Written Responses to Questions from Senator Grassley by

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before
Senate Committee on the Judiciary, Subcommittee on the Administrative Oversight of the Courts

"Could Bankruptcy Reform Help Preserve Small Business Jobs?"

April 7, 2010

Chairman Leahy, Subcommittee Chairman Whitehouse, Ranking Member Sessions, and Members of the Subcommittee, I am setting forth my responses to questions from Senator Grassley regarding the proposal to amend certain portions of the Bankruptcy Code, 11 U.S.C. §§ 101 et seq., dealing with what are described as small businesses. As with my prior testimony, my answers to Senator Grassley's questions constitute my views, not those suggested to me by others. Furthermore, my responses are not made as a representative, member or officer of any group or organization.

Question 1. At the hearing, you expressed concerns about expanding Chapter 12 to small businesses because it "might mess up those provisions" that have worked well for family farmers and fishermen. Could you please elaborate in more detail your concerns about applying Chapter 12 to small businesses?

Response to Question 1. To cite to a specific application of just what might happen in the future should small businesses be able to utilize the provisions of Chapter 12 of the Bankruptcy Code is difficult to do before it occurs. In order to understand my concerns, one must know and understand the severe limitations on what lawyers and judges do. It is the analytical tool that lawyers and judges use, words, and the structural foundation for making decisions, case law extrapolation, that cause decisions of a court in one case to be applicable to many, if not innumerable, other legal and factual combinations never contemplated by the court making the first decision in a given fact and law context.

There is a reason why mathematics and other quantitative methods are utilized in disciplines other than the law. It is that it becomes very difficult, and ultimately impossible, to study a topic and its implications by using verbal analysis. Although up to a point, some very bright individuals may be able to manipulate multiple facts and laws to reach a "ruling" or similar legal conclusion, beyond some number of facts and applicable laws or legal principles, be it three or four or five or twenty or some other number of facts that vary as applied to multiple legal principles, a point is reached when one may no longer use verbal analysis.

In the belief that lawyers and judges may get around the limitations of verbal analysis, a method that is the opposite of what is done by use of mathematics and other quantitative methods has been developed in our legal system. Unfortunately, it is simply a bandage covering what is the bigger problem: use of verbal analysis to reach a legal conclusion will be inapt for many cases in the universe of relevant variations of laws to facts. Why this happens is the impact of our common law system where an initial decision by one court – particularly if it is an appellate court – governs all future cases perceived by the decision maker as being within the set of facts and law that are within the boundaries viewed as the same, or similar enough, to those of the case where the first ruling occurred. Recognition of this limitation is inherent in what lawyers and judges are taught to do in law school. It is to distinguish a particular matter from what would otherwise be the controlling precedent by either arguing that a fact or facts or another legal principle or principles make it so different from the governing case law that the governing case law should either be modified or not apply.

What is essentially being done is that one set of facts and one set of legal principles are by verbal analysis being used to make a rule in one case that by our system of precedent is applicable to all future cases within what is verbally perceived as the same universe of facts and law as the first case which set the governing law. Pictorially, this is looking at a glass ball with numerous marbles representing the perceived universe of relevant variations of facts and law and selecting one marble for making one's legal decision. Because this marble came from the glass bowl with, for instance, many iterations of facts making up the same universal set, the decision based on one marble with its fact pattern becomes the governing rule for all of the other marbles in the bowl with all sorts of factual variations. More simply, the first case governs all future ones viewed as similar until and unless one may distinguish the first ruling in a later case. Absent such modification or exclusion, the problem is that this method of legal analysis means that the first decision will be incorrect when applied to the fact patterns represented by other of the marbles in the universal set represented by the bowl.

As indicated, lawyers and judges use the technique of distinguishing by demonstrating a significant degree of variance in facts or applicable legal principles to take subsequent marbles out of the set of facts and law creating the initial legal ruling. The structure of this precedent methodology used in our legal system which is premised on the subsequent ruling looking at fact variations that were not and often could not be considered at the time of the first ruling, creates modified rules governing all of the variations of facts – all of the marbles in the bowl – with fewer mistakes from application of the modified rule or its exclusion. It is a honing of the initial court's ruling to make it more accurately apply to the potentially vast variations of facts that may arise in application of legal principles to fact patterns. From one vantage point, this is decision by trial and error with the hope that the degree of error is not too great and that the time to correct the errors inherent in our system of legal decision making is not too long.

