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Enhancing Rescue in Chapter 11:
Lessons from Reform Efforts in the United Kingdom

by

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Enhancing Rescue in Chapter 11: Lessons from Reform Efforts in the United Kingdom

Abstract: This is a dynamic time for insolvency law. Many jurisdictions have or are considering reforms to their insolvency regimes. The U.K. has proposed a new standalone restructuring mechanism that incorporates many attributes of Chapter 11, including a cross-class cram down and the absolute priority rule. A distinctive feature of the U.K. proposal is the infusion of judicial discretion permitting courts to deviate from the absolute priority rule. This discretion is not permitted in the U.S. This judicial discretion addresses a key problem with the application of the absolute priority rule in the U.S. – it serves as an impediment to reorganization. This impediment is exacerbated by the recent U.S. Supreme Court decision, *Czyzewski v. Jevic Holding Corp.*, which impacts the effective use of Chapter 11 rescue tools. This article explores the absolute priority rule, the problems associated with it and the effect of *Jevic* in the U.S. The case is made that the strict application of the absolute priority rule in the U.S. is antiquated and drawing on the U.K. reform proposal the author argues that the U.S. should implement reforms that infuse judicial discretion into the application of the absolute priority rule. Doing so will facilitate the underlying the policy goal of rescuing the company in Chapter 11, but also promote a broader policy goal of rescuing the business.

I. Introduction

We are in a dynamic time for insolvency law and proposed reforms thereto.¹ Many jurisdictions, such as Spain and the Netherlands, as well as the European Commission,² are considering reforms to their restructuring regimes that are influenced at least in part by the U.K.’s scheme of arrangement and Chapter 11³ in the U.S.⁴ Other jurisdictions, such as Singapore, have

¹ See Sarah Paterson, *Market Organisations and Institutions in America and England: Valuation in Corporate Bankruptcy*, 93 CHI.-KENT L. REV. 801, 802 (2018) (noting the reform activity in the U.K., European Commission and the U.S.) [hereafter Paterson, *Market*]. See also Bob Wessels & Stephan Madaus, *Business Rescue in Insolvency Law in Europe: Introducing the ELI Business Rescue Report*, 27 INT. INSOLV. REV. 255, 255 (2018) (“Since the global financial crisis, insolvency and restructuring law have been at the forefront of law reform initiatives in Europe and elsewhere.”).

² See Council of the European Union, *Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures designed to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU- General Approach*, 12536/18, October 1, 2018, available at <http://data.consilium.europa.eu/doc/document/ST-12536-2018-INIT/en/pdf> (last accessed February 26, 2019).

³ Chapter 11 as used throughout this article refers to 11 U.S.C. § 1101 – 1174 of the U.S. Code.

⁴ Jennifer Payne, *The Continuing Importance of the Scheme of Arrangement as a Debt Restructuring Tool*, 15 EUR. CO. FIN. L. REV. 445, 445-46 (2018) [hereafter Payne, *Continuing*].

already implemented significant reforms to its restructuring regime.⁵ The U.K.⁶ and the U.S.⁷ have both engaged in a review of their restructuring regimes.⁸ The U.S. review has not gained much legislative traction;⁹ however, the U.K. review has resulted in a reform proposal that will add a new standalone restructuring mechanism to the restructuring options currently available.¹⁰

The proposed standalone restructuring mechanism includes a cross-class cram down,¹¹ as well as a statutory moratorium, both of which are not available in a single restructuring option in English law.¹² These features are generally viewed as positive attributes of a restructuring regime.¹³ The Chapter 11 statutory framework includes both features¹⁴ and has influenced the U.K. proposed reform.¹⁵ However, the U.K. has not blindly replicated Chapter 11. Notably, the proposed cross-class cram down includes the absolute priority rule (APR), the primary focus of this paper, but adds flexibility, not available in Chapter 11, for courts in the U.K. to deviate from the APR in very limited circumstances.¹⁶ Such flexibility addresses a key criticism of a rigid application of the APR in Chapter 11 - it can act as an impediment to reorganization of a company,¹⁷ the traditional policy objective of Chapter 11.¹⁸ Moreover, a rigid application of the APR also impedes the rescue of a business, a broader conceptualization of the fundamental goal of insolvency law beyond the reorganization or rescue of a company.¹⁹

Just as the U.K. has drawn upon positive attributes of Chapter 11 in formulating their reform proposal, the U.S. should look to the U.K. reform proposal for guidance on how to improve applying the APR in Chapter 11. The need to reform the APR in the U.S. is not new as problems

⁵ See Meng Seng Wee, *The Singapore Story of Injecting US Chapter 11 into the Commonwealth Scheme*, 15 EUR. CO. FIN. L. REV. 553-584 (2018) (providing overview of the reforms in Singapore).

⁶ See *infra* notes 248-276 and accompanying text.

⁷ The U.S. review by the American Bankruptcy Institute (ABI) was completed in 2014 with the issuance of a very detailed report. See AM. BANKR. INST. COMM'N TO STUDY THE REFORM OF CHAPTER 11, 2012-2014 FINAL REPORT AND RECOMMENDATIONS (2014) [hereafter ABI REPORT].

⁸ Payne, *Continuing*, *supra* note 4, at 446.

⁹ See, e.g., Peter C. Blain, *Chapter 11 of the Bankruptcy Code: As It Was, As It Is, and As It May Be*, ASPATORE, 2016 WL 676460, *16 (January 2016) (prospect of the ABI proposals becoming law is unclear).

¹⁰ Jennifer Payne, *Debt Restructuring in the UK*, 15 EUR. CO. FIN. L. REV. 449, 459 (2018) [hereafter Payne, *Restructuring*].

¹¹ “Cram down” is a phrase used in bankruptcy parlance referring to a court’s authority to “cram” an “opposed plan down upon a creditor in a nonconsenting class.” *In re Lett*, 632 R.3d 1216, 1228 (11th Cir. 2011).

¹² *Id.* (both aspects are available with the twinning a scheme with administration).

¹³ See, e.g., Sarah Paterson, *Reflections of English Law Schemes of Arrangement in Distress and Proposals for Reform*, 15 EUR. CO. FIN. L. REV. 472, 473, 478-88 (2018) (analyzing why a moratorium and cross-class cram down may be beneficial to the UK restructuring regime) [hereafter Paterson, *Reflections*].

¹⁴ See 11 U.S.C. § 362(a) (automatic stay) and § 1129(b) (cram down).

¹⁵ Howard Morris, *Not Chapter 11 but Chapter 11sh*, RECOVERY 32, 33 (Spring 2017) (acknowledging the influence of Chapter 11 on the U.K. proposal). See also Tim Verdoes & Anthon Verweij, *The (Implicit) Dogmas of Business Rescue Culture*, 27 INT. INSOLV. REV. 398,400 (2018) (noting the influence of Chapter 11 on recent reform proposals throughout Europe).

¹⁶ See *infra* notes 267-268 and accompanying text.

¹⁷ See *infra* notes 122-126, 264-266 and accompanying text.

¹⁸ See ABI REPORT, *supra* note 7, at 10 (discussing purpose of Chapter 11). See also Sarah Paterson, *Rethinking Corporate Bankruptcy Theory in the Twenty-First Century*, 36 OXFORD J. LEGAL STUD. 697, 699-700 (2016) (summarizing policy orientation of Chapter 11) [hereafter Paterson, *Rethinking*]; Jennifer Payne, *Debt Restructuring in English Law: Lessons from the United States and the Need for Reform*, 130 LAW Q. REV. 282, 299 (2014) (noting the reorganization policy of Chapter 11) [hereafter, Payne, *Lessons*].

¹⁹ Unless otherwise indicated, “rescue” as used in this article encompasses both rescue of a company and rescue of a business. This broader conceptualization of rescue policy is explored in Part II.

associated with the APR are well documented.²⁰ However, in light of the recent U.S. Supreme Court decision, *Czyzewski v. Jevic Holding Corp.*,²¹ the necessity for reform is more acute now than at any time since the enactment of the Bankruptcy Code²² in 1978.²³ Although, the APR is well entrenched in U.S. bankruptcy law in the context of confirming of a Chapter 11 plan,²⁴ *Jevic* crystalized the application of the APR in a non-Chapter 11 confirmation of plan context – a structured dismissal.²⁵

Such a ruling by the Supreme Court appears positive. It arguably enhances protection the APR provides for minority interests in Chapter 11,²⁶ which may serve to diminish the surge of secured creditor power in recent years²⁷ and return power to the debtor, which is consistent with the traditional policy of Chapter 11.²⁸ However, *Jevic* may impede the effective use of Chapter 11 rescue tools including settlements,²⁹ § 363³⁰ sales and first-day orders.³¹ This cascading effect of *Jevic* may frustrate Chapter 11's ability to foster rescue. To counter this effect U.S. policymakers should consider the U.K. proposed reform that adds discretion for courts to deviate from the APR.

²⁰ See *infra* notes 123-126.

²¹ *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017).

²² All references to Bankruptcy Code or Code are to Title 11 of the U.S. Code.

²³ Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2539 (1978).

²⁴ See *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 983-84 (recognizing the importance of the priority structure and inability to violate the priority structure without consent in the context of a Chapter 11 plan). See also Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930, 1932 (2006) (APR “has been the foundation of our corporate reorganization laws for decades”).

²⁵ *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 983. The structured dismissal is not provided for in the Code, but is a construct of various aspects of bankruptcy law resulting in an order that combines aspects of a typical confirmation order with a dismissal order in Chapter 11. See *id.* at 979. The ABI characterizes the structured dismissal as a “hybrid dismissal and confirmation order . . . that . . . typically dismisses the case while, among other things, approving certain distributions to creditors, granting certain third-party releases, enjoining certain conduct by creditors, and not necessarily vacating orders or unwinding transactions undertaken during the case.” ABI REPORT, *supra* note 7, at 270. For an overview of the structured dismissal, see generally Kaylyn Webb, Comment, *Utilizing the Fourth Option: Examining the Permissibility of Structured Dismissals that do not Deviate from the Bankruptcy Code's Priority Scheme*, 33 EMORY BANKR. DEV. J. 355, 372-379 (2018) (detaining the legal authority for the structured dismissal and appropriate use thereof); Norman L. Pernick & G. David Dean, *Structured Chapter 11 Dismissals: A Viable and Growing Alternative after Sales*, 29 AM. BANKR. INST. J. 1 (2010) (overview of structured dismissals).

²⁶ See *infra* notes 118-121 and accompanying text (discussing minority protection the APR affords generally).

²⁷ See David A. Skeel, Jr., *Creditor's Ball: The “New” New Corporate Governance in Chapter 11*, 152 U. PENN. L. REV. 917, 918-928 (discussing shift from manager orientation to the “creditor-oriented cast”). For an analysis that suggests secured creditor control theory is overstated, see generally Jay Lawrence Westbrook, *Secured Creditor Control and Bankruptcy Sales: An Empirical View*, 2015 U. ILL. L. REV. 831-848.

²⁸ Concentrated secured creditor power diminishes Chapter 11's ability to achieve the goals of “reorganization of businesses and the maximization of asset values for all creditors.” Juliet M. Moringiello, *When Does Some Federal Interest Require a Different Result?: An Essay on the Use and Misuse of Butner v. United States*, 2015 U. ILL. L. REV. 657, 658-59. Tilting the power back to the debtor away from secured creditors enhances the underlying reorganization goal of Chapter 11.

²⁹ See *infra* notes 153-169 and accompanying text (analyzing the use of settlements as a rescue tool post-*Jevic*).

³⁰ See *infra* notes 170-188 and accompanying text (analyzing the use of § 363 as a rescue tool post-*Jevic*).

³¹ See *infra* notes 189-205 and accompanying text (analyzing the use of first day orders, their role in promoting rescue and how *Jevic* may impact them as effective tools). See also, Hollace T. Cohen, *Pre-Plan Settlements Post-Jevic – Jevic's Impact on the Absolute Priority Rule and Other Core Bankruptcy Principles*, 27 NORT. J. BANKR. L. & PRACT. 1, 16-23 (2018) (analyzing the impact of *Jevic* on settlements and first day orders that violate the APR); Ralph Brubaker, *Taking Bankruptcy's Distribution Rules Seriously: How the Supreme Court Saved Bankruptcy from Self-Destruction*, 37 BANKR. L. LETTER 1, 1 (2017) (questioning validity of priority-skipping devices post-*Jevic*).

Following this Introduction, an overview of the broad conceptualization of rescue policy in Chapter 11 as used in this article is explored. Part III details the cross-class cram down and the role of the APR in Chapter 11. Part IV summarizes *Jevic* and its cascading effect on rescue tools. The need for reform and shortcomings of prior U.S. reform proposals pertaining to the APR are addressed in Part V. This is followed by Part VI which highlights key aspects of the proposed U.K. reform that can guide U.S. reform, along with a specific reform proposal. Part VII provides the conclusion.

II. Conceptualization of Rescue Policy in Chapter 11

Any consideration of a reform in a particular policy domain must begin with a clear articulation of the goal of that particular policy domain. Only with a clear goal in mind, can the existence of a problem be determined, or perhaps a potential problem, that policymakers need to address.³² The policy goal is inextricably linked to the definition of the policy problem and the ultimate policy solution to the defined problem.³³

In this section the theoretical and normative debate around the rescue policy goal in Chapter 11 is explored. Following that foundational discussion, the primary rescue policy goal reflected in Chapter 11, the reorganization of the company and the parameters it entails, is detailed. In the final subsection, reorganization of the company, it is argued, is too restrictive of a policy goal and a broader conceptualization of rescue is offered. The rescue goal of Chapter 11 should encompass rescuing the company, as well as the business.³⁴ This sets the stage to consider, in Parts III and IV, the current application of the APR, *Jevic* and the problems each present for Chapter 11 in achieving a policy goal consistent with a broad conceptualization of rescue. With those problems identified in light of the broad policy goal of rescue, the policy reform to address these problems can be considered.

