the creditors' preferred interests, reduced by any cash or other distributions received by the holders of the creditors' preferred interests (whether under the plan on account of their unsecured claims or on account of the creditors' preferred interests) prior to liquidation.
- Finally, the prepetition equity must commit to support the plan, the debtor's emergence from chapter 11, and its postconfirmation operations.

The Commission voted to recommend an equity-retention plan structure option built on these basic elements. It believed that such a structure will provide appropriate incentives and protections, basically giving prepetition equity security holders four years after confirmation to repay the business's prepetition unsecured creditors. If the prepetition equity security holders are not able to achieve this result in that time period, then the unsecured creditors may convert their preferred interests into common ownership interests, significantly diluting the common ownership held by the prepetition equity security holders. Under this structure, both prepetition equity security holders and unsecured creditors have incentives to foster a sustainable and profitable reorganized business. Critically, this option is a default mechanism; it will only be necessary if the constituencies involved do not negotiate a different deal. As with the current "cramdown" option, a deal will usually be reached and resort to the default mechanism will be rare.

Finally, the Commissioners recommended other modifications to the section 1129(a) confirmation standards, including a mandatory bifurcation of undersecured creditors' claims so that only the allowed secured claim of such creditor would be subject to the cramdown requirements of section 1129(b)(2)(A), and its unsecured deficiency claim would

be subject to the treatment provided general unsecured creditors. In addition, certain other modifications proposed by these principles to plan confirmation requirements for all chapter 11 cases would apply to SME cases, such as the elimination of an accepting impaired class of creditors under section 1129(a)(10).

### Conclusion

I thank the Subcommittee for holding this hearing today, and for taking this critical first step in considering the Commission's Report. We look forward to working with Congress to bring to fruition these carefully considered and valuable reforms to the Bankruptcy Code.

## A BILL

To amend the Bankruptcy Code to establish a separate chapter to reorganize small and medium-sized enterprises, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*  
2 *tives of the United States of America in Congress assembled,*

3 **SECTION 1. SHORT TITLE; TABLE OF CONTENTS.**

4 (a) **SHORT TITLE.**—This Act may be cited as the Small and Medium-Sized Enterprise  
5 Bankruptcy Amendments Act.

6 (b) **TABLE OF CONTENTS.**—The table of contents of  
7 this Act is as follows:

[to be inserted]

1 **SEC. 2. EFFECTIVE DATE.**

2 (a) **IN GENERAL.**—This Act shall take effect on the date of the enactment  
4 of this Act with respect to cases filed under chapter 10 of title 11, United  
5 States Code, on or after the date of enactment of this Act.

6 **SEC. 3. Establishment of Chapter 10 of the Bankruptcy Code.**

7 Title 11, United States Code, is amended by inserting after chapter 9 and before chapter 11  
the following new chapter:

8 Chapter 10—Small and Medium-Sized Enterprise Reorganization

9 **SUBCHAPTER I—General Provisions**

10 **§ 1001. Applicability of other sections of this title**

(a) Except to the extent provided in subsection (b), subchapters I, II, and III of chapter 11  
apply in a case under this chapter.

(b) Sections 1102, 1111(b), and 1129(a)(7)(B) do not apply under this chapter.