Regrettably, errors are sometimes made of great magnitude by courts from the Supreme Court of the United States and the comparable courts of our States to the trial courts of our federal and state systems. One need only look at decisions of the Supreme Court in the antitrust context made decades ago and overruled in more modern times to decisions of lower courts that were incorrect and took an extended time to alter or correct.

This is why other disciplines use mathematics and other quantitative methods. What they do is convert facts and applicable principles to mathematical representations. Once converted, methods of varying one to some or all of the various permutations of applicable facts and principles may be utilized to arrive at a rule or principle that more accurately governs all permutations. More concisely, mathematics is used to overcome the limitations of verbal analysis and to derive a "rule" that may be accurately applied to far more of the marbles in the bowl. It is the reverse of what lawyers and judges do using words!

Once one knows and understands why what lawyers and judges do using verbal analysis is innately inaccurate in many instances, one may apprehend why allowing what could be thousands and thousands of so-called small business cases to utilize Chapter 12, compared to the much smaller number of family farmers and fishermen, will undoubtedly create problems for family farmer and fishermen cases. First, the possibility of a significant increase in number of cases in Chapter 12 heightens the likelihood of a ruling made in a non-farm and non-fisherman case being applied to family farmer and fishermen cases which does not work for a farm or fishery. Second, the facts involving farming and fishing will tend to be different from many small business cases. This means that to get a correct result in a family farm or fishing case, one may have to resort to distinguishing a decision made first in a non-farm or non-fisherman small business case. This distinguishing may take years or decades before it successfully occurs. In the meantime, family farmers and fishermen will be subject to a governing rule of law that may be inaccurate or, worse, downright wrong when applied to them.

It is because of the heightened potential for incorrect or inaccurate results inherent in our legal system's methods of deciding cases and issues should Chapter 12 be expanded that I suggest that any change in small business provisions not be placed in Chapter 12. Rather, it should be elsewhere such as where it currently is in Chapter 11 of the Bankruptcy Code, 11 U.S.C. §§ 1101 et seq. It is not a question of whether such a problem would occur. Rather, it is only when and in what context it would happen.

Question 2. In your opinion, does it make more sense to amend Chapter 11 to accommodate small business bankruptcy concerns? What about creating a new small business bankruptcy chapter in the Bankruptcy Code?

Response to Question 2. If Chapter 12 were expanded to encompass small business cases, it would result in business bankruptcy reorganizations being able to be placed under four (4) portions of the Bankruptcy Code set forth in three (3) chapters of the statute: Chapter 11 for non-small business bankruptcies, Chapter 11 for small business bankruptcies with just under $2,200,000.00 in aggregate debt, Chapter 13 for certain individuals with noncontingent, liquidated, secured debt of approximately $1,000,000.00 and noncontingent, liquidated, unsecured debt of just under approximately $340,000.00, and the National Bankruptcy Conference's proposed Chapter 12 for those entities with aggregate debt of $10,000,000.00 or less. Depending on any final definition of what is a small business, this also means that some small businesses will have three (3) options for a bankruptcy filing: Chapter 11, Chapter 12, and Chapter 13. This is the category for certain individuals in business. For legal entities which come within the definition of a small business, it would provide potentially two (2) venues to reorganize: Chapter 11 and Chapter 12.

Despite the fact that some family farmers and fishermen contemplating bankruptcy have three (3) options for reorganization, Chapters 11, 12, & 13, it only further complicates an already technical statute to allow Chapter 12 to be used by small businesses. I say this not just based on my comments in response to Question 1 along with what is set forth above in response to this question, but also from the viewpoint that altering the existing provisions of Chapter 11 allows the small business provisions to remain where they are currently are located. This is a little more on why I believe that amending Chapter 11 is a better approach.

As for creating a new small business bankruptcy chapter in the Bankruptcy Code, I generally believe this is not the better approach. I say "generally" because it is subject to a couple of factors. One is the definition of a small business. It may be that the definition of a small business could be set so that it represents a smaller fraction of all businesses consisting of those with few employees, low levels of debt and revenues, and limited complexities, if any at all. The other is whether Congress determines that it wants to change the fundamental basis of reorganization as it currently exists in Chapter 11, one designed to be consensual when possible, to one where creditors have far less input into the reorganization of a debtor and where the debtor has control of the reorganization plan subject only to compliance with what bankruptcy law allows as is the case under Chapter 12. Should the definition be of the nature set forth in this paragraph, and Congress determine that a non-consensual, debtor-controlled plan of reorganization is what is appropriate, then a separate chapter may be the better approach.

