PENN RESTRUCTURING INSTITUTE & GOVERNMENT PARTICIPATION IN RESOLUTION PROCESSES: AN INTRODUCTION

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INTRODUCTION

On March 11, 2016, we helped organize a symposium, titled "Government Participation in Resolution Processes," that explored whether the recent trend of expanding governmental involvement in corporate restructurings creates marketplace or other distortions—and then considered possible solutions that might increase predictability and certainty when the government does intervene in chapter 11 proceedings. Beyond the considerable substantive contributions of the panels, the symposium was notable for another reason: it was the inaugural event of the University of Pennsylvania Institute for Restructuring Studies, also referred to as the Penn Restructuring Institute.

As co-founders of the Institute, we are grateful to the *Journal of Business Law* for devoting part of this issue to publishing the extended presentations of several of the symposium's panelists. We also appreciate the *Journal* graciously providing us this space not only to preview those articles, but also to explain the Institute's background and goals. We hope and believe the mission of the Penn Restructuring Institute will further the educational objectives of the University of Pennsylvania generally, and the

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Journal of Business Law specifically, and thus it seems fitting to use these pages to formally introduce this project.

I. THE INSTITUTE

First, our mission. The Penn Restructuring Institute is a multidisciplinary initiative intended to address timely corporate and municipal insolvency issues and influence the public policy debate in a manner that has practical application for investors, practitioners, regulators, and academics—and to do so at a university that is both well known for producing restructuring industry leaders and located within the financial, legal, intellectual, and political nexus of New York and Washington, D.C.

Let's unpack that. As we have taught and practiced restructuring law, and through our writing, speaking, and testifying on related issues, we have encountered a distinct disconnect among the various constituencies deeply involved and interested in bankruptcy-related reforms. Put simply, there are many influential actors in this space, but there is little connective tissue between investors, practitioners, regulators, and the academic community. Other than the American Bankruptcy Institute, which has its own multifaceted approach to similar issues, there are few opportunities for the different constituencies involved in restructuring issues to engage one another directly.

This void is the primary impetus for the Penn Restructuring Institute. There are many persons and entities separately pursuing important restructuring initiatives. We hope to link these thought leaders, and to facilitate a vigorous, informative, and nonpartisan debate about the most consequential issues driving our profession.

Thus far, the Institute has enlisted the leadership of approximately twenty-five of our colleagues, from varied private and public sectors of the restructuring industry, to comprise a blue-ribbon Advisory Board that will help guide our efforts.[1] Beginning with this symposium, and continuing with a series of further collaborative events and work products, the Advisory Board will help, we hope, to generate a wide-ranging and productive dialogue.

Why does this matter? There are several key reasons, with the common theme that, even more than other areas of law, restructuring law and practice develop within and across multiple realms.

While difficult to quantify precisely, the vast majority of corporate restructurings are accomplished through out-of-court workouts, as opposed

1. Like the authors, all members of the Advisory Board are participating in the Institute's work in their individual capacities only, and not as representatives of their respective institutions.

to in-court chapter 11 cases. (This is especially true to the extent the reorganization primarily involves financial deleveraging transactions, which are more prevalent than operational overhauls.) To be sure, chapter 11 plays a role even here. A company's ability to obtain sufficient creditor consensus to avoid the need for a formal bankruptcy proceeding is significantly affected by the parties' understanding of the respective legal benefits and risks to their position(s) in a chapter 11 case. But the reality is that a huge amount of restructuring "law"—*i.e.*, the dynamics governing the art of the possible—advances outside of courtrooms and judicial decisions.

