DESIGN FLAWS IN THE BANKRUPTCY REGIME: LESSONS FROM THE U.K. FOR PREVENTING A RESURGENT CREDITORS' RACE IN THE U.S.

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A current trend in U.S. bankruptcy law reflects the predictions of economic theory related to "common pool" resources. According to the theory, without coordinating law to account for and distribute limited assets in an orderly way, creditors race to claim the assets for themselves. The winners of the race deprive other creditors of value and make the rehabilitation of economically viable companies more difficult, a situation that economists would describe as a "tragedy of the commons." Increasingly, secured creditors divert bankrupt companies from the traditional Chapter 11 process, which has protected the interests of junior creditors, and push them instead into asset sales under Section 363 of the U.S. Bankruptcy Code. Secured creditors use Section 363 to maximize their recoveries to the detriment of unsecured creditors and the broader goals of the traditional bankruptcy process.

That a similar trend persists in the UK, despite concerted legislative efforts to reverse secured creditor control, indicates the pressures on bankruptcy law to withstand the tendency towards a creditors' race. It has become necessary to retool the bankruptcy regime to better withstand secured creditor circumvention. The English experience suggests that empowering a neutral regulator that can use soft law to influence the incentives of secured creditors may provide a solution.

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INTRODUCTION

Bankruptcy law forces individual creditors into collective procedures that take the place of a race for assets, in order to maximize overall recoveries and provide the opportunity for corporate rescue.[1] In the United States, however, secured creditors increasingly circumvent the cooperative process.[2]

Bankrupt companies with little to offer in exchange for new credit have grown dependent on existing secured creditors.[3] When the creditors have provided new financing, they have imposed covenants granting them

1. *See, e.g.*, H.R. REP. NO. 95-595 at 340 (1977) ("Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that.") *See also* Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 789 (1987) (describing the "deliberately created chance" for rehabilitation in bankruptcy).

2. *See, e.g.*, Douglas G. Baird, *The New Face of Chapter 11*, 12 AM. BANKR. INST. L. REV. 69, 73-74 (2004) (listing examples of bankrupt companies whose creditors ensured that the companies' assets would be sold to the highest bidder).

3. *See, e.g.*, Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129, 154 (2005) ("Because debtors that file for Chapter 11 protection increasingly have balance sheets that are encumbered by large amounts of secured debt . . . negotiations over DIP loan agreements have become more and more one sided . . . .").

effective control of the bankruptcy.[4] They have used their position to cash out their claims in a sale of assets under Section 363 of the U.S. Bankruptcy Code, rather than support the company through a conventional Chapter 11 process.[5] This has decreased recoveries for other creditors and eliminated possibilities for rehabilitating viable companies.[6]

That a parallel trend has developed in the United Kingdom indicates the pressures bankruptcy law faces in preventing secured creditors from reintroducing the creditors' race.[7] The United Kingdom actively reformed its procedures to reduce secured creditor control, yet secured creditors increasingly evade the new requirements by negotiating in advance with companies.[8]

In order to maximize and more fairly allocate asset recoveries, it has become necessary to devise new ways to align the incentives of secured creditors with the traditional collective bankruptcy process. This article draws on the English experience to inform developments in the United States.[9]

Section I anchors the issues at stake in economic theory related to "common pool" resources and the narrative of the "tragedy of the

4. *See, e.g.*, *id.* ("Such leverage has enabled DIP lenders to impose increasingly severe covenants and conditions on the debtor and its activities to the point that control of the Chapter 11 case has been taken away from the bankruptcy court.")

5. *See* Boris I. Mankovetskiy, *Creditor Issues in Chapter 11 Filings*, *in* CREDITOR'S RIGHTS IN CHAPTER 11 CASES 1 (2013) (finding that there are fewer Chapter 11 filings and those that are filed, are "quick sales of the debtor's assets under Section 363 of the Bankruptcy Code" rather than traditional Chapter 11 filings).

6. *Cf.* Stephanie Ben-Ishai & Stephen J. Lubben, *Sales or Plans: A Comparative Account of the "New" Corporate Reorganization*, 56 MCGILL L.J. 591, 598 (2011) ("There are concerns about the propriety of turning the bankruptcy court and Chapter 11 into a glorified foreclosure process, particularly if the cost of that process is not borne by secured lenders. Moreover, some recent studies suggest that secured lenders may be driven to embrace quick sales for reasons that have nothing to do with maximizing asset values.") *See also* Thomas Jackson & Robert Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155, 159-160 (1989) ("Going concern value does not exceed liquidation value in all cases, however. The assumption of greater going concern value-depends upon the existence of two factors: the debtor's assets must be worth more in combination than if they were broken up and sold, and the long-term prospects of the debtor must be brighter than the short-term prospects. In cases where either of these factors does not hold, total group welfare would be enhanced by a prompt liquidation . . . .").

7. *See infra* Section IV.C.

8. *See generally* John Tribe, *Company Voluntary Arrangements and Rescue: A New Hope and a Tudor Orthodoxy*, 5 J. BUS. L. 454 (2009) (discussing recent changes in bankruptcy law in the United Kingdom with a particular emphasis on the utilitarian approach that seeks to maximize creditor value); *See also infra* Section IV.C.

9. *See infra* Sections IV, V.

commons."[10] Bankrupt companies with limited assets present a classic "common pool" problem, making strong bankruptcy law necessary to avoid a "tragedy of the commons" and instead facilitate normative objectives that include the equitable distribution of assets and the survival of distressed companies where appropriate.[11]

Section II traces developments in the United States and explains how and why secured creditors have reasserted control in bankruptcy and used it to avoid conventional reorganization procedures.[12] The creditors have used financing arrangements as a means for forcing companies into Section 363 asset sales, where they recover more and other creditors recover less.[13] The Section presents the Section 363 asset sale of Chrysler to illustrate more specifically the benefits and pitfalls of the trend.[14]

Section III examines more closely the tradeoffs between conventional corporate reorganization under Chapter 11 and market-based alternatives that lack protections for less powerful creditors.[15] Section 363 asset sales speed the bankruptcy process, reducing professional fees, but the sales often take place at an undervalue and reduce overall creditor returns.[16]

Section IV presents a comparison of the United States trend with developments in the United Kingdom.[17] English bankruptcy law would appear to offer a compromise position of a faster, more market-based process that retains protections for junior creditors.[18] England has deliberately sought to reduce control by secured creditors and increase participation by creditors of all types.[19] Nevertheless, secured creditors in the United Kingdom have undermined the new procedures and reasserted their dominance.[20]

The fact that secured creditors in both systems have reverted to a race for assets evidences significant obstacles to achieving the collective goals of bankruptcy law.[21] Section V queries how to reinstate secured creditors into the cooperative process that bankruptcy law has intended to provide.[22] The Section draws on the English experience and concludes by advocating for the establishment of an impartial regulator that can use soft law to

10. *See infra* Section I.
11. *Id*.
12. *See infra* Section II.A, B.
13. *Id*.
14. *See infra* Section II.C.
15. *See infra* Section III.
16. *See infra* Section III.A, B.
17. *See infra* Section IV.
18. *See infra* Section IV.A, B.
19. *Id*.
20. *See infra* Section IV.C.
21. *See infra* Sections I, II.B, III.B, IV.C.
22. *See infra* Section V.

influence secured creditors to fund and participate in reorganization once again.[23]

I. ECONOMIC THEORY

A classic account of bankruptcy law derives from economic theory related to "common pool" resources and the narrative of the "tragedy of the commons."[24] The term "common pool" refers to a collectively-managed natural resource, marked by scarcity, such as a fishery.[25] It serves the individual interests of those with access to the fishery to quickly appropriate as many fish for themselves as possible, even though society might fare better under a managed system in which fishing is limited to preserve a stock for the future.[26] Without centralized supervision, a "tragedy of the commons" occurs: the individuals overexploit the shared resource and frequently destroy it.[27] The example of the fishery illustrates how the preservation of a "common pool" for the benefit of all necessitates coordinated decision-making and control.[28] Otherwise, individuals will pursue their own self-interest and decrease overall value.[29]

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23. *Id*.

24. D. BAIRD & T. JACKSON, CASES, PROBLEMS AND MATERIALS ON BANKRUPTCY, 20-30 (2d ed. 1990); THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 10-13 (1986) (describing bankruptcy law as a solution for a common pool problem in which individuals race to extract resources); Susan Block-Lieb, *Congress's Temptation to Defect: A Political and Economic Theory of Legislative Resolutions to Financial Common Pool Problems*, 39 ARIZ. L. REV. 801, 802-803 (1997) (same); Jackson & Scott, *supra* note 6, at 178 (1989) (same).

25. *See* Sara R. Curran & Tundi Agardy, *Common Property Systems, Migration, and Coastal Ecosystems*, 31 AMBIO: A J. OF THE HUMAN ENVIRONMENT 303, 304 (2002) (discussing the common pool problem in the context of environmental resources).

26. *See* Simon Deakin, *The Corporation as Commons: Rethinking Property Rights, Governance and Sustainability in the Business Enterprise*, 37 QUEEN'S L.J. 339, 368 (2012) (applying the concept of the common pool to corporations which have various "owners" who could potentially conflict if each owner sought to maximize his or her own self interest); H. Scott Gordon, *The Economic Theory of a Common-Property Resource: The Fishery*, 62 J. POL. ECON. 124, 135 (1954) (discussing the common property problem as a situation in which each person acting in his or her own self-interest ultimately depletes the common resources making everyone's situation worse); Agasha Mugasha, *Solutions for Developing-Country External Debt: Insolvency of Forgiveness*, 13 L. & BUS. REV. OF THE AMERICAS 859, 874 n.66 (2007) (applying the concept of the common pool to creditors).

27. *See, e.g.*, Deakin, *supra* note 26 (discussing the role of the legal system to maintain the business enterprise as a "commons"); Steven L. Schwarcz & Iman Anabtawi, *Regulating Systemic Risk: Towards an Analytical Framework,* 86 NOTRE DAME L. REV. 1349, 1402 (2011) (stating that the supervisory process operates to protect the financial system because the "overexploitation of shared resources occurs in advance of its impact on individual group members.").

28. *See, e.g.*, Irit Mevorach, *Towards a Consensus on the Treatment of Multinational Enterprise Groups in Insolvency,* 18 CARDOZO J. INT'L & COMP. L. 359, 393 (2010)

A bankrupt company can be viewed as presenting a "common pool" problem.[30] Similar to the fish in a fishery, the assets of the company are subject to conflicting creditor claims because the company has undertaken too much debt.[31] Individual creditors have incentives to enforce their claims against the company before the assets to pay them run out.[32]

Without coordinating law, inefficient outcomes equivalent to the "tragedy of the commons" result.[33] Theorists assume that creditors will race to claim assets more quickly than others.[34] Dissipation of the assets, in turn, decreases the utility of the creditors as a group.[35] When creditors dismantle the assets of companies in a piecemeal way, they often destroy the "going concern" value of firms.[36] "Going concern" value represents the value of intact companies that can continue in their businesses without interruption.[37] As companies break apart and the value is lost, all of the stakeholders dependent on them become less well off.[38]

(discussing the benefits of a coordinated process in resolving the "common pool" problem that arrives in multinational corporate group bankruptcy).

29. *See generally* Garrett Hardin, *The Tragedy of the Commons*, 162 SCI. 1243, 1243 (1968) (describing the principle of the common pool).

30. *See* JACKSON *supra*, note 24, at 10-11 (noting that the role of bankruptcy to solve "a common pool problem" is "largely unquestioned").

31. *See, e.g.*, Douglas G. Baird & Anthony J. Casey, *Bankruptcy Step Zero,* 2012 SUP. CT. REV. 203, 206 (describing the facts of the RadLAX case, in which a company borrowed heavily and had insufficient assets remaining to meet the claims of its creditors in full).

32. *See, e.g.*, Kenneth Ayotte & David A. Skeel Jr., *Bankruptcy Law as a Liquidity Provider*, 80 U. CHI. L. REV. 1557, 1564 (2013) (describing pressure under state law "first in time, first in right" regimes for creditors to act quickly to secure that they are paid in full, even though this behavior may lead to the long-term detriment of the collective interests of all creditors).

33. Bryan G. Faubus, *Narrowing The Bankruptcy Safe Harbor For Derivatives To Combat Systemic Risk*, 59 DUKE L.J. 801, 826 (2010); David L. Perechocky, *Should Ad Hoc Committees Have Fiduciary Duties?: Judicial Regulation of the Bankruptcy Market*, 86 AM. BANKR. L.J. 527, 528 (2012).

34. *See, e.g.*, Kara J. Bruce, *Rehabilitating Bankruptcy Reform*, 13 NEV. L.J. 174, 175 n.2 (2012) ("[C]reditors, left to their own devices, would pursue self-interested actions that would deplete the common pool of funds available to the wider creditor body.").

35. *See* Ayotte & Skeel, *supra* note 32, at 1573-574 ("A creditor that chooses to pursue its individual, state law collection rights may be causing the premature liquidation of a viable firm, and this may hurt all creditors.").

36. *See* JACKSON, *supra* note 24, at 14-17.

37. Kimball Laundry Co. v. United States, 338 U.S. 1, 9 (1949).

38. *See* Timothy W. Hoffmann & Laura L. Swanson, *Nonmonetary Defaults in Executory Contracts: A Potential Hurdle to a Successful Restructuring, in* NORTON ANN. SURV. BANKR. L. 219 (2013) ("One of Chapter 11's fundamental objectives is to provide a framework that allows financially distressed companies to maintain their going concern value for the benefit of all stakeholders."); Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 844 (2004) ("[S]ecured lenders . . . [may] want to liquidate a debtor quickly to maximize the value of their security interests, even if delayed liquidation or reorganization might be in the best interests of other stakeholders.") (citation

Bankruptcy law can, in theory, force creditors to join an orderly process to account for and distribute limited assets.[39] It can provide a mechanism for settling at once the overlapping obligations of companies, so that creditors do not try to grab assets before others can claim them.[40] Law professor Thomas Jackson described it as a tool for constraining individual creditor actions to increase collective utility as follows:

> The grab rules of nonbankruptcy law and their allocation of assets on the basis of first-come, first-served create an incentive on the part of the individual creditors, when they sense that a debtor may have more liabilities than assets, to get in line today (by, for example, getting a sheriff to execute on the debtor's equipment), because if they do not, they run the risk of getting nothing. This decision by numerous individual creditors, however, may be the wrong decision for the creditors as a group. Even though the debtor is insolvent, they might be better off if they held the assets together. Bankruptcy provides a way to make these diverse individuals act as one, by imposing a collective and compulsory proceeding on them.[41]

omitted). Some scholars do not think that bankruptcy law should only be concerned with efficiency for creditors. *See, e.g.*, Karen Gross, *Taking Community Interests into Account in Bankruptcy: An Essay*, 72 WASH. U. L. Q. 1031, 1031 (1994) ("[C]ommunity interests must be taken into account in both the corporate and personal bankruptcy systems."); Donald R. Korobkin, *Employee Interests in Bankruptcy*, 4 AM. BANKR. INST. L. REV. 5 (1996) (examining the interests of employees in bankruptcy proceedings); Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 777 (1987) ("Bankruptcy encompasses a number of competing—and sometimes conflicting—values . . . . [N]o one value [ought to] dominate[], so that bankruptcy policy becomes a composite of factors that bear on a better answer to the question, 'How shall the losses be distributed?'"). *But see* Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 822 (1987) (arguing that the "legal rule to distribute losses in bankruptcy" should be equivalent to the "legal rule that distributes the same loss outside of bankruptcy"); Hon. Barry S. Schermer, *Response to Professor Gross: Taking the Interests of the Community Into Account in Bankruptcy—A Modern Day Tale of Belling the Cat*, 72 WASH. U. L. Q. 1049 (1994) (noting that the community interest argument is "certain to fail in [its] application because [it] does not consider present realities.").