Question 3. In your written statement, you take issue with the lack of quality data from bankruptcy cases that could be used to accurately understand the utility of Chapter 11 for small businesses. Could you describe the kinds of data that you believe should be collected?

Response to Question 3. Although made in the context of proposed changes to the Bankruptcy Code for small businesses, my comments regarding the failure to capture and make available data extends to all aspects of bankruptcies filed under our laws. I will limit my suggestions to small businesses, but many are equally applicable to all debtors under all chapters of the Bankruptcy Code.

Some of what is needed is being better able to know the debt structure along with the revenues of small businesses. Part of improving this data is to ensure that debtors accurately complete the currently required forms. As my written testimony of March 17th and supplemental testimony of March 23rd indicate, thousands of those filing business bankruptcy cases either leave blank or only partially complete Official Forms 1 and 6. With many completed forms, the responses are inconsistent for the identical information required to be disclosed in both.

Additional information about the businesses in a readily accessible format would also enhance what it is that Congress wants to know and how to make changes to accomplish its goals. For instance, adding categories for revenues by fiscal or calendar year and the number of employees of a business in the initial filing documents would allow one to more easily determine whether a business is truly a small one or not.

Other information would help our understanding of what works in reorganizations under our bankruptcy laws. For instance, keeping track of the number of cases that proposed a plan of reorganization and how long it took to propose a plan coupled with information about the size of a particular debtor and other financial data such as cash flow may enable one to learn if one or more factors contribute to a longer or shorter time before a plan of reorganization is proposed. Similar data on the rate of confirmation of plans and the size and type of business involved could give a better understanding of how these factors interplay with others in the reorganization process, including achieving confirmation of a plan.

Keeping track of what happens to a reorganized debtor following confirmation of a plan is yet another example of needed facts. What this would permit is one to know the success – or lack thereof – over time for reorganized entities. Today, the success of our bankruptcy laws for truly reorganized debtors is guess work, at best, due to the absence of knowing what has happened over time following confirmation of a plan of reorganization.

Other areas of interest should include data that may be used to analyze what are the causes of filing bankruptcy. Having better data in this area would lessen attributing bankruptcies to one factor or another without the needed information and analysis and contriving ideas of cause and effect based on what is the desired outcome. Stated differently, it would cut down those who say something is caused by a factor(s) when the reality is that what is being said is not accurate.

Unfortunately, the list of categories of what we should know is rather long and beyond a more detailed discussion in my responses to Senator Grassley's questions.

What needs to occur is a determination by Congress, along with other professionals beyond lawyers and judges, of what is important to know on a factual basis and what is helpful to know for developing better functioning bankruptcy laws. Why this must occur is that one of the ways to improve what happens in bankruptcy is to know how it really works, or does not work, and adopt changes based on quantitatively verifiable data, not speculation and guess. Improvement in how the bankruptcy process functions based on such data has the added benefit of, among other things, reducing the risks of bankruptcy to creditors along with a better allocation of scarce resources to better uses for our economy. Simultaneously, it would assist debtors to better understand the whens and hows of bankruptcy so a better outcome may be achieved. In other words, it permits us to better redesign bankruptcy laws to potentially save jobs of some or reallocate resources to other enterprises with greater job creation potential than that of a business that is declining. A further discussion of this potential is set forth in response to question 9.

Question 4. *In your written statement, you discuss the fact that the National Bankruptcy Conference relies on flawed studies to make the case for its proposed new bankruptcy law revisions. In you opinion, what is the single biggest flaw in these studies?*

Response to Question 4. In my written statement, I did not indicate that any particular study relied on by the National Bankruptcy Conference was flawed because I did not have to do so. Although I believe at least one to be fundamentally flawed for purposes of actually knowing, as opposed to speculating, what are some of the problems with bankruptcy cases, my point was that the essential studies relied on by the National Bankruptcy Conference may not properly be utilized for the purposes for which they have been cited.

