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THE UNITED STATES' SPECIALIZED BANKRUPTCY COURTS

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Courts wholly dedicated to bankruptcy^{2/} matters are a critical part of the United States federal court system. Bankruptcy matters tend to be highly complex. The United States experience has been that the judges in the specialized courts develop the expertise necessary to administer insolvency proceedings in a speedy and transparent fashion. Given the highly commercial and time-sensitive nature of bankruptcy-related matters, this speed and transparency have been very important to the effectiveness of the United States bankruptcy system.

FRAMEWORK

Introduction to the United States Court System

Each state of the United States has its own court system. In addition, the United States federal Constitution establishes the basis for a separate United States federal court system. The states' courts are courts of general jurisdiction, empowered to hear and resolve all disputes that arise under the laws of the state. On the other hand, the United States federal courts are courts of limited jurisdiction. The federal courts only may hear and resolve disputes that are specified in the federal Constitution or that are sufficiently related to the federal laws of the United States.

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^{2/} In the United States, the term "bankruptcy" includes both liquidation of a debtor's assets as well as rehabilitation of a debtor's business or affairs. While not the most common usage outside the United States, we have used "bankruptcy" throughout this paper.

One of the subjects that the United States federal constitution specifically delegates to the United States federal Government is “bankruptcies”. The section of the Constitution where this delegation appears, however, is the section that sets forth the powers of the United States Government’s legislative branch, Congress. The separate section of the Constitution that describes the jurisdiction of the United States courts makes no mention of bankruptcies. As a result of this constitutional ambiguity, there has been confusion over the years about the proper form and jurisdiction of the courts that address bankruptcy matters in the United States. Since the mid-1980’s, a workable system seems to have emerged. In sum, each United States federal district court contains a United States bankruptcy court to which the district court generally refers bankruptcy matters.

Role of the Bankruptcy Courts

The bankruptcy courts hear and resolve all matters related to bankruptcy proceedings. These matters include disputes about the commencement of proceedings, matters concerning the administration of liquidation or reorganization proceedings, resolution of such proceedings, supervising liquidation auctions and determining whether to approve reorganization plans. As much as possible, the judges’ role is limited to the resolution of disputes pertaining to these matters, and the majority of the day-to-day administration of the proceedings is left to other parties (see below). In their dispute resolution role, the judge’s discretion is limited by the common law principle of precedent – the binding nature of previous rulings from superior courts.

Nevertheless, since expeditious resolution of bankruptcy matters is a critical goal of the bankruptcy courts, the judges regularly seek out ways to ensure that the proceedings are kept moving along as rapidly as is commercially reasonable. Thus, they sometimes exercise their discretion and play a fairly pro-active and expansive role under the authority provided by the United States bankruptcy law. This primarily means organizing and condensing the typically-lengthy United States federal litigation process, so that it delays the resolution of bankruptcy matters as little as possible. Especially important is encouraging the settlement of disputes before they are fully (and expensively) litigated and require a judicial decision, which would likely be appealed. One method that judges increasingly use in reorganization cases is mediation, in order to achieve more efficient resolution of difficult disputes.

Appeals Process

The process of appealing the bankruptcy judges’ decisions has been subject to some criticism. While the time for taking appeals from the decisions of bankruptcy courts is shorter than for other federal courts (ten days as opposed to 30 days), and the appeals courts do seek to act quickly on bankruptcy matters, there are many levels of possible appeals. Ordinarily, appeals from the bankruptcy courts are heard first by the

federal district court of which the bankruptcy court is a part.^{3/} Then, there is the possibility of an appeal to the appropriate federal circuit court of appeal, and finally to the United States Supreme Court. This multi-tiered appeals process alone has caused frustrating delays in many instances.

Role of the United States Trustees

While the judges are primarily charged with the expeditious resolution of bankruptcy-related disputes, the United States system includes officers of the court who are charged with overseeing the administrative aspects of bankruptcy proceedings. Known as United States Trustees, these officers' duties include, among other things, (i) ensuring that the parties to the proceedings file all required documents and schedules in a timely fashion, (ii) appointing creditors' committees, (iii) reviewing and commenting on all requests for professionals' compensation that is to be paid out of the bankruptcy estate, and (iv) reviewing reorganization plans that are filed in the proceedings, as well as other filings, and assisting the court in determining whether such documents comply with the law. Through these various activities, the United States Trustees aid the judges in ensuring speedy and fair proceedings.

The United States experience has been that this general separation of the dispute resolution role from the administrative supervisory role has helped keep bankruptcy proceedings moving along rapidly and efficiently.

Role of the Private Sector

One of the lynchpins of the United States bankruptcy system is its heavy reliance on a well-trained body of private sector professionals. The courts count on assistance from the stakeholders and their professional advisors in informing their decision-making. The United States judicial system is an adversarial system in which all stakeholders assert their positions as vigorously as they can. As part of that process, the stakeholders are motivated to demonstrate to the court all of the factual evidence and legal authorities that support their view points. In hearing from the various interested stakeholders, the judges find (at least in well-handled matters) that the stakeholders and their professionals have outlined the issues, the possible resolutions, and the supporting theories quite well. Having been briefed, the judge's role is then to render a decision consistent with the judge's conclusions about the evidence presented and the strength of the various arguments.

