

Testimony of  
A. Thomas Small  
on behalf of the  
National Bankruptcy Conference  
before the  
Senate Judiciary Committee's Subcommittee on  
Administrative Oversight and the Courts  
111th Congress, 2nd Session  
on the subject of  
"Could Bankruptcy Reform Help Preserve Small Business Jobs"  
March 17, 2010

The National Bankruptcy Conference is grateful for the opportunity to participate in this hearing and to present its recommendation to expand chapter 12 to include small business enterprises. The National Bankruptcy Conference is a voluntary, non-profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and bankruptcy judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and on any proposed changes to those laws. Attached to this statement is a Fact Sheet about the Conference, including a list of its Conferees. Also attached is the Conference's proposal.

Today, many small businesses are in financial distress - and they need and deserve a fair and efficient vehicle to reorganize their capital structures. Unfortunately, the federal bankruptcy laws, as currently written, do not serve this purpose well. If a small business that is organized as a corporation, a limited liability company or a partnership wishes to avoid liquidation, it must use Chapter 11 of the Bankruptcy Code. However, Chapter 11 was designed for large companies, and works poorly, or not at all, for small businesses.

Recognizing this problem, the National Bankruptcy Conference has studied the current situation and now proposes an alternative, which is described in the attached "Proposal for Amending Chapter 12 to Accommodate Small Business Enterprises Seeking Reorganization." As we explain in the Proposal, Chapter 12 of the Bankruptcy Code - which is currently available to family farmers and family fishermen - provides a time-

tested, fair and effective means to reorganize businesses, which should be expanded to apply to small businesses.

Once again, thank you for inviting the National Bankruptcy Conference to testify at this important hearing. Allowing small business enterprises access to chapter 12 will not help all small businesses that are in financial distress, but it will provide many with a chance to survive and prosper, preserving going concern values for the benefit of creditors and saving jobs for their employees. The Conference would be happy to provide any additional information if the Committee would find it helpful. The Conference also would be pleased to formulate drafting proposals and assist in technical matters.

A. Thomas Small

United States Bankruptcy Judge – Retired  
Co-Chair Small Business Working Group  
National Bankruptcy Conference  
[tomsmall@nc.rr.com](mailto:tomsmall@nc.rr.com)

**A Proposal for Amending Chapter 12 to Accommodate  
Small Business Enterprises Seeking to Reorganize**

National Bankruptcy Conference

January 3, 2010

**Executive Summary**

Today's small businesses have few options when they suffer financial distress. If they want to avoid liquidation, and if they are organized as a partnership or corporation, they must use Chapter 11 of the Bankruptcy Code. But judges, attorneys, and academics have known for years that Chapter 11 works poorly or not at all for small businesses. This law was designed for large corporations with extensive operations and complex capital structures, not small enterprises that depend critically on the skills of a single owner-manager and family members. The model for Chapter 11 was the publicly-traded manufacturer, not the local diner. As a result, many distressed small businesses are forced to wind down using antiquated state-law procedures instead of Chapter 11. If they do enter Chapter 11, their cases are often dismissed or converted to liquidation. The few that do succeed at reorganizing find that 20 percent or more of their assets were consumed by the administrative costs of the bankruptcy process.

There is a simple solution to this problem, and it already exists in another chapter of the Bankruptcy Code: Chapter 12, which now offers a reorganization opportunity for family farmers and family fishermen. This chapter provides a time-tested, successful model for efficient reorganization of small businesses. We recommend making it available to small businesses generally. With appropriate modifications, outlined in our proposal below, Chapter 12 would fill a gap in the reorganization laws for small businesses, save a significant number of viable small businesses from liquidation, and lower the costs of business failure for both small businesses and their creditors.

Our proposal begins with a statistical profile of small business bankruptcy, documenting the ill-fitting match between existing Chapter 11 and the problems of most small businesses. We then propose Chapter 12 as the appropriate solution and show that few legislative changes would be required to make this Chapter accessible to small businesses. The appendix presents the statutory amendments that would be necessary.

## **I. Motivation: Chapter 11 is a poor fit for small businesses**

Bankruptcy judges, practitioners, and academics have known for decades that Chapter 11 works poorly or not at all for small businesses. There are many good reasons for this misfit. Fundamentally, Chapter 11 was conceived as a “big” business chapter with public companies as the model. Complex debt and asset structures arguably justify the SEC-style disclosures, multi-layered plans, voting and the like that characterize money-center Chapter 11 cases.<sup>1</sup> These same features make Chapter 11 too expensive, too complicated and too time consuming for small business debtors and their creditors.

Although a number of courts have fashioned local rules and practices that soften the unwelcoming aspects of Chapter 11,<sup>2</sup> they are limited to working with blunt tools, such as deadlines for submitting a plan and the threat of dismissal or conversion to Chapter 7. Some Local rules and practices have been counteracted by recent legislation (in 2005) that makes Chapter 11 less hospitable to small businesses by increasing disclosure requirements, compressing the time available, swamping cases with administration, and setting “drop dead” traps at every turn.<sup>3</sup>

---

<sup>1</sup>See, e.g., Hon. Leif M. Clark, *Chapter 11—Does One Size Fit All?*, 4 AM. BANKR. INST. L. REV. 167, 170-75 (1996).

<sup>2</sup>See Hon. A. Thomas Small, *Small Business Bankruptcy Cases*, 1 AM. BANKR. INST. L. REV. 305 (1993); Brian A. Blum, *The Goals and Process of Reorganizing Small Businesses in Bankruptcy*, 4 J. SMALL & EMERGING BUS. L. 181, 205-07 & nn.78-85 (2000) (“The initiative in dealing with [the small success rate of small businesses in Chapter 11] came from the courts. Beginning in the late 1980s, some judges began to use their discretionary power to create a system of case management under which they could quicken the pace of cases that were proceeding too slowly and could more rapidly dismiss, or convert to Chapter 7, cases that had poor prospects of successful rehabilitation. The best known of these methods came to be known as the ‘fast-track.’ In essence, the fast-track procedure provided for an early evaluation by an official equivalent to the U.S. Trustee of all cases filed, to determine if they should be subject to an accelerated deadline for filing the plan. There were no specific articulated guidelines for this determination, which was made case by case and was not confined to debtors below any defined size. If the case was one for which accelerated treatment was appropriate, the court would order the debtor to file a plan by a specified date, usually sixty to ninety days following the order for relief. In addition, instead of following the usual (indeed, it can be argued, the required) procedure of conducting a formal hearing on notice to approve the disclosure statement before acceptances of the plan were solicited, the court informally reviewed the disclosure statement and would provisionally approve it if it appeared adequate. The final approval hearing, with an opportunity afforded for objections to the statement, was postponed to be combined with the plan confirmation hearing. If the debtor missed the deadline for plan filing set by the court, the case could be dismissed or converted unless the debtor could show cause for the delay. A short extension may have been granted if the plan was not confirmable, but the debtor would not be allowed wide latitude in producing a timely confirmable plan.”) (footnotes omitted).

<sup>3</sup>See, e.g., 11 U.S.C. §§ 308 (small business debtor reporting requirements), 1116 (additional duties of a debtor or trustee in a small business case); 1121(e) (reorganization plan must be submitted within 300 days), 1129(e) (plan must be confirmed within 45 days after plan is filed); 28 U.S.C § 586(a)(7) (establishing expanded U.S. Trustee duties and responsibilities in small business cases). See also Hon. A. Thomas Small, *If You Fix It, They Will Come—A New Playing Field for Small Business Bankruptcies*, 79

This section presents a statistical profile of the challenges small businesses experience in Chapter 11. Drawing on a wide range of empirical studies, there are four fundamental flaws in the current reorganization process for small businesses:

1. **Excessive Secured Creditor Influence:** Chapter 11 gives secured creditors excessive influence over the process,
2. **Monitoring Deficits:** Chapter 11 fails to give the judge or trustee sufficient information to monitor the firm's viability,
3. **High Costs:** Chapter 11 generates exorbitant administrative costs,
4. **Obstacles to Reorganization:** Chapter 11 includes a set of procedures (due in part to the reforms of 2005) that create serious roadblocks to reorganization.

Section II explains how Chapter 12 can remedy these problems.

#### A. Small Business Chapter 11s: Basic Facts

Several recent studies have produced basic facts about the small business Chapter 11 process, including:

- IL Study: analyzed bankruptcy filings during 1998 and 2006 in the Northern District of Illinois. The study excluded filings by non-corporate, non-profit, and real estate businesses.<sup>4</sup>
- NY/AZ Study: analyzed filings between 1995 and 2001 in the Southern District of New York and the District of Arizona. The study excluded cases that were dismissed or converted to Chapter 7.<sup>5</sup>
- Multi-District Study: analyzed filings during 1998 and 2006 in a variety of districts (23 districts in 1998 and 9 in 2006). The study includes filings by individuals, partnerships, and corporations.<sup>6</sup>

---

AM. BANKR. L.J. 981, 982 (2005) ("These provisions probably will not reduce costs, and certainly do not address most of the roadblocks that confront a small business Chapter 11 debtor.").