This is because the critical ones do not purport to be based on a random sample of data from across the United States regarding small business bankruptcies or business bankruptcies, big, medium, or small. Instead, one is based on the authors' admittedly non-random sample of data from only a minority of bankruptcy jurisdictions using only business bankruptcy cases of certain types by size of selected dollar categories such as debt and assets. The authors of this study admit that their conclusions are not necessarily correct, but, for want of better data, are their best interpretation of what they believe to be the state of affairs for a time period from over a decade ago. The single biggest flaw in this study is that it is not much better than intuition for what was and is the real state of affairs and its causes. This is not the kind and quality of information upon which Congress should base legislation.

The other purports to be a complete sample for a particular time period of one division of one bankruptcy district of the United States. It does not obtain data from a random sampling of all portions of the United States and of all categories of businesses. The author also sets forth that what he has determined is not expandable to a general discussion of bankruptcies across the

United States. Furthermore and should its findings for the Northern District of Illinois, Eastern Division hold true for the United States as a whole, it indicates the incorrect nature of three of the four so-called fundamental flaws of the current Chapter 11 process upon which the National Bankruptcy Conference premised its position paper for small business bankruptcies.

The central point of this portion of my written statement regarding the lack of random sampling and quantitatively verifiable data was and is that none of the critical studies upon which the National Bankruptcy Conference has relied may properly be used to support its assertions about small business bankruptcies. This arises from the authors' explicit limitations on such extrapolations. This means that the legislative changes, too, should not be premised on such impermissible extensions of data.

Question 5. You indicate that 67% of all Chapter 11 cases could qualify as small businesses. Do you believe that the National Bankruptcy Conference's proposed definition of small business is too broad?

Response to Question 5. Yes. Because of the failure of Chapter 11 debtors to entirely fill out Official Form 1 and Official Form 6, the data regarding assets and liabilities for all business bankruptcy cases filed in 2009 varies between these forms. Using the $10,000,000.00 or less in aggregate debt as the cut off for small business entities, Official Form 1 responses for 2009 indicate that about 67% of all cases filed in 2009 could come within the definition of a small business entity. From Official Form 6, the responses indicate that potentially 87% of cases filed in 2009 would be within the National Bankruptcy Conference's proposed definition of a small business entity. See pp. 8-9, 17-18 of March 17, 2010 Written Testimony of Hon. Thomas B. Bennett. In my supplemental written testimony, the 2009 data for small business filings under the existing definition of a small business – those with aggregate debt of approximately $2,200,000.00 – is in the range of 21.15% to 23.47%. Had the NBC's definition been in place for calendar year 2009, the percentage of small business filings would go from just under one quarter to somewhere between approximately two-thirds to almost 90% of all Chapter 11 cases filed. Included as a small business entity using the NBC's definition would have been three (3) with assets over a billion dollars, seven (7) with assets exceeding five hundred million dollars up to a billion dollars, twenty-one (21) with assets of over one hundred million dollars up to five hundred million dollars, thirty-four (34) with assets greater than fifty million dollars up to one hundred million dollars, and two hundred sixty-three (263) with assets over ten million dollars up to fifty million dollars. Under its proposed definition, some businesses that are not small are classified as small business entities.

Question 6. Do you believe that the National Bankruptcy Conference's proposed definition of small business could be gamed or abused?

Response to Question 6. Unless there is an intentional misrepresentation of the debt levels, the aggregate amount of qualifying debt under the NBC's suggested definition is ascertainable. As a result, I do not see that it is capable of being gamed or abused. To the extent that debt is accurately disclosed, is at or below the $10,000,000.00 sum, and includes entities that are not really small businesses, for example those with thousands of employees or assets in the multiple hundreds of millions of dollars or more, using the NBC's proposed Chapter 12 instead of Chapter 11 would be a permissible option for such businesses. I do not view this as gaming or abusing a system should it be so designed. However and for reasons already delineated, I do not believe the proposed definition should be that which the NBC proffers.

Question 7. How would you define small business for a small business bankruptcy chapter?

Response to Question 7. As I set forth in my supplemental written testimony of March 23, 2010, I do not believe that aggregate debt, by itself, is susceptible of defining a small business entity. Rather, I believe another factor or factors should be utilized which include one or more of total assets, total revenues, and number of employees. Each is relatively easy to determine and verify. Total revenues and number of employees are better measures for some businesses such as those with relatively little in assets and those with insignificant debt that still have substantial operations which may be more accurately indicated by revenues or employees. An example is a service business which will frequently have relatively little in assets, but significant revenues and potentially a large employee base. Additionally, I would create a mechanism by which a business entity could be excluded from the small business category because of complexities that are not usually associated with debtors having debt, assets, revenues, or employees below a set number or within the other factor(s) Congress may select to define a small business entity.

