

21 Emory Bankr. Dev. J. 19

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**\*19** HIJACKING CHAPTER 11

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The money is the key to this thing.<sup>1</sup>

**\*20 TABLE OF CONTENTS**

	Introduction	21
I.	Setting the Stage: The Bankruptcy Code's Key Administrative Changes to the Previous Bankruptcy System	33
	A. From Administrator to Adjudicator: The Demise and Rise of the Bankruptcy Judge	33
	B. Encouraging Higher Fees and Incentivizing Professionals	39
	C. The Stage Is Set: Diverting the Process from Benefit to Unsecured Creditors and Equity to Secured Creditors, Insiders, and Professionals	45
II.	Secured Creditor Dip Financing Provisions and Techniques	46
	A. DIP Financing Under § 364 of the Bankruptcy Code	47
	B. The Structure of DIP Financing	50
	1. Short-Term, Restrictive DIP Financing	50
	2. Covenants in DIP Financing	52
	3. Pricing and Fees Associated with DIP Financing	56
	C. Controversial DIP Lender Protections	57
	1. Cross-Collateralization and Rollups	60
	2. Waiver of the Debtor's Claims Against the DIP Lender	64
	3. Superpriority in a Converted Chapter 7 Case	66
	4. Carve-Outs	67
	5. Immediate Relief from the Stay	68
	6. Change in Control	69
	7. Plan Approval Provisions	70
	8. Enhancement Fees	72
	9. Liens on Avoidance Actions	73
	10. Summary of DIP Lender Protections	74
III.	Insider Retention Programs	74
	A. Payments to Employees and Retention Plans	77
	B. Terms Contained in Retention Plans: Golden Parachutes, Severance Packages, and Bonuses	81
	1. Golden Parachutes	82
	2. Severance Packages	83
	a. Terms of Severance Packages	84
	b. Treatment of Severance Claims in Chapter 11	84
	3. Bonuses	86

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

---

	a. Lump Sum Bonuses	86
	b. Stock and Stock Options	87
	c. Performance-Based Compensation	88
	4 . Conclusion: Compensation for “Key” Employees	89
IV.	Liability Releases for Insiders	90
	A. Third Party Releases	91
	1. Temporary Injunctions	93
	2. Permanent Injunctions	98
	B. Channeling Injunctions	102
	C. Conclusion: Use of Liability Protections for Insiders	105
V.	Sales of Substantially All the Assets of a Business	105
	A. Sales of Estate Assets Under the Bankruptcy Code	106
	B. Section 363(f) Sales Favor Purchasers and Secured Creditors	108
VI.	Conclusion: A Federal Unified Foreclosure System Run by Incentivizing Insiders and Professionals	110

**\*21 Introduction**

For all the public attention lavished on the process of cleaning up the business world through corporate reform, little attention is paid to assessing and, if necessary, fixing the process that awaits companies that fall victim to corporate malfeasance--chapter 11. It is like cleaning the kitchen sink--once the garbage and scraps have passed through the black sound baffle of the disposer into the drain, nobody pays much attention to what happens below. It is enough to know that there is a disposer--how it works, what goes on in there, and where and in what condition it expels its waste is of little apparent public interest.

The Bankruptcy Code<sup>2</sup> was enacted in 1978 and became effective twenty-five years ago in 1979.<sup>3</sup> Since then it has been portrayed as a debtor-friendly statute featuring a fresh start for debtors<sup>4</sup> and the prospect of reorganization for businesses.<sup>5</sup>

\*22 Enthusiasts claim the Code generates net social gains by capturing going concern value<sup>6</sup> and serving the needs of a wide set of interest groups.<sup>7</sup> Detractors have attacked the Bankruptcy Code and the resulting bankruptcy system as too costly for debtors,<sup>8</sup> too costly for taxpayers,<sup>9</sup> too debtor friendly,<sup>10</sup> producing too little benefit for unsecured creditors,<sup>11</sup> and being too time consuming.<sup>12</sup> Early on, debtors and their counsel were quick to seize upon the new statute and create ways to increase debtor and, in some cases, unsecured creditor or equity holder, leverage vis-à-vis secured and other classes of creditors.<sup>13</sup> The bankruptcy bench largely--but perhaps \*23 erroneously<sup>14</sup>--perceived as pro-debtor,<sup>15</sup> encouraged this trend somewhat.<sup>16</sup>