<sup>4</sup> Edward R. Morrison, *Bankruptcy Decision Making: An Empirical Study of Continuation Bias in Small-Business Bankruptcies*, 50 J. L. & Econ. 381 (2007); Douglas G. Baird & Edward R. Morrison, *Serial Entrepreneurs and Small Business Bankruptcies*, 105 Colum. L. Rev. 2310 (2005); and Douglas G. Baird & Edward R. Morrison, *Adversary Proceedings: A Sideshow*, 79 Am. Bankr. L.J. 951 (2005).

<sup>5</sup> This study produced Douglas Baird, Arturo Bris & Ning Zhu, *The Dynamics of Large and Small Chapter 11 Cases: An Empirical Study*, working paper (2007), and Arturo Bris, Ivo Welch & Ning Zhu, *The Costs of Bankruptcy: Chapter 7 Liquidation versus Chapter 11 Reorganization*, 61 J. Fin. 1280 (2006).

<sup>6</sup> Papers from this study include Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 Mich. L. Rev. 603 (2009); Elizabeth Warren & Jay Lawrence Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 Am. Bankr. L. J. 499 (1999).

- D&B Studies: analyzed Dun & Bradstreet data on small business closures. One study analyzed distressed businesses in Cook County during the period 1998 to 2005.<sup>7</sup> Another analyzed a nationally representative sample of small business closures during 2004 and 2006.<sup>8</sup> Both studies included data on corporations, proprietorships, and partnerships that filed for bankruptcy or shut down without filing.
- Tax Studies: several papers have studied the pervasiveness and composition of small business tax debts.<sup>9</sup>

These studies report the following patterns:

*Small businesses have relatively simple capital structures and many wind down or reorganize without filing for bankruptcy.* Among businesses with less than \$200,000 in assets, the NY/AZ Study found, the median firm has only 1 or 2 secured creditors, neither of which is usually a bank.<sup>10</sup> The number of unsecured creditors is fewer than 20 for the median firm, and a bank is rarely, if ever, among these creditors.<sup>11</sup> Due to the simplicity of their capital structures, distressed small businesses frequently resolve their distress without filing for bankruptcy. For example, the D&B Studies found that 80 percent of distressed businesses wind down or reorganize without filing. Bankruptcy is most attractive to firms with a relatively large number of creditors (e.g., 3 or more secured creditors).<sup>12</sup>

*Secured debt accounts for a large share of total debt and assets, but significant value remains for unsecured creditors.* Data from the IL Study, for example, show that secured debt accounted for 23 percent of total debt and 51 percent of total assets in the median firm.<sup>13</sup>

*Administrative costs of Chapter 11 are significant.* Looking across both Chapter 7s and confirmed Chapter 11s, the NY/AZ found that median professional fees equaled 23% of asset value (as reported at filing) among firms with assets worth less than \$100,000. Fees equaled 4.9% of assets among firms with assets worth between \$100,000 and \$1 million and about 1% among larger firms.<sup>14</sup> Another study, of individual and business Chapter 11s in six geographically diverse districts between 1986 and 1993, found administrative costs equal to 3.5

---

<sup>7</sup> Edward R. Morrison, *Bargaining Around Bankruptcy: Small Business Workouts and State Law*, 38 J. Legal Stud. 255 (2009).

<sup>8</sup> Edward R. Morrison, *Bankruptcy's Rarity, Small Business Workouts in the United States*, 5 Eur. Company & Fin. L. Rev. 172 (2008); Edward R. Morrison, *Small Business Bankruptcy and the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, Report Submitted to the Small Business Administration (2008).

<sup>9</sup> These include Rafael Efrat, *The Tax Debts of Small Business Owners in Bankruptcy*, 24 Akron Tax L. J. 175 (2009); Rafael Efrat, *The Tax Burden and the Propensity of Small-Business Entrepreneurs to File for Bankruptcy*, 4 Hastings Bus. L. J. 175 (2008); Baird, et al., *Dynamics of Large and Small Chapter 11 Cases*, *supra* note 5; and Baird & Morrison, *Serial Entrepreneurs and Small Business Bankruptcies*, *supra* note 4.

<sup>10</sup> Baird, Bris & Zhu, *supra* note 2, at 18-9.

<sup>11</sup> *Id.*

<sup>12</sup> Morrison, *Small Business*, *supra* note 1, at 6.

<sup>13</sup> These statistics were computed for this proposal.

<sup>14</sup> Bris, Welch & Zhu, *supra* note 2, at 1282

percent of assets (at filing) in the median case (“Lawless, et al., Study”).<sup>15</sup> Practitioners claim that these costs exceed those of comparable state procedures such as assignments for the benefit of creditors.<sup>16</sup>

*Administrative costs and priority tax claims consume the bulk of unencumbered property in confirmed Chapter 11s.* The NY/AZ study calculated the median recovery rate for creditors holding non-priority unsecured claims. It was zero among firms with assets (at filing) under \$200,000 and around 3 percent among firms with assets under \$2 million. Priority tax claims, in particular, constituted a large fraction of total debt, accounting for 20 percent or more of unsecured debt among firms with assets under \$2 million.<sup>17</sup> The Lawless et al., Study found that professional fees and other administrative expenses consumed about 18 percent of distributions to unsecured creditors in the median case.<sup>18</sup>

*Most Chapter 11s terminate in dismissal or conversion to Chapter 7.* The IL study found that, among firms with debt under \$2 million, dismissal or conversion occurred in 77% of cases filed during 1998 and 66% of cases filed during 2006.<sup>19</sup> Similarly, the Multi-District study found dismissal or conversion in 70% of cases filed in 1994 and 67% of those filed in 2002.<sup>20</sup> These patterns are consonant with those reported by the National Bankruptcy Review Commission, which observed that “only a small fraction of the Chapter 11 cases filed nationwide end in confirmation of a plan of reorganization.”<sup>21</sup> Failure to reach confirmation, however, is not necessarily an indicator of failure. A “successful” Chapter 11 could culminate in dismissal because the debtor has resolved its problems or has found a buyer.<sup>22</sup>

---

<sup>15</sup> Robert M. Lawless & Steven Ferris, *The Expenses of Financial Distress: The Direct Costs of Chapter 11*, 61 U. Pitt. L. Rev. 629, 651 (1999-2000).

<sup>16</sup> See, e.g., Melanie Rovner Cohen & Joanna L. Challacombe, *Assignment for the Benefit of Creditors—Contemporary Alternatives for Corporations*, 2 DePaul Bus. L. J. 269, 270 (1990) (“In contrast to a Chapter 7 liquidation under the Bankruptcy Code, an assignment [for the benefit of creditors (ABC)] is generally more efficient, less costly, of shorter duration, more successful in terms of the value received for the assets and amounts paid to creditors and more tailored to the needs of debtors and their creditors.”); David S. Kupetz, *Assignment for the Benefit of Creditors: Advantageous Vehicle for Selling and Acquiring Distressed Enterprises*, 6 J. Private Equity 16, 18 (2003) (“Compared to bankruptcy liquidation, assignments may involve a faster and more flexible liquidation process.”); Ronald J. Mann, *An Empirical Investigation of Liquidation Choices of Failed High-Tech Firms*, 82 Wash. U. L. Q. 1375, 1392-93 (2004) (concluding, based on interviews with practitioners, that “the net cost of the [ABC] process seems to be less than a bankruptcy proceeding”); Bruce C. Scalabrino, *Representing a Creditor in an Assignment for the Benefit of Creditors*, 92 Ill. Bar J. 263 (2004) (explaining that under Illinois law, “ABCs take less time than bankruptcy and require less in the way of court intervention and approval, which can mean lower professional fees for debtors.”).

<sup>17</sup> Baird, Bris & Zhu, *supra* note 2, at Table 5.

<sup>18</sup> Robert M. Lawless, et al., *A Glimpse at Professional Fees and Other Direct Costs in Small Firm Bankruptcies*, 1994 U. Ill. L. Rev. 847, 863 (1994).

<sup>19</sup> Morrison, *Small Business*, *supra* note 1, at 79.

<sup>20</sup> Warren & Westbrook, *Success*, *supra* note 3, at 615.

<sup>21</sup> NBRC Report, *supra* note 6, at 610.

<sup>22</sup> Warren & Westbrook, *Success*, *supra* note 3, at 610-11. The IL Study found that about 17% of dismissals involved debtors that had undergone a going-concern sale or had hammered out an agreement

*Most dismissals and conversions occur early in the case, pointing to quick decision-making by the judge.* In the IL study, 70% of dismissals and conversions occurred within the first 6 months of the case; 44% occurred within three months.<sup>23</sup> That study also marshaled evidence showing that judges were adept in distinguishing viable and non-viable firms.<sup>24</sup> Consistent evidence is presented in the Multi-District study, which finds that the probability of confirmation was 47% among firms that avoided dismissal or conversion during the first 6 months. The probability rose to 67% among those that avoided those outcomes during the first 12 months. Judges “pushed the losers out early.”<sup>25</sup>

*Debtor in possession (DIP) financing appears uncommon.* To our knowledge, the best available evidence is from a study of small business filings between 1986 and 1994 in the Northern District of Georgia.<sup>26</sup> That study found DIP financing (new loans or lines of credit that must be approved by the court) in 10 percent of Chapter 11s. The financing was rarely provided by a bank; 95 percent of loans were extended by suppliers with secured prepetition claims. On the other hand, the authors did not investigate the frequency and terms of cash collateral orders based on prepetition credit relationships, which can serve as a substitute for DIP loans and can subject debtors to the kinds of control often seen in DIP loans.