Question 8. The hearing witnesses have discussed problems that small businesses have in filing for bankruptcy under Chapter 11. What provisions in Chapter 11 do not pose problems for small businesses in bankruptcy?

Response to Question 8. This question is somewhat difficult to answer due to its broad scope and whatone sees as a "problem." In any given Chapter 11 case, a debtor may face a problem caused by the requirements of certain sections of this chapter. That one debtor or a few may have a "problem" with compliance with a given section of Chapter 11 does not mean that for most it is a problem. So, I limit my response to those provisions that generally do not present difficulties regarding compliance or enforcement.

There are four (4) subchapters to Chapter 11. Subchapter IV deals with railroad reorganization and is excluded from consideration as part of this response. The remaining subchapters are Subchapter I involving officers and administration of a debtor's estate, Subchapter II delineating the who, what, how, and when of a plan of reorganization, and Subchapter III for postconfirmation matters such as the effect of confirmation, plan implementation, distributions under a plan, revocation of confirmation, and two sections dealing with specialized matters involving taxation and securities laws.

For those provisions of Subchapter III for postconfirmation matters, which are set forth in 11 U.S.C. §§ 1141-1146, these do not generally pose problems for small businesses. As for Subchapter I, officers and administration of the estate, these sections with the exception of 11 U.S.C. §§ 1113-14, generally do not cause problems for small business debtors other than the fact that having a creditors' or equity security holders' committee or an examiner will tend to increase the professional costs of a case. As for the rejection of collective bargaining agreements and payment of insurance benefits to retired employees set forth in 11 U.S.C. §§ 1113-14, these provisions in some small business cases make reorganization more difficult, if not impossible. The same is true of these two sections for medium and large Chapter 11 cases.

The bulk of the problems encountered by small business Chapter 11 cases arise in what is governed by Subchapter II which deals with plans of reorganization. Section 1121 on who may file a plan and its timing is not a problem unless one views the time periods too short or too long and the ability of a creditor to propose a plan as a problem. Similarly, the classification of claims or interests in § 1122 does not generally create difficulties for small business entities. The same is true for § 1128 dealing with the confirmation hearing's notice and who may appear and object to confirmation and § 1124 on delineating what is an impaired claim or interest.

The bulk, if not almost all, of the "problems" of Chapter 11 for small business entities arise from what is required to be in a plan under § 1123, the postpetition disclosure and solicitation of acceptance of a plan under § 1125, § 1126's acceptance of a plan provisions, modification of a plan under § 1127, and plan confirmation necessities under § 1129. It is not the entirety of these sections which cause problems, but only portions of each. When viewed from the context of all of the relevant provisions for small business entities, it is only parts of a few of them that present any significant "problem."

<u>Question 9.</u> Could you elaborate on how you think that broadening Chapter 12 to include non-farm businesses could increase borrowing costs for small business borrowers?

<u>Response to Question 9.</u> On pages 9 through 11 of my written testimony of March 17, 2010, I set forth a discussion of what NBC's proposed changes for small business bankruptcy cases could shift the majority, if not substantially all, cases now reorganizing under Chapter 11 to Chapter 12's regime. To avoid repetition, I incorporate the prior testimony as part of this response to Senator Grassley's question and will summarize and expand this earlier testimony.