39. *See* Christopher W. Frost, *Another Look at Arbitration in Bankruptcy,* BANKR. L. LETTER (Thomson Reuters), January 2013, at ¶ 5 *available at* 33 No. 1 Bankruptcy Law Letter 1 (examining "arbitration focusing on two recent decisions from the Ninth Circuit in which the courts denied a creditor's motion to compel arbitration").

40. DAVID G. EPSTEIN ET AL., BANKRUPTCY 1-3 (1993); Craig H. Averch & Michael J. Collins, *Avoidance of Foreclosure Sales As Preferential Transfers: Another Serious Threat to Secured Creditors?*, 24 TEX. TECH L. REV. 985, 1037 (1993) ("In essence, bankruptcy is a collective proceeding designed to eliminate, or at least reduce, the inequities of nonbankruptcy "grab" law.").

41. JACKSON, *supra* note 24, at 12-13.

Bankruptcy law thus can solve the "common pool" problem that results from the shortfall of assets to meet the claims of every creditor in full.[42]

Specifically, Chapter 11 of the U.S. Bankruptcy Code and Administration, as set out in the English Insolvency Act 1986, prevent the creditors' race for assets by imposing a moratorium against individual creditor actions.[43] The suspension of creditor actions allows companies "breathing space" in which to negotiate a comprehensive plan of reorganization.[44] The American and English statutory frameworks both require distributions of assets to accord with existing creditor hierarchies and to treat creditors within the same priority class equally.[45] The American and English procedures, therefore, seek to maximize overall, rather than individual, value by protecting corporate assets from unilateral creditor actions.[46]

II. AMERICAN REALITY

In actual practice, secured creditors in the U.S. increasingly circumvent the collective provisions legislated in Chapter 11.[47] Secured creditors offer the only source of post-petition financing to bankrupt companies.[48] Without further bargaining power, the companies agree to grant them rights that facilitate asset sales under Section 363 of the U.S. Bankruptcy Code.[49] The sales take the place of traditional reorganizations

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42. *Id.* at 10-11.

43. 11 U.S.C. § 362(a) (2012); H.R. REP. NO. 95-595, at 340 (1977); Bruce Leonard, *The International Year in Review*, *in* NORTON ANN. SURV. BANKR. L. 15 (2002)

44. *See* Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1238 (2006) ("Chapter 11 is supposed to provide 'breathing space' to a struggling business from the collection efforts of its creditors.").

45. In the U.S., this is referred to as the "absolute priority rule." The English equivalent is found in Insolvency Act, 1986, c. 45, §§ 40, 175 (Eng.).

46. *See supra* notes 43-44.

47. *See, e.g.*, Yaad Rotem & Omer Dekel, *The Bankruptcy Auction as a Game — Designing an Optimal Auction in Bankruptcy*, 32 REV. LITIG. 330, 331 (2013) ("[A] sale under Section 363(b) of the Bankruptcy Code, which states that '[t]he trustee, after notice and hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate' . . . is allowed not only for trustees in Chapter 7 liquidations, but also as an out-of-plan maneuver for debtors-in-possession . . . during a Chapter 11 proceeding. In the Chapter 11 context, Section 363(b) presents an anomaly, as it bypasses rather easily the classic and carefully designed Chapter 11 structure of the negotiation-plan-confirmation.") (internal citation omitted).

48. *See, e.g.*, Kenneth Klee & Richard Levin, *Rethinking Chapter 11*, 21 J. BANKR. L. & PRAC. 465, 472-73 (2012).

49. *See* Ben-Ishai & Lubben, *supra* note 6, at 623 (finding that "secured lenders can

and enable secured creditors to recreate and dominate a resurgent race for assets.[50] They use the bankruptcy process as a sales forum to maximize their own recoveries, to the detriment of other creditors.[51]

The high-profile Section 363 asset sale of Chrysler to Fiat in 2009 reflected the trend.[52] While in the 1980s, of the ten largest companies that reorganized, nine reorganized successfully in Chapter 11, by 2002, less than a quarter of companies did.[53] In 2009, thirty-four percent of cases proceeded through a sale of assets under Section 363.[54] In recent years, secured creditors have forced companies including Lehman Brothers, Washington Mutual, TWA, Ritz Camera, Eddie Bauer, Blockbuster, and Borders into asset sales, rather than conventional reorganizations.[55]

A. Secured Creditor Control

Secured lenders have incentives to eschew the managed Chapter 11 bankruptcy process and reinstate the creditors' race.[56] They fare better by selling corporate assets quickly to recoup the value of their collateral, regardless of whether a company could continue in its business intact.[57]

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create an emergency at will simply by freezing the debtor's access to the case needed for daily operations. . . . to set a timetable for the bankruptcy case that will preclude any other option than a quick sale.").

50. *See* Gerard McCormack, *Control and Corporate Rescue — An Anglo-American Evaluation*, 56 INT'L COMP. L. QUART. 515, 532 (2007) ("Chapter 11 no longer functions like an anti-takeover device for managers; it has become, instead, the most important new frontier for corporate control, complete with asset sales and faster cases.") (quoting David A. Skeel, Jr., *Creditors' Ball: The "New" Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 918 (2003)).

51. Melissa B. Jacoby, *Fast, Cheap, and Creditor-Controlled: Is Corporate Reorganization Failing?*, 54 BUFF. L. REV. 401, 414, 430-31 (2006); George W. Kuney, *Misinterpreting Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process*, 76 AM. BANKR. L. J. 235 (2002).

52. Ben-Ishai & Lubben, *supra* note 6, at 593.

53. Baird, *supra* note 2, at 80-81.

54. Andrew A. Wood, *The Decline of Unsecured Creditor and Shareholder Recoveries in Large Public Company Bankruptcies*, 85 AM. BANKR. L.J. 429, 442 (2011).

55. *In re* Trans World Airlines, Inc., 322 F.3d 283, 288-90, 293 (3d Cir. 2003); Stephen D. Lerner, *Bankruptcy and Financial Restructuring Law 2013: Recent Bankruptcy and Financial Restructuring Law*, ASPATORE (THOMSON REUTERS), at *2 (2013), *available at* 2013 WL 574481.

56. *See* Eyal Z. Geva, *The Trajectory of Labor Relations Under Chapter 11*, 10 DEPAUL BUS. & COM. L.J. 347, 378 (2012) ("The transformation of Chapter 11 into a foreclosure mechanism through § 363 is attributed to the emergence of secured creditor-driven reorganizations, rather than just to the attractiveness of this possibility to the [debtor-in-possession].").

57. *See* Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 36-37 (2007) ("[Debtor-in-possession] lenders make high-interest loans to debtors at the beginning of the bankruptcy cases and, assuming the recovery is sufficient—as it almost

Although restructuring often would provide greater returns to all of the other creditors, preserve jobs for the company's employees, and sustain other businesses in the community serving the company, the secured lenders receive only a marginal benefit.[58] Chapter 11 has imposed a process that furthers the overall interests of creditors, to the detriment of the individual interests of secured lenders.[59]

Chapter 11 of the Code has not changed, but broader transformations in the bankruptcy environment have facilitated the shift towards renewed secured creditor control.[60] Paramount among the changes has been the increasing amount of secured debt on companies' books.[61] In 1978, when Chapter 11 was enacted, companies that filed for bankruptcy had unsecured assets available to offer as collateral in exchange for additional credit.[62] The availability of unencumbered assets reduced the risk of the loans and induced lenders to fund reorganization.[63] In 1999, the median amount of secured debt in American companies accounted for only twenty-three percent of total median assets.[64] By 2010, it had risen to forty-one percent.[65] Increasingly, companies entering bankruptcy do not have any unsecured assets, and often have extended second, third, and fourth priority security on their assets.[66]

With every asset already pledged as collateral, companies facing bankruptcy have grown dependent on existing creditors to provide them

always is—are paid in full at the end.").

58. *See* Miller & Waisman, *supra* note 3, at 157 ("Distressed-debt traders, for example, often consider an extended Chapter 11 process to be undesirable, given that their primary concern is achieving a quick return on their investments. DIP lenders, which are often senior secured creditors, also may favor asset sales in Chapter 11, given that they face limited upside potential but significant down-side risk from an extended Chapter 11 case.").

59. *See* Benjamin A. Berringer, *"It's All Just A Little Bit of History Repeating": An Examination of the Chrysler and GM Bankruptcies and Their Implications for Future Chapter 11 Reorganizations*, 7 N.Y.U. J.L. & BUS. 361, 378 (2010) ("[S]afeguards create a lengthy, time-consuming process that can be subject to capture by holdouts who are unwilling to approve a plan unless their interests are accommodated."); Miller & Waisman, *supra* note 3, at 153 (describing the motivations of financial institutions seeking liquidity versus distressed debt traders buying claims at substantial discounts).

60. *See, e.g.*, David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 921 (2003) (Finding that "creditors now exert much more influence over a case than at any time in recent history.").

61. Geva, *supra* note 56, at 395-96.

62. Charles J. Tabb, *Credit Bidding, Security, and the Obsolescence of Chapter 11*, 2013 U. ILL. L. REV. 103, 139-41.

63. Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 523 (2009).

64. Wood, *supra* note 54, at 430.

65. *Id.*

66. Klee & Levin, *supra* note 48, at 466.

with new money.[67] The Code has included incentives to encourage them to lend.[68] Pursuant to section 364, existing creditors that offer funding to companies already in bankruptcy, typically known as debtor-in-possession creditors (DIP creditors), receive "priming liens" that take priority over existing security interests in the same collateral.[69]

DIP lenders have leveraged their position to gain control of the bankruptcy process and maximize their individual recoveries.[70] They have included covenants with their loans that have imposed a range of requirements on companies.[71] The Bankruptcy Code contains few limits on their demands, and the companies have little ability to deny the creditors.[72] Without unencumbered assets to offer as collateral, they have had no alternative sources of funding and thus little bargaining power with existing lenders.[73]

The secured creditors have, for example, used their position to demand control over the management of bankrupt companies in exchange for DIP financing.[74] In the bankruptcy of the telecommunications company WorldCom, the creditor required the board of the company to hire a new chief restructuring officer off of a list of three candidates.[75] Empirical studies have found "a 52% likelihood of senior management turnover" in the wake of a DIP loan.[76]

In addition to forcing governance changes, DIP lenders have used loan covenants to control corporate decision-making and guarantee their recoveries. They have imposed, for example, restrictions on the time that companies could spend trying to reorganize.[77] They have also required

67. *See* Tabb, *supra* note 62, at 104-05 ("[T]he reality is that senior secured creditors often have liens on all of the firm's assets and exercise virtually total control over the debtor's access to cash and thus call the shots . . . .").

68. *See* Skeel, *supra* note 60, at 923 ("The magical provision is Section 364, which authorizes the bankruptcy court to roll out the red carpet for a lender that is willing to make a new loan to the debtor.") (citing 11 U.S.C. § 364 (2000)).

69. 11 U.S.C. § 364 (2012).

70. *See, e.g.*, James J. White, *Death and Resurrection of Secured Credit*, 12 AM. BANKR. INST. L. REV. 139, 165 (2004) (describing the protection against "cramdowns" which prioritize a plan over a secure creditor's objection).

71. *See, e.g.*, McCormack, *supra* note 50, at 547-49 (depicting how financing companies may require changes in management to obtain more credit).

72. *See, e.g.*, Klee & Levin, *supra* note 48, at 472-78.

73. White, *supra* note 70, at 175-76.

74. *See, e.g.*, Baird & Rasmussen, *supra* note 44, at 1227-28 ("Trip wires are tied to the performance of the business . . . to ensure that lenders have control over major decisions and the ability to insist on changes in management when the business encounter reverses.").

75. Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 685 (2003).

76. Miller & Waisman, *supra* note 3, at 155.

77. *E.g.*, McCormack, *supra* note 50, at 548 ("[C]ovenants in the loan agreement may

companies to pay them in full, should the company file for reorganization without their consent.[78] Other stipulations have forced companies to liquidate immediately if they failed to post profits at a minimum level by a particular date.[79] The DIP lender to the grocery chain Winn Dixie specified that it had the right to reclaim the value of its secured collateral at any time with five days' notice.[80] These and similar provisions have enabled DIP lenders to eliminate the "breathing space" Chapter 11 has provided, in which management could negotiate plans free from collection efforts by creditors.[81]

B. *Control to Force Asset Sales*

Increasingly, secured creditors have used the control that they have appropriated through the terms of DIP loans to push bankrupt companies into asset sales under Section 363 of the U.S. Bankruptcy Code.[82] In doing so, they have undermined the cooperative nature of the bankruptcy law and reintroduced the race for assets among creditors.[83] Obstructing the traditional Chapter 11 process has guaranteed their own recoveries but decreased returns to other creditors.[84]

include a time schedule, setting out a date by which the company must confirm a reorganization plan or else corporate assets will be auctioned off to the highest bidder."); *see* Kimon Korres, *Bankrupting Bankruptcy: Circumventing Chapter 11 Protections through Manipulation of the Business Justification Standard in § 363 Asset Sales, and A Refined Standard to Safeguard against Abuse*, 63 FLA. L. REV. 959, 967 (2011) ("[D]ebtors often enter into debtor-in-possession financial agreements involving restrictive covenants that effectively give control to the creditor.").

78. *See* Miller & Waisman, *supra* note 3, at 154 (describing many restrictive methods lenders use for controlling companies that borrow money, including "consent requirements that may go so far as to prohibit the filing of a Chapter 11 plan without the prior written consent of the lenders.").

79. *See, e.g.*, Ayotte & Morrison, *supra* note 63, at 514, 525.

80. Baird & Rasmussen, *supra* note 44, at 1239.

81. *Id.* at 1238.

82. Note that alternative arguments exist for the prevalence of Section 363 asset sales, including the ability of new institutional investors to purchase companies, the fungibility of assets, and incentives in the Bankruptcy Code. *See, e.g.*, Miller & Waisman, *supra* note 3, at 156 (explaining how the fungibility of assets increases the potential for acquisitions, and that the bankruptcy code itself encourages asset sales). The Bankruptcy Abuse Prevention and Consumer Protection Act has also made plan confirmation in Chapter 11 more difficult. Joseph S. Lawder, et al., *Helping Creditor Clients Achieve Their Goals in Chapter 11*, ASPATORE (THOMSON REUTERS), at *4 (2013), *available at* 2013 WL 936391.

83. *See, e.g.*, Matt Miller & Terry Brennan, *Creditors in Possession*, THE DEAL, Jan. 12, 2004 (describing how borrowers are backed against the wall in their position against banks).