11 **§ 1002. Definitions for this chapter**

In this chapter—

- (1) The term “small or medium-sized enterprise” means a business debtor with—
  - (A)(i) no publicly traded securities in its capital structure or in the capital structure of any affiliated debtors whose cases are jointly administered with the debtor’s case; and
  - (ii) except as provided in subparagraph (C), less than \$10 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates as of the date of the filing of the petition; but
  - (B) excluding a business debtor that owns or operates “single asset real estate” as defined by section 101(51B) of this title; or
  - (C) more than \$10 million but less than \$50 million in assets or liabilities on a consolidated basis with any debtor or nondebtor affiliates, which meets the requirements of subparagraph (A)(i) and has obtained a court order granting a motion by the debtor seeking to be treated as a small or medium-sized enterprise under this chapter.
- (2) The term “creditors’ preferred interests” means preferred stock, similar preferred interests, or other payment obligations issued by the reorganized debtor with the following features: (i) *pro rata* voting rights, limited to voting only on extraordinary transactions; and (ii) entitlement as a class to receive 85 percent of any economic distributions from the reorganized debtor, including dividends, liquidation or sale proceeds, merger or acquisition consideration, or other consideration distributed to any of the economic owners of the reorganized debtor. (3) The term “extraordinary transactions” means any of the following post-effective date transactions: (i) any change to the compensation of, or payments to, insiders of the reorganized debtor as set forth in the chapter 10 plan, including any compensation or payments to or for the benefit of relatives or affiliates of such insiders; (ii) dividends or other distributions of value to equity security holders of the reorganized debtor; (iii) decisions to forgo or roll over any dividends or other distributions of value required to be paid under the organizational documents on account of the economic ownership interests held by holders of creditors’ preferred interests; (iv) sale of all or substantially all of the assets of the reorganized debtor, dissolution or winding-up of the reorganized debtor, or merger of the reorganized debtor with or its acquisition of another entity; and (v) any amendments to the organizational documents that would modify, alter, or otherwise affect the rights of holders of creditors’ preferred interests.

## **SUBCHAPTER II—Officers and Administration**

### **§ 1021. Petition and proceedings related to petition**

- (a) (1) A debtor purporting to qualify as a small or medium-sized enterprise under this chapter must file with its chapter 10 petition a balance sheet reflecting audited financial statements, or, if such statements are unavailable, a good faith estimate of its assets and liabilities as of the date of the filing of the petition.
- (2) If the debtor fails to file with its chapter 10 petition a balance sheet reflecting a good faith estimate of its assets and liabilities as of the date of the filing of the

petition, the court *sua sponte* may dismiss, or the United States trustee or a party in interest may file a motion to obtain as of right dismissal of, the chapter 10 case.

(3) On request of a party in interest, the court may order the debtor to turn over the valuation information package, subject to appropriate confidentiality restrictions.

- (b) The court *sua sponte*, the United States trustee, or a party in interest may object to the debtor's qualification as a small or medium-sized enterprise under this chapter, but only on the ground that the debtor does not in fact meet the definition. Such objection must be made by or filed with the court on or before 14 days after the date of the filing of the chapter 10 petition, and will be resolved on an expedited basis after notice and a hearing.
- (c) Pending resolution of an objection under subsection (b), the debtor will be treated for all purposes as a small or medium-sized enterprise under this chapter.

#### **§ 1022. Operation of the small or medium-sized enterprise**

- (a) Unless the court orders otherwise, or a trustee has been elected or appointed and is serving in the case, the debtor may operate the business of the debtor and, subject to any limitations on a trustee under sections 363(c) and 364 of this title and to such limitations or conditions as the court prescribes, shall have the rights and powers of the trustee under such sections.
- (b) A debtor operating its business shall perform the duties of the trustee specified in section 704(a)(8) of this title.

#### **§ 1023. Creditors' Committees**

Only on motion of the United States trustee or a creditor holding an unsecured claim, after notice and a hearing, may the court order the appointment of a creditors' committee, if and only if the court determines that such appointment is necessary to protect the interests of unsecured creditors in the case.

#### **§ 1024. Estate Neutral**

- (a) On motion of the United States trustee, the debtor, or a party in interest, after notice and a hearing, or acting *sua sponte*, the court may order the United States trustee to appoint an estate neutral that has the authority to advise the debtor in possession on operational and financial matters, as well as the content and negotiation of its plan.
- (b) An estate neutral appointed in accordance with subsection (a) represents the interests of the estate and has the capacity to sue and be sued on behalf of the estate.
- (c) The estate neutral will be compensated as a professional person in accordance with section 330 of this title with total compensation and reimbursement of expenses for such neutral not to exceed ten percent of the aggregate amount of creditor distributions.
- (d) The estate neutral lacks the capacity to retain professionals for itself or on behalf of the estate.