*Small businesses make up the vast majority of Chapter 11 filings.* The IL study found that 75 percent of debtors had debt under \$2 million and 77 percent had fewer than 20 employees.<sup>27</sup> Similar statistics are reported in the Multi-District Study. The NY/AZ Study found that, among confirmed Chapter 11s, median asset value was about \$1.2 million.<sup>28</sup> Likewise, the National Bankruptcy Review Commission surveyed 1995-97 data from six districts and found that that 72 percent of debtors had debt under \$2 million.<sup>29</sup>

*Many Chapter 11s involve businesses with little measurable value as a going concern relative to liquidation.* Value as a going concern typically stems from specialized assets. The IL Study found that at most 5.5 percent of the median firm’s assets were specialized. Excluding restaurants, the percentage falls to 2.2. These percentages characterize firms with confirmed plans as well as those whose cases were dismissed or converted.<sup>30</sup>

*Chapter 11s can function as a “waiting period” for serial entrepreneurs as they consider their next ventures and resolve personal liability for business debts.* The IL Study found that, among cases that were dismissed or converted, 70 percent of owner-managers went on to start

---

with key creditors. Morrison, *supra* note 4, at 390 tab. 4. Another 23% survived more than one year after the case was dismissed. *Id.*, at 291 tab. 5.

<sup>23</sup> Morrison, *Continuation Bias*, *supra* note 1, at 391.

<sup>24</sup> *Id.*, at 441.

<sup>25</sup> Warren & Westbrook, *Success*, *supra* note 3, at 621.

<sup>26</sup> Jocelyn Evans and Timothy Koch, *Surviving Chapter 11: Why Small Firms Prefer Supplier Financing*, 31 J. Econ. & Fin. 186, 191 (2007).

<sup>27</sup> These statistics were computed for this proposal.

<sup>28</sup> Bris, Welch & Zhu, *supra* note 2, at 1258.

<sup>29</sup> NATIONAL BANKR. REVIEW COMM’N, *BANKRUPTCY: THE NEXT TWENTY YEARS* 631 (1997) (Hereinafter “NBRC Report”).

<sup>30</sup> *Id.* at 2332.

new businesses or continued running other, non-bankrupt businesses. 85 percent of the owner-managers had founded a separate business in the past or went on to start another after the case was dismissed or converted.<sup>31</sup> This may be unsurprising because entrepreneurs are highly unlikely to exit self-employment once they have owned businesses for several years.<sup>32</sup>

*Tax claims and personal guarantees are ubiquitous in small Chapter 11 cases.* The IL Study, for example, found that the owner-manager was personally liable for business debts in 85 percent of the cases, due to personal guarantees (56 percent of cases) or liability for trust fund taxes (61 percent).<sup>33</sup> Another study surveyed owners of small businesses that filed for bankruptcy in the Central District of California (San Fernando Valley Division) during 2004 and 2005.<sup>34</sup> Thirteen percent of respondents stated that tax liabilities were a cause of their bankruptcy filings.

*Unsecured creditors' committees are rarely formed in small Chapter 11 cases.* The IL Study found unsecured creditors' committees in only 3% of cases in which business debts were less than \$2 million (2% in 1998, 6% in 2006).<sup>35</sup> The percentage rises to about 8% in cases reaching plan confirmation. By contrast, among firms with debt greater than \$2 million, a committee was formed in 33% of the cases. Another study reports similar statistics based on a quasi-random sample of cases throughout the United States.<sup>36</sup> It finds a committee in 19 percent of cases generally (median debt equal to \$1.2 million) and in 67 percent of cases involving large publicly-traded and privately-held firms (median debt equal to \$50.2 million). Similar statistics were reported by the National Bankruptcy Review Commission.<sup>37</sup>

*BAPCPA appears to have placed additional demands on the cash flow of Chapter 11 debtors.* Sections 366(b), (c), and 503(b)(9) of the Bankruptcy Code now require the debtor to deposit cash sufficient to offer "adequate assurance" to utility suppliers and to give administrative expense priority to claims for goods supplied within 20 days of the bankruptcy petition. Although no empirical work has studied these sections yet, they likely impose larger burdens on small businesses than large firms because small businesses appear to face greater borrowing constraints.<sup>38</sup> Put differently, Sections 366(b) and 503(b)(9) increase the cost of

---

<sup>31</sup> Baird & Morrison, *Serial Entrepreneurs*, *supra* note 1, at 2337-40.

<sup>32</sup> See, e.g., David S. Evans & Linda S. Leighton, *Some Empirical Aspects of Entrepreneurship*, 79 Am. Econ. Rev. 519 (1989) (studying 1966-81 data from the National Longitudinal Study of Youth and finding that the probability of exiting self-employment falls to zero after eleven years of owning a business).

<sup>33</sup> Baird & Morrison, *Serial Entrepreneurs*, *supra* note 1, at 2362 tab. 17.

<sup>34</sup> Efrat, *The Tax Burden and the Propensity of Small-Business Entrepreneurs to File for Bankruptcy*, *supra* note 9, at 201.

<sup>35</sup> These statistics were computed for this proposal.

<sup>36</sup> Stephen Lubben, *Corporate Reorganization and Professional Fees*, 82 Am. Bankr. L. J. 77, 93-95 (2008).

<sup>37</sup> NBRC Report at 642.

<sup>38</sup> William M. Gentry & Glenn R. Hubbard, *Entrepreneurship and Household Saving*, 4 Adv. in Econ. Anal. & Policy, article 8 (2004), available at <http://www.bepress.com/bejeap/advances/vol4/iss1/art8>. But compare Erik Hurst & Annamaria Lusardi, *Liquidity Constraints, Household Wealth, and Entrepreneurship*, 112 J. Pol. Econ. 319 (2004) (doubting the importance of liquidity constraints for small businesses) with Robert W. Fairlie & Harry A. Krashinski, *Liquidity Constraints, Household Wealth, and*

Chapter 11 by forcing a small business to generate sufficient cash flow to cover these requirements immediately.

### **B. Fundamental problems in small business Chapter 11s**

The foregoing statistical patterns suggest that when a small business attempts reorganization, these problems loom large:

- 1. Excessive Secured Creditor Influence.** Due to the small stakes for unsecured creditors, and the rarity of creditors' committees, secured creditors have excessive influence.
- 2. Monitoring Deficits.** Without active involvement from unsecured creditors, it can be difficult for a judge to assess whether the firm is a viable candidate for reorganization. The judge must rely heavily on the U.S. Trustee or bankruptcy administrator, but he or she is primarily concerned about the debtor's compliance with procedural requirements. Because around two-thirds of all cases end in dismissal or conversion, one of the judge's most important jobs is to "filter out" non-viable cases as quickly as possible. Although judges have developed tools for doing this, the success of these tools likely depends on the amount of time and effort that judges can devote to monitoring and supervising cases, something the 1978 Code discourages.<sup>39</sup>
- 3. High Costs.** Administrative costs consume a significant percentage of firm value. These costs may deter distressed businesses, the majority of which use non-bankruptcy procedures (negotiation with creditors, assignments for the benefit of creditors, etc.) to resolve financial distress.
- 4. Obstacles to Reorganization.** BAPCPA's new requirements with respect to administrative expenses and adequate assurance effectively tax the cash flow of cash-strapped businesses, undermining chances for successful reorganization.

To be sure, the first three of these issues are not new. Monitoring Deficits and High Costs in particular were a concern of the National Bankruptcy Review Commission, which was created by Congress in 1994 to study the Bankruptcy Code.<sup>40</sup> With respect to the first issue, the Commission recommended, and BAPCPA adopted, various measures to give the U.S. Trustee greater power to monitor small business cases and to increase the information available to the court and Trustee. For example, the U.S. Trustee is now instructed to investigate the debtor's viability at the outset of the case,<sup>41</sup> and the debtor is instructed to submit periodic financial

---

*Entrepreneurship Revisited*, (IZA Discussion Paper No. 2201 2006), available at <http://ssrn.com/abstract=920640> (challenging the work of Hurst & Lusardi).

<sup>39</sup> See, e.g., Harvey R. Miller, *The Changing Face of Chapter 11: A Reemergence of the Bankruptcy Judge as Producer, Director, and Sometimes Star of the Reorganization Passion Play*, 69 Am. Bankr. L.J. 431, 4333-35 (1995); Dennis S. Meir & Theodore Brown, Jr., *Representing Creditors' Committees Under Chapter 11 of the Bankruptcy Code*, 56 Am. Bankr. L.J. 217, 217 (1982).