84. *See* Westbrook, *supra* note 38, at 844 (explaining how a "creditor-controlled sale" gives rise to a potentially socially undesirable result).

Section 363 states that, "[t]he trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate . . . ."[85] Pursuant to the provision, with only notice and a hearing, secured creditors can use the control they acquire through DIP loans to sell assets free and clear of any existing liabilities.[86] While courts must approve the sales, the legislation does not require the consent from other creditors necessary in a traditional Chapter 11.[87]

Secured creditors have included covenants in DIP financing arrangements that mandate Section 363 asset sales.[88] Credit Suisse First Boston, for example, required the insolvent car rental company Budget to complete a sale within 50 days.[89] Budget complied with the terms, but the strict timetable prevented management from soliciting bids at higher prices or pursuing alternatives to the sale.[90]

Secured lenders have pushed for sales to guarantee repayment of their claims.[91] When they sell the assets for a higher price than the value of their collateral, they make a full recovery.[92] Studies have indicated that they have recouped on average ninety-four percent of the amount owed to them through sales.[93] While sacrificing the guaranteed payment from a sale to fund reorganization potentially could make others better off, it would not increase their own returns.[94]

The sales gain speed by bypassing the protections on other creditors that Chapter 11 has provided.[95] Chapter 11 requires disclosures to

85. 11 U.S.C. § 363(b)(1) (2012).

86. Todd L. Friedman, *The Unjustified Business Justification Rule: A Reexamination of the Lionel Canon in Light of the Bankruptcies of Lehman, Chrysler, and General Motors*, 11 U.C. DAVIS BUS. L.J. 181, 182 (2010).

87. *Id.*

88. *See, e.g.*, Klee & Levin, *supra* note 48, at 473-74 (describing the increased use of such clauses in loans).

89. *See* LoPucki & Doherty, *supra* note 57, at 37 ("discussing an agreement involving 'terms that would put Budget in default if it failed to have a "definitive agreement" to sell its business within fifty days of filing.'").

90. *Id.*

91. *See* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 780 (2002) ("The secured creditor . . . has the incentive to force an inefficient sale of its collateral when the proceeds of the sale will pay the creditor in full.").

92. Ayotte & Morrison, *supra* note 63, at 528.

93. This figure pertains to companies with assets worth more than $5 million. Douglas G. Baird et al., *The Dynamics of Large and Small Chapter 11 Cases: An Empirical Study* 37 (Int'l Ctr. for Fin. at Yale Sch. of Mgmt., Working Paper No. 05-29, 2007), *available at* http://ssrn.com/abstract=866865.

94. *See, e.g.*, Skeel, *supra* note 60, at 939 (describing the indifference of another party since they will get paid from the collateral in any event).

95. *See* Berringer, *supra* note 59, at 376-78 (explaining how § 363 sales are a direct result of the Bankruptcy Code's problems with collective action and maintaining proper governance over the firm during bankruptcy).

creditors, solicitation of their consent, and creditor voting, and the provisions prolong the bankruptcy process.[96] The steel company LTV, for example, spent seven years in Chapter 11, consuming most of the assets remaining in the company.[97] Eastern Airlines failed to complete a plan of reorganization after two years.[98] While Chapter 11 emphasizes rehabilitation of economically viable companies, sales have enabled secured creditors to claim the value of their collateral as quickly as possible, without regard for the effect that their actions have on restructuring such companies.[99]

Courts have interpreted gaps in the statutory language of Section 363 to support more sales.[100] The statute left unanswered aspects of when sales could be conducted and how.[101] It does not address who may propose them, and under what circumstances, or on what basis courts should approve them.[102] Originally, the courts viewed Section 363 as applying only to rare situations involving perishable assets.[103] In cases such as *Guaranty Corp. v. Braniff Airways Inc.*, which involved a bankrupt airline, the court demanded evidence that no time could be spared without the assets of the company dissipating, and they rejected attempts by secured creditors to use Section 363 to avoid the more onerous requirements of traditional Chapter 11.[104] Later, in cases such as *Holders v. Lionel Corp.* (*In re Lionel. Corp.*), which concerned a bankrupt toy company, courts looked only for business justifications to confirm the sales.[105] The Second

96. *See* Gennady Zilberman, *Bankruptcy Section 363(b) Sales: Market Test Procedures and Heightened Scrutiny of Expedited Sales May Prevent Abuses and Safeguard Creditors without Limiting the Power of the Courts*, 5 BROOK. J. CORP. FIN. & COM. L. 241, 251, 253-54 (2010) (showing how non-consenting creditors may object to a plan that is not in their best interest).

97. David A. Skeel, Jr., *Competing Narratives in Corporate Bankruptcy: Debtor in Control vs. No Time to Spare*, 2009 MICH. ST. L. REV. 1187, 1199 (2009).

98. White, *supra* note 70, at 150.

99. *See* Geva, *supra* note 56, at 379-80 (asserting that such secured creditors prefer these sales because they have priority and such transactions reduce risk, and that courts can correct the inefficiency as well as reduce the frequency of these sales through “increased scrutiny and better information flow to creditors”).

100. *See, e.g.*, David R. Kuney, *Overview of the Bankruptcy System*, *in* 2013 ALI-ABA COURSE OF STUDY: COMMERCIAL REAL ESTATE DEFAULTS, WORKOUTS, REORGANIZATIONS 611.

101. Klee & Levin, *supra* note 48, at 480-81.

102. *See, e.g.*, Zilberman, *supra* note 96, at 246 (noting that the language of Section 363(b) gave little guidance).

103. *See, e.g.*, Rotem & Dekel, *supra* note 47, at 331-32 (noting that Section 363(b) was enacted to aid firms with finances or assets depreciating with each day).

104. Pension Benefit Guar. Corp., Cont’l Air Lines, Inc. v. Braniff Airways, Inc. *(In re* Braniff Airways, Inc.*)*, 700 F.2d 935, 940 (5th Cir. 1983); James J. White, *Death and Resurrection of Secured Credit*, 12 AM. BANKR. INST. L. REV. 139, 148 (2004).

105. Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063,

Circuit stated in *Lionel*: "[t]here must be some articulated business justification, other than appeasement of major creditors, for using, selling, or leasing property outside the normal course of business before the bankruptcy judge may order such a disposition under 363(b)."[106] In the wake of *Lionel*, however, even the "appeasement of major creditors" evolved into sufficient justification.[107] The U.S. Bankruptcy Court in the Southern District of New York permitted a sale of the assets of the financial services firm Lehman Brothers on the basis of the exigencies of the subprime mortgage crisis.[108]

Courts thus have facilitated deviations from the goals of Chapter 11.[109] Increasingly lenient interpretations of Section 363 have supported a resurgent creditors' race.[110] By expanding the availability of sales, the courts have allowed secured creditors more opportunities to claim their collateral and override the "breathing space" in which management traditionally negotiated with all of a company's creditors in an orderly way.[111]

C. *Chrysler*

The Section 363 asset sale of the automobile manufacturer Chrysler highlighted the trend of increasing DIP lender control in bankruptcy.[112] A high-profile case, it involved the anomaly of the government acting as DIP lender and working to safeguard the interests of employees and pensioners.[113] The magnitude of the power that the government wielded nevertheless illustrated how secured creditors with other objectives could utilize the sales to appropriate assets from employees and other creditors.[114] The case therefore underscored potential concerns over the changes that

1069-72 (2d Cir. 1983).

106. *In re* Lionel Corp., 722 F.2d 1063, 1070 (2d Cir. 1983).

107. White, *supra* note 104, at 162.

108. *See, e.g.*, *In re Lehman Bros. Holdings, Inc.*, 416 B.R. 392 (Bankr. S.D.N.Y. 2008); David A. Skeel, *Competing Narratives in Corporate Bankruptcy: Debtor in Control v. No Time to Spare*, 2009 MICH. ST. L. REV. 1187, 1200 (2009) (noting that the Bankruptcy Court acknowledged the extraordinary nature of the case and approved the sale).

109. *See supra* text accompanying notes 100-108.

110. *See supra* text accompanying notes 39-46 (discussing the coordinating effects of bankruptcy law, which serve to preventing the creditors' race).

111. *See, e.g.*, Baird & Rasmussen, *supra* note 44, at 1238.

112. *See, e.g.*, Ben-Ishai & Lubben, *supra* note 6, at 599 (noting that GM and Chrysler's sales are part of a larger trend).

113. *See, e.g.*, Korres, *supra* note 77, at 963-64 (noting that one of the concerns of the government was a voluntary employees' beneficiary association (VEBA) to protect employee health care).

114. Geva, *supra* note 56, at 394-95.

have occurred in large corporate bankruptcies.[115] While Chapter 11 in theory protected against abuses of secured lenders through the imposition of a collective forum, secured lenders, acting as DIP financiers, have seemed to leverage Section 363 asset sales to force speedy fire sales to the detriment of the overall interests of creditors.[116]

When it filed for bankruptcy, Chrysler's balance sheet read as follows:

Senior Secured Bond Holders: first priority $6.9 Billion
Daimler & Cerberus: second priority lien $2.0 Billion
U.S. Government: third priority lien $4.0 Billion
UAW/Voluntary Employee Beneficiary Association: unsecured $10.6 Billion
Unsecured creditors: Primarily Tier 1 component suppliers $2.0 Billion[117]

The U.S. Treasury and the Canadian government provided $5 billion in DIP financing that carried restrictive covenants typical of the arrangements forged by other secured creditors.[118] Under the terms of the loan, Chrysler had to, among other actions: 1) comply with a weekly budget; 2) refrain from making changes to management; 3) obtain approval for auction procedures within one week of filing for bankruptcy; and 4) conclude an asset sale within 40 days of filing.[119] If the company failed to meet any of the covenants, the loan would terminate, forcing Chrysler into immediate liquidation.[120]

115. *See, e.g.*, Douglas G. Baird, *Lessons from the Automobile Reorganizations*, 4 J. LEGAL ANALYSIS 271, 272 (2012) (noting the potential for abuse); Korres, *supra* note 77, at 961.

116. *See, e.g.*, Edward R. Morrison, *Chrysler, GM and the Future of Chapter 11* 11 (Ctr. for L. & Econ. Stud. at Colum., Working Paper No. 365, 2009), *available at* http://papers.ssrn.com/so13/papers.cfm?abstract_id=1529734 (citing a study of low recoveries of unsecured creditors in asset sales as compared to reorganization and noting the risk of fire sales).

117. *See, e.g.*, Kan Munn & Bill Byrne, *Distributions to Lower Priority Creditors in Chrysler's Bankruptcy: A Car Wreck Waiting to Happen for Investors?* 110-11 (Am. Bankr. Inst. Cent. States Bankr. Workshop Conference Paper for Panel on The Evolving Chapter 11—Current and Future Issues in Chapter 11 Cases, 2010).

118. *See, e.g.*, Berringer, *supra* note 59, at 380-81 (noting Chrysler's requirements); A. Joseph Warburton, *Understanding the Bankruptcies of Chrysler and General Motors: A Primer*, 60 SYRACUSE L. REV. 531, 536 (2010).

119. Edward R. Morrison, *Chrysler, GM and the Future of Chapter 11* 8 (Ctr. for L. & Econ. Stud. at Colum., Working Paper No. 365, 2009), *available at* http://papers.ssrn.com/so13/papers.cfm?abstract_id=1529734.

120. *Id.* at 10.

Chrysler sold its good assets to a newly-created entity, New CarCo Acquisition LLC.[121] The new entity paid $2 billion for them and also assumed some of Chrysler's existing liabilities.[122] The first-priority secured creditors received the $2 billion as payment towards their $6.9 billion claim, a recovery of only 29 cents on the dollar, while the other creditors and equity holders received nothing.[123] New CarCo also paid the United Auto Workers trust, the entity that had provided benefits to Chrysler employees, $1.5 billion in cash, and gave it a 55% equity stake in the new company along with a $4.6 billion equity note.[124] In return, the United Auto Workers union accepted a reduced wage structure and reduced future pension payments.[125] Some have argued that the arrangement violated the absolute priority rule, which requires creditors in bankruptcy to recoup assets in accordance with the priority rights associated with their loans, because the United Auto Workers trust recovered assets when the secured creditors had not yet been paid in full.[126] Others have argued, however, that

121. *See, e.g.*, Stephen J. Lubben, *The Truth About Detroit's Bankruptcies*, FORBES (July 26, 2009, 2:00 PM), http://www.forbes.com/2009/07/26/chrysler-gm-bankruptcy-opinions-contributors-chapter-11-tarp.html.

122. *See, e.g.*, Warburton, *supra* note 118, at 534-35 (noting that such liabilities included obligations to the UAW Trust).

123. *See, e.g.*, Geva, *supra* note 56, at 392; Baird, *supra* note 115, at 278 ("Chrysler, the debtor that filed the bankruptcy petition, gave everything it had to its secured creditors. It did not pay its general creditors anything. It sold its assets to New CarCo for $2 billion in cash."); Munn & Byrne, *supra* note 117, at 111. ("Under the Government-orchestrated plan, the above participants would receive / recover or lose the following: Senior Secured Bond Holders – received $2.0 Billion in cash a - 29% recovery, Daimler & Cerberus – received $ 0 cash – 100% Loss, U.S. Government – received $ 0 cash – 100% Loss + stock in New Chrysler, UAW / VEBA Trust – Unsecured – received a $4.6 Billion Note – 43% recovery + stock in New Chrysler unsecured Creditors – primarily paid in full through § 365 and § 503(b)(9) (noting that the recovery percent varies according to the party calculating the "cure" amount) – 99% recovery"); Warburton, *supra* note 118, at 534-35 ("The crucial features of the Chrysler reorganization are set forth in a master transaction agreement, and are illustrated in Figure 1 hereto. Under the agreement, with the approval of the bankruptcy court, Old Chrysler sold substantially all its operating assets to a newly-formed entity, New CarCo Acquisition LLC ("New Chrysler") in exchange for $2 billion in cash from New Chrysler and the assumption of some of Old Chrysler's liabilities (including certain obligations owed to the UAW Trust). The $2 billion received by Old Chrysler was distributed to the first-priority secured lenders. Since the first-priority secured lenders were owed $6.9 billion, they received twenty-nine cents on the dollar, leaving no assets for junior secured lenders or for unsecured creditors (including the UAW Trust). Chrysler's equity holders received nothing.").

124. Munn & Byrne, *supra* note 117, at 111.

125. Warburton, *supra* note 118, at 536-37.

126. Three Indiana state pension funds objected to the sale on this basis. *See, e.g.*, John A. Nasr, *Selling Assets Free and Clear of an Interest in Property Under § 363(f)*, 11 DEPAUL BUS. & COM. L.J. 237, 247 (2013) (noting that the pension funds objected on the grounds that the plan was inconsistent with the absolute priority rule).