A. The Theoretical and Normative Debate

When a company is economically viable but experiencing cash-flow insolvency, i.e. financial distress,³⁵ most bankruptcy scholars agree that Chapter 11 can be used to address the common pool problem caused by a race to the courthouse among individual creditors.³⁶ Further agreement is found in Chapter 11's role at maximizing value of the debtor's pool of assets.³⁷ At this point, there is divergence among scholars at what the policy goal of Chapter 11 should be in

³² Professor Jackson recognized this basic and fundamental step in bankruptcy policymaking. See THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 2-3 (1986). There must be an understanding of what bankruptcy can and should do, i.e. the goal of bankruptcy law. *Id.* With that underpinning "problems" in the bankruptcy system can be resolved. *Id.*

³³ For a discussion of the importance of problem definition in a policy analysis and reform efforts, see Nan. S. Ellis & Cheryl M. Miller, *Welfare Waiting Periods: A Public Policy Analysis of Saenza v. Roe*, 11 STAN. FL. & POL'Y REV. 343, n. 122 (2000). See also John A. Kingdon, *A Model of Agenda-Setting, with Applications*, 2001 L. REV. MICH. ST. U. DETROIT C. L. 331, 331-32 (Kingdon sets forth his streams theory where the problem, policy and political (solution) streams all operate independently but converge to achieve policy change.).

³⁴ For a thoughtful analysis of the trend for a broad conceptualization of rescue, a "rescue culture," see generally Verdoes & Verweij, *supra* note 15, at 399-401.

³⁵ Alan Schwartz, *A Normative Theory of Business Bankruptcy*, 91 VA. L. REV. 1199, 1200 (2005) ("A firm is only in financial distress if it would have positive earnings were it not required to service its debt.").

³⁶ Paterson, *Rethinking*, *supra* note 18, at 698.

³⁷ *Id.*

terms of distribution of the pool of assets.³⁸ Painting with broad strokes, on one side of the modern debate are law and economic scholars advancing the creditors' bargain theory,³⁹ under which the pre-bankruptcy rights of creditors should be given effect in Chapter 11, except when pre-bankruptcy rights interfere with maximization of the pool of assets.⁴⁰ On the other side of the debate are scholars in the progressive school⁴¹ advocating a more eclectic view of the policy goal of Chapter 11 so that distributions consider the consequences of the financial failure among a panoply of actors and interests, not just the creditors.⁴² Each side of the debate over what Chapter 11 should do⁴³ –maximize the return to creditors only or consider other goals and interests⁴⁴ - needs unpacking.⁴⁵

1. Creditors' Bargain

In the early 1980s the creditors' bargain theory was advanced by Professor Thomas Jackson,⁴⁶ and was developed in writings with Professor Douglas Baird⁴⁷ and Professor Robert Scott.⁴⁸ The creditors' bargain theory was also the normative cornerstone of Jackson's book, *The Logic and Limits of Bankruptcy Law*.⁴⁹ In Jackson's view bankruptcy is designed to address the common pool problem that arises by individual collection action.⁵⁰ As such, bankruptcy is debt-collection law.⁵¹ The objective of bankruptcy law under this law and economics framework is "to maximize the collective returns to creditors."⁵²

According to Jackson, the only relevant question for bankruptcy is what "is the most appropriate deployment for the group of the firm's assets given the initial entitlements."⁵³ Initial entitlements are those that exist outside of bankruptcy law under state law. The bankruptcy system should "mirror the agreement one would expect the creditors to form among themselves were they

³⁸ *See id.*

³⁹ Paterson, *Rethinking*, *supra* note 18, at 699.

⁴⁰ VANESSA FINCH & DAVID MILMAN, *CORPORATE INSOLVENCY LAW: PERSPECTIVES AND PRINCIPLES*, THIRD EDITION 29 (2017).

⁴¹ Paterson, *Rethinking*, *supra* note 18, at 699 (characterizing scholars on this side as the "progressive school"). *See also* DAVID A. SKEEL, JR., *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 12 (2001) (characterizing the policy debate tween the law and economics scholars and the "progressive scholars").

⁴² FINCH & MILAM, *supra* note 40, at 40.

⁴³ The debate, as Professor Skeel viewed it, was about the "nature and purpose of bankruptcy." SKEEL, *supra* note 41, at 12.

⁴⁴ *See* BO XIE, *COMPARATIVE INSOLVENCY LAW: THE PRE-PACK APPROACH IN CORPORATE RESCUE* 8 (2016) (characterizing the two viewpoints of the debate).

⁴⁵ For a succinct summary contrasting the two schools of thought on reorganization policy, see Vincent S.J. Buccola, *The Janas Faces of Reorganization Law*, 44 J. CORP. L. 1, 5-6 (2018).

⁴⁶ Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 860 (1982) [hereafter Jackson, *Bankruptcy*].

⁴⁷ *See* Douglas G. Baird & Thomas H. Jackson, *Fraudulent Conveyance Law and Its Proper Domain*, 38 VAND. L. REV. 829 (1985).

⁴⁸ *See* Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155 (1989). For a comprehensive collection of the literature developing the creditors bargain theory, see Buccola, *supra* note 45, at 6, n.17.

⁴⁹ *See* JACKSON, *supra* note 32, at 21-22.

⁵⁰ *Id.* at 10-11, 21.

⁵¹ *Id.* at 3.

⁵² FINCH & MILAM, *supra* note 40, at 28-29.

⁵³ JACKSON, *supra* note 32, at 210.

able to negotiate such an agreement from an ex ante position.”⁵⁴ Under the creditors’ bargain theory the rights of creditors outside of bankruptcy should not be altered in bankruptcy, except if it is something creditors would have hypothetically agreed to.⁵⁵ The theory is contractarian in nature.⁵⁶ Once the terms that creditors would have hypothetically agreed upon are derived, that is the basis with which to critique bankruptcy law.⁵⁷

Thus under this view of the role of bankruptcy law, the only focus is on hypothetical contract creditors.⁵⁸ The focus on creditor wealth maximization does not leave room for consideration of other interests and stakeholders.⁵⁹ A more expansive view of bankruptcy policy, according to Jackson, “would lead to costly, inefficient struggles between parties who prefer nonbankruptcy law and those who fare better in bankruptcy.”⁶⁰ That more expansive view of bankruptcy policy brings us to the other side of the debate advanced by the progressives.

2. Progressive School

Although the creditors’ bargain theory has been quite influential⁶¹ and adopted by many,⁶² it has received extensive criticism from progressive scholars.⁶³ The progressive school views the normative goal of Chapter 11 to encompass much more than simply the enhancement of the collection efforts creditors.⁶⁴ This school believes that Chapter 11 policy should encompass the interests of a wide array of actors including creditors, but also employees, taxing authorities, suppliers, customers and others impacted by a business failure.⁶⁵ This approach to bankruptcy policy is eclectic in nature and considers multiple values.⁶⁶ Bankruptcy policy in the progressive’s

⁵⁴ Jackson, *Bankruptcy*, supra note 46, at 860.

⁵⁵ See Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725, 750 (1984) (Under the “creditors’ bargain model . . . nonbankruptcy entitlements . . . should constitute the normative baseline for valuing bankruptcy entitlements and that a collective proceeding must upset only those rules that work to the detriment of the creditors as a group.”). As Professor Buccola explained, under the creditors’ theory bargain “bankruptcy justifiably alters creditor rights, as defined by ordinary commercial law, only to the extent creditors and other investors would agree to such changes in a hypothetical world of costless bargains.” Buccola, supra note 45, at 6. See also Lynn M. LoPucki, *A Team Production Theory of Bankruptcy Reorganization*, 57 VA. L. REV. 741, 744-745 (2004) (explaining the creditors’ bargain theory).

⁵⁶ Buccola, supra note 45, at 6; LoPucki, supra note 55, at 745.

⁵⁷ LoPucki, supra note 55, at 745.

⁵⁸ XIE, supra note 44, at 10.

⁵⁹ *Id.* at 10.

⁶⁰ SKEEL, supra note 41, at 13.

⁶¹ FINCH & MILAM, supra note 40, at 29.

⁶² Buccola, supra note 45, at 6.

⁶³ FINCH & MILAM, supra note 40, at 29-30. See also, Buccola, supra note 45, at 6 (noting the countervailing viewpoint raised in opposition to the creditors’ bargain theory). For example, see Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHIC. L. REV. 775, 77 (1987) (views bankruptcy policy has dealing with the distribution of losses among a host of actors and competing interests – not just addressing the enhancement of collection efforts for creditors) [hereafter Warren, *Bankruptcy*]; Donald B. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 762, 781 (1991) (proposing an alternative to the creditors’ bargain model to one that includes a consideration of non-economic values and dimensions including “moral, political, personal and social” values); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 337, n.4 (1993) (collecting scholarship challenging creditors’ bargain theory) [hereafter Warren, *Imperfect*]; LoPucki, supra note 45, 744-49 (critiquing creditors’ bargain theory).

⁶⁴ Warren, *Bankruptcy*, supra note 63, at 777.

⁶⁵ Warren, *Imperfect*, supra note 63, at 354-55.

⁶⁶ FINCH & MILAM, supra note 40, at 29.

view cannot be reduced a single economic construct.⁶⁷ A bankruptcy reorganization is complex and dirty, and even though there are a host of interconnected actors and interests at play, it is elastic.⁶⁸ Bankruptcy policy, according to the progressives, should reflect these varying interests and not the single vision advocated by the law and economic scholars.

B. Rescue Policy Reflected in Chapter 11

There are aspects of the creditors' bargain theory and the progressive school reflected in the Bankruptcy Code. However, on the whole the theoretical underpinnings of the progressive school of thought is more prevalent in Chapter 11 than creditors' bargain theory.⁶⁹ A consideration of the options available for a company in Chapter 11 highlights this policy orientation.

There are two options to deal with the financial distress in Chapter 11: rescue the company in its present form or rescue the business in a new entity.⁷⁰ First, rescue of the company entails a rehabilitation through a reorganization or restructuring of the company's debt.⁷¹ Chapter 11's policy goal is firmly rooted in a rescue of the company through reorganization or restructuring the company.⁷² The Bankruptcy Code gives a Chapter 11 debtor powers that give the debtor leverage to facilitate a rescue of the company.⁷³ Such powers include debtor-in-possession control,⁷⁴ exclusivity to propose a reorganization plan,⁷⁵ an *ipso facto* ban⁷⁶ and the ability to assume, reject and assign contracts.⁷⁷ The premise of this emphasis on debtor power or control is that the debtor

⁶⁷ Warren, *Bankruptcy*, *supra* note 63, at 811.

⁶⁸ *Id.*

⁶⁹ Paterson, *Rethinking*, *supra* note 18, at 699.

⁷⁰ See Payne, *Lessons*, *supra* note 18, at 282 (detailing the options).

⁷¹ *Id.* at 282.

⁷² Courts have recognized that Chapter 11's paramount goal is to rehabilitate the debtor. Lynn M. LoPucki, *Changes in Chapter 11 Success Levels Since 1980*, 87 TEMP. L. REV. 989, 998 (2015) (citations omitted). This rehabilitation or reorganization is designed to save or rescue, the company – the goal of Chapter 11. See *id.*

⁷³ See Comment, Elizabeth B. Rose, *Chocolate, Flowers, and § 363(b): The Opportunity for Sweetheart Deals without Chapter 11 Protections*, 23 EMORY BANKR. DEV. J. 249, 254 (2006) (recognizing the powers provided to a debtor in Chapter 11 that provide “the debtor leveraging power in a reorganization”). Congress recognized this need to give the debtor power in Chapter 11 to facilitate a rescue. See H.R. Rep. No. 595, 95th Cong., 1st Sess., at 231-232 (“Proposed Chapter 11 recognizes the need for the debtor to remain in control to some degree, or else debtors will avoid the reorganization provisions in the bill until it would be too late for them to be an effective remedy.”).

⁷⁴ Rose, *supra* note 74, at 254. See also Foteini Teloni, *The Bankruptcy Abuse Prevention and Consumer Protection Act: An Empirical Examination of the Act's Business Bankruptcy Effects*, 88 AM. BANKR. L.J. 237, 240 (2014) (observing that debtor-in-possession feature gives the debtor-in-possession control in the Chapter 11 process).

⁷⁵ 11 U.S.C. § 1121(b) (providing exclusivity for debtor to file a plan of reorganization). See also Rose, *supra* note 74, at 255 (noting the control exclusivity gives a debtor-in-possession); Teloni, *supra* note 75, at 240 (discussing role exclusivity plays in giving debtor-in-possession control in Chapter 11).

⁷⁶ For example, in the context of utilities § 366 of the Code limits the ability of a utility to modify services post-petition for twenty-one days so as to provide the debtor-in-possession the opportunity to provide adequate assurance of payment. Teloni, *supra* note 75, at 247-48.