Moreover, even chapter 11 itself evolves largely beyond the formal legislative process. While Congress does periodically amend the Bankruptcy Code, those changes are often reactive—and at the margins. During the long periods of relative legislative calm, bankruptcy practice norms undergo gradual, yet often dramatic, changes. To cite one example, section 363 of the Code was enacted to allow a debtor "after notice and a hearing . . . [to] sell . . . other than in the ordinary course of business, property of the estate. . . ."[2] This provision originally was understood to allow courts to authorize companies to sell discrete *pieces* of property (such as an individual building or perhaps even a specific business unit). Over time, however, section 363 was expanded to permit the sale of effectively all of a debtor's most valuable assets, frequently at the outset of a case (with the sale proceeds and less desirable property left behind in the chapter 11 estate for later distribution to creditors). Whatever one thinks of this trend, the acceptance of so-called rapid section 363 sales for most or all of a company has undeniably influenced the tactical options and bargaining leverage among debtors and their secured and unsecured creditors. While the text of the Bankruptcy Code itself may be largely static, its use and interpretation is very dynamic.[3]

Finally, in the context of corporate reorganizations, the application of law to facts is dissimilar from conventional commercial litigation. In the latter, the key parties and the underlying evidence) often are largely fixed (though subject to development through discovery). This means that if the relevant law is well established, it should be a reasonably straightforward

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2. 11 U.S.C. § 363(b)(1) (2015).

3. We acknowledge there are exceptions to our point about practice being the principal source of change. In 2005, Congress amended section 365(d)(4) to require debtors to assume or reject all real property leases within 120 days (subject to a 90-day extension). This significantly curtailed the ability of retailers, with hundreds or perhaps thousands of leased store locations, to undertake and accomplish orderly reorganizations—and resulted in a spate of liquidations. We do not claim that legislative changes are irrelevant—it is that they typically are infrequent, and piecemeal, but the evolution of chapter 11 practice under the Code marches forward in the interim.

exercise to determine a risk-adjusted litigation expected outcome. In a restructuring, by contrast, certain facts may be settled, such as the textual provisions of credit agreements and indentures (though their meanings are often subject to debate). Yet even if the applicable law is clear, the identities of the key parties may shift repeatedly, as certain investor-creditors trade in and out of various positions within the company's capital structure. Further, their motivations and actions will be impacted by the market prices of the company's debt and equity securities, which are variable and subject to multiple exogenous factors, economic and otherwise. Navigating a restructuring is akin to playing a game of chess where the other side's pieces (and those pieces' abilities to make different moves) may change constantly—often based on factors out of the parties' control.

Although we have focused above on chapter 11 and its relationship to out-of-court restructuring practice, other forms of insolvency resolution proceedings—from bank failures to municipal bankruptcies—have many of the same characteristics. They are highly interdisciplinary and continuously evolving.

Which brings us back to the mission of the Penn Restructuring Institute. If one believes, as we do, that bankruptcy and other forms of restructuring are critical tools for enhancing a functioning capitalist economy, seeking to improve predictability and certainty—both for companies and for their existing and potential stakeholders—is a worthwhile endeavor. Events of the last few decades demonstrate that any of America's largest and most iconic corporations—and indeed, entire crucial industries—may need to resort to chapter 11 or other formal or informal restructuring frameworks. Given the dynamism and fluidity described above, and the ever-expanding domain of restructuring law and practice, there is an enormous need to bridge the informational gaps and promote interaction between the many communities at the forefront of these issues. We believe the timing is ideal, and the need is distinct, for an initiative like the Penn Restructuring Institute.

II. THE SYMPOSIUM

As we have already noted, the Institute's inaugural symposium focused on government participation in resolution processes. The first of the two panels considered the government's role as a "prepetition actor," that is, when the government provides start-up funds or other financing to systemically important firms that have not yet defaulted; the second emphasized government involvement as a "postpetition actor" after a default has occurred. Speakers on the first panel included Professor Stuart

Gilson of Harvard Business School; Professor Robert Rasmussen, professor and immediate past dean of the University of Southern California Law School; Jonathan Silver, managing partner of Tax Equity Advisors and a former high level official on government financing in the Obama administration; and Doug Schoen, a pollster who worked in the Clinton administration. The second panel featured Patrick Bolton, a professor at Columbia Business School; Charles Gray, Vice President of the Financial Institution Supervisory Group at the Federal Reserve Bank of New York; Marc Heimowitz, a portfolio manager at Claren Road Asset Management; and Jim Millstein, founder of Millstein & Co. and former Chief Restructuring Officer in the Obama Administration.

