

NATIONAL BANKRUPTCY CONFERENCE

A Voluntary Organization Composed of Persons Interested in the
Improvement of the Bankruptcy Code and Its Administration

OFFICERS

Chair

PROF. DOUGLAS G. BAIRD

Vice Chair

RICHARD G. MASON

Treasurer

EDWIN E. SMITH

Secretary

HON. CRAIG GOLDBLATT

CONFEREES

OMAR ALANIZ

HON. THOMAS L. AMBRO

MICHAEL ST. PATRICK BAXTER

RONIT J. BERKOVICH

DONALD S. BERNSTEIN

PROF. RALPH BRUBAKER

BABETTE A. CECCOTTI

HON. SHELLEY C. CHAPMAN

HON. LEIF M. CLARK

HON. REBECCA CONNELLY

DAVID COX

HON. DENNIS R. DOW

DENNIS F. DUNNE

SUSAN M. FREEMAN

DANIEL M. GLOS BAND

MARCIA L. GOLDSTEIN

HON. ALLAN L. GROPPER

HON. MICHELLE HARNER

HON. JOHN E. HOFFMAN

HON. WHITMAN L. HOLT

HON. BARBARA J. HOUSER

MARSHALL S. HUEBNER

CHAD J. HUSNICK

PROF. MELISSA B. JACOBY

HON. BENJAMIN A. KAHN

RICHARDO I. KILPATRICK

SUSHEEL KIRPALANI

EMIL A. KLEINHAUS

ALAN W. KORNBERG

COLLEEN E. LADUZINSKI

JONATHAN M. LANDERS

PROF. ROBERT LAWLESS

HEATHER LENNOX

STEPHEN D. LERNER

RICHARD LEVIN

MARC A. LEVINSON

HON. CHRISTOPHER M. LOPEZ

HON. KEITH LUNDIN

PROF. BRUCE A. MARKELL

THOMAS MOERS MAYER

TODD F. MAYNES

DEAN TROY A. MCKENZIE

PROF. EDWARD R. MORRISON

HAROLD S. NOVIKOFF

ISAAC M. PACHULSKI

PROF. RANDAL C. PICKER

JOHN RAO

K. JOHN SHAFFER

HON. BRENDAN L. SHANNON

RAYMOND L. SHAPIRO

HENRY J. SOMMER

JAMES H.M. SPRAYREGEN

DANIELLE SPINELLI

CATHERINE STEEGE

J. RONALD TROST

R. PATRICK VANCE

JANE L. VRIS

PROF. JAY L. WESTBROOK

BRADY C. WILLIAMSON

Honorable Thomas Massie
Chairman
Subcommittee on the Administrative
State, Regulatory Reform and
Antitrust
2453 Rayburn House Office Building
Washington, DC 20515

Honorable Luis Correa
Ranking Member
Subcommittee on the Administrative
State, Regulatory Reform and
Antitrust
House of Representatives
2301 Rayburn House Office Building
Washington, DC 20515

Honorable Richard J. Durbin
Chairman
Committee on the Judiciary
United States Senate
711 Hart Senate Office Building
Washington, D.C. 20510

Honorable Lindsey Graham
Ranking Member
Committee on the Judiciary
United States Senate
211 Russell Senate Office Building
Washington DC 20510

March 26, 2024

Re: Exclusion of Insider or Affiliate Debt in Determining Eligibility for
Subchapter V of Chapter 11 of the Bankruptcy Code

Dear Reps. Massie and Correa and Sens. Durbin and Graham:

I write on behalf of the National Bankruptcy Conference to address the proposal to strike the exclusion of affiliate or insider debt from the definition of debtor under §1182(1) of title 11 of the United States Code (the “Bankruptcy Code”). Under current law, money loaned to a business by an insider is not included in the calculation of subchapter V’s \$7.5 million debt cap. We believe this exclusion is sound bankruptcy policy, so we recommend that the committees *reject* the proposed amendment. This letter sets out the reasons for our position.

The National Bankruptcy Conference (“NBC”) is a voluntary, nonpartisan, not-for-profit organization composed of about sixty of the nation’s leading bankruptcy judges, academics, and practitioners. It has provided advice to Congress on bankruptcy legislation for eighty years. I enclose a Fact Sheet which provides further information about the NBC.

There are some subchapter V cases where the amount of noninsider debt falls below the current \$7.5 million cap, but would exceed the cap if insider debt were counted. For the vast majority of small business cases, insider debt takes the form of loans from the entrepreneurs themselves or their families, both of whom fall squarely within the definition of an insider under 11 U.S.C. §101(31). This source of funding should be encouraged and should not prevent a debtor from using the effective reorganization tools of subchapter V.