⁷⁷ For example, in the context of commercial leases a debtor-in-possession is given certain limited rights early on in a case under § 365. See Teloni, *supra* note 75, at 250-54 (discussing the rights of the debtor-in-possession and balancing of those with that of the landlord).

will promote a rescue the company through reorganization⁷⁸ which is the value maximizing option in Chapter 11.⁷⁹

Under this option, the rescue of the company, the Bankruptcy Code does provide “distributional entitlements only to creditors and shareholders”⁸⁰ through the APR⁸¹ which is consistent with the creditors’ bargain theory.⁸² However, in application, the APR is not consistently adhered to.⁸³ That deviation from the APR is consistent with the progressive school in that it moves away from the creditors’ bargain theory to consider other interests at play in Chapter 11.

The second option, a rescue of the business in a new entity, typically involves a sale of the company to a new company,⁸⁴ preserving the going concern value of the business.⁸⁵ Although, such a sale does not fit squarely within the traditional reorganization goal of the company, the Bankruptcy Code does provide statutory authority for the sale of the business as a going concern.⁸⁶ With the law on the books permitting such sales, practitioners have adapted their Chapter 11 practice in recent years away from the traditional goal of rescuing the company through a reorganization plan to rescuing the business through a sale of the business. Such sales of the businesses as a going concern in Chapter 11 have increased in recent years, accounting for at least 30 percent of all Chapter 11s.⁸⁷ Thus, facilitating a rescue through a sale of the business as a going concern, is a viable option in Chapter 11.

The rescue of the business through a sale can be consistent with both the creditors’ bargain theory and the progressive school. Which policy orientation a sale of the business advances will depend on the outcome of the sale. For example, a sale of the business may very well bring the most return to creditors and it may keep many jobs intact, keep many suppliers contracts in place and continue the business in the community it is located. In such a sale the creditors’ bargain theory is enhanced as presumably such a sale has enhanced the value of the business. Also, the progressive school concern over other interests outside of creditors such as employee, suppliers or broader community interests may be enhanced or, at least the detrimental impact of the financial distress, is minimized.

⁷⁸ See Rose, *supra* note 74, at 254-55 (observing that debtor-in-possession control enhances opportunity for successful reorganization).

⁷⁹ It is generally viewed that a Chapter 11 plan of reorganization process with bargaining among the players will foster value maximization. See, e.g., J. Bradley Johnston, *The Bankruptcy Bargain*, 65 AM. BANKR. L.J. 213, 257 (1991). The power or control the debtor has facilitates that bargaining process in proposing a reorganization plan.

⁸⁰ LoPucki, *supra* note 55, at 768.

⁸¹ See *infra* notes 111-114 and accompanying text (summarizing the APR).

⁸² See LoPucki, *supra* note 55, at 768 (noting that the cramdown provisions of Chapter 11 are consistent with creditors’ bargain theory).

⁸³ See *infra* notes 135-136 and accompanying text.

⁸⁴ Johnson, *supra* note 80, at 282.

⁸⁵ See Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 688, 691-692 (2003) (noting that sales are a way to preserve going concern value). This benefit of a sale of a business has been recognized for decades in U.S. bankruptcy law. See Recent Case, *Bankruptcy – In General – Sale of Entire Assets not Permitted in Chapter XI Arrangement*, 65 HARV. L. REV. 686, 687 (1952) (“A sale of an entire business may be necessary to preserve going-concern value from the potentially dismembering effect of the secured creditors’ liens or to resolve an otherwise irreconcilable conflict between secured and unsecured creditors over the reorganization plan.”).

⁸⁶ 11 U.S.C. § 363(b).

⁸⁷ In an empirical study of the disposition of Chapter 11 cases from 1997 to 2011, § 363 sales accounted for 20% of the dispositions from 1997 to 2005. This increased to 32% from 2005 to 2011. Teloni, *supra* note 75, at Fig. 4.

A third option is available to address financial distress of a company that has progressed to an economically unviable state, i.e. economic distress.⁸⁸ a liquidation of assets.⁸⁹ Here the value of the assets sold separately is greater than the going concern value of the net worth of the company.⁹⁰ The Bankruptcy Code expressly provides for this option. Chapter 11 provides for a liquidating plan.⁹¹ Additionally a company may file for Chapter 7⁹² and liquidate⁹³ or a Chapter 11 debtor can convert to Chapter 7 for a liquidation.⁹⁴ These options seek to provide a greater return to creditors than the return available in a rescue of the company or rescue the business as a going concern when the company is in economic distress.

This option promotes the creditor's bargain theory as it expressly seeks to enhance the creditors' return. This policy orientation makes sense in this context – economic distress of the company. It assumes that the company is not economically viable, so the only thing that can be done is a liquidation to maximize the return. Although, progressives would not view this as the preferred outcome, Chapter 11 can only do so much and if a company is not viable, liquidation, which will negatively impact a whole host of non-creditor interest, may be the only option. At least in this context, Chapter 11 can serve a debt-collection tool to try to maximize the return to creditors.

C. Broad Conceptualization of Rescue Policy in Chapter 11

The view of Chapter 11 from the creditors' bargain and progressive perspectives are quite stark. Chapter 11 positive law, in large part, reflects the progressive school view, but certainly includes attributes of the creditors' bargain theory. Neither view is fully satisfactory. The rescue policy reflected in Chapter 11 of the Code is too limited.

Rescue in Chapter 11 should not be limited to merely the reorganization or restructuring a company.⁹⁵ Rescue is a broad construct that certainly includes the reorganization and restructuring of a company, but it also includes preserving the going concern of a viable business – the rescue of the business.⁹⁶ Chapter 11's policy goal should be broader and encompass rescue as used in modern Chapter 11 practice – rescuing the business, as well as rescuing the company.⁹⁷

This broader orientation does not discard the importance and consideration of creditor interests. It does not discount the importance of considering a whole host of actors and interests that may be impacted by Chapter 11. All actors and interests impacted by a Chapter 11 bankruptcy should be considered. Chapter 11 is not necessarily a zero-sum game. There will be gains and

⁸⁸ Schwartz, *supra* note 35, at 1200 (“Economic distress occurs when the firm cannot earn revenues sufficient to cover its costs, exclusive of financing costs. Such a firm has negative economic value.”).

⁸⁹ Payne, *Lessons*, *supra* note 18, at 282.

⁹⁰ *Id.*

⁹¹ 11 U.S.C. § 1123(a)(5)(D) (providing for sale of all or part of assets in a plan).

⁹² *Id.* at § 109(a), (b) (detailing who may be a debtor under Chapter 7).

⁹³ *Id.* at § 704(a)(1) (trustee liquidates assets).

⁹⁴ *Id.* at § 1112(b) (provides for conversion of Chapter 11 case to Chapter 7).

⁹⁵ See FINCH & MILMAN, *supra* note 40, at 198 (Recognizing the distinction between rescue of the company, rescue of the business and the various outcomes of a successful rescue.)

⁹⁶ See, e.g., Ignacio Tirado, *Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain*, 15 EUR. CO. FIN. L. REV. 516, n.6 (2018) (articulating a broad view of “rescue” in Spain encompassing both the rescue of the company and the rescue of the business). Such a broad view of rescue is evident in the U.K. in which a turnaround of a company (company rescue) and sale preserving the core assets of a business (business rescue) fall under the umbrella of rescue. See XIE, *supra* note 44, at 4.

⁹⁷ See *supra* note 71-78 and accompanying text.

losses among the various interests. Chapter 11 policy should encompass a panoply of interests with the aim of rescue, whether through reorganization of the company or rescue of the business, for economically viable companies.

Over twenty-five years ago Professor Westbrook recognized a broad view of rescue in noting that the options available in a rescue regime include an administration with a quick sale, a reorganization through a financial restructuring and a third approach, without articulating what that approach may be.⁹⁸ Reorganization through financial restructuring fits neatly within the traditional policy orientation of Chapter 11: reorganization of the company. However, administration through a quick sale, particularly the sale of substantially all of the assets as a whole, embraces a broad concept of rescue: rescuing a business. And Westbrook's third, yet undefined option, offers an even broader orientation of rescue that certainly encompasses rescue of the business.

This type of broad rescue orientation for Chapter 11 reflects the reality of the environment that Chapter 11 operates in. Times have changed since the enactment of the Code in 1978. Chapter 11 was created at time in which the economy was a traditionally manufacturing based economy, but the economy has been transformed to one that is more information based, in which the most valuable assets may be the relationship networks and human capital.⁹⁹ Companies' assets are less hard assets, and more intangible assets including services, intellectual property or contracts.¹⁰⁰ The composition of creditors' classes has changed since 1978 with claims trading and derivative products.¹⁰¹ A going concern sale of a business for such companies operating in an information based environment may be the best way to capture the value of the business.¹⁰² An orientation of Chapter 11 that is narrow in scope emphasizing the reorganization of the company or the normative goal articulated by creditors' bargain theory is not adequate. Companies operate in a different environment and Chapter 11 "was not originally designed to rehabilitate companies efficaciously in this complex environment."¹⁰³

Modern Chapter 11 practice reflects Westbrook's broad conceptualization of rescue – the traditional policy goal of rescuing the company through reorganization as well as modern Chapter 11 practice of a rescuing a business through a sale. This broader conceptualization of rescue in Chapter 11 was recently recognized by the Eleventh Circuit when the court noted that the sale of substantially all of a debtor's assets in Chapter 11 can advance the goals of Chapter 11.¹⁰⁴ Rescue as used throughout this article encompasses this broad conceptualization of rescue. It is the benchmark to gauge whether reforms are needed.

III. Cross-Class Cram Down and the Role of the Absolute Priority Rule in Chapter 11

The Bankruptcy Code permits two types of cram down in the confirmation of a Chapter 11 plan. Confirmation of a plan of reorganization is permitted over dissenting impaired creditors

⁹⁸ Jay Westbrook, *Chapter 11 Reorganization in the United States* in *INSOLVENCY LAW: THEORY AND PRACTICE* 367 (1993).

⁹⁹ XIE, *supra* note 44, at 7.

¹⁰⁰ ABI REPORT, *supra* note 7, at 12.

¹⁰¹ *Id.*

¹⁰² XIE, *supra* note 44, at 7.

¹⁰³ ABI REPORT, *supra* note 7, at 12.

¹⁰⁴ *See In re Walter Energy, Inc. et al.*, 911 F.3d 1121, 1152-54 (11th Cir. 2018).

within a class if that class votes to accept the plan treatment¹⁰⁵ and cross-class cram down over an entire class of dissenting impaired creditors is permitted if the APR is satisfied.¹⁰⁶ Although cram down within a class raises some concerns over the protection of minority interests, the cross-class cram down raises a greater level of concern over the protection of minority interests,¹⁰⁷ which brings into play the APR.¹⁰⁸

In order to confirm a Chapter 11 plan over a dissenting impaired creditor class, the APR requires “that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan.”¹⁰⁹ A creditor, absent consent, must receive the same value of the debtor’s assets in a bankruptcy that the creditor would receive outside of bankruptcy.¹¹⁰ The theory behind the concept of absolute priority is that senior creditors should recover the amount they are owed – no more, no less.¹¹¹ General creditors should be paid in full before equity interests receive anything.¹¹²

The APR is a product of judicial construction with its origins in the equity receivership reorganization cases,¹¹³ but it is now codified in the “fair and equitable”¹¹⁴ requirement of the Code.¹¹⁵ It is rooted in the “common law maxim that creditors would be paid ahead of equity.”¹¹⁶ It is a type of minority creditor protection designed to avoid the problems associated with information asymmetry and disparities in control of a debtor that possibly could result with owners, insiders or a controlling secured creditor reaping value from a failing business for their own benefit.¹¹⁷ If a party appropriates value in a business for their own benefit – creditor or

¹⁰⁵ 11 U.S.C. § 1126(c), (d). *See also*, Jeffrey M. Sharp, *Bankruptcy Reorganizations, Section 1129, and the New Capital Quagmire: A Call for Congressional Response*, 28 AM. BUS. L.J. 525, 531-32 (1991) (summarizing this in class cram down confirmation standard).

¹⁰⁶ *Id.* at § 1129(b)(1), (2). *See also* RODRIGO OLIVARES-CAMINAL, ET AL., *DEBT RESTRUCTURING*, SECOND EDITION 172-3 (2016); Sharp *supra* note 107, at 533-34 (summarizing this cross-class cram down confirmation standard).

¹⁰⁷ *See Payne, Restructuring, supra* note 10, at 469 (noting need for minority interest protection with cram down); Wessel and Madaus, *supra* note 1, at 274 (cross-class cram down power requires protections). *See also, In re Lett*, 632 F.3d at 1128 (recognizing the need to protect minority impaired interests in a cross-class cram down).

¹⁰⁸ The APR is just one of several safeguards for minority interests in Chapter 11. Other safeguards, beyond the scope of this paper, include classification of creditors that are “substantially similar” under 11 U.S.C. § 1122(a), compliance with the best interests test under 11 U.S.C. § 1129(a)(7)(B) (liquidation analysis) and requiring that the plan “not discriminate unfairly” among class members under 11 U.S.C. § 1129(b)(1). *See Payne, Lessons, supra* note 18, at 300-01 (recognizing the safeguards in place in Chapter 11). *See also* RODRIGO OLIVARES-CAMINAL, ET AL., *supra* note 108, at 169-76 (analyzing the best interest test, the requirement to not unfairly discriminate and the APR).