Chrysler paid the $2 billion raised in the asset sale to the secured creditors in satisfaction of the absolute priority rule, and a different entity, New CarCo, awarded the money that the union received.[127]

The U.S. Bankruptcy Court for the Southern District of New York approved the sale.[128] The Court sought a business justification for the sale of assets outside the ordinary course of business, pursuant to the *Lionel* standard.[129] It found that the arrangements would preserve going concern value and deemed its preservation a sufficient business reason.[130] The Court also used language in line with the earlier standard, articulated in *Braniff*, which allowed for a sale only when assets could dissipate in a way similar to melting ice cubes, even though the assets of Chrysler were fixed and tangible.[131] On appeal to the Second Circuit, the Court stated that, even "an automobile manufacturing business can be within the ambit of the 'melting ice cube' theory."[132] The Second Circuit affirmed the decision of the Bankruptcy Court, and the U.S. Supreme Court declined review.[133]

The sale concluded in 42 days; however, the speed occurred without the protections embedded in Chapter 11.[134] Chrysler did not face any disclosure requirements or a vote of all of the creditors, as it would have in a traditional reorganization.[135] The company that emerged from the sale maintained the same brand name, headquarters, employees, management, and inventory of cars.[136] Creditors of the old company, rather than arm's

127. *See, e.g.*, Baird, *supra* note 115, at 278 (noting that New CarCo was never in bankruptcy).

128. *In re* Chrysler LLC, 405 B.R. 84, 113 (Bankr. S.D.N.Y. 2009), *aff'd*, 576 F.3d 108 (2d Cir. 2009), *cert. granted, judgment vacated sub nom.* Indiana State Police Pension Trust v. Chrysler LLC, 129 S. Ct. 2275 (2009) and *vacated sub nom. In re* Chrysler, LLC, 592 F.3d 370 (2d Cir. 2010); *In re* Gen. Motors Corp., 407 B.R. 463, 520 (Bankr. S.D.N.Y. 2009), *aff'd sub nom. In re* Motors Liquidation Co., 428 B.R. 43 (S.D.N.Y. 2010) and *aff'd sub nom. In re Motors Liquidation Co.*, 430 B.R. 65 (S.D.N.Y. 2010).

129. *In re* Chrysler LLC, 405 B.R. at 95-96; *In re* Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983).

130. *In re* Chrysler LLC, 405 B.R. at 95-96.

131. *Id*. at 96; *See, e.g.*, Skeel, *supra* note 97, at 1200-01 (noting that the auto company's most significant assets—the plants and assembly line—are fixed and tangible).

132. *In re* Chrysler LLC, 576 F.3d 108, 114 (2d Cir. 2009), *cert. granted, judgment vacated sub nom.* Indiana State Police Pension Trust v. Chrysler LLC, 129 S. Ct. 2275 (2009) and *vacated sub nom. In re* Chrysler, LLC, 592 F.3d 370 (2d Cir. 2010).

133. *In re* Chrysler LLC, 576 F.3d at 127, *vacated sub nom.* Ind. State Police Pension Trust v. Chrysler LLC, 129 S. Ct. 2275, 2276 (2009) (per curiam).

134. Korres, *supra* note 77, at 965-66. *See also,* Mark Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 728 (2010) (arguing that the Chrysler bankruptcy process used undesirable mechanisms that the courts and Congress failed to suppress).

135. Korres, *supra* note 77, at 965-66.

136. Brief for Appellants Indiana State Police Pension Trust et al. at 44, Ind. State Police Pension Trust v. Chrysler LLC, 576 F.3d 108 (2d Cir. 2009) (No. 09-2311-bk).

length purchasers, held half of the equity.[137] The sale returned only a third of the amount owed to first-lien secured creditors and never underwent a genuine market test or judicial valuation.[138]

III. BENEFIT/COST ANALYSIS

The rise of Section 363 asset sales in the U.S. appears to evidence the pressures on bankruptcy law to withstand the incentives of secured creditors to revert to a race to claim assets.[139] While the sales reach completion faster than collective negotiations, they inflict losses on unsecured creditors.[140] This section explores the extent to which control by secured creditors reduces costs through speed and the countervailing burdens it imposes.[141] Losses to other creditors appear to outweigh the savings from speed.[142]

A. Speed and Expense

Chapter 11 is expensive; the shorter duration of Section 363 asset sales reduces some costs.[143] This part explains how the sales generate efficiencies from speed.[144]

1. Expense of Chapter 11

The high costs of Chapter 11 can be conceived of as falling into two categories.[145] Direct costs comprise professional fees and other payments such as quarterly dues to the Trustee's office, the arm of the Department of

137. Roe & Skeel, *supra* note 134, at 756.

138. *Id.* at 734.

139. *See, e.g.*, Baird, *supra* note 115, at 291 (stating that the incremental protections being discovered for sales under Section 363 are already embedded in Chapter 11 and that the law should go straight to the end point rather than waiting for evolution).

140. *See, e.g.*, Roe & Skeel, *supra* note 134, at 732 (stating that in view of *Chrysler*, Section 363 has the potential benefit of quick repositioning but the potential to much damage by bypassing Chapter 11 structure).

141. *See infra* Section III.A, B.

142. *See* Section III.B.

143. Korres, *supra* note 77, at 960; *see, e.g.*, Lerner, *supra* note 55, at *2 (pointing out the trend for large companies like Lehman Brothers, General Motors, and Blockbuster to use Section 363 sales and liquidations to keep costs down when lenders are reluctant to lend).

144. *See infra* Section III.A.1.

145. *See, e.g.*, Stephen Lubben, *Chapter 11 as Intrigue*, 28 BANKING. & FIN. L. REV. 171, 173 (2012) (reviewing LYNN M. LOPUCKI & JOSEPH W. DOHERTY, PROFESSIONAL FEES IN CORPORATE BANKRUPTCIES: DATA, ANALYSIS, AND EVALUATION).

Justice responsible for overseeing bankruptcy cases.[146] Indirect costs include lost revenues, lost opportunities, and lost goodwill. Indirect costs generally result in income transfers to competitors.[147]

Professional fees have accounted for a significant proportion of direct costs. The bankruptcy estate compensates financial advisors, investment bankers, appraisers, industry experts, counsel to companies, and counsel to committees of unsecured creditors for their time.[148] The estate pays for obtaining approvals for major operating decisions, resolving disputes related to distribution priorities and collateral positions, adjudicating claim objections, soliciting permission to use cash collateral, and petitioning the court to confirm proposals.[149]

Several studies have documented high and increasing fees. In a 2000 study, excluding distributions to secured creditors, professional fees consumed more than seventeen cents of every dollar paid from bankruptcy estates.[150] A 2011 study has indicated that between 1998 and 2007 professional fees increased by 25%, the equivalent of eight times the general increase in prices over the same period.[151] Another recent study found that professional fees in middle-market Chapter 11 cases typically approached or exceeded $1 million.[152] Of large Chapter 11 plans

146. *Id.* at 174.

147. *Id.* ("First, there are the direct costs, comprised chiefly of the professionals fees associated with reorganization, but also including other lesser costs like court filing fees and, in the United States, quarterly fees due to the United States Trustee's office. In addition, there are also indirect costs of a firm's bankruptcy, which are more abstract but include things like lost revenues, lost opportunities, and lost goodwill. Some of these costs may be of concern to the firm's stakeholders, but not to policymakers if, for example, financial distress simply results in the shifting of sales from the distressed firm to a competitor firm—unless the competitor is abroad.").

148. Jill Nicholson, *Guiding Clients Through the Chapter 11 Process, in* CHAPTER 11 BANKRUPTCY AND RESTRUCTURING STRATEGIES 2013 EDITION: LEADING LAWYERS ON NAVIGATING RECENT TRENDS, CASES, AND STRATEGIES AFFECTING CHAPTER 11 CLIENTS, *available at* 2012 WL 5884858, at *5 (2012).

149. *See, e.g.*, Lawder et al., *supra* note 82, at *2 (noting that avoidance of Chapter 11 may create savings because of the substantial costs associated with the Chapter 11 process like approving major operating decisions, resolving disputes as to priorities, and claim objections).

150. Stephen Ferris & Robert Lawless, *The Expenses of Financial Distress: The Direct Costs of Chapter 11*, 61 U. PITT. L. REV. 629, 651 (2000).

151. LYNN M. LOPUCKI & JOSEPH W. DOHERTY, CHAPTER 11 AS INTRIGUE—PROFESSIONAL FEES IN CORPORATE BANKRUPTCIES: DATA, ANALYSIS, AND EVALUATION 71 tbl. (Oxford: Oxford University Press, 2011).

152. Jeffrey Wurst, *Is Chapter 11 Still a Viable Option — Or Has High Cost Rendered the Process Unaffordable?,* ABF J., Mar. 2013, at 56, *available at* http://rmfpc.com/wp-content/uploads/2013/03/Wurst-ABFJ-Mar-2013.pdf.

confirmed in 2007, financial advisors received on average $213 million, while attorneys received $523 million.[153]

2. Speed of Sales Reduces Costs

Section 363 asset sales generally not only increase the recoveries of secured creditors but also speed up the bankruptcy process.[154] A recent study concluded that the sales, coupled with a structured dismissal, resulted in significantly lower professional fees than conventional Chapter 11 because they concluded more quickly.[155]

Speed reduces direct expenses, preserving value in the bankruptcy estate for creditors.[156] In traditional Chapter 11, by contrast, management has 120 days in which to file a plan, plus potential extensions.[157] Each day that a company spends in Chapter 11 consumes additional assets in costs.[158] A prolonged process, moreover, can destroy companies unable to survive long enough to complete it.[159]

Legal academics that support a contractualist theory of bankruptcy, such as Barry Adler, Lucien Arye Bebchuk, and Alan Schwartz, have argued for market-based solutions to corporate distress.[160] Negotiations

153. LOPUCKI & DOHERTY, *supra* note 151, at 85 fig. 5.1.

154. *See, e.g.*, Jason Brege, *An Efficiency Model of Section 363(b) Sales*, 92 VA. L. REV. 1639, 1644 (2006) (offering a less cynical view of Section 363(b) suggesting that it is more efficient at extracting value of the assets).

155. Wurst, *supra* note 152, at 56.

156. *See, e.g.*, *Valuation Issues a Key Topic at Chapter 11 Commission Hearing In Las Vegas*, 32 AM. BANKR. INST. J. 10, 128 (2013).

157. 11 U.S.C. § 1121(b) (2009); *see also*, *In re* Express One Int'l, Inc., 194 B.R. 98, 100 (Bankr. E.D. Tex. 1996) (stating that during the first 120 days of the Chapter 11 case, only the debtor-in-possession may file a plan of reorganization).

158. *See, e.g.*, Miller & Brennan, *supra* note 83 ("There's a burn rate attached to this Chapter 11. We don't want to burn value. Sell the assets.") (internal quotation marks omitted).

159. *See, e.g.*, Ben-Ishai & Lubben, *supra* note 6, at 622-23 (pointing to Lehman Brothers as a case where the debtor had going-concern value but was unlikely to survive long enough to complete a formal reorganization process).

160. *See, e.g.*, Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 319-24 (1993) (suggesting that while market-based or ex ante structuring proposals may offer some improvement over current bankruptcy law, each could leave investors with substantial costs of reorganization, risk of dismemberment, or restrictions on capital structure and thus, these proposals do not provide a conclusive reason to expect that investors given the choice would adopt an alternative to bankruptcy law); Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775, 776-77 (1988) (proposing a method where the participants in a reorganization would receive a set of rights with respect to the securities of the reorganized company and these rights are designed so that, whatever the reorganization value, the participants will never end up with less than the value to which they are entitled); Robert K. Rasmussen, *Debtor's*

among creditors in traditional Chapter 11, they believe, waste time and raise the possibility of holdout by dissenting creditors.[161] They support freeing assets from the plodding Chapter 11 claims resolution process.[162]

To the extent that asset sales reduce the length of bankruptcy, fees to professionals paid for their time decrease in parallel.[163] The UCLA-LoPucki Bankruptcy Research Database includes data on the number of days it took individual companies to complete Section 363 asset sales, as well as the dates on which companies filed for Chapter 11 and confirmed a reorganization plan.[164] After selecting for cases commenced in the years

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Choice: A Menu Approach to Corporate Bankruptcy, 71 TEX. L. REV. 51, 117 (1992) (noting that the case for forgoing Chapter 11 is strongest in the case of a publicly held firm and sensible restraints are needed if the law begins allowing firms to change their bankruptcy options); Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807, 1850-51 (1998) (arguing that the state should permit parties to contract for the bankruptcy system that they prefer).

161. *See, e.g.*, Miller & Waisman, *supra* note 3, at 159-60 (pointing to *In re Armstrong World Industries Inc.* to demonstrate creditors—who previously indicated support of the contractual model—filing objections after the court rejected the plan).

162. *See, e.g.*, Ben-Ishai & Lubben, *supra* note 6, at 623 (stating that after a sale, the debtor's assets can be disengaged from the claims resolution process, allowing the business to resume normal operations in a swift manner that does not depend on the pace of the bankruptcy process).

163. *See* Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases*, 1 J. EMP. L. STUD. 111, 120 (2004) (stating that their model indicates that the size of the firm and the length of time a case remains pending are the strongest determinants of professional fees awarded in a bankruptcy case); *see also* Edward I. Altman, Comment, *Evaluating the Chapter 11 Bankruptcy-Reorganization Process*, 1993 COLUM. BUS. L. REV. 1, 2-4 (1993) (arguing for shortening the reorganization period under Chapter 11 because time and out-of-pocket costs are positively correlated); Julian R. Franks & Walter N. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. FIN. 747, 747-48, 751 (1989) (pointing out that Chapter 11 proceedings are costly and lengthy but firms still consider it the least costly because equity holders bear little costs); Robert K. Rasmussen & Randall S. Thomas, *Whither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations*, 54 VAND. L. REV. 283, 295 (2001) ("fees may be correlated roughly with the length of the bankruptcy proceeding. The longer the proceeding, the greater the fees."); James J. White, *Harvey's Silence*, 69 AM. BANKR. L.J. 467, 473-74 (1995) ("[T]he largest and most palpable costs of Chapter 11 arise from delay.").

164. *See* UCLA-LoPucki Bankruptcy Research Database, UCLA SCHOOL OF LAW, *available at* http://lopucki.law.ucla.edu/. The UCLA-LoPucki database contains five sets of data on "more than one-thousand large public companies that have filed [Chapter 7 or Chapter 11] bankruptcy cases since October 1 1979." *Id.* The data set relied on for purposes of this article was "The Cases Table," which "consists of about 200 fields of regression-ready data" displayed in a Microsoft Excel file. *Id.* Information regarding the precise meaning of each data field is located in the User Protocol Manual. LYNN M. LOPUCKI, PROTOCOLS FOR THE UCLA-LOPUCKI BANKRUPTCY RESEARCH DATABASE 32 (2015), *available at* http://lopucki.law.ucla.edu/documentation/Protocols.pdf.