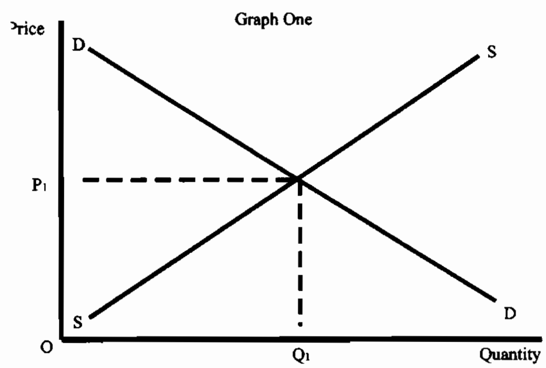
In its quintessence, the NBC's suggested changes for small business entities alters the fundamental dynamics of Chapter 11's preferred consensual form of reorganization where creditors and other interest holders have input in a debtor's ongoing operations, plan design and its implementation to one in Chapter 12 where there is no real input and only the ability to object to what a debtor does and would like to do in a plan. It also alters certain critical treatments for creditors regarding adequate protection of a creditor's secured status, the use, sale, and lease of a creditor's collateral or interest holder's interest in property, conversion or dismissal of a case, treatment of rejection of collective bargaining agreements, and payment of insurance benefits for retired employees, among other provisions. Each of these changes imposes a burden on creditors and certain parties in interest. Also, it eliminates the absolute priority rule of 11 U.S.C. § 1129 for debtors that are not individuals. Its elimination in many cases will result in the risk of failure and of additional losses to be borne solely by creditors, not by the owners of a reorganized entity. To put it differently, alterations of each of these increases the risks associated with bankruptcy for creditors of a small business entity should the NBC's proposed changes be enacted without modification.

In a similar fashion, Chapter 12's less detail and loosened requirements of debtors, when compared to the stricter and heightened mandates of Chapter 11, give creditors less ability to approximate the costs of failure by a small business entity. Lowering some of the of what is now required of small businesses under Chapter 1 as is done under the NBC's proposal also increases the risks associated with providing credit to businesses.

For analytical purposes, changes in the risk, as with changes in other factors bearing on the supply of credit excluding its price, are classified by economists as non-price changes. To assess the impact of a change in a non-price factor on the supply of credit, one needs to hold constant all other variables that influence its supply. By doing this, it isolates the effect of a change in the factor being considered, here increased risk caused by a change in bankruptcy laws, from other factors that may simultaneously change for unrelated reasons. More simply put, it lets one see the impact of the factor being viewed without its effect being covered up or masked by what others may cause to happen. For example, the increase or decrease in the supply of money by the Federal Reserve may be of such a magnitude when compared to a change in risk associated with bankruptcies that one is unable to see what the change in risk in bankruptcies did to the cost of credit without isolating the effects of other variable such as changes in the supply of money by a central bank.

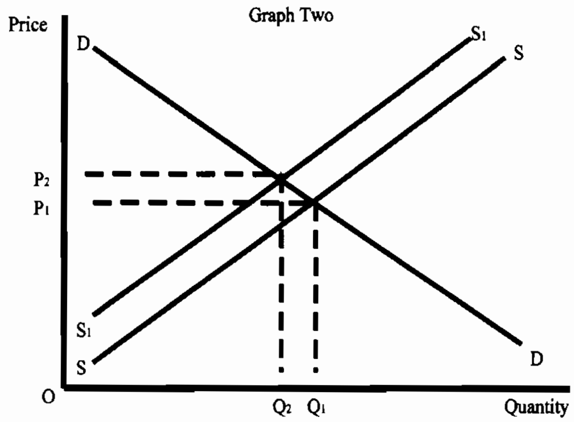
Before going forward with this discussion, please note that my earlier testimony was in terms of increasing the cost of credit over what it otherwise would have been and decreasing the supply of credit from what it otherwise would have been as a result of the increase in risks associated with the NBC's offered changes to bankruptcy reorganizations. In other words, it was a discussion of what could be expected to occur if all other factors influencing the supply and demand for credit were held constant or isolated from the effects of an alteration in the bankruptcy laws. Also, it was not that interest rates would necessarily go up or down or that the aggregate supply of credit would increase or decrease. Added to this is that the discussion was in the context of the market for credit generally and not with reference to what some might call the submarket for credit for small businesses, if such a submarket exists. This means that the discussion was on the impact such bankruptcy law changes would have on the cost and supply of credit for all who lend and borrow, not just small businesses.

Having set forth an outline of what I previously testified to, use of graphs will help one understand what one would expect to occur from an increase in risk to the suppliers of credit from the NBC's suggestions for small business bankruptcies. Before any changes, one would expect that those supplying credit and those demanding credit would each be willing to supply credit in varying amounts at different prices, or interest rates, and that borrowers would be willing to purchase credit – borrow – at varying amounts at different prices. The mathematics of both the amounts offered as the supply and the demand for credit may be seen by a graph such as the one below captioned Graph One because a graph is merely a picture of the mathematics.