Where a small business is facing financial distress, often the only source of new funding will be the entrepreneur or relatives of the entrepreneur.¹ Including such debt in the calculation of the cap is counterproductive. To the extent that the small business is well advised, counting insider debt against the cap would make it less likely that entrepreneurs and their relatives will contribute additional resources to the venture. Consequently, some small businesses might end up filing bankruptcy cases that could have been averted had the business obtained additional help from the debtor's relatives. Indeed, with or without a bankruptcy case, the lack of access to insider funding will make it more likely that the business will fail. Sending these small businesses into a regular, more costly and less streamlined chapter 11 case merely because the insider debt brings the amount over the definitional cap is simply not practical. To the extent the small business is not well advised, this change would spring a trap on the unwary who were loaning resources to a family member to prevent a business failure.

We see no valid reason to take away an incentive for insiders to fund for small businesses. Indeed, insider debt is treated differently in bankruptcy in certain respects and subject to particular scrutiny precisely because it is not a transaction done at arm's length.

To be sure, large amounts of insider debt can exist in the rare subchapter V case that does not look like a typical family-owned small business. We do not, however, believe that such cases are likely to be a source of abuse, and bankruptcy judges have a variety of different tools that they can and do draw upon to ensure that the rights of creditors are protected in such cases.

For example, a trustee is appointed in each subchapter V case. Even without removing a debtor from possession, the court may expand the trustee's duties to include the investigation of insider or affiliate transactions under §1183(b)(2) and §1106(a)(3). The trustee might be asked to report under §1106(a)(4) on the efficacy of any actions under chapter 5 of the Bankruptcy Code, including §510, §541, §544, §§547–550. The trustee can also be empowered to commence an adversary proceeding that seeks to reclassify insider or affiliate debt as equity.

Subchapter V also provides for the appointment of a creditors' committee. Bankruptcy judges are appropriately chary in appointing committees in most subchapter V cases. The burden in terms of cost and delay in a small case can be considerable and even fatal. In the unusual case, however, appointing a committee can be useful. The committee is clothed with fiduciary obligations and can engage capable professionals to conduct any necessary analysis that is beyond the resources and capacity of the court. The committee also possesses an economic incentive to make sure that creditor claims are treated appropriately in accordance with the Bankruptcy Code.

Expanding the powers of the trustee and appointing a committee are only two ways that the bankruptcy judge can ensure any potential abuse involving insider debt is addressed appropriately. Additional steps the bankruptcy judge can take include the following:

- If warranted, the court may remove a debtor from possession under §1185, thereby authorizing the trustee to bring any appropriate actions with respect to

¹ See, e.g., *In re Lifschultz Fast Freight*, 132 F.3d 339, 345–47, 352 (7th Cir. 1997).

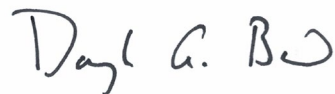
insider claims. Alternatively, the trustee can help facilitate a consensual plan that takes any such claims into account;

- The court may deny confirmation under §1191(b) if the plan unfairly treats affiliate debt vis á vis the general unsecured creditors even if the plan otherwise meets the disposable income test;
- The court can set the plan term under §1191(c) at five years instead of three;
- The court can set deadlines for the debtor to file any amended plan with certain terms included or excluded or order that the case will be dismissed or converted. *See In re Duling*, 650 B.R. 578 (Bankr. D. SD. 2023);
- The court can convert the case to a case under chapter 7; or
- The court can dismiss the case.

Given that insider debt should be welcome in the typical small business case and that bankruptcy judges already have many effective tools to prevent abuse in the unusual ones, the NBC believes that the current exclusion of insider debt in determining compliance with the debt cap should be preserved.² It encourages entrepreneurs to invest in their businesses without opening the door to unchecked abuse.

As always, we stand ready to help as you work to improve subchapter V and our bankruptcy laws more generally.

Sincerely,

A handwritten signature in black ink that reads "Douglas G. Baird". The signature is written in a cursive, slightly slanted style.

Douglas G. Baird, Chair
dbaird@uchicago.edu
773 459 2719

² As we understand the proposal, it would not change the definition of “small business debtor” under 11 U.S.C. §101(51D). This definition would still exclude insider or affiliate debt. This could create incongruencies. A debtor could be a small business debtor subject to the small business provisions of the Bankruptcy Code, but not eligible to elect relief under subchapter V. There is no sound bankruptcy policy supporting such a distinction.

NATIONAL BANKRUPTCY CONFERENCE

A 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 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. Most recently, the Conference played a leading role in developing the Small Business Reorganization Act of 2019, Pub. L. 116-54.

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

P.O. Box 249 • Stanardsville, VA 22973

434-939-6008 Fax: 434-939-6030 • Email: sbedker@nbconf.org • Web: www.nbconf.org

NATIONAL BANKRUPTCY CONFERENCE

Chair

Prof. Douglas G. Baird
University of Chicago Law School
Chicago, IL

Vice Chair

Richard G. Mason, Esq.
Wachtell, Lipton, Rosen & Katz
New York, NY

Treasurer

Edwin E. Smith, Esq.
Morgan, Lewis & Bockius LLP
Boston, MA

Secretary

Hon. Craig T. Goldblatt
U.S. Bankruptcy Court
Wilmington, DE

Chair, Legislation Committee

Michael St. Patrick Baxter, Esq.
Covington & Burling LLP
Washington, D.C.

