Commission: bankruptcy reform could mean ‘starting from scratch’

By Nick Brown

NEW YORK, Oct 17 2012 (Reuters) - A commission charged with exploring bankruptcy reform said on Wednesday it may recommend ditching outdated bankruptcy laws altogether and "starting from scratch."

The Commission to Study the Reform of Chapter 11, whose 22 members constitute a venerable bankruptcy industry Hall of Fame, on Wednesday held its first in a series of hearings to gather feedback on what is right and wrong with the statutory scheme that has governed Chapter 11 bankruptcy since 1978.

The commission's charge includes "literally considering starting from scratch and re-inventing the statute," said Robert Keach, attorney and commission co-chairman.

The group, formed earlier this year by trade group the American Bankruptcy Institute, heard feedback from lending industry leaders at the Loan Syndication and Trading Association's annual conference in New York.

It plans to eventually submit a report to Congress, targeted for April, 2014, that could serve as "part blueprint, part outline" for new legislation, Keach said.

The current bankruptcy code, which tries to balance a debtor's need to save its business with a creditor's need to recover its money, has become outdated as the investing community has grown more sophisticated and capital structures more complex, Keach said.

It was written at a time when the biggest employers were manufacturers with U.S. operations, not service companies with principal assets comprised of contracts and intellectual property, which dominate today's markets, Keach said.

"The code does not clearly provide for the treatment of such assets," he said.

Keach co-chairs the commission with fellow bankruptcy lawyer Albert Togut. Its members, all bankruptcy A-listers, include Harvey Miller, the Weil Gotshal & Manges lawyer who led Lehman Brothers through bankruptcy, and retired Manhattan bankruptcy Judge Arthur Gonzalez. Jim Millstein, the former U.S. Treasury chief restructuring officer, and Rich Levin, the Cravath Swaine & Moore attorney who helped write the original code in 1978, are also on the team.

While the code has gone through periodic modifications, most recently in 2005, this commission's ambitious charge suggests bigger changes could lie ahead.

The commission will study 13 areas of bankruptcy law, including labor & benefits issues, financing rules and government supervision. It is collecting feedback from several groups through a series of hearings, with scheduled dates at the National Conference of Bankruptcy Judges in San Diego on Oct. 26, and a convention of trade group the Turnaround Management Association in Boston on Nov. 3.

At Wednesday's hearing, lending industry leaders expressed measured concern that the undertaking could be read as an attempt to deter or limit the use of secured credit in bankruptcy.

The mission statement "suggests that the expansive use of secured credit has interfered with companies' ability to reorganize in bankruptcy," said A.J. Murphy, who heads leveraged finance at Bank of America Merrill Lynch.

Lee Shaiman, a managing director at the Blackstone Group's GSO Capital Partners, said major changes could "seriously impair the functioning of the capital markets and thus harm businesses both in and out of bankruptcy."

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