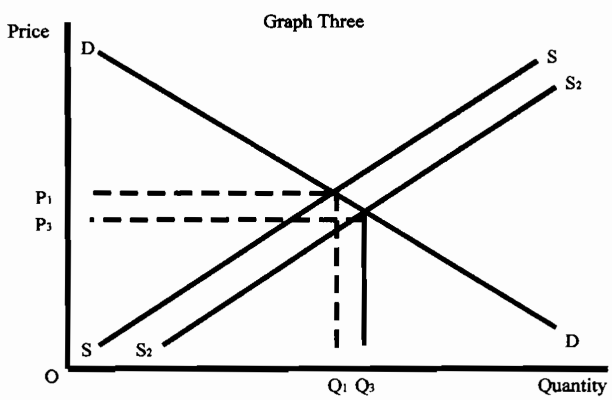
In Graph One, the line SS is the market supply of credit at various prices and the line DD is the market demand for credit at various prices. The downward slope of DD represents what one would normally expect to occur which is that the higher the price of credit, its interest rate, a lower amount of aggregate borrowing would occur and at lower interest rates more borrowing would take place. Similarly, the upward slope of the supply curve for credit, SS, reflects that at lower interest rates lenders would in the aggregate offer less credit and as the price for credit increases they would be willing to offer more credit. The intersection of these lines at the price P1 and quantity Q1 is where the amount of credit supplied equals the amount of credit demanded. It is sometimes referred to as the equilibrium point. At various times, one would expect the supply of and for credit to reach an equilibrium. Here it is at P1 and Q1.

When one changes the risks of lending, one would expect to find that creditors are unwilling to lend the same amounts at each given price as they were before a change in the risks of lending. If there is an increase in risk, a lender would normally not be willing to lend the same amount of monies unless the price received goes up. This would be true for each amount of credit and for each lender. Thus, an increase in the risk associated with a change in the bankruptcy laws will cause the original supply of credit represented by SS to shift to the left and upward to the line represented by S1S1. This is shown in Graph Two. What S1S1 shows is that for each amount of credit offered by all lenders a higher price – the interest rate – is associated. Joined with this and without other factors changing, the new equilibrium point where the demand for credit equals its supply will be at a price P2 which is higher than it was before the risk increasing change in bankruptcy laws and at a demand for credit at the quantity Q2 which is below the equilibrium between supply and demand before the risk increasing change in bankruptcy laws.



In summary and when other factors affecting the supply and demand for credit are held constant, the cost of credit will increase over what it otherwise would have been and its supply will decrease from what it otherwise would have been at each price point. What this means is that if interest rates increase overall, they will increase more than they would have had the increase risk of changes to bankruptcy laws not occurred. Conversely, if interest rates decrease overall, they will decrease less than they would have otherwise but for the increase in risk caused by the proposed changes to the bankruptcy laws by the NBC. This means that the cost of credit will be higher than it otherwise would have been for all borrowers, including small businesses, and the supply of credit by lenders will be less than it would have been. These are the implications from increasing risk to lenders from changes in the bankruptcy laws.

There is a potential countervailing factor that is not taken into account by the NBC's proposal or set forth in its discussion. If one redesigns the bankruptcy laws governing small businesses in a way that decreases the risks associated with bankruptcies, the supply of credit would be expected to shift to the right and downward representing lenders willingness to loan greater amounts at lower prices. This is shown on Graph Three by the supply curve marked S2S2. At each price, lenders are willing to lend more in the aggregate than what was the case before a decrease in risks caused by a change in bankruptcy laws. It also would create a new equilibrium at a quantity of credit Q3 – more credit supplied at a given price – which is greater than it was before the law change at Q1 and a decrease in the price of credit to P3 from what it was at P1 before the alteration of bankruptcy laws. Increasing credit availability at the same or lower price than it would otherwise have been is achieved by a change or changes in bankruptcy laws creating a decrease in risks to creditors that more than offsets the increase in risks associated with the changes proposed by the NBC. Unfortunately, it does not appear that this is what will occur under the proposed amendments to Chapter 12. This is because there is no question that certain risks increase for lenders under the proposal. However, there is no such certainty that risk decreasing factors will occur, if any would exist at all. To get to any goal that does not lower creditors' willingness to laon, what should be done if a change in bankruptcy laws is to be made is to ensure that any increase in risk to lenders associated with such a change is fully offset by other alterations of the law that will decrease lenders' risks.