Citations to data discovered in the UCLA-LoPucki database throughout this article refer to the data contained in "The Cases Table" Microsoft Excel file. To access this data

2011 and 2012 by companies with assets of more than $100 million, measured in 1980 dollars, the database lists twenty-five cases.[165] Two of the companies, A123 Systems and Real Mex Restaurants, opted for Section 363 asset sales.[166] A123 Systems completed a sale in less than two months, while Real Mex Restaurants required just over four months.[167] For companies that pursued a traditional Chapter 11, excluding those that pre-negotiated a plan, only two completed the process in less than a year.[168]

Speed has become more crucial in recent years. Some have argued that corporate assets have become less tangible, as compared to the railroad parts and steel machinery that companies of the Nineteenth-Century primarily owned.[169] Knowledge and ideas will not remain in place during a long restructuring: human capital will migrate to competing companies.[170] When asset prices fall, as they have during the recent economic contraction, speed grows increasingly important.[171]

set, one must submit a registration request to the Database Manager through the UCLA-LoPucki website. *See Academic Request*, UCLA-LoPucki Bankruptcy Research Database, UCLA SCHOOL OF LAW, *available at* http://lopucki.law.ucla.edu/academic_form.htm (providing the form for the academic request with accompanying instructions).

165. *See Contents of the BRD*, UCLA-LoPucki Bankruptcy Research Database, UCLA SCHOOL OF LAW, *available at* http://lopucki.law.ucla.edu/contents_of_the_webbred.htm (noting that the data set considers a company "large" if its "Annual Report reported assets worth $100 million or more, measured in 1980 dollars (about $287 million in current dollars.")).

166. *See* UCLA-LoPucki Bankruptcy Research Database, *supra* note 164. This data is displayed under the "Sale363" field in the "The Cases Table" Microsoft Excel file. *See* LOPUCKI, *supra* note 164, at 32.

167. *See* UCLA-LoPucki Bankruptcy Research Database, *supra* note 164. This data is displayed under the "DaysFiledto363" field in the "The Cases Table" Microsoft Excel file. *See* LOPUCKI, *supra* note 164, at 15.

168. *See* UCLA-LoPucki Bankruptcy Research Database, *supra* note 164. This data is displayed under the "DaysIn" field in the "The Cases Table" Microsoft Excel file. *See* LOPUCKI, *supra* note 164, at 14. Note that one of these, Delta Petroleum Corporation, won awards for best turnaround from the Global M&A Network. *See* GLOBAL M&A NETWORK, TURNAROUND ATLAS AWARDS, CONGRATULATIONS: 2013 FINALISTS CIRCLE 5 (2013) *available at* https://globalmanetwork.com/wp-content/uploads/2013/06/2013-FINALISTS-CIRCLE-Annual-Turnaround-Atlas-Awards-June-25-2013.pdf.

169. *See, e.g.*, Skeel, *supra* note 60, at 922 (noting that modern businesses depend on knowledge and ideas as assets rather than hard assets).

170. *Id.*

171. *See, e.g.*, Sarah Pei Woo, *Simultaneous Distress of Residential Developers and Their Secured Lenders: An Analysis of Bankruptcy & Bank Regulation*, 15 FORDHAM J. CORP & FIN. L. 617, 621 (2010) (stating that lenders need to liquidate quickly to preserve the value of assets when these values are declining) (quoting Counsel for Barclays Bank in the bankruptcy of the developer LandSource Communities Development).

B. Cost to Unsecured Creditors

While Section 363 asset sales may offer some efficiency gains, they impose losses on other creditors.[172] As classic "common pool" theory predicts, control by secured creditors reduces overall utility and results in agency costs and waste.[173]

The evidence shows that secured creditors have appropriated benefits for themselves using Section 363 asset sales while others have borne the costs.[174] Without the collective protections of Chapter 11, secured creditors have forced sales that pay out their own claims against the company, regardless of the surplus lost to others.[175] They have sold companies piecemeal that it may have been in the collective interest to rehabilitate.[176]

According to the 2007 study, *Bankruptcy Fire Sales*, by Lynn LoPucki and Joseph Doherty of UCLA Law School, Section 363 asset sales yield half the value of reorganizations.[177] The sales generate 35% book value, as compared to 91% in a traditional Chapter 11.[178] The database that LoPucki and Doherty compiled indicates that two bankruptcy cases filed in 2011 and 2012 proceeded to Section 363 sales.[179] While unsecured creditors of the first company, A123 Systems, recouped 65 cents on the dollar,[180]

172. *See, e.g.*, *Valuation Issues a Key Topic at Chapter 11 Commission Hearing In Las Vegas*, 32 AM. BANKR. INST. J. 10, 126 (2013) (noting that traditional restructuring rather than Section 363 sales could help unsecured creditors recover value for their assets).

173. *See, e.g.*, Brege, *supra* note 154, at 1643-44 (analyzing the agency costs of a Section 363(b) sale that is at odds with the goals of Chapter 11 bankruptcy).

174. *See, e.g.*, Ayotte & Skeel, *supra* note 32, at 464 (showing two forms of expropriation where bank lenders take value for themselves at the expense of the debtor's other creditors).

175. *See, e.g.*, Berringer, *supra* note 59, at 379 (noting that creditors who want to get out of bankruptcy as quickly as possible will sacrifice the debtor's needs for their own).

176. *See, e.g.*, McCormack, *supra* note 50, at 549-50 (noting that Chapter 11 encourages the externalization of risk in the form of sweetheart deals where lenders are incentivized to cut costs rather than reorganize).

177. LoPucki & Doherty, *supra* note 57, at 4.

178. *Id.* at 3-4.

179. *See* UCLA-LoPucki Bankruptcy Research Database, *supra* note 164. This data is displayed under the "Sale363" field in the "The Cases Table" Microsoft Excel file. *See* LOPUCKI, *supra* note 164, at 32.

180. *See* UCLA-LoPucki Bankruptcy Research Database, *supra* note 164; *see also In re* B456 Sys., Inc., No. 12-12859-KJC (D. Del. 2013) (proposed findings of fact, conclusions of law and order confirming modified first amended joint plan of liquidation of B456 Systems, Inc., et al.); *id.* Exhibit D at 24 (reproducing the modified first amended joint plan of liquidation and discussing treatment of general unsecured creditors); *Former A123 Systems wins court approval of bankruptcy plan*, FINANCIER WORLDWIDE, July 2013, *available at* http://www.financierworldwide.com/ former-a123-systems-wins-court-approval-of-bankruptcy-plan/#.VP3rVmRdXlM (noting that under the liquidation plan unsecured creditors will "receive between 32.7 percent and 63.6 percent of their claims, or

unsecured creditors of the second company, Real Mex Restaurants, recovered nothing.[181]

Another database, the Bankruptcy DataSource, reports the final plans that creditors confirmed in companies that completed conventional Chapter 11 procedures.[182] Using the twenty-five Chapter 11 cases commenced in the years 2011 and 2012 obtained from the UCLA-LoPucki database,[183] and setting aside the companies that used prenegotiated plans, unsecured creditors received less than 100 cents on the dollar in only three Chapter 11 cases.[184] Unsecured creditors also earned a full recovery in many, though by no means all, of the prenegotiated plans.[185] Secured creditors that have forced Section 363 asset sales have therefore appeared to interfere with the value creation that could have resulted from a traditional reorganization.[186]

Asset sales often result in assets being undervalued and sold at a lower price due in part to a classic economics dilemma. DIP lenders generally have informational advantages over other potential bidders.[187] Before providing post-petition funding, they have opportunities to investigate the bankrupt companies.[188] They can continue to monitor the financial condition of the companies they have lent to.[189] American Airlines, for example, gained access to the financial records of TWA Airlines by

around 65 cents in [sic] the dollar”). This data is displayed under the “Distribunsec” field in the “The Cases Table” Microsoft Excel file. *See* LoPucki, *supra* note 164, at 18.

181. *See* UCLA-LoPucki Bankruptcy Research Database, *supra* note 164; *see also* Lance Duroni, *Noteholders Scoop Up Real Mex Assets For $126M*, LAW 360 (Feb. 10, 2012, 6:21 PM), http://www.law360.com/articles/308852/noteholders-scoop-up-real-mex-assets-for-126m (noting that “the deal provides no recovery for unsecured creditors”). This data is displayed under the “Distribunsec” field in the “The Cases Table” Microsoft Excel file. *See* LOPUCKI, *supra* note 164, at 18.

182. The database is accessible through the Lexis database, operated by LexisNexis, under the “Find A Source” tab.

183. *See supra* text accompanying note 165.

184. These figures result from the final plans accessible in the Bankruptcy DataSource database, setting aside those companies that had prenegotiated plans, and then looking at the creditor recoveries in the remaining plans.

185. *Id*.

186. *See infra* text accompanying notes 186-188. A company with a viable business that continues as a going concern also employs workers, buys from suppliers, offers products or services, and generates tax revenues. H.R. Rep. No. 95-595, at 220 (1977).

187. *See, e.g.*, Korres, *supra* note 77, at 968-69 (using the example of a Chrysler negotiation where the Treasury had direct control over the business outcome that favored specific lenders over others).

188. *See, e.g.*, Ayotte & Skeel, *supra* note 32, at 465 (stating that the postpetition financer has better information than an outside bidder because it investigates the debtor and monitors the financial condition before making a loan).

189. *See, e.g.*, Baird & Rasmussen, *supra* note 44, at 1229 (noting that technology allows a lender to stay apprised of a debtor’s activities).

providing DIP financing, before bidding for its assets.[190] Other bidders, consequently, typically understand that if they bid higher than the DIP lender has, they will have bid too much.[191] Without time or access to gather information to improve the accuracy of their offers, they underbid the DIP lender or refrain from bidding at all.[192] Derby Cycles, a company selling motorcycle accessories, debated whether to file for bankruptcy over a period of eight months.[193] The owner of the company then spent an additional five months preparing a bid to buy the assets in a Section 363 asset sale.[194] The public bidding window for the assets, by contrast, lasted for only five weeks.[195]

DIP lenders may also intentionally bid low because losing to competitors does not harm them.[196] They frequently have contracted to receive termination fees that compensate them when they are outbid.[197] In a Section 363 asset sale of the photography company Polaroid, the DIP lender received a termination fee of $5 million, even after it attempted to discourage other bidders by misrepresenting the worth of corporate divisions.[198]

The original concerns of the U.S. Bankruptcy Code extended beyond returning value to secured creditors.[199] As the Congressional record evidences, the Code sought to protect the investing public, protect jobs, save troubled businesses, reduce the impact of bankruptcy on the community, and further the public interest.[200] According to the House report:

> The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it

190. *Id.* at 1249.

191. Ayotte & Skeel, *supra* note 32, at 465.

192. *Id.*

193. Elizabeth B. Rose, *Chocolate, Flowers, and § 363(b): The Opportunity for Sweetheart Deals without Chapter 11 Protections*, 23 EMORY BANKR. DEV. J. 249, 282 (2006).

194. *Id.*

195. *Id.*

196. *See, e.g.*, *id.* at 281 (describing the no-lose situation for credit bidders because their low bid would give them more value than they paid for and an outbid would give them a termination fee).

197. *Id.*

198. Lynn M. LoPucki, COURTING FAILURE: HOW COMPETITION FOR BIG BANKRUPTCY CASES IS CORRUPTING THE BANKRUPTCY COURTS 179 (2005).

199. NLRB v. Bildisco, 465 U.S. 513, 528 (1983); *see, e.g.*, MILLER & WAISMAN, *supra* note 3, at 149 (noting that judges used to further the policies of rehabilitation and reorganization underlying the Bankruptcy Code of 1978).

200. *See, e.g.,* Gerard McCormack, *Super-Priority New Financing And Corporate Rescue*, 2007 J. BUS. L. 701, 720.

> may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap.[201]

Chapter 11 protected general creditors through the procedural requirements that asset sales now eschew.[202] The negotiation process among dispersed creditors in Chapter 11 promoted information dispersal, transparency, employee voice, and agency.[203] Debtor rehabilitation and the preservation of jobs necessitated their involvement.[204] The lack of minority safeguards in Section 363 asset sales, by contrast, appears to have made it possible for secured creditors to manipulate the value of businesses to benefit themselves.[205] They have short-circuited the protections embedded in Chapter 11 designed to defend others against the costs of a creditors' race.[206]

IV. UK REALITY

The UK initially appears to suggest a potential middle ground in light of the trend in the U.S. of secured creditors bypassing collective procedures, at the expense of other creditors, including employees.[207] While secured creditors in the U.S. have avoided the rules of Chapter 11,[208] the UK offers a less rule-based procedure protective of group interests.[209] The explicit English policy has been to decrease secured creditor control to

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201. H.R. REP. NO. 95-595, at 220 (1977), *reprinted in* 1978 U.S.C.A. §§ 5963, 6179.

202. *See, e.g.*, Jeffrey M. Anapolsky & Jessica F. Woods, *Pitfalls in Brazilian Bankruptcy Law for International Bond Investors*, 8 J. BUS. & TECH. L. 397, 444 (2013) (listing the ways a Section 363 sale protects the integrity of the sale process).

203. *See, e.g.*, Rose, *supra* note 193, at 280 (2006) (noting that §363(b) sales lack the procedural safeguards in traditional reorganizations).

204. *See, e.g.*, Geva, *supra* note 56 at 380 (explaining the reasons why sales of company assets in today's context departs from Chapter 11's original intention).

205. LoPucki & Doherty, *supra* note 57, at 3.

206. *See, e.g.*, Brege, *supra* note 154, at 1669 (describing the three agency problems creditors face when deciding whether to sell an asset under Section 363(b)).

207. *See, e.g.*, Arturo Bris & Ning Zhu, *The Dynamics of Large and Small Chapter 11 Cases: An Empirical Study* 37 (Yale Int'l Ctr. for Fin., Working Paper No. 05-29, 2007) (suggesting that existing Chapter 11 practices have increasingly taken the form of the market-based alternatives proposed by academics).

208. *See, e.g.*, Korres, *supra* note 77, at 961 (discussing the fact that powerful creditors are often able to manipulate the system in such a way that increases their influence at the expense of smaller creditors).

209. *See, e.g.*, Tribe, *supra* note 8, at 470 (noting the strength of the UK statute is its substance over form approach which enables its less rule-based approach).

achieve more effective corporate rehabilitation.[210] In reality, however, secured creditors in the UK have reinstated their dominance in spite of reforms to English bankruptcy laws, and the creditors' race has reemerged there too.[211]

A. Receivership to Administration

The UK government has sought to promote collectivity in bankruptcy.[212] In 2002, the government enacted the Enterprise Act in order to decrease secured creditor control and realize a more robust culture of corporate rescue.[213] The Act largely abolished the dominant insolvency procedure at the time, Administrative Receivership, which secured creditors controlled and used to maximize their own recoveries.[214] The Act introduced a new, alternative Administration procedure intended to enable economically viable companies to continue in their businesses, for the benefit of all creditors.[215]

In 1977 the government established the Cork Committee to devise procedures for corporate restructuring. Without any official avenues for

210. *See, e.g.*, DEPARTMENT OF TRADE AND INDUSTRY, INSOLVENCY—A SECOND CHANCE, 2001, Cm. 5234, at foreword (U.K.), *available at* https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/263523/5234.pdf (proclaiming that policies that give control of the direction and outcome of the bankruptcy proceeding to the secured creditor are outdated).

211. This article uses the term "bankruptcy" in describing the U.S. and the UK for consistency, even though the English term properly should be "insolvency," as technically the term "bankruptcy" applies only to English individuals, not English companies.