<sup>40</sup> The commission's history is discussed at this website:  
<http://govinfo.library.unt.edu/nbrbc/facts.html>.

<sup>41</sup> 28 U.S.C. § 586(a)(7).

reports and schedules, attend all meetings, timely pay taxes, and maintain insurance.<sup>42</sup> Although BAPCPA extended the exclusivity period (from 100 to 180 days<sup>43</sup>) and deadline for submitting a plan (from 160 days to 300 days<sup>44</sup>)—contrary to the Commission’s recommendation<sup>45</sup>—the Act imposed a new 45-day deadline for achieving plan confirmation.<sup>46</sup> These changes increased the obligations on small businesses but did not necessarily create the conditions to facilitate reorganization. Furthermore, BAPCPA reduced judges’ discretion in determining whether to dismiss or convert chapter 11 cases even though the empirical research reviewed earlier suggests that courts had good track records of sorting viable and nonviable cases.<sup>47</sup>

The National Bankruptcy Review Commission addressed High Costs to some extent by recommending that disclosure statements be simplified or eliminated in small business cases and that courts promulgate standardized disclosure statements and reorganization plans. The first recommendation found its way into BAPCPA,<sup>48</sup> and there are now Official Forms for small business plans and disclosure statements.<sup>49</sup> Although this was a useful step, it did not address the many other ways in which Chapter 11 produces considerable administrative costs in small business cases.

## II. Chapter 12 is a solution to the problems facing small business reorganizations

A promising fix to the problems of reorganizing small businesses already exists in the Bankruptcy Code. That approach, chapter 12, was enacted in response to a small business problem not unlike the one we face today. During the early 1980’s (and still today), farms were small businesses, often owned by members of a single family. Farm product prices were falling because of technological advances, improved transportation and mechanization and the growth of corporate farms.<sup>50</sup> The value of farmland was falling, especially in the Midwest. The lenders to farmers were in crisis for many reasons, including an avalanche of failed or failing banks that reduced the availability of credit. Lending to small business farmers dried up. Farmers couldn’t put in crops and soon could not make their mortgage payments.

Many small farm businesses attempted to reorganize in Chapter 11 cases.<sup>51</sup> These cases inevitably failed for several reasons.<sup>52</sup> Small farmers often could not afford the cost of the

---

<sup>42</sup> 11 U.S.C. §§ 308, 1116.

<sup>43</sup> § 1121(e)(1).

<sup>44</sup> § 1121(e)(2).

<sup>45</sup> NBRC Report, at 64-65.

<sup>46</sup> 11 U.S.C. § 1129(e).

<sup>47</sup> 11 U.S.C. § 1112(b).

<sup>48</sup> § 1125(f).

<sup>49</sup> See [http://www.uscourts.gov/bkforms/bankruptcy\\_forms.html#official](http://www.uscourts.gov/bkforms/bankruptcy_forms.html#official).

<sup>50</sup> This paragraph draws on the discussion in Joshua T. Crain, *Resolution of an Apparent Conflict: Rowley versus Anderson*, 10 DRAKE J. AGR. L. 483, 484-86 (2005); Steven Shapiro, Note, *An Analysis of the Family Farmer Bankruptcy Act of 1986*, 15 Hofstra L. Rev. 353, 360-62 (1987).

<sup>51</sup> Shapiro, *supra* note 50, at 364.

<sup>52</sup> This paragraph draws from Hon. A. Thomas Small, *Chapter 12-The Family Farmer Bankruptcy Act of 1986*, 1987 Norton Ann. Surv. Bankr. L. 1.

process.<sup>53</sup> Farm lenders lacked flexibility to negotiate outcomes that would work for small farm reorganizations. Lenders secured by farmland were often undersecured (that is, their debt exceeded the value of the property) and could vote the unsecured portion of their claims to defeat confirmation of any plan. Farmers in Chapter 11 could not sell part of their farms to reduce the operation to a size that was viable without the consent of their lenders.<sup>54</sup> Chapter 13 was rarely a useful alternative because the debt limits were too low,<sup>55</sup> only individuals were eligible<sup>56</sup> and the tools for management of secured debt were not robust enough to help farmers.<sup>57</sup>

At the urging of Senator Grassley (R. Iowa) and the late Congressman Mike Synar (D. Okla.), Chapter 12 of the Bankruptcy Code was hatched to address the reorganization needs of farm businesses. The instructions from Synar and Grassley were simple: draft a new reorganization chapter accessible for farm businesses up to a certain size with ownership limited to the members of an extended family without the disclosure, voting and other complications of Chapter 11. The basic rights of creditors in a Chapter 11 case must be retained. Unsecured creditors must be paid at least what they would receive in a liquidation of assets under Chapter 7. Secured creditors must receive surrender of their collateral or the debtor must pay the “present value” of that collateral (meaning, with interest) through the plan. In recognition of the long-term nature of loans secured by farmland and equipment, farm businesses must be able to pay secured creditors (with interest) over an appropriate period of years. Legislation creating Chapter 12—The Bankruptcy Judges, United States Trustees, and Family Farmer Bankruptcy Act of 1986<sup>58</sup>—was signed into law by President Reagan on October 27, 1986. The law became effective November 26, 1986.<sup>59</sup>

---

<sup>53</sup> H.R. Conf. Rep. 99-958 at 5249, 1986 USCCAN 5246 (Oct. 2, 1986) (“Most family farmers have too much debt to qualify as debtors under Chapter 13 and are thus limited to relief under Chapter 11. Unfortunately, many family farmers have found Chapter 11 needlessly complicated, unduly time-consuming, inordinately expensive and, in too many cases, unworkable.”).

<sup>54</sup> *Id.* (“Most family farm reorganizations, to be successful, will involve the sale of unnecessary property. [Section 1206] . . . allows Chapter 12 debtors to scale down the size of their farming operations by selling unnecessary property. This section modifies 11 USC 363(f) to allow family farmers to sell assets not needed for the reorganization prior to confirmation . . . the creditor's interest . . . would attach to the proceeds of the sale.”).

<sup>55</sup> See 11 U.S.C. § 109(e) (secured and unsecured debt limitations for Chapter 13). See also Joshua T. Crain, *Resolution of an Apparent Conflict: Rowley versus Anderson*, 10 DRAKE J. AGR. L. 483, 486 (2005) (“debt limits allowed under Chapter 13 were too low for most family farmers”).

<sup>56</sup> § 109(e) (“Only an individual with regular income . . . may be a debtor under chapter 13 of this title.”). “Individual with regular income” is defined in § 101(30) to mean “an individual whose income is sufficiently stable and regular to enable such individual to make payments under a plan under chapter 13 of this title[.]”

<sup>57</sup> In Chapter 13, farmers could not modify real estate secured loans and were limited in ability to sell property. See, e.g., § 1322(b)(2).

<sup>58</sup> Pub. L. No. 99-544, 100 Stat. 3105 (1986).

<sup>59</sup> Pub. L. No. 99-544, § 302(a).

### A. Comparing Chapters 11 and 12

Table 1 sets out key differences between small business reorganization under Chapters 11 and 12. Perhaps the most important differences involve the appointment of a standing trustee, tighter deadline for submitting a plan of reorganization, lower repayment obligations, and more flexible treatment of administrative expenses in Chapter 12.

Although the debtor remains in control of his or her business regardless of the Chapter, only Chapter 12 mandates the appointment of a standing trustee in every case.<sup>60</sup> The trustee is charged with responsibility to monitor the case and to be heard at any hearing involving the valuation or sale of assets or the confirmation or modification of a plan.<sup>61</sup> The standing trustee ensures that the court receives an unbiased, continuous flow of information about the firm's viability.

Chapter 12 also imposes stricter deadlines on the submission of plan of reorganization: a plan must be submitted within 90 days<sup>62</sup> and either confirmed or rejected no more than 45 days later.<sup>63</sup> This contrasts with the much longer deadlines (300 days for plan submission) under Chapter 11's small business provisions.<sup>64</sup> The strict deadlines in Chapter 12 prevent firms from using the Code solely as a means for thwarting creditor collection efforts.

In Chapter 12, family farmers and fishermen can retain ownership interests in their businesses even if they cannot pay creditors in full. This outcome is prohibited by Chapter 11's absolute priority rule, but permitted under Chapter 12 because unsecured creditors are instead entitled to all of a Chapter 12 debtor's disposable income for up to five years<sup>65</sup> following plan confirmation and must receive at least what they would be paid in a Chapter 7 liquidation.<sup>66</sup> At the end of the repayment period, any unpaid unsecured claims are discharged. (Secured claims must be repaid in full, but payments can exceed the five year period of the Chapter 12 plan<sup>67</sup>). These repayment rules ensure that a family farmer or fisherman does not engage in wasteful efforts to avoid bankruptcy for fear of losing ownership of the business. As long as secured creditors are repaid in full and unsecured creditors receive all of the business's disposable income for up to five years, the farmer or fisherman can retain ownership.

Finally, Chapter 12 offers debtors greater flexibility in repaying administrative expenses, such as attorney fees and the claims of suppliers who delivered goods within 20 days prior to the bankruptcy petition.<sup>68</sup> Chapter 11 requires immediate payment in cash on the date of confirmation (unless the claimants agree to different treatment).<sup>69</sup> Because family farmers and

---

<sup>60</sup> 11 U.S.C. § 1202.