Chair, Drafting Committee

Dean Troy A. McKenzie
New York University School of Law
New York, NY

Omar J. Alaniz, Esq.

Reed Smith LLP
Dallas, Texas

Hon. Thomas L. Ambro

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

Ronit J. Berkovich, Esq.

Weil, Gotshal & Manges LLP
New York, NY

Donald S. Bernstein, Esq.

Davis Polk & Wardwell
New York, NY

Prof. Ralph Brubaker

University of Illinois College of Law
Champaign, IL

Babette A. Ceccotti, Esq.

Retired
Hoboken, NJ

Hon. Shelley C. Chapman (ret.)

Willkie Farr & Gallagher LLP
New York, NY

Hon. Leif M. Clark

San Antonio, TX

Hon. Rebecca Connelly

U.S. Bankruptcy Court
Harrisonburg, VA

H. David Cox, Esq.

Cox Law Group, PLLC
Lynchburg, VA

Hon. Dennis R. Dow

Retired
Leawood, KS

Dennis F. Dunne, Esq.

Milbank, Tweed, Hadley & McCloy
New York, NY

Susan M. Freeman, Esq.

Lewis Roca Rothberger Christie
Phoenix, AZ

Daniel M. Glosband, Esq.

Goodwin Procter LLP
Boston, MA

Marcia L. Goldstein, Esq.

New York, NY

Hon. Allan L. Gropper (ret.)

U.S. Bankruptcy Court
New York, NY

Hon. Michelle M. Harner

U.S. Bankruptcy Court
Baltimore, MD

Hon. John E. Hoffman

U.S. Bankruptcy Court
Columbus, OH

Hon. Whitman L. Holt

U.S. Bankruptcy Court
Yakima, WA

Hon. Barbara J. Houser

U.S. Bankruptcy Court
Dallas, TX

Marshall S. Huebner, Esq.

Davis Polk & Wardwell
New York, NY

Chad J. Husnick, Esq.

Kirkland & Ellis LLP
Chicago, IL

Prof. Melissa B. Jacoby

Univ. of North Carolina Law School
Chapel Hill, NC

Hon. Benjamin A. Kahn

U.S. Bankruptcy Court
Greensboro, NC

Richardo I. Kilpatrick, Esq.

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

Susheel Kirpalani, Esq.

Quinn Emanuel Urquhart &
Sullivan LLP
New York, NY

Emil A. Kleinhaus, Esq.

Wachtell, Lipton, Rosen & Katz
New York, NY

Alan W. Kornberg, Esq.

Paul, Weiss, Rifkind, Wharton &
Garrison LLP
New York, NY

Colleen E. Laduzinski, Esq.

Jones Day
Boston, MA

Jonathan M. Landers, Esq.

Scarola Malone & Zubatov LLP
New York, NY

Prof. Robert Lawless

University of Illinois College of Law
Champaign, IL

Heather Lennox, Esq.

Jones Day
Cleveland, OH

Stephen D. Lerner, Esq.

Squire Patton Boggs (US) LLP
Cincinnati, OH

Richard Levin, Esq.

Jenner & Block LLP
New York, NY

Marc A. Levinson, Esq.

Orrick, Herington & Sutcliffe LLP
San Francisco, CA

Hon. Christopher M. Lopez

U.S. Bankruptcy Court
Houston, TX

Hon. Keith Lundin

U.S. Bankruptcy Court
Nashville, TN

Prof. Bruce A. Markell

Northwestern School of Law
Chicago, IL

Thomas Moers Mayer, Esq.

Kramer Levin Naftalis &
Frankel LLP
New York, NY

Todd F. Maynes, Esq.

Kirkland & Ellis LLP
Chicago, IL

Prof. Edward R. Morrison

Columbia Law School
New York, NY

Isaac M. Pachulski, Esq.

Pachulski Stang Ziehl & Jones LLP
Los Angeles, CA

Prof. Randal C. Picker

University of Chicago Law School
Chicago, IL

John Rao, Esq.

National Consumer Law Center
Boston, MA

K. John Shaffer, Esq.

Quinn Emanuel Urquhart &
Sullivan LLP
Los Angeles, CA

Hon. Brendan L. Shannon

U.S. Bankruptcy Court
Wilmington, DE

Henry J. Sommer, Esq.

Retired
Philadelphia, PA

Danielle Spinelli, Esq.

Retired
Washington, D.C.

James H.M. Sprayregen, Esq.

Kirkland & Ellis LLP
Chicago, IL

Catherine Steege, Esq.

Jenner & Block LLP
Chicago, IL

J. Ronald Trost, Esq.

Retired
New York, NY

R. Patrick Vance, Esq.

Jones Walker LLP
New Orleans, LA

Jane L. Vris, Esq.

Retired
New York, NY

Prof. Jay Lawrence Westbrook

University of Texas School of Law
Austin, TX

Brady C. Williamson, Esq.

Godfrey & Kahn, S.C.
Madison, WI