<u>Question 10.</u> In you opinion, are there any provisions in Chapter12 that could be helpful to small businesses in bankruptcy? Are there other improvements that Congress should consider for small businesses in bankruptcy?

<u>Response to Question 10.</u> Whether any provisions of Chapter 12 could be helpful to small businesses depends on whether Congress determines that the currently applicable provisions should be fundamentally altered to eliminate various requirements in Chapter 11 such as the absolute priority rule and the preferred consensual concept on which Chapter 11 reorganizations are premised. Without making such an initial determination and because many of the provisions of Chapter 12 mimic in part what is in Chapter 11, I am not able to respond to what parts of Chapter 12 which differ in important aspects would be helpful for small businesses. Having made this disclaimer, there is one feature of Chapter 12 that in concept has merit for purposes of designing modifications for small business entities attempting to reorganize via a bankruptcy filing. It is the simplification of the plan and plan confirmation process for small businesses. This is different from the idea that the Chapter 12 plan and plan process is the vehicle that should be adopted for small business bankruptcies. In my view, there needs to be a better plan development, disclosure and confirmation process for truly small businesses.

From an historical viewpoint, much of what is the current Chapter 11 plan and plan process has come forward from what was developed under earlier bankruptcy statutes. By way of example and in particular, the involvement of the Securities and Exchange Commission was greater in many cases brought under the Bankruptcy Act of 1898 as amended. For this reason, some of what is boilerplate in current plans of reorganization has been carried forward from earlier days and is not really necessary, but for certain of the requirements of the Bankruptcy Code. Most of what is important to creditors and other parties in interest is a demonstration of workable business and financial plans with sufficient data to enable one to assess the likelihood that a plan will succeed. Unfortunately for small businesses, a lot of what is required is unrelated to the financial and business plans. What makes more sense is to have small businesses submit plans that principally address the business and financial issues, not side issues unrelated to financial and business planning. Doing this will simplify the plan process and its confirmation or not.

Joined with this is the need for better information from debtors regarding both business and financial planning that many small businesses do not have the ability to provide or they are unable to afford the necessary expertise. A means should be implemented to assist small business entities. Various options should be considered that would assist small businesses in this regard. One is to fund hiring of such professionals. Another is to require expertise to be made available by one or more government agencies which could include, but is certainly not limited to, the Bankruptcy Administrator Program and the U. S. Trustee Program.

Question 11. *Chapter 12 was a temporary chapter of the Bankruptcy Code for many years. Do you believe that changes to the Bankruptcy Code for small businesses should be temporary so that Congress can determine whether those changes do not have adverse consequences? What about a pilot program for small business bankruptcy?*

Response to Question 11. With all due respect for Congress, I believe that a pilot program does not have merit **unless** the implementation of such a program for small business entities requires that data is accumulated in a meaningful manner that enables one to analyze in a verifiable method what has occurred during the pilot program. This requires planning from both a legal and nonlegal perspective for not just the types of changes needed to the bankruptcy laws, but also what sort of information will be needed to study what is desired to be known from such a program. Without such advanced planning and without appropriate data, what will most likely occur is speculation on the success or lack thereof of such a small business experiment. If the quality and quantity of data is required and obtained in a manner allowing valid and verifiable analysis of the impact of such a pilot program, it is better than adopting a wholesale alteration in the nature of reorganizations of businesses on the scale contemplated by the proposed modifications to Chapter 12.

<u>Question 12.</u> I've heard concerns that requiring a dedicated trustee for small business bankruptcies would cause significant problems in the trustee workload and overwhelm the trustee system. Do you believe those concerns are valid?

<u>Response to Question 12.</u> It is a valid concern. Under the NBC's proposal for Chapter 12, there is no question that any significant shift of small business filings from Chapter 11 to Chapter 12 would dramatically increase the caseload for existing Chapter 12 standing trustees. Likewise, there would be a need for trustees that currently does not exist in areas without standing Chapter12 trustees. The NBC's proposal on page 18 reflects the potential for thousands of additional Chapter 12 cases being filed instead of the hundreds filed in recent years which would necessitate appointment of more trustees and the hiring of added staff for existing and newly appointed trustees. Depending on how long such a process takes, it is possible that the existing trustees could be inundated for a period and that trustees and staff would not be able to timely handle the increased caseload. However, and if hiring of trustees and staffing does not occur fast enough, this problem should lessen over time and ultimately end once sufficient trustees and staff are hired.