212. *See, e.g.*, DEPARTMENT OF TRADE AND INDUSTRY, *supra* note 210, at Annex D, ¶ 2.5 (stating that while there might be increased pressure on the court system with more administration orders, this impact will be offset by the streamlining of the administration procedure).

213. *See, e.g.*, INSOLVENCY SERV., CORPORATE INSOLVENCY IN THE UNITED KINGDOM: THE IMPACT OF THE ENTERPRISE ACT 2002 ON REALISATIONS AND COSTS IN CORPORATE RESCUE PROCEEDINGS, 2006, at 5 (U.K.), *available at* http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.96.6853&rep=rep1&type=pdf (explaining the policy shift away from a concentrated creditor model of governance).

214. *See, e.g.*, Sandra Frisby, *In Search of a Rescue Regime: The Enterprise Act 2002*, 67 MODERN L. REV. 247, 252 (2004) (analyzing the new policies that were designed to create a better corporate rescue environment in which there was in general a fairer system of insolvency distribution).

215. *See* William Goddard, *The Revolution of the Times: Recent Changes in U.K. Insurance Insolvency Laws and the Implications of Those Changes Viewed from A U.S. Perspective*, 10 CONN. INS. L.J. 139, 152-53 (2004); Bruce Johnston, Peter Sharp, & Yasseen Gailani, *Encouraging Company Rescue: Proposals for Reforming the UK's Insolvency Laws*, 5 PRATT'S J. OF BANKR. L. 537, 546 n.3 (2009); Korres, *supra* note 77, at 971 (discussing how the refined standard attempted to make the business justification standard more flexible, but in the end these loose business judgment standards can be manipulated easily).

rehabilitation, English companies frequently liquidated unnecessarily, causing job losses and low creditor returns.[216] In response, the Cork Committee drafted a report ("Cork Report") that stressed the importance of rescuing bankrupt companies whenever possible.[217] The report stated that "good modern insolvency law" should "provide the means for the preservation of viable commercial enterprises capable of making a useful contribution to the economic life of the country."[218]

The Insolvency Act of 1986 established Administrative Receivership on the basis of the suggestions of the Cork Committee.[219] The new process empowered secured creditors to appoint agents to act on their behalf to recoup the value of their collateral.[220] The Cork Committee felt that they should be able to monitor management and then act quickly and independently out of court, without the delays that negotiations among other creditors would generate.[221] The Committee emphasized the benefits of procedures quick to initiate and flexible in outcome.[222]

Secured creditors used Administrative Receivership to quickly cash out their holdings in a way similar to a Section 363 asset sale.[223] The terms of secured lending arrangements, resembling DIP financing agreements in the U.S., set out procedures by which the creditors could appoint receivers to represent their interests.[224] The agreements enumerated triggers for the appointments, such as the companies becoming unable to pay their debts as they fell due.[225]

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216. *See, e.g.*, DELOITTE & TOUCHE TAX & LEGAL, BANKRUPTCY AND A FRESH START: STIGMA ON FAILURE AND LEGAL CONSEQUENCES OF BANKRUPTCY 2, *available at* http://www.pedz.uni-mannheim.de/daten/edz-h/gdb/02/report_uk.pdf (discussing compulsory requirements for companies that restructured during the 1970s).

217. INSOLVENCY LAW AND PRACTICE: REPORT OF THE REVIEW COMMITTEE, 1982, Cm. 8558, ¶ 198 (U.K.) [hereinafter Cork Report].

218. *Id.*

219. *See, e.g.*, DELOITTE & TOUCHE TAX & LEGAL, *supra* note 216, at 2 (discussing how the Act incorporated the suggestions of the Cork Committee).

220. *See, e.g.*, Nick Segal, *The Effect of Reorganization Proceedings on Security Interests: The Position Under English and U.S. Law*, 32 BROOK. J. INT'L L. 927, 943 (2007) (analyzing the effect of how the Act allowed for agents to represent secured creditors).

221. *See, e.g.*, John Armour et al., *The Impact of the Enterprise Act 2002*, 5 EUR. COMPANY & FIN. L. REV. 148, 161 (2008) (discussing the Cork Committee's desire to act quickly and independently of the court).

222. *Id.* (discussing the benefits of flexible outcomes and quick procedures when dealing with restructuring).

223. *Id.* (analyzing the process by which secured creditors used Administrative Receiverships to cash out their holdings).

224. ALAN DIGNAM, HICKS & GOO'S CASES AND MATERIALS ON COMPANY LAW 515 (Oxford Univ. Press 2011).

225. LEN SEALY & SARAH WORTHINGTON, SEALY & WORTHINGTON'S CASES AND MATERIALS IN COMPANY LAW 778 (Oxford Univ. Press 2013).

Secured creditors could push companies into Administrative Receivership without support from other creditors or corporate directors.[226] The Insolvency Act of 1986 had established additional rescue procedures, Administration and the Company Voluntary Arrangement (CVA).[227] Both emphasized participation by all creditors.[228] Secured creditors, however, prevented companies from using either process.[229] The Receivership legislation permitted secured creditors to appoint receivers for companies already undergoing Administrations or CVAs and divert them into Receivership instead.[230]

Upon the appointment of an administrative receiver, legal control of the company transferred from the directors to the receiver.[231] The company still traded, still retained the same management, and still held legal title to its assets.[232] The receiver, however, managed the company and did so solely on behalf of the secured creditor that appointed him.[233] The receiver acted for the company as an agent would, but acted with the primary aim of recouping the value of the secured creditor's collateral.[234]

While initially the Cork Committee supported Administrative Receivership as an instrument of corporate rescue, recession and a growing sense that economically viable firms emerged from Receivership into liquidation made its dominance seem increasingly problematic.[235] The Committee conceived of bankruptcy as a means for advancing the collective interests of corporate stakeholders.[236] The Cork Report stated:

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226. VANESSA FINCH, CORPORATE INSOLVENCY LAW: PERSPECTIVES AND PRINCIPLES 241 (Cambridge Univ. Press 2002).

227. *See, e.g.*, DELOITTE AND TOUCHE TAX & LEGAL, *supra* note 216, at 2 (analyzing the additional rescue procedures that the Insolvency Act of 1986 created).

228. *See, e.g.*, ROGER BARKER , INSTITUTE OF DIRECTORS, DOES THE UK NEED CHAPTER 11? 19 (2009), *available at* https://www.iod.com/MainWebsite/Resources/Document/article_chapter_11.pdf (pointing out that Administration and the CVA emphasized the importance of participation by all creditors).

229. *See, e.g.*, Armour et al., *supra* note 221, at 154-55 (discussing the challenges of implementation of these new processes).

230. *See id.* (explaining how secured creditors were able to circumvent the new legislation).

231. DIGNAM, *supra* note 224, at 516; FINCH, *supra* note 226, at 241.

232. DIGNAM, *supra* note 224, at 515; FINCH, *supra* note 226, at 242.

233. *See, e.g.*, Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 819 (2004).

234. *See, e.g.*, ROY GOODE, PRINCIPLES OF CORPORATE INSOLVENCY LAW 217 (Sweet & Maxwell, 4th ed. 2011); SEALY & WORTHINGTON, *supra* note 225, at 778-79.

235. *See, e.g.*, D.C. Webb, *An Economic Evaluation of Insolvency Procedures in the United Kingdom: Does the 1986 Insolvency Act Satisfy the Creditors' Bargain?*, 43 OXFORD ECON. PAPERS 139, 152 (1991) (addressing the problems with Administrative Receivership).

236. Sandra Frisby, *Insolvency Law and Insolvency Practice: Principles and Pragmatism Diverge?*, 10 CURRENT LEGAL PROBS. 1, 14 (2011).

> We believe that a concern for the livelihood and well-being of those dependent upon an enterprise, which may well be the lifeblood of a whole town or even a region, is a legitimate factor to which a modern law of insolvency must have regard. The chain reaction consequent upon any given failure can potentially be so disastrous to creditors, employees and the community that it must not be overlooked.[237]

The development of a rescue culture in the UK, the original animus of Administrative Receivership, eventually caught up with its realities and compelled its restriction.[238] The incentives of administrative receivers appeared skewed to many, as the receivers had no obligation to try to rehabilitate bankrupt companies.[239] Acting only in the interests of the secured creditors that appointed them, they attempted restructurings only when doing so would increase the recoveries of those creditors.[240] Uncertain attempts at rescue, however, generally did not appear likely to increase recoveries, and they instead quickly realized the value of the collateral.[241] Increasingly, therefore, it seemed that Administrative Receivership was thwarting corporate rescue.[242]

Moreover, the power that the procedures accorded to secured creditors raised fairness concerns.[243] Administrative receivers, acting to recoup the value of secured assets, decreased returns to other creditors without their consent.[244] The other creditors appeared to be paying for secured creditor recoveries.[245]

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237. Cork Report, *supra* note 217, at ¶ 204.

238. *See, e.g.*, Keith Crawford, The Law and Economics of Orderly and Effective Insolvency (Dec. 2012) (unpublished Ph.D thesis, University of Nottingham), *available at* http://eprints.nottingham.ac.uk/13372/1/Keith_Crawford_Doctoral_Thesis_Submitted_Final_Draft.pdf.

239. *See, e.g.*, Lathia v. Dronsfield Bros. [1987] B.C.L.C. 321 (noting that is unclear what duties are owed by a receiver but that the context can help identify those duties); DEPARTMENT OF TRADE AND INDUSTRY, *supra* note 210, at ¶¶ 2.2-2.3.

240. *See, e.g.*, DEPARTMENT OF TRADE AND INDUSTRY, *supra* note 210, at ¶¶ 2.2-2.3 (discussing the skewed incentives of administrative receivers).

241. *See, e.g.*, Rizwaan Jameel Mokal, *Administrative Receivership and Administration—An Analysis*, 57 CURRENT LEGAL PROBS. 355 (analyzing the effects of receivers on corporate rescue).

242. *See, e.g.*, DEPARTMENT OF TRADE AND INDUSTRY, *supra* note 210, at ¶ 2.1 (explaining why attempts at corporate rescue were often scuttled).

243. FINCH, *supra* note 226, at 262.

244. *Id.*

245. *Id.* at 263.

The perceived problems with Administrative Receivership found their way into a series of government reports, culminating in legislative changes. In 1997, the New Labour government came to power and initiated a review of business rescue and restructuring.[246] The review determined that secured creditor control stymied rescue objectives.[247] The 2001 government white paper *Insolvency – A Second Chance* reiterated the same argument.[248] The white paper reviewed the goals of the Cork Committee and concluded that Administrative Receivership inhibited them.[249] The paper criticized Administrative Receivership for diminishing returns to unsecured creditors.[250]

The Enterprise Act 2002 therefore reformed English insolvency procedures to end most uses of Administrative Receivership, initially taking English law in a direction opposite from the American trend.[251] The Enterprise Act put into practice the 2001 white paper and revamped existing bankruptcy procedures in an attempt to increase corporate rescue.[252] The new legislation instituted changes to the existing Administration process in order to make it more attractive to companies and creditors and to prevent Receivership from displacing it.[253]

B. New Administration

Reforms to Administration initially undercut secured creditor control of English bankruptcy and forced the creditors to join a more collaborative process.[254] The Enterprise Act largely eliminated Administrative

246. *See* Review Group, *A Review of Company Rescue and Business Reconstruction Mechanisms, The Insolvency Service* (2000).

247. GERARD MCCORMACK, CORPORATE RESCUE LAW – AN ANGLO-AMERICAN PERSPECTIVE 54 (Edward Elgar Publ'g. 2008).

248. DEPARTMENT OF TRADE AND INDUSTRY, *supra* note 210, at ¶¶ 2.1-2.3 (U.K.)

249. *Id.* at ¶ 2.1.

250. *Id.* at ¶ 2.3 .

251. *See, e.g.,* Richard Nevins, *A Thorough Analysis of the United Kingdom's Restructuring Process,* ASPATORE (THOMSON REUTERS), at *2 (2010), *available at* 2010 WL 2848369 ("The title of that act speaks volumes, and indicates a genuine desire to liberalize English bankruptcy law and stimulate a sense of 'enterprise.' The most important feature of the Enterprise Act was to introduce a new administration regime with a clear focus on corporate rescue, including the creation of an out-of-court route into administration. Simultaneously, the Enterprise Act sought to scale back the right of secured lenders to appoint an administrative receiver.").

252. MCCORMACK, *supra* note 247, at 54.

253. BARKER, *supra* note 228, at 17, 19.

254. *See, e.g.,* INSOLVENCY SERV., ADMINISTRATION GUIDANCE NOTES ¶ 2.2.1 (2003), *available at* http://webarchive.nationalarchives.gov.uk/20080610162606/http://www.insolvency.gov.uk/insolvencyprofessionandlegislation/legislation/reform.htm.

Receivership.[255] Instead of using it to race to grab assets, the Act channeled secured creditors, in most instances, into Administration procedures oriented towards corporate rescue.[256] In Administration, outside insolvency professionals, serving as administrators, assumed the management of bankrupt companies and developed comprehensive reorganization plans in the collective interest in consultation with all of the creditors.[257]

The new procedures, which remain in place, bear little resemblance to U.S. Chapter 11. The new Administration requires companies to qualify as "insolvent," according to one of two definitions, prior to entry.[258] Once Administration begins, control of the companies passes from the existing management to outside administrators, known as the "insolvency professionals."[259] The rules do not enable one class of creditors to force another to accept a course of action against its will, as American bankruptcy law does, and they offer no special priority to post-petition lenders.[260] Administration also emphasizes rescuing businesses by selling them to new owners, rather than continuing the original companies intact.[261]

Arguably, Administration therefore resembles a Section 363 asset sale, but with more protections.[262] The English procedures balance rescuing companies with achieving better results for creditors as a group.[263] The legislation sets out a hierarchy of objectives.[264] Rescuing companies as going concerns tops the list, but if administrators conclude that rescue would not be "reasonably practicable" or would not "achieve the best result for the company's creditors as a whole" then they need not pursue it.[265]

255. *Id.*

256. *Id.*

257. Pontian Okoli, *Rescue Culture in the United Kingdom: Realities and the Need for a Delicate Balancing Act*, 23 INT'L. COMP. COMM. L. REV. 61, 62 (2012).

258. Keith Wilson and Alpar Deniz, *A Short Guide to UK Insolvency Law: Administration*, PAUL HASTINGS: STAY CURRENT 1, 2 (2008), *available at* http://www.paulhastings.com/assets/publications/1028.pdf.

259. ROY GOODE & EWAN MCKENDRICK, GOODE ON COMMERCIAL LAW 929 (2010).

260. *See, e.g.*, McCormack, *supra* note 200, at 702.

261. For an explanation of the difference, see INSOLVENCY SERV., *supra* note 213, at 2; McCormack, *supra* note 50, at 531 (explaining that "a speedy sale of company assets to a purchaser who will put them to better use and, in the process, maintain employment is often seen as the better result than the tedious process of restructuring the existing corporate vehicle and getting the reorganization plan approved.").

262. *See, e.g.*, Vanessa Finch, *Corporate Rescue Processes: The Search for Quality and the Capacity to Resolve*, 6 J. BUS. L. 502, 509 (2010) (describing stakeholder protections).