¹⁰⁹ *Norwest Bank Worthington v. Ahlers*, 108 S. Ct. 963, 966 (1998) (citation omitted). *See Sharp, supra* note 107, at 526 (“The absolute priority rule requires that claims to nonexempt assets of the debtor be assigned strict priority of payment and that each class of claims be paid in full before any junior class receives value.”); JACKSON, *supra* note 32, at 214 (succinctly summarizing application of the APR under the Code).

¹¹⁰ JACKSON, *supra* note 32, at 213.

¹¹¹ Douglas G. Baird, *Bankruptcy’s Quiet Revolution*, 91 AM. BANKR. L.J. 593, 595 (2017) [hereafter Baird, *Revolution*].

¹¹² *Id.*

¹¹³ OLIVARES-CAMINAL ET AL., *supra* note 108, at 172; JACKSON, *supra* note 32, at 213, n.11.

¹¹⁴ 11 U.S.C. § 1129(b)(1).

¹¹⁵ *Norwest Bank Worthington v. Ahlers*, 108 S. Ct. at 966. *See also* OLIVARES-CAMINAL, ET AL., *supra* note 108, at n. 192.

¹¹⁶ Elizabeth Warren, *A Theory of Absolute Priority*, 1991 ANN. SURV. AM. L. 9, 37 [hereafter Warren, *Absolute*].

¹¹⁷ *Id.* Professor Warren focuses on the power of owners/insiders to the detriment of creditors, but the APR plays a role in protecting minority creditors from dominant secured creditors. *See also Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 986-7 (recognizing the risk of collusion between senior secured creditors and other creditors to squeeze out intermediate creditors).

equityholder – the party whose priority rights have been infringed upon should be able assert that their rights have been violated under the APR.¹¹⁸

Although the APR can offer protection to minority interests, its application has been criticized.¹¹⁹ It is viewed as an impediment to reorganizations in that it increases costs, limits compromise and may eliminate junior interests unnecessarily.¹²⁰ For example, as Professor Warren explained, if old equity is barred from participating in a reorganized debtor (i.e. retain their equity interest) under a strict application of the APR because a senior class of creditors object to the reorganization plan, then the APR may actually impede a reorganization.¹²¹ If holdout creditors overvalue their position, the APR will ensure their participation but this may lead to a break down in bargaining resulting in a failed reorganization or in a diversion of value of the company to holdout creditors.¹²² Moreover, a *carte blanche* application of the APR to prohibit participation by equity in the reorganized debtor may reduce the going-concern value of the debtor because the equity holder's knowledge, attributes of continued management and willingness to fund the debtor may be lost.¹²³

Importantly, by the letter of the Code, the APR only applies to distributions in nonconsensual plans of reorganization subject to a cram down.¹²⁴ However, the APR principle is often employed in other aspects of Chapter 11 as a normative guiding principle.¹²⁵ When the APR is applied in a broad way throughout Chapter 11 as a principle it bolsters its importance. The criticisms of a rigid application APR in the context of a confirmation of a plan, highlighted above, carry over to a rigid application in other aspects of a Chapter 11 reorganization.

A strict application of the APR, whether under the Code in a cram down scenario or as a guiding principle in other contexts, is impractical and ignores the dynamic nature of business outside and inside a Chapter 11 reorganization.¹²⁶ Outside of bankruptcy the rigid application of the APR does not exist.¹²⁷ Businesses decide to pay some creditors, delay payment and to not pay others in the operations of their business based on business needs and not legal priority.¹²⁸ Within a bankruptcy reorganization these business decisions are still at play, albeit overseen by the bankruptcy court.¹²⁹ The business in bankruptcy is not merely a pool of assets to be distributed,¹³⁰ but rather a dynamic creature making business decisions and often making distributions to creditors that run afoul of the notion of absolute priority with the blessing of the bankruptcy

¹¹⁸ Baird, *Revolution*, *supra* note 13, at 595.

¹¹⁹ See Note, *The Proposed Bankruptcy Act: Changes in the Absolute Priority Rule for Corporate Reorganization*, 87 HARV. L. REV. 1786, 1786-87 (1974) (collecting authorities criticizing the APR) [hereafter *Proposed Bankruptcy Act*]; Gregory K. Jones, *The Classification and Cram Down Controversy in Single Asset Bankruptcy Cases: A Need for the Repeal of Bankruptcy Code Section 1129(a)(10)*, 42 UCLA L. REV. 623, n. 115 (1994) (collecting authorities detailing criticisms).

¹²⁰ *Proposed Bankruptcy Act*, *supra* note 73, at 1786-87. See also, Yesha Yadav, *Too-Big-To-Fail Shareholders*, 103 MINN. L. REV. 587, n. 12 (2018) (collecting authorities criticizing the APR).

¹²¹ Warren, *Absolute*, *supra* note 118, at 32.

¹²² *Id.*

¹²³ *Id.* at 32-3. See also JACKSON, *supra* note 32, at 221 (noting the argument that existing owners or shareholders have expertise and knowledge in the debtor that can enhance the value of the debtor).

¹²⁴ Buccola, *supra* note 45_, at 8, 10.

¹²⁵ *Id.* at 7-8.

¹²⁶ See Stephen J. Lubben, *The Overstated Absolute Priority Rule*, 21 FORDHAM J. CORP. & FIN. L. 581, 585, 602 (2016).

¹²⁷ *Id.* at 585.

¹²⁸ *Id.*

¹²⁹ *Id.*

¹³⁰ *Id.*

court.¹³¹ These priority-violating distributions, such as paying critical vendors, employees or settlement payments,¹³² are all done in an effort to enhance the long-term value of the debtor's estate.¹³³ These are not rigid priority driven decisions, but rather practical oriented decisions that debtors make and bankruptcy courts approve with an eye towards an ultimate rescue in a case. Thus, the “absolute” nature of the APR is in reality a fiction – outside of and within Chapter 11,¹³⁴ at least in contexts outside the confirmation of a plan.¹³⁵

Even though the application of the APR is not “absolute” in practice, that does not obviate the need for the reform proposed herein. The debtor in Chapter 11 needs to be able to deal with all creditors from the beginning of the case through the confirmation of a plan without application of a mandatory rule of absolute priority in the confirmation of a plan or as a principle applied throughout a case. Flexibility in application of the APR, subject to judicial supervision, can avoid the problems associated with a rigid application of the APR. If the rule is more flexible in the context of the confirmation of a plan, the normative principle of absolute priority in other aspects of the case will likewise be more flexible in nature. The case for this type of reform is strengthened when we consider how the cascading effect of *Jevic*, as outlined in the next section, exacerbates the difficulties associated with a rigid application APR throughout a case.

IV. *Jevic* and its Cascading Effect

A. *Jevic* in a Nutshell

The basic facts of *Jevic* are straightforward.¹³⁶ Two creditors (Sun and CIT), *Jevic* (the debtor) and the unsecured creditors committee¹³⁷ reached a settlement resolving litigation among the parties that would result in the following: (1) CIT paying \$2 million dollars to cover unsecured creditors' committee's fees; (2) Sun assigning a lien in *Jevic*'s remaining cash (\$1.7 million dollars) so that administrative expenses and taxes could be paid, with the balance of funds going

¹³¹ See *id.* at 583 (noting the APR is violated numerous times in a chapter 11 cases).

¹³² See Buccola, *supra* note 45, at 16-19 (noting the mechanisms debtors employ to prefer creditors over others).

¹³³ Lubben, *supra* note 129, at 596-598. See also Buccola, *supra* note 45, at 8 (recognizing that these redistributions outside of a confirmed plan can help maintain the going-concern value of the debtor); Barry E. Adler & George Triantis, *Debt Priority and Options in Bankruptcy: A Policy Intervention*, 91 AM. BANKR. L.J. 563, 569-570 (noting the need for courts to authorize priority violating distributions in a case to ensure that “the going concern value of the debtor” is not dissipated prior to plan confirmation.).

¹³⁴ Lubben, *supra* note 129, at 606 (“the absolute priority rule is both more flexible and less absolute than often asserted. . .”). Professor Baird has aptly characterized the APR in Chapter 11 as “a regime of *approximate* absolute priority.” Baird, *Revolution*, *supra* note 113, at 598 (emphasis added). In the context a confirmation of a plan a bankruptcy court confirms plans if the values provided for the firm and the claim amount, the interest rates and priority positions, are “within a reasonable range.” *Id.* Chapter 11 is not a true absolute priority regime, but one of approximate absolute priority. *Id.*

¹³⁵ Adler & Triantis, *supra* note 136, at 576 (recognizing that deviations from the APR during the bankruptcy case, but strictly enforcing in the plan confirmation context).

¹³⁶ For a detailed factual analysis of *Jevic*, see Jonathan C. Lipson, *The Secret Life of Priority: Corporate Reorganization after Jevic*, 93 WASH. L. REV., 631, 640-46 (2018); Nicholas L. Georgakopoulos, *Through Jevic's Mirror: Orders, Fees, and Settlements*, 72 BUS. LAW. 917, 924-33 (2017).

¹³⁷ The Code provides for the appointment of a committee of unsecured creditors, as well as other potential committees of creditors or equity holders. 11 U.S.C. § 1102(a)(1). Such committees are conferred powers and duties. 11 U.S.C. § 1103. Effectively committees have a seat at the table in a Chapter 11 proceedings as the committee is a “party in interest” with a right to be heard. 11. U.S.C. § 1109(b).

to general unsecured creditors; and (3) dismissal of the Chapter 11 case.¹³⁸ The settlement required that the funds assigned by Sun not be distributed to priority wage claims.¹³⁹

This distribution violated the Code's priority rules because the priority wage claims were skipped in favor of lower general unsecured claims.¹⁴⁰ This provided the Supreme Court the opportunity to determine the applicability of the APR in a non-confirmation of a Chapter 11 plan context. The Supreme Court provided an answer to this narrow question: whether, in the absent of consent, can a bankruptcy court "approve a structured dismissal that provides for distributions that do not follow ordinary priority rules[?]"¹⁴¹ The Supreme Court said no¹⁴² and held that the priority rules, such as the APR, are applicable in the context of a Chapter 11 structured dismissal.¹⁴³

B. Cascading Effect of *Jevic*

Although the *Jevic* holding is limited to structured dismissals that violate the APR,¹⁴⁴ it has important implications beyond the structured dismissal. Dissenting Justices Alito and Thomas noted the "novel and important question" the case presented¹⁴⁵ and scholars are recognizing the significance of the opinion.¹⁴⁶ The importance of *Jevic* is also seen as courts begin to grapple with applying the decision.¹⁴⁷ It is in the application of *Jevic* to other rescue tools - settlements, § 363 sales and first-day orders¹⁴⁸ - that may violate the APR in which *Jevic*'s importance materializes.¹⁴⁹ If the effective use of these tools is curtailed post-*Jevic*, the capacity of Chapter 11 to promote the broad orientation of rescue, as well enhancing the value of the estate, may be undercut, making the need to reform the APR more pressing. The impact of *Jevic* on these three tools is detailed below.

1. Settlements

Bankruptcy judges have authority to approve a settlement between a debtor and other parties, such as creditors and committees, if the court finds the settlement fair and equitable.¹⁵⁰ The ability for the debtor and the parties in a Chapter 11 case to compromise and settle disputes is an important rescue tool. The more that contested issues are resolved consensually prior to a

¹³⁸ *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 981.

¹³⁹ *Id.* Sun required this provision because priority wage claimants had a lawsuit against Sun and Sun did not want the funds to finance the litigation. *Id.*

¹⁴⁰ *Id.* at 978, 981.

¹⁴¹ *Id.* at 983. See also Georgakopoulos, *supra* note 139, at 932 (noting the narrow scope of the question answered).

¹⁴² *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 978, 983.

¹⁴³ See Lipson, *supra* note 139, at 646 (citing *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 984-86).

¹⁴⁴ Brubaker, *supra* note 31, at 2, 4.

¹⁴⁵ *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 987.

¹⁴⁶ Lipson, *supra* note 139, at 633 (citing Brubaker, *supra* note 31, at 1).

¹⁴⁷ See *infra* notes 158-168, 183-186, 202-204 and accompanying text.

¹⁴⁸ Other rescue tools beyond the scope of this paper, such as gifting, may be impacted by *Jevic*. Cohen, *supra* note 31, at 3, 15-19. Interestingly, the structured dismissal itself as a rescue tool may be subject to future litigation. The Supreme Court did not opine on the legality of the structured dismissal. *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 985.

¹⁴⁹ See, e.g., Brubaker, *supra* note 31, at 1 (recognizing the importance of *Jevic* and noting that "*Jevic* should prompt a serious re-examination of the entire gamut of priority-violation distributions devices.").

¹⁵⁰ See FED. R. BANKR. P. 9019(a); *In re Fryar*, 570 B.R. at 607 (citation omitted). See also Bethany K. Smith, Note, *Up the chute, Down the Ladder: Shifting Priorities Through Structured Dismissals in Bankruptcy*, 84 *FORDHAM L. REV.* 2989, 2296-2998 (2016) (summarizing the caselaw requirements for approval of a settlement in bankruptcy).

confirmation hearing of a plan of reorganization, the more likely a plan will be confirmed provided it does not violate the Code's requirements for confirmation.¹⁵¹ Confirmation of the plan will not guarantee that a Chapter 11 will successfully achieve Chapter 11's rescue goal, but confirmation of a plan certainly enhances the prospects of rescue. Thus, the ability to reach settlements and compromises along the way toward confirmation is a vital rescue tool.