<sup>61</sup> § 1202(b).

<sup>62</sup> § 1221.

<sup>63</sup> § 1224.

<sup>64</sup> §§ 1121(e)(2) (300 day deadline for submitting plan), 1129(e) (45 day deadline for confirmation hearing).

<sup>65</sup> §§ 1222(c), 1225(b).

<sup>66</sup> § 1225(a)(4).

<sup>67</sup> § 1225(a)(5).

<sup>68</sup> § 1222(a)(2).

<sup>69</sup> § 1129(a)(9).

fisherman, like all small businesses, are often cash-strapped, the Chapter 11 rule creates barriers to confirming a plan. Chapter 12 eliminates this barrier by permitting gradual repayment of attorney fees and other administrative expenses over time.

Since its enactment in 1986, thousands of family farmers and fishermen have reorganized under Chapter 12.<sup>70</sup> Figure 1 plots the number of Chapter 12 filings since the law's enactment. Although Chapter 12 began as an emergency measure, Congress made it a permanent part of the Code—and made it available to family fishermen as well as farmers—in the Bankruptcy Abuse and Consumer Protection Act of 2005.<sup>71</sup> Although the law has not been used frequently in recent years, this could be seen as a measure of its success.<sup>72</sup> Over time, lenders and farm owners have come to understand what happens in a Chapter 12 case; many small farm businesses have been able to reorganize without resorting to bankruptcy.

---

<sup>70</sup> See, e.g., Jonathan K. Van Patten, *Chapter 12 in the Courts*, 38 S.D.L.R. 52, 54-55 (1993).

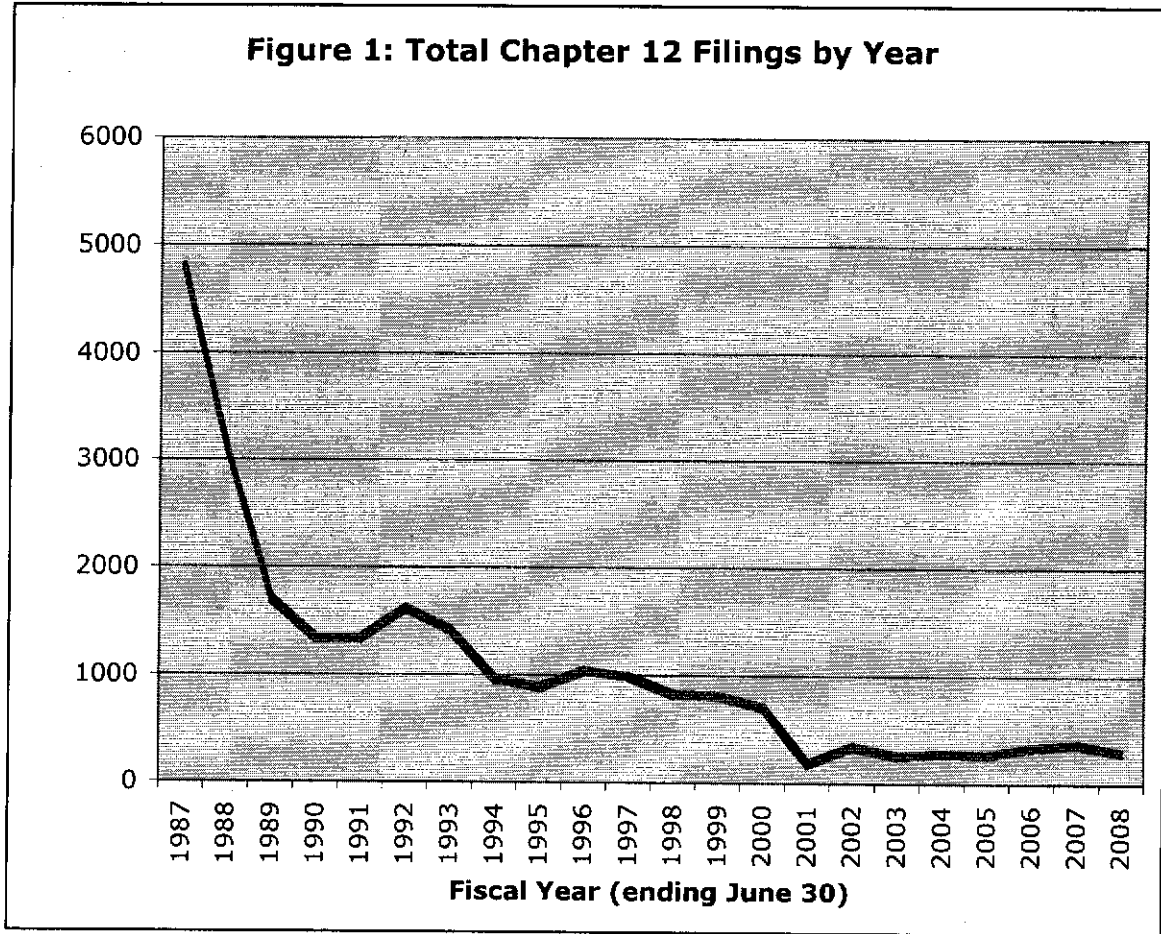
<sup>71</sup> BAPCPA made Chapter 12 permanent as of July 1, 2005, to coincide with expiration of the 2004 extension.

<sup>72</sup> See, e.g., Katherine M. Porter, *Phantom Farmers: Chapter 12 of the Bankruptcy Code*, 70 AM. BANKR. L.J. 729, 743 (2005) (“Chapter 12 may have its greatest effect in the shadow of bankruptcy. The mere existence of Chapter 12 influences a creditor’s willingness to engage in loan workouts because the creditor must evaluate its recovery if the debtor filed bankruptcy. By defining the boundaries of what each party’s rights will be in bankruptcy, Chapter 12 provides a firm structure against which debtors and creditors can negotiate in restructuring loans. All of bankruptcy law has this potential, but Chapter 12 offers a particularly powerful incentive for creditors to reach a non-bankruptcy resolution. Compared to Chapter 11, a creditor in a Chapter 12 case has relatively few tools at its disposal to derail a debtor’s effort to reorganize. A survey of attorneys who represented distressed farmers or agricultural creditors found that between one-third and half of disputes were negotiated successfully. Attorneys cited the existence of Chapter 12 as an ‘influencing factor in 58.06 percent of these successful negotiations.’ The ‘shadow’ effect of Chapter 12 is difficult to measure exactly but Chapter 12 appears to provide substantial assistance to farmers in obtaining a forbearance or write down of their debt even if no bankruptcy case is ever filed.”) (footnotes omitted).

**Table 1: Comparison of Chapters 11 and 12**

Issue	Chapter 11 (small business provisions)	Chapter 12
Eligibility	Any individual or business described in 109(d).	Any family farmer or fisherman with regular annual income, including a corporation
Involuntary filings permitted	Yes	No
Debtor remains in possession of business?	Yes	Yes
Unsecured creditors committee can be formed	Yes	No
Standing trustee	No	Yes
Debtor has exclusive right to file a plan of reorganization	No: debtor has exclusivity only for the first 180 days	Yes
Deadline for filing plan of reorganization	Yes: 300 days	Yes: 90 days
Maximum term of plan	No	Yes: five years
Creditors vote on the plan	Yes	No: creditors may object to a plan; the court rules on the objections
Creditors entitled to full payment before owner receives value	Yes, except in cases filed by individual debtors	No: creditors are entitled to all of debtor's projected disposable income for up to five years.
Administrative expenses must be paid in full at plan confirmation	Yes	No: deferred cash payments are acceptable
Secured debt repayments can exceed the term of the plan	No	Yes
Secured claims can be modified, including reducing secured debts to the value of the collateral	Yes, except for home mortgages in individual debtor cases	Yes
Plan must pay creditors at least what they would receive in liquidation	Yes	Yes

**Figure 1: Total Chapter 12 Filings by Year**



*Source: Administrative Office of the U.S. Courts*

## **B. Making Chapter 12 available to small businesses generally**

Family farmers and fishermen are small businesses, and Chapter 12 has proven to be a viable, low-cost reorganization procedure. Chapter 12 would be equally effective in addressing the needs of small businesses generally. As the foregoing discussion has shown, it addresses the key problems facing small business corporations seeking to reorganize:

- 1. Excessive Secured Creditor Influence:** The influence of secured creditors is moderated by the presence of a standing trustee and the debtor's ability to confirm a reorganization plan without a creditor vote.
- 2. Monitoring Deficits.** The standing trustee provides a continuous, unbiased source of information about the debtor's viability. In a small business case, the trustee "would give impartial oversight of the debtor's operations, examine the debtor's affairs, make recommendations concerning confirmation of the plan, mediate disputes, monitor compliance for three years after confirmation, and carry out the terms of the plan if the debtor does not."<sup>73</sup>
- 3. High Costs.** Administrative costs are reduced by tight deadlines for submitting plans of reorganization, the elimination of big-case procedures such as the Chapter 11 disclosure statement, and the court's ready access to information about the debtor's viability.
- 4. Obstacles to Reorganization.** Chapter 12 imposes fewer demands on the debtor's cash flow by allowing administrative expenses to be paid over time after plan confirmation.