^{3/} Alternatively, there is the possibility of appeal to a so-called bankruptcy appellate panel, which is a panel of three specially appointed bankruptcy judges who hear bankruptcy appeals in lieu of the district courts doing so.

As such, the bankruptcy system in the United States is rather expert-driven. It only functions effectively as long as there are capable professionals that can aid the court in this way. These professionals include the lawyers who act for the stakeholders and who actually present the arguments and the legal authorities to the judges. Furthermore, there has to be a body of expert witnesses who are able to understand the complexities of bankruptcy matters and to present them, in understandable and persuasive terms, to the judges. Of course, it is also important that the lawyers and experts be able to advise the stakeholders on a day-to-day basis how to conduct their affairs so as to maximize the value of their interests and to optimize their positions in any disputes that may later arise before the courts.

Creditors' Committees and their Professionals

Worth mentioning is the special role played by the creditors' committee that is appointed in reorganization proceedings. In order to maximize the influence that creditors have on the process of plan formulation, the law provides that a creditors' committee is to be appointed to monitor the proceedings on behalf of creditors and to negotiate the plan with the debtor. Importantly, the law empowers the committee to engage professional advisors as needed and for these advisors' fees to be paid out of the bankruptcy estate. This is a fundamentally critical feature of the system in as much as it empowers a collective creditor body, whose members individually would be relatively powerless. On an individual basis, it usually would not be cost effective for creditors to become deeply involved in bankruptcy proceedings and pay for their own professionals.

JUDICIAL INDEPENDENCE AND SKILLS

Judicial Conduct

As is the case with all judges in the United States, bankruptcy judges are held to very high ethical standards. They may not hear or resolve matters in which they are biased or may appear to be biased (including on the basis of investments or relationships). They are required to disqualify themselves as needed to ensure that they comply with this requirement. Judges generally are not permitted to engage in commercial activities that would cause them to be biased or appear to be biased. They also are required to file an annual public report disclosing any compensation or reimbursement received for extra-judicial or quasi-judicial activities in which they participated. In addition, like lawyers in the United States, the American Bar Association has promulgated a code of judicial ethics to which judges must adhere, on penalty of disciplinary action. These features of the United States system, among others, have helped foster a highly ethical set of bankruptcy judges.

In addition to these ethical requirements, judges are required to publish their decisions and underlying reasoning. All bankruptcy court proceedings are a matter of public record, available for all to inspect. This required disclosure also tends to reinforce judicial integrity.

If judges are not in compliance with these various requirements, there are well established procedures for their removal from office and/or other appropriate disciplinary actions.

Training for Bankruptcy Judges

Another significant contribution to the success of the United States court system is the formalized training for judges and court personnel. Bankruptcy judges, as well as all federal judges and magistrates, receive formal judicial training from the Federal Judicial Center in Washington, D.C. The Center delivers the research, training and continuing education programs necessary to increase the skills of the judges. The Center runs an orientation training for all new federal judges providing an in-depth introduction to the federal court system and to substantive and procedural areas pertinent to the areas of law with which the judges deal. The Center also provides continuing legal education programs offering each judge an update in relevant areas of statutory and case law and in case management. There is also specialized training in specific subject areas, such as financial accounting, which is very important to the development of bankruptcy judges' skills.

Impartiality, Skills and Commercialism of the Bankruptcy Judges

As a result of these ethical standards and formalized training programs, bankruptcy judges are perceived to be highly independent, unbiased, and skilled in presiding over bankruptcy proceedings. And, since they are able to devote their entire professional time to bankruptcy matters, the judge's develop the commercial skills necessary to deal with all of the related complexities. The reality and the perception of these dynamics has been fundamental to the success of the United States bankruptcy system.

POSSIBLE LESSONS?

Value of Capable Judges, Professionals, and Empowered Creditors' Committees

The United States bankruptcy system is certainly susceptible to criticism. It has been seen as sometimes slow, usually expensive, and rather debtor-friendly. Nevertheless, it has been fairly successful in helping the United States economy address troubled companies, liquidating many companies that should be liquidated and enabling the reorganizations of many troubled companies that were able to turn around.

In our view, the specialized bankruptcy courts have played a large role in this success. The features outlined above could be considered profitably in most places. While implementation and detail will vary from country to country, the concepts of a highly-skilled, commercial, speedy, and unbiased bankruptcy judiciary should be helpful in any country.

Equally important to the United States' success in this field has been the presence and efficient use of a specialized body of bankruptcy professionals. The generally high quality of the United States lawyers and experts who work on bankruptcy matters contributes to the success of the United States system every bit as much as the competency of the judges. Additionally, the fundamental role of the professionally-advised creditors' committee cannot be overstated. We believe that each country should consider how to build these strengths into their court systems as well.

Pitfalls To Avoid

Weaknesses in the United States bankruptcy court system that should be avoided, if possible, include the constitutional uncertainty regarding the permissible scope and nature of a specialized court to address all bankruptcy-related matters. This should be relatively straightforward to avoid in the constitutional or statutory language that creates any specialized court.

Countries also should try to avoid the delay that is inherent in multiple levels of appeal. Countries should consider expedited access to a court of final instance in order to minimize the detrimental effects that appeals-related delays can have on the business of an already-struggling debtor.