In *Jevic* the Supreme Court discussed settlements that include interim distributions that violate the Code's priority rules contrasting them with structured dismissals with final distributions.¹⁵² This discussion was dicta, but implicit in the Court's discussion is that interim distributions may be permissible if there are "significant offsetting bankruptcy-related justification[s],"¹⁵³ whereas final distributions in a structured dismissal with no justification for violating the priorities of the Code is impermissible.¹⁵⁴ Bankruptcy courts are beginning to tackle approval of settlements post-*Jevic*.

For example, in the case of *In re Fryar*¹⁵⁵ a bankruptcy court, relying on *Jevic*, denied approval of a settlement, over objection, that included distributions that violated the Code's priority rules because there was no "significant code-related objective."¹⁵⁶ Similarly, a bankruptcy court in the case of *In re Constellation*,¹⁵⁷ relying on *Jevic*, did not approve a settlement, over objection, that violated the APR.¹⁵⁸ Just as in *Fryar*, there was no evidence that the settlement promoted saving the business or plan,¹⁵⁹ i.e., no "significant code-related objective" for violating APR.

In a third bankruptcy decision, *In re Short Bark Industries, Inc.*,¹⁶⁰ the bankruptcy court approved a settlement, over objection, as part of a proposed debtor-in-possession financing which provided for escrowing \$110,000 for payment of general unsecured creditors, thus skipping priority and administrative claims.¹⁶¹ The bankruptcy court distinguished *Jevic* because the settlement was early in the case, its approval provided for the continued employment of over 500 people and it permitted the business to continue.¹⁶² Thus, in contrast to *Fryar* and *Constellation*, there was a "significant code-related objective" to deviate from the Code's priority scheme.

Post-*Jevic*, beyond showing a settlement is "fair and equitable",¹⁶³ parties seeking approval of a settlement with interim distributions that violate the underlying priority principle of the APR will likely need to make an additional showing of a "significant offsetting bankruptcy-related justification."¹⁶⁴ This may be able to be shown as in the *Short Bark* case, but in cases where there

¹⁵¹ If a plan complies with § 1129(a) or complies with § 1129(b) bankruptcy courts do not have discretion to deny confirmation. *In re Trenton Ridge Investors, LLC*, 461 B.R. 440, 455-58 (Bankr. S.D. Ohio 2011).

¹⁵² See *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 985-86.

¹⁵³ *Id.* at 986.

¹⁵⁴ See Georgakopoulos, *supra* note 139, at 940. See also Buccola, *supra* note 45, at 19 (noting the distinction in dicta that the *Jevic* court made regarding the timing of priority-violating distributions).

¹⁵⁵ *In re Fryar*, 570 B.R. 602 (Bankr. E.D. Tenn. 2017).

¹⁵⁶ *Id.* at 610.

¹⁵⁷ *In re Constellation Enterprises LLC*, Case No. 16-11213, Order Denying Joint Motion Approving Settlement, Doc. No. 963 (Bankr. D. Del., May 16, 2017).

¹⁵⁸ Robert J. Keach & Andrew C. Helman, *Life After Jevic, An End to Priority-Skipping Distributions*, 36 AM. BANKR. INST. J. 12, 73 (2017).

¹⁵⁹ Cohen, *supra* note 31, at 30; Keach & Helman, *supra* note 161, at 73.

¹⁶⁰ *In re Short Bark Industries, Inc.*, Case No. 17-11502, Final Order, Doc. No. 200 (Bankr. D. Del., Sept. 11, 2017).

¹⁶¹ Cohen, *supra* note 31, at 20. See also Shane G. Ramsey, *Despite Jevic, Priority Skipping Found to be Permitted as Part of Final Approval of DIP Financing*, THE BANKRUPTCY PROTECTOR (Sept. 19, 2017).

¹⁶² Cohen, *supra* note 31, at 22; Ramsey, *supra* note 164.

¹⁶³ *In re Fryar*, 570 B.R. at 610 (detailing the "fair and equitable" requirement).

¹⁶⁴ See Georgakopoulos, *supra* note 139, at 940; Cohen, *supra* note 31, at 19.

is no rescue on the horizon, obtaining approval of a settlement that violates the priority rules in the APR will likely be a difficult task post-*Jevic*. If this showing cannot be made, then the APR as a principle, which *Jevic* certainly embraced in the structured dismissal context,¹⁶⁵ may hamper the approval of settlements or compromises. Settlements with certain parties, that violate the priority principle behind the APR, may be necessary in a case to facilitate the continued operation of a debtor or help maintain the going concern value of the business on the road to a plan of reorganization or a sale. Outside of Chapter 11 businesses do not adhere to rigid legal priority in reaching settlements and compromises.¹⁶⁶ Rather these are often business driven decisions. This potential limitation that *Jevic* presents on reaching settlements in a Chapter 11 may infringe upon the ability to foster rescue through a plan of reorganization or a sale. Such an outcome runs afoul of promoting rescue, as well as the underlying value maximization goal of those in the law and economics school.

2. § 363(b) Sales

In *Jevic* the Supreme Court recognized that there are three conclusions to a Chapter 11 case: confirmation of a plan which may include a distribution of assets and possibly the continuation of the business; conversion to Chapter 7 for liquidation; or dismissal.¹⁶⁷ The Eleventh Circuit recently noted the options to bring a Chapter 11 to conclusion are a little broader, to include a sale of substantially all of a debtor's assets under § 363.¹⁶⁸ In fact, the sale of substantially all of a Chapter 11 debtor's assets under § 363(b), rather than through a plan, to a successor corporation¹⁶⁹ is the rescue tool of choice in an increasingly number of Chapter 11s.¹⁷⁰ Such a sale may or may not be followed by a liquidation plan,¹⁷¹ conversion to Chapter 7¹⁷² or a dismissal.¹⁷³

The § 363(b) sale of substantially of a debtor's assets is a vital rescue tool.¹⁷⁴ Just as with a successful classic Chapter 11 with a plan of reorganization in which the business continues to operate, a § 363(b) sale of substantially of assets as a going concern the underlying business is not shut down as in a Chapter 7 liquidation.¹⁷⁵ The outcome of this type of sale "bears a close resemblance to the end result of a classic reorganization."¹⁷⁶ This outcome through a § 363(b) is quicker than a Chapter 11 plan and can be accomplished without

¹⁶⁵ See *infra* notes 144-146 and accompanying text.

¹⁶⁶ See *supra* notes 129-138 and accompanying text.

¹⁶⁷ *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 975.

¹⁶⁸ See *In re Walter Energy, Inc. et al.*, 911 F.3d 1121, 1152-54 (11th Cir. 2018).

¹⁶⁹ *In re Daily Gazette Company*, 584 B.R. 540, 546 (Bankr. S.D. Va. 2018).

¹⁷⁰ See, e.g., Jodie A. Kirshner, *Design Flaws in the Bankruptcy Regime: Lessons from the U.K. for Preventing a Resurgent Creditors' Race in the U.S.*, 17 U. PENN. J. BUS. L. 527, 529 (2015) (highlighting the increased use of sales rather than plans).

¹⁷¹ *In re Daily Gazette Company*, 584 B.R. at 546-7.

¹⁷² *In re Walter Energy, Inc. et al.*, 911 F.3d at 1135 (§ 363 sale of substantially all assets followed by a conversion to Chapter 7).

¹⁷³ 11 U.S.C. § 1112(b) (provides for dismissal for cause). See also Webb, *supra* note 25, at 355-358 (analyzing the exit options available in the context of a § 363(b) sale in Chapter 11)

¹⁷⁴ A sale of a business is a rescue tool in that the distressed business is sold to a stronger owner without all or some of the business debts, resulting a business "rescue" with a new owner. Wessel & Madaus, *supra* note 1, at 261-2, 271-72.

¹⁷⁵ *In re Walter Energy, Inc. et al.*, 911 F.3d at 1153.

¹⁷⁶ *Id.* See also William T. Bodoh & Michelle M. Morgan, *Inequality Among Creditors: The Unconstitutional use of Successor Liability to Create a New Class of Priority Claimants*, 4 AM. BANKR. INST. L. REV. 325, 335 (1996) (noting the result of a § 363 sale can be substantially the same as a sale through a plan of reorganization).

meeting the requirements of the Chapter 11 plan process.¹⁷⁷ The quicker process saves not only time and monetary costs associated with the plan process,¹⁷⁸ but helps preserve the going concern value of the business.¹⁷⁹

Post-*Jevic* if a proposed § 363(b) sale includes distributions that violate the APR the approval of the sale may be subject to attack because the logic of *Jevic* in prohibiting priority violating final distributions in a structured dismissal are applicable to such a sale.¹⁸⁰ For example, the First Circuit was presented with the argument that the bankruptcy court's approval of a § 363(b) sale violated *Jevic* because the sale provided for payment of some unsecured claims without paying higher priority administrative claims.¹⁸¹ The distributions violated the APR.¹⁸² The First Circuit did not address the merits of the argument because the sale order was final and not stayed under § 363(m),¹⁸³ but the case shows how the argument can be presented and but for the procedural quandary of the appellant, the court would have had to address the applicability of *Jevic* to § 363(b) sales.

The ability to facilitate rescues through § 363(b) sales may be curtailed in light of the uncertainty of *Jevic*'s applicability to such sales. It is likely that bankruptcy courts will reach divergent viewpoints on this issue. As the parties litigate, the advantages of § 363(b) sales, such as the savings in monetary costs, quick outcomes, and preservation of the going concern value of a business, may be diminished. Post-*Jevic*, the importance of this rescue tool may be lessened, at least in the short term, and perhaps longer term depending on how courts apply *Jevic*. If this tool is less effective, rescue policy will be eroded, particularly since many Chapter 11 cases are resolved with § 363(b) sales of substantially all assets, rather than the traditional Chapter 11 plan of reorganization as in the past.¹⁸⁴ This erosion of rescue will likely harm creditors and all stakeholders if sales are less effective, particularly since stakeholders can realize as much value under a sale as a plan of reorganization.¹⁸⁵ The will not only erode the broad conceptualization of rescue advocated herein, but also the more creditor dominated orientation as advocated the law and economics scholars, as delayed sales or piecemeal sales may result in diminution of value of the pool of assets available for distribution.

3. First-Day Orders

Often at the outset of a Chapter 11 filing a debtor will file certain motions, collectively called "first-day motions."¹⁸⁶ In such motions a Chapter 11 debtor may seek authority to pay

¹⁷⁷ *In re* Walter Energy, Inc. et al., 911 F.3d at 1153.

¹⁷⁸ Bodoh & Morgan, *supra* note 179, at 335 ("One advantage that a section 363 sale has over a sale pursuant to a plan of reorganization is efficiency, in terms of both time and money.").

¹⁷⁹ Georgakopoulos, *supra* note 139, at 921 ("Sales realize value, preserve going-concern value, resolve uncertainties, and restore productivity in ways that fundamentally promote the goals of reorganization . . .").

¹⁸⁰ See Brubaker, *supra* note 31, at 4, 8 (noting the applicability of the logic of *Jevic* to other priority-skipping mechanisms, including sales).

¹⁸¹ *In re* Old Cold LLC, 879 F.3d 376, 388 (1st Cir. 2018).

¹⁸² *Id.*

¹⁸³ *Id.*

¹⁸⁴ Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 865-66, 877, n.54 (2014).

¹⁸⁵ See, e.g., Jarad A. Wilkerson, *Defending the Current State of Section 363 Sales*, 86 AM. BANKR. L.J. 591, 625-26 (2012) (presenting the argument that in a § 363 sales creditors generally are able ensure the business is sold for fair value).

¹⁸⁶ *In re* The Colad Group, Inc., 324 B.R. 208, 212 (Bankr. W.D. N.Y. 2005).

certain creditors for pre-petition services or goods that the debtor views as vital to continued operations of the business, i.e., the creditor is a “critical” vendor.¹⁸⁷ In some instances requests to pay prepetition wages of employees are included in such motions.¹⁸⁸ Sometimes debtor-in-possession financing is included in such motions that provides for paying a lender on their prepetition claim first when the lender continues financing the debtor post-petition - a “roll-up.”¹⁸⁹ Such payments violate the priority structure of the Code and are not expressly authorized by the Code, but some courts approve such payments out of necessity to promote the reorganization of the debtor.¹⁹⁰

The idea behind permitting these priority violating distributions is that they are needed to make a reorganization successful.¹⁹¹ For example, employees may leave if pre-petition wages are not paid or vendors of important supplies that are not paid for prepetition supplies may not trade with the debtor post-petition. If valuable employees leave or important vendors do not trade, it may be a significant constraint on the debtor’s ability to rescue the business. Some employees may be so vital that the business will have trouble continuing to operate. Other critical vendors who provide services or goods that are vital to an operation may actually lead to standstill of operations.¹⁹² Debtor-in-possession financing that includes priority violating provisions can be justified under the logic of other critical vendor orders.¹⁹³ Post-petition financing is necessary to keep the business trading and incentives such as “roll-ups” are needed to obtain the financing. Post-petition financing is a type of critical vendor – financial capital.¹⁹⁴ Thus, the use of first-day motions to obtain these types of relief are an important tools in rescuing a business. Bankruptcy courts when presented with such motions commonly grant them.¹⁹⁵

In *Jevic* the Supreme Court discussed, in dicta, first-day orders and arguably¹⁹⁶ approved such orders if they had a “significant offsetting bankruptcy-related justification.”¹⁹⁷ Whether *Jevic* sanctions approval of such orders across the board is doubtful because the logic behind striking down the structured dismissal is applicable to first-day orders that violate the APR.¹⁹⁸ At least one bankruptcy court post-*Jevic* has not interpreted the dicta so broadly.