A relatively small number of amendments would be necessary to make Chapter 12 available to small businesses generally. The following paragraphs discuss the amendments. In an Appendix, we present draft legislation.

**Eligibility:** In addition to family farmers and fishermen, only small business enterprises should be eligible to use Chapter 12. We propose making Chapter 12 available to a "small business enterprise" ("SBE"), defined as a corporate or non-corporate person—other than a family farmer or family fisherman—who is engaged in a business or commercial activity and has total debts not exceeding \$10 million, provided at least fifty percent of the debt arises from the person's business or commercial activities. This definition would appear in new Section 101(51E). We would amend Section 109(f) to state that a SBE is eligible to be a debtor under Chapter 12 only if the SBE has regular income. (A technical amendment to Section 104(a) would be needed to periodically adjust the \$10 million threshold for inflation.)

Our proposed definition of a SBE is broader than the Code's current definition of a "small business debtor," which includes any business with total debt not exceeding \$2 million.

---

<sup>73</sup> Small, *If You Fix It, They Will Come*, *supra* note 3, at 983. See also, Hon. A. Thomas Small, *Paying the Piper: Rethinking Professional Compensation In Bankruptcy—Small Business Bankruptcy Cases*, 1 Am. Bankr. Inst. L. Rev. 305 (1993); Hon. A. Thomas Small, *Suggestions for the National Bankruptcy Review Commission and Congress*, 4 Am. Bankr. Inst. L. Rev. 550 (1996).

We do not propose changing the definition of a small business debtor. A SBE should remain free to use Chapter 11 if that is a preferable option. And if it qualifies as a small business debtor, it will be subject to the special rules governing those businesses in Chapter 11.

**Rights and powers of the debtor:** Many small businesses enter bankruptcy with debts to their attorneys and accountants. Section 327(a) requires that the debtor's attorney or accountant must be "disinterested" during the pendency of the case. Section § 101(14), in turn, states that a creditor is not a disinterested person. It would be unduly burdensome to force small businesses to find new attorneys or accountants after commencing a Chapter 12 case. We therefore propose amending Section 1203 to declare that a professional person is not disqualified from employment solely because he or she has a prepetition claim. This amendment would apply to all debtors in a Chapter 12 case, not just SBEs.

**Reporting requirements:** SBEs should be subject to most of the same reporting requirements in Chapter 12 that are currently applicable to small business debtors in Chapter 11. We therefore propose adding new Section 1209, which largely replicates the requirements of § 308 and § 1116. In order to clarify that 1209 captures the full reporting duties of a SBE, we propose amending § 308 to apply only in small business Chapter 11 cases.

**Discharge:** The date on which a debtor obtains a discharge varies by Chapter and debtor. In cases under Chapter 12, all debtors typically receive a discharge upon completion of payments,<sup>74</sup> but may also receive a discharge before completing all payments if creditors have already been paid what they would receive in a liquidation and if the failure to complete payments is due to circumstances for which the debtor should not justly be held accountable.<sup>75</sup> In cases under Chapter 11, the rule varies by debtor. Corporate debtors receive discharge at confirmation.<sup>76</sup> Among *individual* debtors, three rules govern discharge: a court can grant discharge (i) upon completion of plan payments,<sup>77</sup> (ii) prior to completion of plan payments if creditors have already received at least what they would expect in a liquidation and modification of the plan is not practicable,<sup>78</sup> or (iii) at confirmation or any other date prior to completion of plan payments if the court determines—for cause and after notice and hearing—that an earlier date for discharge is appropriate.<sup>79</sup>

We propose applying the Chapter 11 individual debtor rules to SBEs in Chapter 12. Discharge should typically be available after the SBE completes plan payments, but the judge should have discretion to grant an earlier discharge *either* for cause *or* because creditors have already received their liquidation rights and circumstances beyond the debtor's control prevent further payments. Although it would be the exceptional case in which a SBE merits discharge at confirmation, the court should have authority to grant such a discharge.

---

<sup>74</sup> § 1228(a).

<sup>75</sup> § 1228(b).

<sup>76</sup> § 1141(c).

<sup>77</sup> § 1141(d)(5)(A).

<sup>78</sup> § 1141(d)(5)(B).

<sup>79</sup> § 1141(d)(5)(A). *See also* In re *Sheridan*, 391 B.R. 287 (Bankr. E.D.N.C. 2008).

### C. Potential Controversies

Several aspects of Chapter 12 merit further discussion: treatment of residential mortgages, creditor voting, creditors' committees, and appointment of standing trustees.

**Residential mortgages.** Chapter 12 permits debtors to restructure secured debt, including real estate mortgages that are secured by the debtor's residence.<sup>80</sup> The value of the secured claim can be reduced to the value of the collateral. That value must be paid over time with interest, but the difference between the original secured debt and the value of the collateral—the deficiency—is treated as an unsecured claim. Although Chapter 12 debtors can therefore "cram down" a home mortgage, this right would be available only to SBEs that own residences. Thus, a sole proprietor would be able to cram down a residential mortgage. That power is already possessed by family farmers and fishermen.<sup>81</sup> Similarly, a corporate SBE could cram down a home mortgage, provided the corporation owned the residence. This power too is already possessed by any corporation or partnership that files a Chapter 11 case.<sup>82</sup>

It is important to emphasize, however, that most real estate secured debts, such as residential home mortgages, would not find their way into Chapter 12. Few residences are owned by the types of small businesses—enterprises that are engaged in commerce or business and whose debts are primarily business-related—that would be newly eligible for Chapter 12. Ordinary wage earners would not be eligible for an expanded Chapter 12.

**Voting.** Creditors have the right to vote on small business chapter 11 plans today but would not have the right to vote on small business plans in chapter 12. This is an important change, but is not a significant concern for the following reasons. First, small businesses already use Chapter 13, which does not permit creditor voting.<sup>83</sup> Second, it is the experience of bankruptcy professionals everywhere that creditors don't participate in small business Chapter 11 cases even though they have the right to vote on plans.<sup>84</sup> For the most part, small business cases simply aren't large enough to command the attention of individual creditors. Voting is a possibility but rarely a reality in small business Chapter 11 cases.

Furthermore, voting is not essential to protect unsecured creditors because chapter 12 expressly requires debtors to pay creditors in accordance with specified standards. With respect to unsecured creditors, Chapter 12 contains a "those who can pay should pay" provision.<sup>85</sup> Upon appropriate objection, every Chapter 12 debtor must commit all projected disposable income to payments to creditors for no less than three years.<sup>86</sup>

**Unsecured creditors committee.** Chapter 12 does not permit formation of official creditors' committees, but this change will impose few if any burdens on unsecured creditors. As

---

<sup>80</sup> § 1222(b)(9) and (c).

<sup>81</sup> *Id.*

<sup>82</sup> § 1123(b)(5).

<sup>83</sup> § 1325.

<sup>84</sup> See Small, *If You Fix It, They Will Come*, *supra* note 3, at 983-84.

<sup>85</sup> § 1225(b).

<sup>86</sup> § 1225(b)(1)(B).

noted above,<sup>87</sup> these committees are rarely formed in small business cases. Instead of committees, Chapter 12 relies on the standing trustee to protect the rights of unsecured creditors. Because a trustee is appointed in every Chapter 12 case, but a committee is rarely assembled in a Chapter 11 case, unsecured creditors will generally enjoy greater protection in Chapter 12 cases.

**Trustee caseload and compensation.** As SBEs begin using Chapter 12, the caseload of Chapter 12 trustees will increase dramatically. There were only 345 Chapter 12 filings but nearly 10,000 Chapter 11 cases during calendar year 2008.<sup>88</sup> The bulk of Chapter 11 cases are filed by small businesses.<sup>89</sup> Again, this proposal would not preclude SBEs from filing Chapter 11 petitions. However, if most of these businesses choose Chapter 12 instead of Chapter 11, Chapter 12 trustees will see a much heavier docket. This will necessitate the appointment of additional trustees and the hiring of staff to assist trustees in evaluating cases and providing the counseling necessary to move a small business through Chapter 12 quickly.

Respectfully submitted,

**Small Business Working Group**

Hon. A. Thomas Small, Co-Chair

Prof. Edward Morrison, Co-Chair

Hon. Keith Lundin

Prof. Melissa B. Jacoby

Richardo I. Kilpatrick, Esq.

David Lander, Esq.

Prof. Alan N. Resnick

---

<sup>87</sup> See text accompanying notes 35-36, *supra*.

<sup>88</sup> These statistics are drawn from the website of the Administrative Office of the U.S. Courts. See <http://www.uscourts.gov/bnkrpctystats/bankruptcystats.htm>.

<sup>89</sup> See text accompanying footnotes 27-29, *supra*.