### **SUBCHAPTER III—The Plan**

#### **§ 1031. Soliciting Acceptances of the Plan**

- (a) Within 60 days after the entry of the order for relief, after consultation with any estate neutral or committee serving in the case, the debtor shall file with the court a timeline for filing the plan and disclosure statement and soliciting acceptances of the plan, and, to the extent applicable, any budget that describes the excess cash flow calculation method and includes projections of the debtor's excess cash flow for the three fiscal years following the anticipated effective date of the plan.
- (b) After the debtor files the timeline for filing and soliciting acceptances of its plan, the court shall promptly enter an order under section 105(d)(2) of this title setting the deadlines for the debtor to file a plan and disclosure statement, parties in interest to solicit acceptance or rejection of the plan, establishing a briefing schedule, and setting the time for the confirmation hearing.

**§ 1032. Confirmation of Plan**

**(a) Notwithstanding section 1129 of this title, the court shall confirm a plan that satisfies all of the requirements of section 1129 other than subsections (a)(8), (b)(1), and (b)(2)(B) if and only if—**

(1) The prepetition holders of the debtor's equity securities will continue to support the debtor's successful emergence from chapter 10 by remaining involved, on a basis reasonably comparable to their prepetition involvement, in the ongoing operations of the reorganized debtor; and the reorganized debtor will pay to the holders of allowed unsecured claims, no less often than annually, all of its excess cash flow calculated in a manner reasonable in relation to its operating cash flow for each of the three full fiscal years following the effective date of the plan;

(2) The prepetition holders of the debtor's equity securities will receive or retain 100 percent of the common stock, or similar ownership interests, issued or outstanding as of the effective date entitling the holders as a class to receive, while any creditors' preferred interests are outstanding, 15 percent of any economic distributions from the reorganized debtor, including dividends, liquidation or sale proceeds, merger or acquisition consideration, or other consideration distributed to the economic owners of the reorganized debtor;

(3) The holders of allowed unsecured claims as a class receive on the effective date of the plan 100 percent of a class of creditors' preferred interests;

(4) The creditors' preferred interests mature on the fourth anniversary of the effective date, at which time the interests will convert into 85 percent of the common stock, or similar ownership interests, of the reorganized debtor, unless the reorganized debtor exercises its right to redeem such preferred interests in cash on or before the maturity date for their full face amount, and

(A) The face amount of the creditors' preferred interests equals the amount of the allowed unsecured claims held by those creditors receiving the creditors' preferred interests and established under the plan or confirmation order; and (B) Any cash or other distributions received by the holders of the creditors' preferred interests (whether under the plan on account of their unsecured claims or on account of the creditors' preferred interests) before the maturity date will reduce the redemption or conversion value of such interests accordingly;

(5) Any extraordinary transactions will require at least an absolute majority vote of the holders of creditors' preferred interest, but the chapter 10 plan may require a higher level of approval. Whether an extraordinary transaction has been approved by the requisite majority vote (or such higher level as required by the plan) should be determined in accordance with applicable state entity governance law; and

(6) The consummation of any extraordinary transactions without the requisite approval will constitute a default under the chapter 10 plan, and holders of creditors' preferred interests will have the ability to request appropriate relief for such breach from the court that confirmed the plan. In addition, upon any such default, the creditors' preferred interests will be entitled to a liquidation preference over the common stock in the full face amount of the creditors' preferred interests, reduced by any cash or other distributions received by the holders of the creditors' preferred interests (whether under the plan on account of their unsecured claims or on account of the creditors' preferred interests) prior to liquidation.

#### **SEC. 4. Conforming Amendments.**

(a) Title 11, United States Code, is amended by deleting sections 101(51C) and (51D), 308, 362(n), 1102(a)(3), 1116, 1121(e), 1125(f), and 1129(e).

(b) Section 103 of title 11, United States Code, is amended by—

(i) inserting in subsection (a) “10,” after “7,”;

(ii) adding at the end the following new subsection: “(l) Chapter 10 of this title applies only in a case under such chapter.”

(c) Section 109 of title 11, United States Code, is amended by adding at the end the following new subsection: “(i) Only a small or medium-sized enterprise may be a debtor under chapter 10 of this title.”

(d) Section 365(d)(2), (g)(1), and (g)(2) of title 11, United States Code, are amended by inserting “10,” after “9,”.

(e) Section 502(g)(1) of title 11, United States Code, is amended by inserting “10,” after “9,”.