In the case of *In re Pioneer Health Services, Inc.*,¹⁹⁹ the bankruptcy court considered *Jevic* and viewed it as providing a “restrictive view of critical vendor payments” and that such payments

¹⁸⁷ See *In re Pioneer Health Services, Inc.*, 570 B.R. 228, 232 (Bankr. S.D. Miss. 2017).

¹⁸⁸ *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 985.

¹⁸⁹ *Id.* Such provisions effectively cross-collateralize a lender’s pre-petition loan with both the pre-petition collateral and new post-petition collateral. This type of forward looking cross-collateralization of a pre-petition debt with post-petition collateral is not authorized in the Code and some courts do not permit such terms in a post-petition financing agreement. See *In re Saybrook Mfg. Co.*, 963 F.2d 1490, 1494–95 (11th Cir. 1992) (“cross-collateralization is not authorized as a method of postpetition financing under section 364 it is beyond the scope of the bankruptcy court’s inherent equitable power because it is directly contrary to the fundamental priority scheme of the Bankruptcy Code”).

¹⁹⁰ See *In re Pioneer Health Services, Inc.*, 570 B.R. at 233.

¹⁹¹ *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 985.

¹⁹² Buccola, *supra* note 45, at 17 (recognizing this is the argument offered for paying critical vendors in this context).

¹⁹³ *Id.* at 18.

¹⁹⁴ See *id.* at 18 (observing that in post-petition financing the critical vendor is the financial institution).

¹⁹⁵ See *id.* at 17 (noting this at least as to critical vendor orders).

¹⁹⁶ Georgakopoulos, *supra* note 139, at 924, 934.

¹⁹⁷ See *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 985-6.

¹⁹⁸ See Brubaker, *supra* note 31, at 5.

¹⁹⁹ 570 B.R. 228 (Bankr. S.D. Miss. 2017).

should be limited to those that have “significant offsetting bankruptcy-related justification.”²⁰⁰ In so doing the bankruptcy court did not approve payments to physicians for prepetition claims as critical vendors of the debtor which operated hospitals and other health care facilities because there was no showing of a “significant offsetting bankruptcy-related justification.”²⁰¹

This interpretation of *Jevic* indicates that post-*Jevic* first-day orders that violate the Code’s priority structure may well be subject to higher scrutiny.²⁰² If the ability to pay employee prepetition wages, pay critical vendors or obtain post-petition financing is limited in light *Jevic*, the ability of Chapter 11 to facilitate a rescue may be compromised. For example, in the context of post-petition financing, the only game in town for a debtor to obtain post-petition financing may be the pre-petition lender and the inability to provide that lender a “roll-up” may be a deal breaker. If that is the case, and if there is not another vehicle to obtain post-petition capital, the ability of Chapter 11 to enable a rescue may well be short-lived. Similar arguments can be made with critical vendors or vital employees. If certain employees are an integral part of the business of a debtor and the skills and services provided are not easily replaceable, without the ability to provide priority violating distributions, the viability of the business will be marginalized. Rescue will be eroded and the value of the estate may well be diminished.

V. Need for Reform and Prior U.S. Reform Proposals

The traditional criticism of a strict application of the APR, i.e. that it is an impediment to reorganization, applies today just as it has in the past. However, with the cascading effect of *Jevic* on important rescue tools in modern Chapter 11 practice the traditional criticism has more teeth. Reform to the Code is necessary to lessen the bite of a rigid application of the APR. In crafting a reform, consideration of prior U.S. reform proposals can be a starting point. Even though prior reform proposals, as discussed below, do not adequately address the problems associated with the APR, they illustrate some options available for reform.

In the 1970s the Commission on the Bankruptcy Laws of the United States (Commission) effectively proposed abolishment of the APR because it was viewed as largely impractical in application, but the proposed Bankruptcy Act of 1973 never became law.²⁰³ This proposed reform was extreme in that it would seriously impede the minority protection the APR can provide. Although Congress did not follow the recommendation of the Commission, the Commission’s concerns were reflected in the Bankruptcy Reform Act of 1978²⁰⁴ as the codified APR was more limited in scope than the common law rule.²⁰⁵ Since 1978 the statutory language of the APR in Chapter 11 is largely unchanged.²⁰⁶

²⁰⁰ *Id.* at 235.

²⁰¹ *Id.* at 236.

²⁰² Cohen, *supra* note 31, at 20.

²⁰³ Lubben, *supra* note 129, at 593-4. *See also*, Sharp, *supra* note 107, at 530-31 (discussing the Commission proposal and noting the proposed reform to permit retention of property by owners without complying the APR was not adopted by Congress).

²⁰⁴ Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).

²⁰⁵ *See* Lubben, *supra* note 129, at 594. For example, the APR as codified in the Bankruptcy Code was relaxed in that it applied only to classes of creditors, as opposed to each creditor individually. Pamela Foohey, *Chapter 11 Reorganization and the Fair and Equitable Standard: How the Absolute Priority Rule Applies to All Nonprofit Entities*, 86 S. JOHN’S L. REV. 31, 46-47 (2012).

²⁰⁶ One notable exception is The Bankruptcy Abuse and Consumer Protection Act of 2005 (BAPCPA) which did modify the application of the APR in individual Chapter 11 cases only. *See In re Maharaj*, 681 F.3d 558, 569-73 (4th Cir. 2012) (analyzing change made by BAPCPA to the APR in individual Chapter 11s). *See generally*, Stanley

In the 1990s the National Bankruptcy Review Commission (NBRC) recommended amending the Code to provide for the purchase of a reorganized debtor by “members of a junior class of claims or interests” without violating the APR.²⁰⁷ This proposal facilitates the sale of a business to equity holders or to creditors that would otherwise violate the APR. However, this proposal does not go far enough. It did not address the application of the APR to settlements or financing associated with first-day orders and roll-ups – other rescue tools.

More recently the ABI proposed a modification of the APR in Chapter 11.²⁰⁸ The proposal provided that a plan can be confirmed over the objection of an immediately junior class provided that class received “not less than the redemption option value.”²⁰⁹ Moreover, a plan may be confirmed over the objection of a senior class that is not paid in full provided the “deviation from the absolute priority rule treatment of the senior class is solely for the distribution to an immediately junior class of the redemption option value.”²¹⁰ The heart of the proposal is the redemption option value that attempts “to capture the total enterprise value of the firm,” which the ABI recognized was complex.²¹¹ It would interject another layer of complexity in the Chapter 11 process in determining the value of the hypothetical option to purchase the debtor for a three year redemption period following the petition date based on the full amount of the senior class claims, with fees, expenses and interest.²¹² In light of the complexity the proposal has not garnered much interest.²¹³ Beyond the problem of complexity, the proposal would not resolve the issues arising under the cascading effect of *Jevic* on other rescue tools.

The ABI proposal is based on, at least in part, the concept of relative priority,²¹⁴ rather than absolute priority.²¹⁵ Under relative priority the senior creditors receive the equity of the reorganized debtor and junior creditors receive a call option valued at the amount owed to the senior creditors.²¹⁶ With relative priority the bankruptcy court only needs to know the amount owed to the senior creditors and the date to exercise the option.²¹⁷ Advocates view relative priority as simple to implement and avoids the need to know the value of the firm²¹⁸ at the time of confirmation of a plan.²¹⁹ However, as with the ABI proposal, the determination of the option

E. Golich, *Plain-Meaning Rules: Did BAPCPA Abolish the Absolute-Priority Rule?*, 31 AM. BANKR. INST. J. 34-35, 82-84 (2012) (analyzing the changes to the APR and caselaw interpreting such after BAPCPA in individual Chapter 11 cases).

²⁰⁷ NATIONAL BANKRUPTCY REVIEW COMMISSION, *BANKRUPTCY: THE NEXT TWENTY YEARS*, 545 (1997).

²⁰⁸ See ABI REPORT, *supra* note 7, at 207-224.

²⁰⁹ *Id.* at 208, 218.

²¹⁰ *Id.* at 208-9, 218-19.

²¹¹ *Id.* at 219. See also Paterson, *Reflections*, *supra* note 13, at 490 (noting the complexity of the options approach proposed).

²¹² See ABI REPORT, *supra* note 7, at 207-211.

²¹³ See Paterson, *Reflections*, *supra* note 13, at 490.

²¹⁴ Relative priority was not new, as it was a “central feature of the reorganization regime that reigned until New Deal reforms. . .”. Douglas G. Baird, *Priority Matters: Absolute Priority, Relative Priority, and the Costs of Bankruptcy*, 165 U. PA. L. REV. 785, 786-87 (2017) [hereafter Baird, *Priority Matters*].

²¹⁵ See *id.* at 787, n.3 (acknowledging that the ABI proposal is a type of relative priority).

²¹⁶ *Id.* at 795.

²¹⁷ *Id.* at 796.

²¹⁸ Valuation of a debtor at confirmation is problematic and can be quite costly. The bankruptcy court does not have an actual “market” based sale to determine value in a reorganization, but rather a judicial evaluation that is “subject to substantial variance.” Baird and Bernstein, *supra* note 24, at 1936.

²¹⁹ Baird, *Priority Matters*, *supra* note 218, at 795-796.

price may be complicated and costly.²²⁰ The benefits of not having to value the firm as in a typical APR analysis may be lost as relative priority may, in some cases, be costly and application of the APR simpler to implement.²²¹ Moreover, as with the ABI proposal, the proposal would not directly address problems associated with the cascading effect of the APR in contexts outside of a reorganization plan.

In late 2018 the Small Business Reorganization Act²²² was introduced into Congress²²³ which would add a new subchapter to Chapter 11 applicable to small business debtors²²⁴ which would modify the APR. The bill did not gain much legislative traction, but in 2019 the Small Business Reorganization Act (SBRA) was re-introduced and quickly passed by both the House and the Senate, and was signed into law in August of 2019.²²⁵ The SBRA makes the APR generally inapplicable to small business debtors²²⁶ and replaces it with a new framework to effectuate a cross-class cram down. Under the SBRA a small business debtor can obtain confirmation over an objecting class of secured creditors as long as the plan provides that the secured creditor retain their lien, received payment equal to value of claim or indubitable equivalent.²²⁷ Confirmation of an objecting class of unsecured claimholders is available if the plan offers all disposable income of the debtor over a 3 to 5 year period.²²⁸ If these requirements are met, the owners of the business can retain their ownership interest without paying senior interests in full.²²⁹

This reform is positive in that it will overcome the impediment the APR presents to owners retaining an interest in a debtor post-confirmation in small business cases. However, the reform is too narrow. It does not expressly provide for the sale to other junior classes of claims or interests and the reform would not curtail the cascading effect of *Jevic* on other rescue tools. Additionally, it does not apply to all business debtors. It applies to a small business debtor – a debtor with approximately \$2.7 million in debt.²³⁰ The problems with the APR²³¹ are not limited to small business debtors, but apply to large debtors as well.

While the SBRA reform of the APR is too limited, it is also too broad. The SBRA eliminates the APR as to unsecured claimholders. The APR does not serve as a baseline to work

²²⁰ See *id.* at 819 (recognizing the difficulty with calculation the strike price (option price) for the senior creditors as it will need to include interests and other costs).

²²¹ *Id.*

²²² Small Business Reorganization Act of 2018, H.R. 7190, 115th Congress (2017-2018); Small Business Reorganization Act of 2018, S. 3689, 115th Congress (2017-2018).

²²³ *Legislative Update: Small Business Reorganization Act*, 38 AM. BANKR. INST. J. 8, 8 (2019) [hereafter *Legislative Update*].

²²⁴ *Id.* For concise overview of the bill, see Katy Stech Ferek, *U.S. Lawmakers Propose New Bankruptcy Process for Small Businesses; Bipartisan Bill could make Process Cheaper and Faster*, WSJ PRO. BANKRUPTCY (Nov 29, 2018), available at <https://www.wsj.com/articles/federal-lawmakers-propose-new-bankruptcy-process-for-small-businesses-1543526806> (last accessed March 3, 2019).

²²⁵ Kyle F. Arendsen, *Small Business Reorganization Act Signed Into Law – A New Frontier for Small Business Bankruptcies*, NAT. L. REV. (Aug. 27, 2019), available at <https://www.natlawreview.com/article/small-business-reorganization-act-signed-law-new-frontier-small-business> (last accessed September 16, 2019).

²²⁶ SBRA, § 1181(a).

²²⁷ SBRA, § 1191(c)(1) (incorporating requirements for cram down of secured creditor class in 11 U.S.C. § 1129(b)(2)(A)).

²²⁸ SBRA, § 1191(c)(2).

²²⁹ Theresa A. Driscoll, *U.S. Senators Propose Legislation That May Make Chapter 11 Reorganization a Viable Option for Small Businesses*, NEW YORK LAW JOURNAL (Dec. 5, 2018).

²³⁰ 11 U.S.C. § 101(51D) (defining small business debtor).

²³¹ See *supra* notes 122-126 and accompanying text (detailing problems with application of the APR).

from under the SBRA. The protections the APR can provide, even if just as a baseline to work from, are eliminated. Thus, the SBRA reform of the APR in this sense is too broad.