## APPENDIX

### PROPOSED AMENDMENTS TO THE BANKRUPTCY CODE RELATING TO CHAPTER 12 CASES FOR SMALL BUSINESS ENTERPRISES

Change the title of Chapter 12 as follows:

**Chapter 12. Adjustment of Debts of a Family Farmer ~~or Fisherman~~ , Family Fisherman, or Small Business Enterprise with Regular Annual Income**

\* \* \* \*

#### Section 101. Definitions

\* \* \* \*

- (51E) The term "small business enterprise" means a person (excluding a family farmer or family fisherman) engaged in commercial or business activities if –
- (a) the person has aggregate noncontingent, liquidated secured and unsecured debts as of the order for relief in an amount not more than \$10,000,000 (excluding debts owed to 1 or more affiliates or insiders); and
  - (b) at least 50 percent of such debts arose from the person's commercial or business activities (determined without including, if the person is an individual, any debt for the personal residence of the person or the person and spouse, unless such debt arose from the person's commercial or business activities).

\* \* \* \*

#### Section 104. Adjustment of Dollar Amounts

(a) On April 1, 1998, and at each 3-year interval ending on April 1 thereafter, each dollar amount in effect under sections 101(3), 101(18), 101(19A), 101(51D), 101(51E), 109(e), 303(b), 507(a), 522(d), 522(f)(3), and 522(f)(4), 522(n), 522(p), 522(q), 523(a)(2)(C), 541(b), 547(c)(9), 707(b), 1322(d), 1325(b) and 1326(b)(3) of this title and section 1409(b) of title 28 immediately before such April 1 shall be adjusted—

- (1) to reflect the change in the Consumer Price Index for All Urban Consumers, published by the Department of Labor, for the most recent 3-year period ending immediately before January 1 preceding such April 1, and
- (2) to round to the nearest \$25 the dollar amount that represents such change.

(b) Not later than March 1, 1998, and at each 3-year interval ending on March 1 thereafter, the Judicial Conference of the United States shall publish in the Federal Register the dollar amounts that will become effective on such April 1 under sections 101(3), 101(18), 101(19A), 101(51D), 101(51E), 109(e), 303(b), 507(a), 522(d),

522(f)(3), and 522(f)(4), 522(n), 522(p), 522(q), 523(a)(2)(C), 541(b), 547(c)(9), 707(b), 1322(d), 1325(b) and 1326(b)(3) of this title and section 1409(b) of title 28.

(c) Adjustments made in accordance with paragraph (1) shall not apply with respect to cases commenced before the date of such adjustments.

\* \* \* \*

### **Section 109. Who May Be a Debtor**

\* \* \* \*

(f) Only a family farmer, ~~or family fisherman,~~ or small business enterprise with regular annual income may be a debtor under chapter 12 of this title.

\* \* \* \*

### **Section 308. Debtor Reporting Requirements**

(a) For purposes of this section, the term “profitability” means, with respect to a debtor, the amount of money that the debtor has earned or lost during current and recent fiscal periods.

(b) In a small business case, the debtor ~~A small business debtor~~ shall file periodic financial and other reports containing information including—

- (1) the debtor’s profitability;
- (2) reasonable approximations of the debtor’s projected cash receipts and cash disbursements over a reasonable period;
- (3) comparisons of actual cash receipts and disbursements with projections in prior reports;
- (4) (A) whether the debtor is—
  - (i) in compliance in all material respects with postpetition requirements imposed by this title and the Federal Rules of Bankruptcy Procedure; and
  - (ii) timely filing tax returns and other required government filings and paying taxes and other administrative expenses when due;(B) if the debtor is not in compliance with the requirements referred to in subparagraph (A)(i) or filing tax returns and other required government filings and making the payments referred to in subparagraph (A)(ii), what the failures are and how, at what cost, and when the debtor intends to remedy such failures; and (C) such other matters as are in the best interests of the debtor and creditors, and in the public interest in fair and efficient procedures under chapter 11 of this title.

\* \* \* \*

### **Section 1203. Rights and powers of debtor**

- (a) Subject to such limitations as the court may prescribe, a debtor in possession shall have all the rights, other than the right to compensation under section 330, and powers, and shall perform all the functions and duties, except the duties specified in paragraphs (3) and (4) of section 1106(a), of a trustee serving in a case under chapter 11, including operating the debtor's farm, commercial fishing operation, or small business enterprise's business.
- (b) Notwithstanding section 327(a) of this title, a person is not disqualified for employment under section 327 of this title by a debtor in possession solely because such person
- (1) was employed by or represented the debtor before the commencement of the case; or
  - (2) is a creditor of the debtor.

\* \* \* \*

### **Section 1206. Sales free of interests**

After notice and a hearing, in addition to the authorization contained in section 363(f), the trustee in a case under this chapter may sell property under section 363(b) and (c) free and clear of any interest in such property of an entity other than the estate if the property is farmland, farm equipment, or property used to carry out a commercial fishing operation (including a commercial fishing vessel) or used in connection with the business of a small business enterprise, except that the proceeds of such sale shall be subject to such interest.

\* \* \* \*

### **Section 1209. Duties of a Debtor in a Case of a Small Business Enterprise**

In a case in which the debtor is a small business enterprise, the debtor, in addition to the duties provided in this title and as otherwise required by law, shall—

- (a) file with the voluntary petition --
- (1) its most recent balance sheet, statement of operations, cash-flow statement, and Federal income tax return; or
  - (2) a statement made under penalty of perjury that no balance sheet, statement of operations, or cash-flow statement has been prepared and no Federal tax return has been filed;
- (b) attend, through its senior management personnel and counsel, any meetings scheduled by the court or the United States trustee, including initial debtor

- interviews and scheduling conferences, and meetings of creditors convened under section 341, unless the court, after notice and a hearing, orders otherwise;
- (c) timely file all schedules and statements of financial affairs, unless the court, after notice and a hearing, grants an extension;
- (d) file all postpetition financial and other reports required by the Federal Rules of Bankruptcy Procedure or by local rule of the district court;
- (e) subject to section 363(c)(2), maintain insurance customary and appropriate to the debtor's business;
- (f) (1) timely file tax returns and other required government filings; and  
(2) subject to section 363(c)(2), timely pay all taxes entitled to administrative expense priority except those being contested by appropriate proceedings being diligently prosecuted; and
- (g) allow the United States trustee, or a designated representative of the United States trustee, to inspect the debtor's business premises, books, and records at reasonable times, after reasonable prior written notice, unless notice is waived by the debtor.
- (h) file periodic financial and other reports containing information including –
- (1) the amount of money that the debtor has earned or lost during the current and recent fiscal periods;
  - (2) reasonable approximations of the debtor's projected cash receipts and cash disbursements over a reasonable period;
  - (3) comparisons of actual cash receipts and disbursements with projections in prior reports;
  - (4) (A) whether the debtor is—
    - (i) in compliance in all material respects with postpetition requirements imposed by this title and the Federal Rules of Bankruptcy Procedure; and
    - (ii) timely filing tax returns and other required government filings and paying taxes and other administrative expenses when due; and(B) if the debtor is not in compliance with the requirements referred to in subparagraph (A)(i) or filing tax returns and other required government filings and making the payments referred to in subparagraph (A)(ii), what the failures are and how, at what cost, and when the debtor intends to remedy such failures.

\* \* \* \*

### **Section 1228. Discharge**

- (a) Subject to subsection (d), as soon as practicable after completion by the debtor of all payments under the plan or, in a case in which the debtor is a small business enterprise, at such earlier time on or after the date on which the plan is confirmed as the court after notice and a hearing orders for cause, and in the case of a debtor who is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, after such debtor certifies that all amounts payable under such order or such statute that are

due on or before the date of the certification (including amounts due before the petition was filed, but only to the extent provided for by the plan) have been paid, other than payments to holders of allowed claims provided for under section 1222(b)(5) or 1222(b)(9) of this title, unless the court approves a written waiver of discharge executed by the debtor after the order for relief under this chapter, the court shall grant the debtor a discharge of all debts provided for by the plan allowed under section 503 of this title or disallowed under section 502 of this title, except any debt—

- (1) provided for under section 1222(b)(5) or 1222(b)(9) of this title; or
- (2) of the kind specified in section 523(a) of this title.

\* \* \* \*

**Effective Date; Application of Amendments [Non-Codified Provision]**

- (a) EFFECTIVE DATE – Except as provided in subsection (b) and (c), this Act and the amendments made by this Act shall take effect 30 days after the date of enactment of this Act.
- (b) APPLICATION OF AMENDMENTS – The amendments made by this Act shall not apply with respect to cases commenced under title 11, United States Code, before the effective date of this Act.
- (c) CONVERSION OF SMALL BUSINESS CASES TO CHAPTER 12 – Small business cases commenced under title 11, United States Code, before the effective date of this Act may not be converted to a case under chapter 12 of title 11 unless the debtor is a family farmer or family fisherman with regular annual income.