The question of whether and how the government should provide rescue—or bailout—financing to troubled financial institutions figured prominently on both panels. Given the continued relevance of and controversy surrounding this issue, it seemed a fitting subject for more extensive analysis. The two speakers who focused most directly on this issue—Marc Heimowitz and Robert Rasmussen—each agreed to develop their insights into formal articles for the purposes of the symposium. We are pleased to say a few words about the articles that have emerged from the earlier insights, and that appear in these pages.

In "Government as a Rescue Financer: Not Just a Private Lender," Heimowitz begins by comparing the role of the government as financer in distressed situations to that of private lenders. As suppliers of needed financing, both are in a position to control the troubled institutions and the distribution of value among claimants. Yet, in sharp contrast to private lenders, the government pursues noncommercial objectives as well as commercial ones. The presence of these two factors—control and noncommercial objectives—creates a great deal of uncertainty for creditors and other market participants. Can this uncertainty be reduced? Heimowitz contends it can and outlines four principles to guide rescue financing by the government in the future. The first is a very clever strategy for market testing government rescue financing. In a true crisis, private lenders are not a realistic alternative to government financing, which makes it impossible to subject the government's loan to a traditional market test. In economic terms, "the slope of the supply curve for massive rescue financing is nearly vertical at needed quantities in the short-term."[4] As an alternative, Heimowitz proposes that a slice of the loan—in an amount that is "very large but possible"—be raised on the private markets, and that the interest rate and other features of the private financing be used

4. Marc J. Heimowitz, *Government as a Rescue Financer: Not Just a Private Lender*, 19 U. PA. J. BUS. L. 49 (forthcoming Fall 2016).

to price the government's rescue loan.[5] The government would no longer need to set the terms of the financing in a vacuum; it could harness the information provided by the market. Heimowitz's other three principles are similarly insightful. We won't summarize them here, lest we spoil the treat of reading the article itself.

In drafting his article for the symposium, Rasmussen joined forces with one of us, more than twenty years after we last co-authored an article.[6] Like Heimowitz, Rasmussen and Skeel contend that bailouts will always be with us, and thus that the crucial question is how best to manage them. In "Government Intervention in an Economic Crisis," Rasmussen and Skeel divide the bailout process into three general stages: the decision to intervene, implementation of the bailout, and exit.[7] A key theme in their analysis is political accountability. At the intervention stage, this requires transparency and a clear articulation of reasons for intervening; with implementation, political accountability calls for respect for priorities and government involvement in the bailout recipient's business only on issues (such as removing managers or directors) that can easily be traced. Rasmussen and Skeel further argue that the government should exit its investment as soon as the crisis has been contained. Rasmussen and Skeel also address the question whether government intervention should be subject to judicial review. They conclude that it should, but that the scope of review should be considerably narrower than it is for transactions between private parties, in order to minimize interference with emergency interventions.

Whether you agree with the conclusions reached in these articles—or with either one, since the conclusions differ in important respects—we hope they provide new insights into the government's handling of rescue financing.

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5. *Id.* Heimowitz's proposal bears an interesting resemblance to a strategy Mark Roe advocated many years ago for determining the capital structure of a debtor in an ordinary chapter 11 case. *See* Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527, 530 (1983) (suggesting that "the reorganization value of the public firm could be found by selling a slice, say 10%, of new common stock into the market, and extrapolating enterprise value from the sale price").

6. Robert K. Rasmussen & David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 AM. BANKR. INST. L. REV. 85 (1995).

7. Robert K. Rasmussen & David A. Skeel, Jr., *Government Intervention in an Economic Crisis*, 19 U. PA. J. BUS. L. 7 (forthcoming Fall 2016).