263. Gerard McCormack, *Control and Corporate Rescue*, 56 INT'L COMP. L. Q. at 529 (2007).

264. Insolvency Act, 1986, c. 45, sch. B1,¶ 3(1).

265. *Id.* ¶ 3(4).

Control of a company in Administration shifts to an administrator, usually an accountant, who has a duty to act in the collective interests of the creditors.[266] While he manages the business, a moratorium prevents secured creditors from reclaiming their collateral.[267] The moratorium stays creditor enforcement actions, unless the administrator or a court approves them.

The administrator generally has 28 days to obtain creditor approval of a plan. At a meeting of the creditors, he presents a proposal for their vote.[268] The creditors can amend it with his consent.[269] If, however, he decides that he must act more quickly, he can sell the company without waiting for the meeting.[270]

When it occurs, creditor voting protects collective interests; however, Administration retains specific protections on the rights of secured creditors.[271] Although unsecured creditors must obtain court approval to appoint an administrator, secured creditors may appoint them out of court.[272] Without "cramdown," the procedure in U.S. Bankruptcy law that permits imposition of a plan on a class of non-consenting creditors, Administration proposals must accommodate secured creditors in order to succeed.[273] Secured creditors maintain rights to petition to lift the moratorium against individual creditor actions and then claim their collateral.[274]

Nevertheless, administrators are required to act in the interests of all

266. *See id* at ¶ 64 ("A company in administration or an officer of a company in administration may not exercise a management power without the consent of the administrator."); McCormack, *supra* note 247, at 59.

267. Ian Fletcher & Christopher Arnold, *An Introduction to UK Corporate Insolvency Law*, 1999 ANN. SURV. BANKR. L. 35 (1999).

268. *See* Insolvency Rules, 1986, S.I. 1986/1925, rule 2.43(1) (U.K.) ("at a creditors' meeting in administration proceedings, a resolution is passed when a majority (in value) of those present and voting, in person or by proxy, have voted in favour of it.").

269. Insolvency Act, 1986, c. 45, sch. B1 ¶ 53(1).

270. *See Re Transbus International Ltd* [2004] 2 All ER 911. *See generally,* Insolvency Act, 1986, c.45, sch. B1, ¶ 52(1). Creditors whose debts amount to at least 10 per cent of the company's total indebtedness can force the administrator to hold an initial creditors' meeting, *see* Insolvency Act, 1986, c.45, sch. B1, ¶ 52(2).

271. *See, e.g.,* Finch, *supra* note 262, at 510; *see also* DEPARTMENT OF TRADE AND INDUSTRY, *supra* note 210, at ¶ 2.6 (stating "whilst our aim is to guarantee unsecured creditors a greater say in the process and its outcome, secured creditors should not feel at any risk from our proposals").

272. *See, e.g.,* INSOLVENCY SERV., *supra* note 254, ¶ 3.2.1.

273. *See* Insolvency Act, 1986, c.45, sch. B1, ¶ 73(1)(a); McCormack, *supra* note 247, at 296.

274. *See* Insolvency Act, 1986, c.45, sch. B1, ¶ 43; Alan Meek & John Reid, *United Kingdom: Lifting The Moratorium In Administration*, MONDAQ, (Nov. 29, 2012), *available at* http://www.mondaq.com/x/208956/Insolvency+Bankruptcy/Lifting+The+Moratorium+In+Administration.

creditors and must comply with other English and European laws that protect employee rights.[275] Unlike in American Section 363 asset sales, English administrators must use reasonable care to sell assets at the highest possible price.[276] If the administrators continue employee contracts when they assume control of a company, payment of the salaries of the employees take priority over every other distribution from the bankruptcy estate, including payment of the expenses of the administration and the wages of the administrator.[277] Under EU law, employee contracts automatically transfer to the buyer when a bankrupt company is sold.[278]

C. Resurgent Secured Creditor Race[279]

Secured creditors, however, increasingly have circumvented the protections on other creditors that distinguished English Administrations from Section 363 asset sales in the U.S; they have regained control of the bankruptcy process by planning sales before companies enter Administration.[280] When the administrators take office, they immediately affect the plans, without calling meetings or votes of creditors.[281] In 2009, roughly half of all Administrations proceeded in this way.[282]

The avoidance of provisions that protect collective interests has occurred without any court review or the approval of less powerful creditors.[283] Unlike in the U.S., where courts must authorize and approve

275. McCormack, *supra* note 247, at 59.

276. NICHOLAS BRIGGS AND PHILIP MAY, GUILDHALL CHAMBERS, IP LIABILITY: AN OVERVIEW ¶ 30 (2008), *available at* http://www.guildhallchambers.co.uk/files/IPLiability_NB&PMay.pdf.

277. Insolvency Act, 1986, c.45, sch. B1, ¶ 99(5) and (3).

278. The Transfer of Undertakings (Protection of Employment) Regulations, 2006, S.I. 2006/246, Regulation 4 (U.K.).

279. Note that the following section is a discussion of the rise of "prepackaged" administrations in the UK. The author, however, has referred to these simply as "prenegotiated administrations" to avoid confusion with "prepacks" in the U.S. Whereas American prepacks must still be confirmed and voted on by all creditors, none of these protections exist in the UK context. *See, e.g.*, John Armour, *The Rise of the 'Pre-Pack': Corporate Restructuring in the UK and Proposals for Reform*, *in* RESTRUCTURING COMPANIES IN TROUBLED TIMES: DIRECTOR & CREDITOR PERSPECTIVES 60-64 (R.P Austin & Fady JG Aoun eds. 2012). The English procedures, therefore, represent a more significant departure from a collective resolution process.

280. Armour, *supra* note 279, at 43-44.

281. Sandra Frisby, *Pre-Packs, Progress, Pragmatism, and Propriety: a View from the United Kingdom*, *in* 2009 NORTON ANN. REV. OF INTL. INSOLVENCY 8.

282. Finch, *supra* note 262, at 516.

283. FINCH, *supra* note 226, at 199; *See, e.g.*, Vanessa Finch, *Corporate Rescue: Who Is Interested?*, 3 J. BUS. L. 190, 201 (2012) (highlighting the lack of sanction toward less powerful creditors).

Section 363 asset sales, English courts do not review the substance of Administration proposals.[284] When courts determine whether to affect agreed plans of reorganization, they scrutinize only whether the appointment of the administrators followed correct procedures.[285] While secured creditors in the U.S. have also conducted advanced negotiations, the companies have still had to complete Chapter 11 procedures, including disclosure, plan confirmation, and creditor voting.[286]

The prearranged sales in the UK have nevertheless saved the time and cost of long, public negotiations in Administration.[287] English bankruptcy law has made no special provision for creditors that lend to companies already in bankruptcy.[288] Without the favorable treatment that American law affords, companies have faced even greater pressure to reduce costs.[289] Although Parliament considered incentivizing post-petition lending in the Enterprise Act, Members of Parliament decided not to offer any inducements.[290]

A survey of recent English Administrations underscores the resulting pressure for funding. The costs of Administration appear to have consumed the potential benefits of the process. Tracing the costs of Administration and returns to creditors entails a two-step research process. In accordance with English laws, companies that enter Administration must publish a notice in the London Gazette, an official journal of record of the government.[291] Once in Administration, the administrator must send periodic progress reports to Companies House, the registrar of companies in the UK.[292] The reports are available in the FAME database.[293]

284. *See, e.g.*, FINCH, *supra* note 226, at 199; Lijie Qi, *The Rise of Pre-Packaged Corporate Rescue on Both Sides of the Atlantic*, 20 INSOLVENCY INTELLIGENCE 129, 130-31 (2007) (comparing the administrative proposals within both the American and English systems).

285. *See, e.g.*, Armour, *supra* note 279, at 43 (indicating the transformation of corporate restructuring in the UK).

286. Qi, *supra* note 284, at 133.

287. *See, e.g.*, Frisby, *supra* note 281, at 8 (discussing the long, drawn out process of public negotiations in UK law).

288. *See, e.g.*, McCormack, *supra* note 50, at 515 (identifying the tendency in current corporate restructuring to produce a more fragmented, difficult coordination during financial distress).

289. *See, e.g.*, Lijie Qi, *Availability of Continuing Financing in Corporate Reorganisations: The UK and US Perspective*, 19 COMP. LAWYER 161, 166 (2008) (emphasizing the ease with which American law affords companies in restructuring).

290. McCormack, *supra* note 200, at 702-03.

291. Insolvency Rules, 1986, S.I. 1986/1925, rule 2.10 (U.K).

292. *Id.* at rule 2.16 (requiring submission of proposals to the registrar of the company).

293. FAME is a database that provides a variety of financial and corporate information about companies in the U.K. and Ireland. *Fame*, BUREAU VAN DIJK, http://www.bvdinfo.com/en-gb/our-products/company-information/national-products/fame

A search through every notice filed in the London Gazette in 2011 and 2012 uncovers ten companies with assets above £100 million that filed for Administration; review of the reports of administrators for the ten companies indicates how Administration expenses deprive creditors of assets. In the ongoing Administration of the real estate development company Ashpol, insolvency professionals have billed the bankruptcy estate £279,114 for 997 hours of work they conducted between March 28, 2012 and September 12, 2013.[294] Payments to tax advisors during the period totaled £8,000, and legal fees amounted to £86,505.[295] Advertising to comply with statutory requirements cost a further £1,158.[296] Meanwhile, the administrators issued stock to secured creditors and distributed to them 66 pence per share, less costs and expenses.[297] At the time of the report, unsecured creditors had not recovered any assets.[298] Similarly, in the Administration of the nightclub operating company, Luminar Group Holdings, the administrators billed the bankruptcy estate £5,318,156 between October 27, 2011 and August 2013 in an ongoing Administration and incurred further expenses of £79,980.[299] Legal fees totaled £1,343,094.98 during the same period.[300] The administrators predicted that the secured creditors, owed £112,400,000, would "experience a significant shortfall following distribution."[301] Unsecured creditors, owed £906,086,000, would receive only the small minimum dividend that the Enterprise Act requires administrators in certain situations to set aside for them.[302]

Pre-negotiated plans of Administration, however, do not appear to have significantly reduced costs or increased creditor recoveries. In the pre-

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294. BEGBIES TRAYNOR (CENTRAL) LLP, ASHPOL PLC: ADMINISTRATOR'S PROGRESS REPORT para. 7 (2013) (on file with the author).

295. *Id.* at app. 2, para 1.11.

296. *Id.* at app. 1.

297. *Id.* at para. 5.

298. *Id.* at para. 5 & app. 1.

299. ERNST & YOUNG LLP, LUMINAR GROUP HOLDINGS: ADMINISTRATOR'S PROGRESS REPORT 10 (2013) (on file with the author).

300. *Id.* at 9.

301. *Id.* at 12.

302. *Id.* This refers to the "Prescribed Part" established by the Enterprise Act. *See* Enterprise Act, 2002, c. 40, § 252 (Eng.). Section 176A of the 1986 Insolvency Act provides that:

> (2) The liquidator, administrator or receiver — (a) shall make a prescribed part of the company's net property available for the satisfaction of unsecured[ ] debts, and (b) shall not distribute that part to the proprietor of a floating charge except in so far as it exceeds the amount[ ]required for the satisfaction of unsecured debts.

Insolvency Act, 1986, ch. 45, § 176A (Eng.)

negotiated sale of Hampson Industries, the aerospace and automotive engineering company, administrators conducted a pre-negotiated sale of the business when they took office on November 19, 2012.[303] Secured creditors recouped roughly 34 pence on the pound: they received £27,331,143 on their claims of £74,800,000.[304] They fared only moderately better than secured creditors in the Section 363 asset sale of Chrysler, whose low recoveries generated public controversy.[305] The administrators of Hampson Industries, moreover, estimated "that there will be no funds available to distribute to unsecured creditors."[306] Nevertheless, the sale cost £1,409,525 in professional fees,[307] and the administrators charged fees of £359,079.[308] The bankruptcy estate paid a further £1,172 in expenses and £11,094 in outside consulting costs, as well as additional legal fees.[309] Reporting to comply with new regulations on prearranged Administrations cost an additional £7,885.[310]

In the pre-negotiated sale of the sports equipment company JJB Sports, secured creditors received only £22,100,000 of their £58,400,000 claims, equivalent to 38 pence on the pound, while unsecured creditors received only the small statutory minimum that Administration procedures sometimes require.[311] Legal fees appear to have amounted to £408,129; professional fees £12,033; fees to consultants to resolve insurance claims £2,000; time costs £274,180; reporting costs £47,227; and advertising costs £1,721.[312]

Meanwhile, the return of secured creditor control, which appears not to have significantly lowered costs, has occurred to the detriment of unsecured creditors.[313] While compressing the time between entry into Administration and its outcome may enable companies to continue to trade without disruption to their suppliers, customers, and employees, and while the proceeds of the sales have satisfied some debts of the businesses, the concomitant lack of transparency has resulted in an absence of

303. FTI CONSULTING LLP, HAMPSON INDUSTRIES PLC: ADMINISTRATOR'S PROGRESS REPORT 3-4 (2013) (on file with the author).

304. *Id.* at 7.

305. *See supra* Section II.C (discussing Chrysler's section 363 asset sale).

306. FTI Consulting LLP, *supra* note 303, at 7.

307. *Id.* at app. B.

308. *Id.* at 7.

309. *Id.*

310. *Id.* at app. C.

311. KPMG LLP, JJB SPORTS PLC: ADMINISTRATOR'S PROGRESS REPORT 4, 11 (2013) (on file with the author).

312. *Id.*

313. *See supra* text accompanying notes 294-312; *see also infra* text accompanying notes 314-317.

accountability.[314] Secured creditors have excluded unsecured creditors from negotiations, even as the Administration procedures have sought explicitly to include them.[315] They have lost the opportunity to defend their interests by considering and voting on proposals.[316] Without any market testing of the prearranged sales, businesses may have been undersold.[317]

Existing empirical data from a study by University of Nottingham law professor Sandra Frisby indicates the extent to which secured creditors have benefitted at the expense of others.[318] According to the data Frisby collected, secured creditors recouped on average sixty-eight percent of their total claims in pre-negotiated sales, while unsecured creditors recouped on average 2.9 percent.[319] Secured creditors fared better in the pre-negotiated setting than in a typical Administration, while unsecured creditors fared worse.[320] Cost savings from the speed of negotiated sales, however, may have contributed to job preservation.[321] Every company employee lost his position in only four percent of pre-negotiated sales, compared with twenty-two percent of traditional business sales.[322]

Concern over abuses has prompted nonbinding codes of good conduct, but compliance with them has appeared low.[323] In response to secured creditors pre-negotiating sales, the committee of regulatory bodies for insolvency practitioners issued Statement of Insolvency Practice 16 ("SIP 16").[324] SIP 16 directs insolvency practitioners to "bear in mind" that they have duties to creditors as a group.[325] To increase transparency, the statement advises administrators to provide notice to creditors if assets will be sold to a connected party without any public marketing.[326] It also suggests that they should file explanations of why pre-negotiated sales have

314. Crawford, *supra* note 238, at 117.

315. *Id.*

316. *Id.* at 117-18; *see also* Armour, *supra* note 279, at 60-64; Re Kayley Vending Ltd. [2009] EWHC 904 (Ch), [11].