# NATIONAL BANKRUPTCY CONFERENCE

*A non-profit, non-partisan, self-supporting organization of approximately sixty lawyers, law professors and judges who are leading scholars and practitioners in the field of bankruptcy law. Its primary purpose is to advise Congress on the operation of bankruptcy and related laws and any proposed changes to those laws.*

**History.** The National Bankruptcy Conference (NBC) was formed from a nucleus of the nation's leading bankruptcy scholars and practitioners, who gathered informally in the 1930's at the request of Congress to assist in the drafting of major Depression-era bankruptcy law amendments, ultimately resulting in the Chandler Act of 1938. The NBC was formalized in the 1940's and has been a resource to Congress on every significant piece of bankruptcy legislation since that time. Members of the NBC formed the core of the Commission on the Bankruptcy Laws of the United States, which in 1973 proposed the overhaul of our bankruptcy laws that led to enactment of the Bankruptcy Code in 1978, and were heavily involved in the work of the National Bankruptcy Review Commission (NBRC), whose 1997 report initiated the process that led to significant amendments to the Bankruptcy Code in 2005.

**Current Members.** Membership in the NBC is by invitation only. Among the NBC's 60 active members are leading bankruptcy scholars at major law schools, as well as current and former judges from eleven different judicial districts and practitioners from leading law firms throughout the country who have been involved in most of the major corporate reorganization cases of the last three decades. The NBC includes leading consumer bankruptcy experts and experts on commercial, employment, pension, mass tort and tax related bankruptcy issues. It also includes former members of the congressional staff who participated in drafting the Bankruptcy Code as originally passed in 1978 and former members and staff of the NBRC. The current members of the NBC and their affiliations are set forth on the second page of this fact sheet.

**Policy Positions.** The Conference regularly takes substantive positions on issues implicating bankruptcy law and policy. It does not, however, take positions on behalf of any organization or interest group. Instead, the NBC seeks to reach a consensus of its members - who represent a broad spectrum of political and economic perspectives - based on their knowledge and experience as practitioners, judges and scholars. The Conference's positions are considered in light of the stated goals of our bankruptcy system: debtor rehabilitation, equal treatment of similarly situated creditors, preservation of jobs, prevention of fraud and abuse, and economical insolvency administration. Conferees are always mindful of their mutual pledge to "leave their clients at the door" when they participate in the deliberations of the Conference.

**Technical and Advisory Services to Congress.** To facilitate the work of Congress, the NBC offers members of Congress, Congressional Committees and their staffs the services of its Conferees as non-partisan technical advisors. These services are offered without regard to any substantive positions the NBC may take on matters of bankruptcy law and policy.

---

## National Bankruptcy Conference

PMB 124, 10332 Main Street • Fairfax, VA 22030-2410

703-273-4918 Fax: 703-802-0207 • Email: [info@nbconf.org](mailto:info@nbconf.org) • Web: [www.nationalbankruptcyconference.org](http://www.nationalbankruptcyconference.org)

# NATIONAL BANKRUPTCY CONFERENCE

## Chair

**Donald S. Bernstein, Esq.**  
Davis Polk & Wardwell  
New York, NY

## Vice Chair

**Richard B. Levin, Esq.**  
Cravath, Swaine & Moore LLP  
New York, NY

## Treasurer

**R. Patrick Vance, Esq.**  
Jones, Walker, Waechter, Poitevent,  
Carrere & Denegre L.L.P.  
New Orleans, LA

## Secretary

**K. John Shaffer, Esq.**  
Stutman, Treister & Glatt, Prof. Corp.  
Los Angeles, CA

## Chair, Legislation Committee

**Sally S. Neely, Esq.**  
Sidley Austin LLP  
Los Angeles, CA

## Chair, Drafting Committee

**Prof. Alan N. Resnick**  
Hofstra University School of Law  
Hempstead, NY

## Hon. Allan L. Gropper

U.S. Bankruptcy Court  
New York, NY

## Nell Hennessy, Esq.

Fiduciary Counselors Inc.  
Washington, D.C.

## Hon. Barbara J. Houser

U.S. Bankruptcy Court  
Dallas, TX

## Marshall S. Huebner, Esq.

Davis Polk & Wardwell  
New York, NY

## Prof. Melissa B. Jacoby

Univ. of North Carolina Law School  
Chapel Hill, NC

## Carl M. Jenks, Esq.

Jones Day  
Cleveland, OH

## \*John J. Jerome, Esq.

Saul Ewing LLP  
New York, NY

## Richardo I. Kilpatrick, Esq.

Kilpatrick and Associates, P.C.  
Auburn Hills, MI

## Prof. Kenneth N. Klee

UCLA School of Law  
Los Angeles, CA

## David A. Lander, Esq.

Thompson Coburn LLP  
St. Louis, MO

## Jonathan M. Landers, Esq.

Milberg LLC  
New York, NY

## \*Hon. Joe Lee

U.S. Bankruptcy Court  
Lexington, KY

## E. Bruce Leonard, Esq.

Cassels Brock & Blackwell LLP  
Toronto, Ontario, Canada

## Marc A. Levinson, Esq.

Orrick, Herington & Sutcliffe LLP  
Sacramento, CA

## Hon. Keith Lundin

U.S. Bankruptcy Court  
Nashville, TN

## Ralph R. Mabey, Esq.

Stutman, Treister & Glatt, Prof. Corp.  
Salt Lake City, UT

## \*Morris W. Macey, Esq.

Macey, Wilensky, Kessler,  
Howick & Westfall  
Atlanta, GA

## Prof. Ronald J. Mann

Columbia Law School  
New York, NY

## Hon. Bruce A. Markell

U.S. Bankruptcy Court  
Las Vegas, NV

## Thomas Moers Mayer, Esq.

Kramer Levin Naftalis & Frankel LLP  
New York, NY

## \*Harvey R. Miller, Esq.

Weil, Gotshal & Manges  
New York, NY

## Herbert P. Minkel, Jr., Esq.

New York, NY

## Prof. Jeffrey W. Morris

University of Dayton School of Law  
Dayton, OH

## Prof. Edward R. Morrison

Columbia Law School  
New York, NY

## \*Gerald F. Munitz, Esq.

Butler Ruben Saltarelli & Boyd  
Chicago, IL

## Harold S. Novikoff, Esq.

Wachtell, Lipton, Rosen & Katz  
New York, NY

## Isaac M. Pachulski, Esq.

Stutman Treister & Glatt, Prof. Corp.  
Los Angeles, CA

## Prof. Randal C. Picker

University of Chicago Law School  
Chicago, IL

## Prof. Katherine M. Porter

The University of Iowa, College of Law  
Iowa City, IA

## John Rao

National Consumer Law Center  
Boston, MA

## Hon. Mary Davies Scott (retired)

Langley, WA

## Raymond L. Shapiro, Esq.

Blank Rome, LLP  
Philadelphia, PA

## \*Myron M. Sheinfeld, Esq.

King & Spalding LLP  
Houston, TX

## Hon. A. Thomas Small

U.S. Bankruptcy Court  
Raleigh, NC

## Edwin E. Smith, Esq.

Bingham McCutchen LLP  
Boston, MA

## Gerald K. Smith, Esq.

Lewis and Roca LLP  
Phoenix, AZ

## Henry J. Sommer, Esq.

Philadelphia, PA

## Richard S. Toder, Esq.

Morgan, Lewis & Bockius LLP  
New York, NY

## \*J. Ronald Trost, Esq.

Vinson & Elkins, LLP  
New York, NY

## Jane L. Vris, Esq.

Vinson & Elkins, LLP  
New York, NY

## Prof. Elizabeth Warren

Harvard Law School  
Cambridge, MA

## Hon. Eugene R. Wedoff

U.S. Bankruptcy Court  
Chicago, IL

## Prof. Jay Lawrence Westbrook

University of Texas School of Law  
Austin, TX

## Robert J. White, Esq.

Los Angeles, CA

## Brady C. Williamson, Esq.

Godfrey & Kahn, S.C.  
Madison, WI

## Hon. Thomas L. Ambro

U.S. Court of Appeals for the Third Circuit  
Wilmington, DE

## Prof. Douglas G. Baird

University of Chicago Law School  
Chicago, IL

## R. Neal Batson, Esq.

Alston & Bird LLP  
Atlanta, GA

## Michael St. Patrick Baxter, Esq.

Covington & Burling LLP  
Washington, D.C.

## Richard F. Broude, Esq.

New York, NY

## Hon. Leif M. Clark

U.S. Bankruptcy Court  
San Antonio, TX

## Michael J. Cramos, Esq.

Davis Polk & Wardwell  
New York, NY

## \*Murray Drabkin, Esq.

Washington, D.C.

## Prof. David G. Epstein

Dedman School of Law  
Southern Methodist University  
Dallas, TX

## Chaim J. Fortgang

Silver Point Capital Advisors, LLC  
Greenwich, CT

## Prof. S. Elizabeth Gibson

Univ. of North Carolina Law School  
Chapel Hill, NC

## Daniel M. Glosband, Esq.

Goodwin Procter LLP  
Boston, MA

## Marcia L. Goldstein, Esq.

Weil, Gotshal & Manges LLP  
New York, NY

## Robert A. Greenfield, Esq.

Stutman, Treister & Glatt, Prof. Corp.  
Los Angeles, CA