VI. Proposed U.K. Reform: Lessons for U.S. Reform

Each of the U.S. proposals described above are flawed in that they do not fully address the traditional difficulties associated with the APR and the problems stemming from *Jevic*. Some reforms are too broad and others are not broad enough. However, recent reform efforts in the U.K. can provide inspiration to U.S. policymakers on how to amend the APR. Simple transplantation of U.K. reforms is not suggested, but rather examining the reform proposal for particular aspects of the reform that can be employed to enhance Chapter 11 and help make it more effective in promoting rescue.²³² A comparative approach to developing a reform can provide ideas on how to improve the policy being examined.²³³ The context of the reform which will be drawn from and the context in which it will be incorporated in are important considerations.²³⁴ Merely drawing one legal rule from a regime and incorporating it to another, without consideration of the context can be problematic.²³⁵

Although, at first blush, the context of the U.K. insolvency regime appears different than the context of Chapter 11 in the U.S., the difference is not very stark and, in fact the two regimes are converging. Chapter 11 is traditionally a debtor-oriented model and was passed at a time with a fragmented banking environment in which there was no meaningful opposition to the debtor-friendly Chapter 11 process.²³⁶ Generally, U.K. insolvency law has been at the other end of the spectrum with a concentrated and strong banking system resulting with strong secured creditor control in insolvency proceedings.²³⁷ Over time, however, there has been an increase in secured creditor control in the U.S. in part to financing arrangements providing liens over virtually all of a debtor's assets.²³⁸ This has led to increased secured creditor control in Chapter 11 away from a debtor-friendly orientation.²³⁹ At the same time U.K. policymakers have been working to reduce

²³² See Payne, *Restructuring*, *supra* note 10, at 302 (Professor Payne recognizes the benefits of looking across the pond for inspiration in reform efforts, but expressly recognizes that transplantation of one reform to another regime would be “dangerous.” Rather she focuses on finding aspects of the legal regime drawing from that work well in the reform effort.).

²³³ See Julian Ellis, *A Comparative Law Approach: Enforceability of Arbitration Agreements in American Insolvency Proceedings*, 92 AM. BANKR. L.J. 141, 197 (2018) (discussing the benefits of a comparative law approach including better understanding of the U.S. framework and as a source of ideas to reshape policy). For a discussion of the benefits of a comparative law approach to advancing legal reforms, see generally Kai Schadback, *The Benefits of Comparative Law: A Continental European View*, 16 BOSTON U. INT. L.J. 331, 387-393 (1998).

²³⁴ See Payne, *Restructuring*, *supra* note 10, at 302 (noting the context is important in drawing inspiration for a particular reform).

²³⁵ Scholars debate the ability to transplant legal rules from one regime to another and the text that the context or culture should be considered. For a summary of the debate and leading scholarship on this point, see Ellis, *supra* note 237, at 199, n.371.

²³⁶ REINIER KRAAKMAN, ET AL., *THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH*, THIRD EDITION 143 (2017).

²³⁷ *Id.*

²³⁸ Paterson, *Rethinking*, *supra* note 18, at 701.

²³⁹ Kirshner, *supra* note 173, at 528-529, 534-535 (recognizing the increase in secured creditor control in Chapter 11).

the secured creditor control orientation, but have not been largely successful.²⁴⁰ Both regimes have, in general, a strong secured creditor orientation.

Additionally, the economic nature of companies in both jurisdictions have changed in similar ways over the years. The service sector has grown in both the U.S. and U.K. with companies having few hard assets.²⁴¹ In both jurisdictions the cash flow value of the firm is more important than hard assets, and keeping employees in tact more important than in the past.²⁴²

In light of this convergence in terms of secured creditor control and economic nature of the firm in both jurisdictions,²⁴³ it is appropriate for the U.S. to look to the U.K. for ideas and possible avenues for reform. The reform suggested is limited and not a “transplanting” of one legal rule from one jurisdiction to another without a consideration context. The proposed reform selects only one aspect of the U.K. reform that if incorporated in Chapter 11 can help facilitate enhancing broad orientation of rescue advanced herein.

A. U.K. Proposed Reform

The U.K. reform proposal for a new standalone restructuring mechanism is the product of the Insolvency Service’s consultation published in May 2016 which explored options for reforming the insolvency framework.²⁴⁴ In September 2016 the Insolvency Service published a summary of responses²⁴⁵ and then in August 2018 the Insolvency Service published the government response detailing the proposed new standalone restructuring mechanism.²⁴⁶ The most germane aspects of the proposed standalone restructuring mechanism to this article are the cross-class cram down and the APR.²⁴⁷

Under the proposed standalone²⁴⁸ restructuring mechanism, cross-class cram down of secured and unsecured creditors will be permitted²⁴⁹ provided certain safeguards²⁵⁰ for the protection of creditors are in place.²⁵¹ A vital aspect of protection is the role envisioned for the courts throughout the process,²⁵² which is similar to the process for schemes of arrangement.²⁵³ The proposal includes requirements pertaining to class formation²⁵⁴ and voting threshold

²⁴⁰ *Id.* at 529, 553-554 (“The explicit English policy has been to decrease secured creditor control . . . but secured creditors in the U.K have reinstated their dominance in spite of reforms. . .”).

²⁴¹ Paterson, *Rethinking*, *supra* note 18, at 701.

²⁴² *Id.*

²⁴³ Professor Paterson characterized the regimes as “meeting somewhere in the middle.” *Id.* at 701-702.

²⁴⁴ Insolvency Service, *A Review of the Corporate Insolvency Framework: A consultation on options for reform*, May 2016 [hereafter Insolvency Service, *Consultation*].

²⁴⁵ Insolvency Service, *Summary of Responses: A Review of the Corporate Insolvency Framework*, Sept. 2016 [hereafter “Insolvency Service, *Summary of Responses*”].

²⁴⁶ Department of Business, Energy & Industrial Strategy (BEIS), *Insolvency and Corporate Governance: Government response*, August 26, 2018 [hereafter “BEIS, *Government response*”].

²⁴⁷ For a concise overview of the proposed reform for a standalone restructuring mechanism, see Payne, *Restructuring*, *supra* note 10, at 469-70.

²⁴⁸ BEIS, *Government response*, *supra* note 250, at ¶ 5.124.

²⁴⁹ *Id.* at ¶ 5.123.

²⁵⁰ *Id.* at ¶ 5.148.

²⁵¹ See Payne, *Restructuring*, *supra* note 10, at 469-70 (noting the need for protections for creditors and summarizing them).

²⁵² *Id.* at 469 (“careful oversight of the courts, provides a significant protection for creditors.”).

²⁵³ BEIS, *Government response*, *supra* note 250, at ¶ 5.135.

²⁵⁴ *Id.* at ¶¶ 5.149-151.

requirements,²⁵⁵ which provide some protection. The protection these afford is manifest in the requirement that the court have a hearing to examine the classes proposed, with parties ability to object to the class formation, and the requirement that the court confirm that the proposal can be voted on.²⁵⁶ Following the vote the court will hold a second hearing to consider confirmation of the proposed plan.²⁵⁷ The court will have “absolute discretion” to confirm the plan or not and there will be a right to appeal if the plan is confirmed.²⁵⁸

Another important protection included in the proposed reform for a dissenting creditor class is the requirement “that a dissenting class of creditors must be satisfied in full before a more junior class may receive any distribution or keep any interest under the restructuring plan[.]”²⁵⁹ i.e., the APR. In light of the criticisms of the APR such as inflexibility,²⁶⁰ impediment to effective reorganization²⁶¹ and potential for abuse by some at the expense of others,²⁶² the Government added flexibility for a court to deviate from a strict application of the rule.²⁶³ Under the proposal a court may confirm a plan that does not comply with the APR “where noncompliance is: [1] necessary to achieve the aims of the restructuring; and [2] just and equitable in the circumstances.”²⁶⁴

This injection of flexibility into application of the APR, at first blush, appears to infringe upon the protection the rule is designed to provide to creditors. However, the test to deviate from the APR is a high threshold that is premised on the baseline standard for confirmation - compliance with the APR.²⁶⁵ To deviate from that baseline standard, the deviation must be vital to “an effective and workable restructuring plan” and sanctioned by the court.²⁶⁶ As with the class formation and voting requirements, it is the integral role of the court in approving such a deviation that provides protection to creditors when there is noncompliance with the APR.

Important in any discussion of the APR is the basis for valuation employed in the analysis to determine compliance with the rule.²⁶⁷ A detailed analysis of valuation in this context is complex²⁶⁸ and well beyond the ambit of this article.²⁶⁹ However, the Government considered the issue and after consultation determined that the “next best alternative for creditors” rather than a “minimum liquidation value” should be the value employed in a cross-class cram down scenario.²⁷⁰ This approach is flexible, but will require courts to decide valuation if there is a challenge to the value employed.²⁷¹ As with other aspects of the proposed reform, courts will be

²⁵⁵ *Id.* at ¶¶ 5.153-155.

²⁵⁶ *Id.* at ¶¶ 5.135, 5.149-151.

²⁵⁷ *Id.* at ¶¶ 5.135, 5.149.

²⁵⁸ *Id.* at ¶¶ 5.152, 5.166.

²⁵⁹ *Id.* at ¶ 5.163.

²⁶⁰ *Id.* at ¶ 5.159.

²⁶¹ *Id.* at ¶ 5.160.

²⁶² *Id.* at ¶ 5.162.

²⁶³ *Id.* at ¶ 5.164.

²⁶⁴ *Id.*

²⁶⁵ *See id.*

²⁶⁶ *Id.*

²⁶⁷ *See* JACKSON, *supra* note 32, at 212-13 (valuation is important in all reorganization cases and the application of the APR in particular).

²⁶⁸ *See id.* at ¶ 5.169 (recognizing complexity of the issue).

²⁶⁹ *See generally* Paterson, *Rethinking*, *supra* note 18, at 718-723 (analyzing the complex valuation options in modern restructuring practice).

²⁷⁰ *Id.* at ¶ 5.174; see also Payne, *Restructuring*, *supra* note 10, at 470.

²⁷¹ *Id.* at ¶ 5.175.

central to the process, and in the case of the proposed valuation standard there may be an increase in litigation and a burden on the courts.²⁷²

B. Lessons for the U.S. Reform

The new U.K. standalone restructuring mechanism has many similarities to Chapter 11 in its current form. Similar to the U.K. reform proposal, Chapter 11 provides for a cross-class cram down²⁷³ and has certain protections for minority creditors and interests through rules pertaining to class composition of claims or interests²⁷⁴ and voting.²⁷⁵

Just as in the U.K. proposal, the bankruptcy court plays an integral role in the Chapter 11 process.²⁷⁶ The bankruptcy court will typically hold a hearing to consider approval of a disclosure statement ensuring it has adequate information,²⁷⁷ prior to the solicitation of votes from creditors or interest holders.²⁷⁸ After voting, the bankruptcy court will hold a second hearing,²⁷⁹ at which parties may object,²⁸⁰ to consider confirmation of the plan.²⁸¹ If the plan is confirmed parties can appeal the order of confirmation.²⁸²

Comparable with the U.K. proposal Chapter 11 has the APR²⁸³ which comes into play when the plan that is up for confirmation has a dissenting class. Section 1129(b)(1) provides that if there is a dissenting class the court “shall confirm the plan . . . if the plan . . . is fair and equitable[.]”²⁸⁴ i.e., complies with the APR. Under Chapter 11 there is no statutory discretion to deviate from the APR.²⁸⁵ Importantly, *Jevic* reinforced the statutorily mandated lack of discretion bankruptcy courts have to deviate from the APR in confirming a plan to structured dismissals²⁸⁶ and likely has a cascading impact on other rescue tools that infringe upon the APR.²⁸⁷

²⁷² Payne, *Restructuring*, *supra* note 10, at 470-1.

²⁷³ 11 U.S.C. §§ 1129(a)(8), (b)(1). *See also supra* notes 107-110 and accompanying text.

²⁷⁴ The Code requires substantially similar claims or interests to be classed together. *Id.* at § 1122(a). This provides some level of minority class and interest protection by minimizing gerrymandering of creditors and interests to manipulate the outcome of plan voting. *See, e.g.,* David R. Hague, *Sare Manipulation: The Hurdles in Single-Asset Real Estate Cases*, 67 CATH. U.L. REV. 280, 280-81 (2018) (noting how classification can be used to isolate dissenting creditors and may be considered gerrymandering in violation of § 1122(a)).

²⁷⁵ 11 U.S.C. § 1126(c), (d) (detailing the voting requirements to determine acceptance or rejection of a plan by a class of creditors or interests).

²⁷⁶ *See* Rafael Efrat, *The Case for Limited Enforceability of a Pre-Petition Waiver of the Automatic Stay*, 32 SAN DIEGO L. REV. 1133, 1161 (1995) (recognizing the important role of bankruptcy judges in the bankruptcy process). This integral role of the bankruptcy judge is part of fabric of the traditionalist view of bankruptcy theory. *See, e.g.,* Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 579 (1998) (“[B]ankruptcy judges should enjoy broad discretion to implement bankruptcy’s substantive policies.”).

²⁷⁷ 11 U.S.C. § 1125(a)(1). In small business cases the court can combine the hearing on the disclosure statement with plan confirmation, thus, negating the need for this initial hearing on the disclosure statement. *Id.* at § 1125(f)(3)(C).

²⁷⁸ *Id.* at § 1125(b).

²⁷⁹ *Id.* at § 1128(a).

²⁸⁰ *Id.* at § 1128(b).

²⁸¹ *See id.* at §§ 1129(a) (requirements for consensual plan) and (b) (cram down requirements).

²⁸² FED. R. BANKR. P. 8002(a) and 8003(a).