317. Companies are frequently sold to connected parties. *See, e.g.,* Armour, *supra* note 279, at 44.

318. Frisby, *supra* note 281, at 143-190.

319. *Id.* at 183-84.

320. *Id.*

321. *Id.* at 185-87.

322. *Id.* at 186.

323. *See, e.g.*, Nadia Saleh & Edward Smith, *Pre-packs Repacked?*, 26 J. INT'L BANKING L. & REG. 620 (2011) (suggesting that the nonbinding codes of good conduct did not have the affect they should).

324. THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES, STATEMENT OF INSOLVENCY PRACTICE 16: PRE-PACKAGED SALES IN ADMINISTRATION, 2009, ¶9 (U.K.) [hereinafter SIP 16] (creating a list of disclosure requirements in a pre-packaged sale); Armour, *supra* note 279, at 64-66 (summarizing the information required by SIP 16).

325. SIP 16, *supra* note 324, ¶ 2.

326. *Id.* ¶ 9.

taken place and confirm that sale prices were appropriate.[327]

In May 2012, the Insolvency Service, the executive agency that regulates the English insolvency profession, reported that thirty-two percent of cases it reviewed during 2009 did not conform with SIP 16, and seven percent substantially violated it.[328] Only six insolvency practitioners, however, have received fines for breach of SIP 16, which ranged from £250 to £2500. [329]

V. RETOOLING

The U.S. and U.K. both evidence how the benefits to secured creditors from racing to claim assets strain the bankruptcy laws.[330] Dominant secured creditors in both countries appear unwilling to fund prolonged periods of negotiation and instead act to collect their collateral as quickly as they can.[331] Doing so has produced distributional effects and destroyed the "going concern" value of companies in some instances.[332] If current bankruptcy law is insufficient to protect the collective interest, and secured creditors can easily circumvent the negotiated process that the laws are intended to impose, do other avenues exist for alleviating the pressure to revert to the creditors' race?

This section explores the possibility for additional measures to constrain or alter the incentives of secured creditors. If bankruptcy law is to provide a forum in which similarly situated creditors receive equal treatment and the recoveries of all creditors are maximized, then serious retooling has become necessary. What would persuade secured creditors to abandon a race for assets and rejoin the collective? What would make them share assets with other creditors in a cooperative process, cognizant of issues of overall efficiency and fairness?

327. *See, e.g.,* Sandra Frisby, *Balancing Interests in Administration: Contributions from the Court and the Coalface,* 24 J. INT'L BANKING & COMM'L L. 198, 199 (2009) (highlighting that sale prices are appropriate because in pre-negotiated sales even though there are independent interests at work).

328. BUSINESS, INNOVATION AND SKILLS COMMITTEE, THE INSOLVENCY SERVICE: SIXTH REPORT OF SESSION 2012-13, H.C. 675, at 25 (U.K.).

329. *Id.* (noting that "[s]ince January 2010 there have been a total of 6 fines given to insolvency practitioners . . . . rangin[g] from £250 to £2500 . . .").

330. *See supra* Sections II.B, III.B, IV.C.

331. *See supra* Sections II.B, IV.C.

332. *See supra* Sections III.B, IV.C.

A. English Example

Secured creditors in the U.S. are not using the traditional Chapter 11 rules.[333] They have grown reluctant to fund prolonged reorganizations that will likely provide them with little direct benefit.[334] The UK has offered a less rule-based system, but its high costs have encouraged secured creditors to short circuit the expense of its protections on minority interests and recoup more value for themselves.[335] An earlier English process, characterized by even fewer rules, however, suggests the possibility for secured creditors to cooperate with others and work again towards corporate rescue in appropriate cases. Empowering an impartial regulator to persuade secured creditors to act in the collective interest may provide a key element to accomplishing that aim.[336]

Funding pressures make speed valuable.[337] In both the U.S. and the U.K., cost appears in part to have driven secured creditors to deviate from conventional reorganization procedures.[338] A significant challenge, therefore, is to devise methods that accelerate traditional processes yet still retain protections on other creditors. It has become necessary to identify cheaper, faster mechanisms that nonetheless distribute assets equitably and encourage the possibility of rescue.

With American courts and English regulators declining to restrain secured creditors, influencing the incentives of secured creditors through soft law appears necessary.[339] Doing so seems more realistic than alternative measures to reduce the cost of reorganization, introduce new ways of funding it, or reverse the special legal treatment of secured credit.[340]

In this light, an English example becomes instructive not for its exact procedures but for demonstrating the possibility of altering the behavior of secured creditors. For a brief period in the UK, secured creditors

333. *See, e.g.*, Brege, *supra* note 154, at 1640 (discussing Chapter 11 loopholes).

334. *See supra* Section II.B.

335. *See supra* Section IV.C.

336. *See infra* Section V.B.

337. *See supra* Sections III.A, IV.C.

338. *See, e.g.*, Mankovetskiy, *supra* note 5 (finding that the common desire to increase returns and accelerate the process has resulted in fewer traditional reorganizations); *supra* Sections III.A, IV.C.

339. *See* Sections II.B, IV.C; LoPucki & Doherty, *supra* note 57, at 13 (explaining how courts have a preference for sale over reorganization).

340. *See, e.g.*, Douglas G. Baird, *The Reorganization of Closely Held Firms and the 'Opt Out' Problem*, 72 WASH. U. L.Q. 913 (1994) (introducing different methods of funding); Daniel S. Mozes, *The Debtor is Dead, Long Live the Debtor*, 85 TEMP. L. REV. 723, 724 (2013) (explaining why changes to the Code would fail); Skeel, *supra* note 60, at 940 (considering alternative measures).

cooperated with other creditors to maximize collective recoveries and facilitate opportunities for corporate rescue.[341] In the 1980s, the Bank of England developed informal principles with which secured creditors, primarily banks, voluntarily complied.[342] The process gained popularity and came to be known as the London Approach.[343]

The London Approach bore similarities to non-bankruptcy workouts in the U.S., but entailed more leadership by secured creditors and greater inclusion of other creditors.[344] Banks, quick to notice that a company had become distressed, forged agreements with other lenders.[345] Together, they allowed the company a break from paying its debts as they fell due and continued to maintain existing lines of credit.[346] An informal committee of creditors, meanwhile, restructured the debts of the company, so that it could attract new financing.[347] The creditors shared equal decision making power and divided among themselves the gains and losses that resulted.[348]

The simple framework of the London Approach appeared to align the interests of secured creditors with a collective bankruptcy process. The banks assumed control of the companies.[349] The creditors then worked together to determine their economic viability and how best to restructure them.[350] The cooperation achieved success in reorganizing companies in the collective interest.[351]

341. *See, e.g.*, Nevins, *supra* note 251, at *1.

342. *See, e.g.*, FINCH, *supra* note 226, at 219-29 (outlining the history of the "London Approach").

343. *Id.*

344. *See* text accompanying notes 345-348.

345. *See, e.g.*, Christoph Paulus, *Some Thoughts on an Insolvency Procedure for Countries*, 50 AM. J. COMP. L. 531, 538 (2002) (discussing the steps in the "London Approach").

346. *See, e.g.*, Nevins, *supra* note 251, at *1 (2010) (discussing the process of maintaining lines of credit).

347. *See, e.g.*, Ruth Lane Neyens, *Principles of Corporate Restructuring and Asset Resolution*, 8 L. & BUS. REV. AM. 371, 381-82 (2002) (examining the process of restructuring in the "London Approach").

348. John Armour & Simon Deakin, *Norms in Private Insolvency Procedures: The 'London Approach' to the Resolution of Financial Distress* 19 , (University of Cambridge Centre for Business Research, Working Paper No. 173, 2000), *available at* http://www.cbr.cam.ac.uk/pdf/WP173.pdf (discussing how banks share the benefits avoiding insolvency and restructuring).

349. John Armour and Brian Cheffins, *Corporate Ownership Structure and the Evolution of Bankruptcy Law in the U.S. and UK* 55 (University of Cambridge Centre for Business Research, Working Paper No. 226, 2002).

350. *See* MANAGING FINANCIAL AND CORPORATE DISTRESS: LESSONS FROM ASIA 303 (Charles F. Adams, Robert E. Litan & Michael Pomerleano, eds. 2000) (describing the main features of the London Approach).

351. *See* CORPORATE RESTRUCTURING: LESSONS FROM EXPERIENCE 64-65 (Michael Pomerleano & William Shaw, eds. 2005) (describing the voluntary nature of the London

Ultimately, changes in the credit markets resulted in increased holdout and made reorganization through the London Approach more difficult.[352] New institutional investors increased the numbers of creditors involved, while claims trading increased their fluidity.[353] As the interests of creditors diverged, negotiation became more expensive, slow, and difficult, just as Chapter 11 and Administration proceedings have recently become.[354] With less repeat interactions, creditors had less reason to make concessions in one negotiation to attain benefits in future negotiations.[355]

The past period in the United Kingdom nevertheless makes clear the ability to harness support for collective processes from secured creditors.[356] How might secured creditors be made to experience the upsides of reorganization and rescue and the downsides of a race for assets? A simple means for tying the incentives of secured creditors to traditional collective procedures may provide a possible solution.

B. Impartial Regulator

Engagement by the regulator, the Bank of England, appears to have encouraged the participation of secured creditors in the London Approach. The Bank facilitated negotiations with creditors and persuaded them to adopt a long-term view.[357] It convened the creditors and outside financial advisors and intervened to broker compromises as disagreements arose.[358] It did not contribute public funds.[359]

A study by the World Bank has highlighted the importance of "a higher authority that can push cases to resolution and arbitrate disputes."[360] According to the World Bank, "the Bank of England was trusted because it was considered impartial, independent and confidential."[361]

None of the U.S. bankruptcy procedures offers similar involvement by

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Approach and its emphasis on cooperation).

352. *See* FINCH, *supra* note 226, at 224-25 (2002) (explaining how the London Approach has been affected by modern changes to the credit market).

353. *Id.*

354. *Id.*

355. *Id.*

356. *See* CORPORATE RESTRUCTURING: LESSONS FROM EXPERIENCE, *supra* note 351, at 64 (describing the success of the London Approach in encouraging creditors to cooperate in efforts aimed at restructuring).

357. MANAGING FINANCIAL AND CORPORATE DISTRESS, *supra* note 350, at 302.

358. *See* FINCH, *supra* note 226, at 220 (describing the role of the Bank of England in facilitating the London Approach).

359. CORPORATE RESTRUCTURING: LESSONS FROM EXPERIENCE, *supra* note 351, at 62

360. *Id.* at 61.

361. *Id.* at 62.

an impartial third party, beyond the bankruptcy judge.[362] Although a governmental body monitors the bankruptcy process, it has acted more as an enforcer than a supervisor. The Office of the U.S. Trustee files civil enforcement actions to protect the integrity of the bankruptcy system and refers suspected bankruptcy crimes to the U.S. Attorneys.[363] The Office reviews professional fee requests, appoints Chapter 11 trustees and examiners, appoints unsecured creditors' committees, and reviews executive bonuses.[364]

It has become crucial to determine whether such an entity, using only soft law, could influence secured creditors to fund and participate in reorganization rather than race to cash out their claims.[365] The significance of the issue for creditors and for the economy demands rigorous study. The London Approach indicates the possibility of inducing secured creditors to rejoin a negotiated process that would provide collective benefits.

CONCLUSION

Secured creditors in the United States have avoided the rules of Chapter 11, to the detriment of other creditors.[366] They have forced companies into Section 363 asset sales in order to quickly recover their collateral.[367] Doing so has eliminated the protections on unsecured creditors that Chapter 11 has provided and reduced overall returns.[368]

English Administration would appear to have suggested the elements of a solution.[369] The Administration procedures bear similarities to Section 363 asset sales, while retaining protections on other creditors.[370] Nevertheless, secured creditors in England have also attempted to evade the

362. *See* text accompanying notes 363-364.

363. *See The United States Trustee Program*, THE UNITED STATES DEPARTMENT OF JUSTICE (Mar. 6, 2014, 8:48 AM), http://www.justice.gov/ust/eo/ust_org/index.htm (explaining the role of the United States Trustee Program in bankruptcy proceedings).

364. *Id.*

365. *Cf.* Mark J. Roe & Federico Cenzi Venezze, *A Capital Market, Corporate Law Approach to Creditor Conduct*, 112 MICH. L. REV. 59, 84 (2013) (noting the conflict of interest present for secure credit holders in managing reorganizations).

366. *See supra* Sections II.B, III.B (explaining how creditors use Section 363 to force the sale of assets for themselves and leave nothing for other creditors).

367. *See, e.g.*, Mankovetskiy, *supra* note 5, at 93, 94-95 (noting the creditor push behind recent increases in quick asset sales and decreasing amounts of reorganizations).

368. *See, e.g.*, George W. Kuney, *Hijacking Chapter 11*, 21 EMORY BANKR. DEV. J. 19, 26-28 (2004) (describing the methods used by secured creditors to take advantage of chapter 11 proceedings to realize financial gains for themselves at the expense of other creditors).

369. *See supra* Section IV.B (explaining how reforms to the English Administration forced creditors into a more collaborative process).

370. *See supra* Section IV.B (describing how creditors can avoid the traditional bankruptcy proceedings but cannot take priority over other creditors).

collective process and raced to increase their own recoveries with no participation from more junior creditors.[371]

The pressure point in both countries appears to be financing cooperative processes. In the United States, companies without unsecured assets available to offer in exchange for new credit rely on super priority for existing secured creditors to induce them to lend.[372] In the United Kingdom, no special mechanism for funding a period of reorganizing exists at all, and the procedural requirements of the reorganization process envisioned are particularly expensive.[373]

The negative overall effects, however, far outweigh the cost reductions gained by undermining national bankruptcy laws. Studies indicate that while professional fees decrease in Section 363 asset sales, burdens fall on unsecured creditors, and their recoveries plummet.[374] Preliminary data from the United Kingdom suggests that renewed secured creditor control has not lowered expenses or increased creditor recoveries.[375]

The purpose of bankruptcy law has been to impose collective procedures on creditors.[376] Otherwise, creditors race to maximize their own recoveries, leaving others with little or nothing.[377] Allocating assets to the fastest, most sophisticated creditors depletes value from companies, generating inefficiencies and waste.[378] In the face of these pressures, it is necessary to reanimate the aims of the law by devising measures to realign the interests of the strongest creditors with participating in collective reorganization efforts.

371. *See supra* Section IV.C (explaining how secured creditors plan sales before the companies enter Administration).

372. *See supra* Section II.A (describing how "priming liens" take priority over existing security interests).

373. *See supra* Section IV.C (outlining the costs of professional, legal, time, reporting and advertising costs).

374. *See supra* Section III (explaining how the length of the proceeding raises professional fees and how much longer traditional proceedings compared to Section 363 proceedings).

375. *See supra* Section IV.C (reporting data on professional fee totals).

376. *See supra* Section I (describing the goals and benefits of collective procedures).

377. *See supra* Section I (explaining how an absence of collective procedures incentives an individual race to collect before other creditors).

378. *See supra* Section I (explaining how the assets might be more valuable as a whole rather than sold off separately).