²⁸³ 11 U.S.C. § 1129(b)(1), (2).

²⁸⁴ *Id.* at § 1129(b)(1).

²⁸⁵ *See* 11 U.S.C. § 1129(b)(1), (2). *See also, In re Lett*, 632 F.3d at 1220 (recognizing that the bankruptcy court has an obligation to ensure compliance with the absolute priority rule).

²⁸⁶ *See supra* notes 144-146 and accompanying text.

²⁸⁷ *See supra* notes 147-152 and accompanying text.

However, English courts under the U.K. proposal will have discretion to deviate from a strict application of the APR in confirming a restructuring plan.²⁸⁸ The U.S. should amend § 1129(b) to statutorily provide discretion to bankruptcy courts to deviate from the APR. The requirements of § 1129(b)(1) and (2) - the “fair and equitable” requirement and the definition thereof - should not be modified and would serve as the baseline for a cram down, just as in the U.K. proposal.²⁸⁹ Discretion for the bankruptcy court to deviate from this baseline standard should be incorporated into the statutory framework.

In crafting a statutory solution, the standard in the U.K. proposed restructuring mechanism, as well as prior U.S. case law, can serve as guides. English courts will have discretion to deviate from the APR if it is “necessary to achieve the aims of the restructuring; and just and equitable in the circumstances.”²⁹⁰ Bankruptcy courts have deviated from the APR when there are “significant Code-related objectives”²⁹¹ or a “significant offsetting bankruptcy-related justification.”²⁹² Section 1129(b)²⁹³ should be amended to add a new subsection (3) that provides as follows:

(3) The court may confirm a plan that is not fair and equitable, as defined in subsection (b)(2), if such is:

(A) necessary to achieve a significant offsetting Chapter 11-related objective; and

(B) just and equitable in the circumstances.

This suggested reform may appear radical in light of the well-entrenched position of the APR.²⁹⁴ However, the reality is that many bankruptcy courts already ignore the APR.²⁹⁵ This leads to litigation with disparate results from court to court and varying degrees of protection afforded to minority interests by the APR.²⁹⁶ This reform proposal will set a statutory standard to guide bankruptcy courts. Granted the litigation will not end, but the statutory standard will provide a framework for courts to apply, rather than inconsistent judicially created deviations from the APR.²⁹⁷

This reform proposal is not as radical as other possible reforms. For example, the SBRA abolishes the APR as to unsecured claimholders and replaces it with the requirement of the plan

²⁸⁸ See *supra* notes 267-268 and accompanying text.

²⁸⁹ See *supra* notes 269-270 and accompanying text.

²⁹⁰ BEIS, *Government response*, *supra* note 250, at ¶ 5.164.

²⁹¹ *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. at 985.

²⁹² *Id.* at 986.

²⁹³ 11 U.S.C. § 1129(b)(1) should be modified to add “except as provided herein” after the phrase “is fair and equitable.”

²⁹⁴ In 1939 the Supreme Court characterized the APR as a “fixed principle” in evaluating reorganizations. *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 116 (1939). See also, Sharp, *supra* note 107, at 527 (noting how early cases recognized the APR was “firmly imbedded” in bankruptcy law); JACKSON, *supra* note 32, at 213, n. 11 (recognizing the “fixed principle” in the caselaw).

²⁹⁵ Baird & Bernstein, *supra* note 24, at 1932; JACKSON, *supra* note 32, at 213 (noting that the APR in practice is regularly circumvented). See also, *supra* notes 163-165, 189-193 and accompanying text analyzing rescue tools that run afoul of a strict application of the APR.

²⁹⁶ See *supra* notes 158-168, 202-204 and accompanying text (discussing the variance in application of the APR to rescue tools by bankruptcy courts).

²⁹⁷ See *supra* notes 193-204 (detailing the inconsistencies in application of the APR in certain contexts).

provided projected disposable income over 3 to 5 years.²⁹⁸ There is no baseline application of the APR that can be deviated from upon a showing of clear and convincing evidence as with the proposed reform herein. The elimination of the APR as to unsecured claimholders under the SBRA is a much greater deviation from the current application of the APR than the proposed reform. With that said, the SBRA would, at least in the small business cases within the scope of the SBRA, reduce the cascading effect of *Jevic*. With the elimination of the APR, there would not be a principle of absolute priority to apply in non-confirmation of plan contexts.

The “redemption option value” reform proposed by the ABI, which is rooted in the concept of relative priority, is much more complex²⁹⁹ than the reform proposed. The ABI reform would add sophisticated valuation methods to determine the value of the firm for the option. This cumbersome approach would lead to greater costs and delay, which may impede rescue. Importantly, the ABI reform or a relative priority scheme would not address the problem posed by a cascading effect of *Jevic*. The normative principle of absolute priority would still be applicable in non-confirmation of plan contexts.³⁰⁰

Arguably, the most serious problem of such a proposal is that the minority protection provided by the APR will be diminished. The concern is that the proposed reform will impede the fairness for the minority interests. Fairness can be thought about in terms of fairness in the process and fairness in the outcome.³⁰¹ The proposed reform is fair in terms of process. Fairness in process includes dimensions such as ensuring voices being heard in the process and reducing partiality in the system.³⁰² The proposed reform maintains the integrity the current procedural safeguards in place including classification of claims into substantially similar classes, voting rights and requirements, hearings on a disclosure statement and plan with the right to object, as well as the right to appeal an adverse confirmation order.³⁰³ Thus, the minority interests will continue to have a voice in the process.

Importantly the fairness in process is ensured with the integral role the bankruptcy court plays in the application of the new reform allowing deviation from the APR. The ultimate decision to permit a deviation from the APR is in the discretion of the bankruptcy judge and requires a “significant offsetting Chapter 11- related objective” to warrant the departure from the APR. The ability of a debtor or a secured creditor to control the outcome in the process of plan confirmation and application of the APR will be scrutinized by and need approval by the bankruptcy judge. This promotes impartiality in the process and fairness across all stakeholders in the case.

Giving bankruptcy judges this type of discretion may give some, particularly those in the proceduralist camp,³⁰⁴ cause for pause. The proceduralist views the role of the bankruptcy judge as limited to primarily adjudicating “disputes about the creditors’ relative entitlements.”³⁰⁵ This

²⁹⁸ See *supra* notes 230-233 and accompanying text.

²⁹⁹ See *supra* notes 211-217 and accompanying text.

³⁰⁰ Other more simple reforms to the APR such as incorporating a market valuation approach would present their own problems. For example, the market approach will be impacted by the timing of the valuation and whether the market is depressed, which seems possible since the debtor is in financial distress. The market approach may indicate that creditors in lower classes have no economic interest in the debtor. This can potentially lead to a “too good a deal” for higher priority creditors as they can capture the value of the debtor if it increases. For a thoughtful discussion of the problems with such a market approach, see Sarah Paterson, *Debt Restructuring and Notions of Fairness*, 80 MOD. L. REV. 600, 613 (2017) [hereafter Paterson, *Fairness*].

³⁰¹ *Id.* at 607.

³⁰² *Id.* at 608-09.

³⁰³ See *supra* notes 110, 281-286 and accompanying text (detailing these minority protections).

³⁰⁴ Buccola, *supra* note 45, at 7 (summarizing the proceduralist perspective as articulated by Professor Baird).

³⁰⁵ *Id.*

viewpoint is closely aligned with creditors' bargain theory. Discretion proposed in the application with the APR would likely run counter to those on this side of the normative debate because the focus should be on the relative entitlements focusing on priority. One would expect the discretion proposed would be more closely aligned with those in the traditionalist camp³⁰⁶ – i.e. the progressives. The progressives likely would view this discretion consistent with the need to advance a wide array of interests and stakeholders, rather than the focus solely on creditor interests.

The reality is that bankruptcy judges play a large role in the Chapter 11 process³⁰⁷ and already have a great deal of discretion. For example, bankruptcy judges exercise discretion to permit priority-violating distributions in various rescue tools with an eye toward rescue.³⁰⁸ They are not merely an umpire but have an active role all along the way in a Chapter 11 case.³⁰⁹ The role the bankruptcy court plays is vital to protecting minority interests, just as it is in the English law and in the proposed reform.³¹⁰ This discretion, just as with English judges in the proposed restructuring mechanism,³¹¹ will give bankruptcy courts the ability to balance the interests of various stakeholders' interests and provide protection for minority stakeholders.³¹² And, importantly, the standard begins with the APR as a baseline and requires a showing of a "significant offsetting Chapter 11-related objective" to deviate from the APR. This standard helps balance the playing field between those in the proceduralist and traditionalist camps.

The proposed reform not only maintains fairness in the process, but the outcome is also fair in that it considers all stakeholders and interests. The bankruptcy court ability to balance the interests and deviate from the APR will enhance all stakeholders' interest in the aggregate, not just the debtor or particular creditors. No longer will the APR serve as a rigid barrier to confirmation of a plan. Nor will the potential cascading effect of *Jevic* serve as a rigid barrier to employing other rescue tools. The bankruptcy court will be able to exercise discretion in limited circumstances to deviate from the APR to achieve "a significant offsetting Chapter 11-related objective" if it is "just and equitable." The bankruptcy court will no longer be blindly tethered to the APR. The bankruptcy court can break away from the APR when necessary with an eye toward rescue.³¹³

³⁰⁶ *Id.* (summarizing the traditionalist perspective as articulated by Professor Baird).

³⁰⁷ See Jennifer Payne, *The Role of the Court in Debt Restructuring*, 77 CAMBRIDGE L. J. 124, 125 (2018) (bankruptcy courts play significant role in Chapter 11) [hereafter Payne, *Role*]. Likewise, English courts play a large role in schemes of arrangement. *Id.* at 126. See also Wessels & Madaus, *supra* note 1, at 258 (recognizing the important role that judges in the U.S. and England play in both restructuring regimes).

³⁰⁸ See *supra* notes 189-193 and accompanying text (detailing incidents of rescue tools that run afoul of the APR).

³⁰⁹ Melissa B. Jacoby, *What Should Judges do in Chapter 11?*, 2015 U. ILL. L. REV. 576 - 81, 583 (bankruptcy judges are not umpires but have vital independent duties in a bankruptcy case). See also, *In re Lett*, 632 F.3d at 1220 (noting the active role bankruptcy judges play in a Chapter 11 confirmation process involving a cram down of a dissenting class).

³¹⁰ See generally Payne, *Role*, *supra* note 315, at 134-141 (discussing role of courts in protecting minority interests). In other common law jurisdictions the courts play a vital role in the insolvency regime. See also Wee, *supra* note 5, at 562-67 (discussing the proactive role of courts in Singapore's insolvency regime).

³¹¹ See *supra* note 270 and accompanying text.

³¹² See BEIS, *Government response*, *supra* note 250, at ¶ 5.165.

³¹³ Two other lessons from the U.K. proposed reform, which are beyond the ambit of this article, warrant further research and consideration by the U.S. First, the U.S. should consider adopting the "absolute discretion whether or not to confirm a plan on just and equitable grounds" that English courts will have, as they do with schemes, under the proposed restructuring reform. BEIS, *Government response*, *supra* note 159, at ¶¶ 5.152, 5.166. Bankruptcy courts do not have discretion to deny confirmation of a plan in compliance with § 1129(a) or § 1129(b). *In re Trenton Ridge Investors, LLC*, 461 B.R. at 455-58.

VII. Conclusion

The Chapter 11 statutory framework and underlying statutory policy rationale of Chapter 11 with an emphasis on fostering reorganization of a company has not materially changed since 1978. However, Chapter 11 practice has changed and evolved to foster not only the reorganization or rescue of a company, but rescue of the business as well. This broader orientation of Chapter 11 is seen in rescue tools, such as § 363 sales, that facilitate a rescue that is broader than rescue of the company. In light of this broader conception of rescue and the role of Chapter 11, the rigid adherence to the APR as codified in 1978, as seen in *Jevic*, is antiquated. This is particularly true when the cascading effect of *Jevic* on the use of Chapter 11 rescue tools is considered.

The U.K. in drawing on Chapter 11 has proposed an APR that is flexible and compatible with a restructuring regime that embraces a broad conceptualization of rescue. U.S. policymakers should take lessons from the U.K. and reform the APR to reflect modern Chapter 11 in practice. Modern Chapter 11 practice and its rescue tools reflect an insolvency regime that is dynamic. The Code and the courts rigid adherence to the APR reflects an insolvency regime that is static.³¹⁴ Policymakers must infuse flexibility into the APR to ensure that the Chapter 11's law on the books is as dynamic as modern Chapter 11 practice and its rescue tools. This is necessary for Chapter 11 to fully foster a broad conceptualization of rescue that includes rescue of the company, as well as rescue of the business.

Secondly, the U.S. should look to the proposed valuation standard in the U.K. restructuring mechanism to see if any lessons can be derived from it to improve the valuation approach in the U.S. The U.S. approach to valuation is complex and it has been suggested that it may be time for reform. *See Paterson, Market supra* note 1, at 802-03; Paterson, *Reflections, supra* note 13, at 490 (noting that some U.S. practitioners have argued reforming the valuation method).

³¹⁴ Professor Sharp recognized this philosophical divide in the application of the confirmation of a plan requirements, including the APR. *See Sharp, supra* note 62, at 543-44. One viewpoint holds that the confirmation standards are static and limited by the Code. *Id.* The other viewpoint embraces a dynamic view of the confirmation standards in the Code in which the standards are the guiding principles. *Id.*