Secured creditors have long funded appeals on issues such as the appropriateness of separate classification and disparate treatment of deficiency claims,<sup>17</sup> lien strip down,<sup>18</sup> the new value exception,<sup>19</sup> pendency interest for under-secured creditors,<sup>20</sup> and \*24 limits on the stretch-out of secured debt in a cram down.<sup>21</sup> In addition, creditors' efforts to achieve further gains in the long-pending but still unenacted bankruptcy reform act<sup>22</sup> and the recently revised Uniform Commercial Code Article 9<sup>23</sup> have been widely discussed.<sup>24</sup> Yet only isolated attention has been paid to a number of phenomena and tactics that, taken together, especially in large corporate cases,<sup>25</sup> have been very effective at allowing secured \*25 creditors capitalizing upon agency problems<sup>26</sup> to gain the help of insiders and insolvency professionals to effectively take over--or “hijack”<sup>27</sup>--the chapter 11 process and essentially create a federal unified foreclosure process.<sup>28</sup> The next phase in this evolution is \*26 signaled by the efforts of the investment banks to amend the Bankruptcy Code's disinterestedness standard so that they too can participate in the lucrative process of reorganizing former clients who have failed to deliver on the financial projections touted in earlier rounds of financing.<sup>29</sup>

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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In 1978, the Bankruptcy Code stripped most administrative case control from bankruptcy judges<sup>30</sup> and simultaneously encouraged awards of higher fees to professionals.<sup>31</sup> Thereby, the stage was set for a form of reorganization practice driven by the enlightened self-interest of the most organized parties with the lowest cost access to relevant information: secured creditors, insiders, and insolvency professionals. What has followed is the rise of debtor-in-possession<sup>32</sup> financing,<sup>33</sup> carve-outs from that financing to pay professional fees including those of the debtor and committee's counsel;<sup>34</sup> the use of cross-collateralization,<sup>35</sup> lien validation,<sup>36</sup> and similar provisions;<sup>37</sup> the use of blanket lien financing,<sup>38</sup> insider<sup>39</sup> retention bonuses;<sup>40</sup> sales of **\*27** substantially all the assets of a business or a division free and clear of claims and interests either under a plan or preplan sale;<sup>41</sup> and broad releases of liability for insiders and professionals.<sup>42</sup> These developments enable knowledgeable and well counseled secured creditors to exploit agency problems within debtor and estate management, and to take over and control a chapter 11 case and use it as an effective, taxpayer-supported, unified federal foreclosure mechanism to maximize the value that they derive from their collateral.<sup>43</sup> This is accomplished with the aid of insiders and professionals who stand both to profit and receive shelter from exposure to liability in exchange for cooperation and active engagement in the process.<sup>44</sup> It is not necessary for this process to require express collusion on the part of the different parties; it can simply result from the agency problems attendant upon any incorporated entity that must act through agents and from the market's "invisible hand"<sup>45</sup> guiding the various players. The proliferation of repeat players in the insolvency community<sup>46</sup> only **\*28** demonstrates specialization and expertise, not collusion. What is clear is that the cumulative effect of these phenomena and tactics have established large chapter 11 proceedings as ones that do much to benefit secured creditors, insiders, their counsel and other professionals<sup>47</sup> and very little to benefit unsecured creditors, shareholders, and employees--precisely those who are held up as the intended beneficiaries of the bankruptcy system.<sup>48</sup> Once secured creditor control has been established and the debtor's agents critical to this control have been taken care of, there is little real incentive on the part of those with the power to do so to realize value for those with lower priority.

A fair reading of the Code and the legislative history of chapter 11 demonstrates that Congress did not intend to enact a broad federal unified foreclosure mechanism to benefit secured creditors.<sup>49</sup> Chapter 11 cases were designed to produce chapter 11 **\*29** plans, not preplan liquidations.<sup>50</sup> Rather than succeed in its goal of allowing for reorganization of troubled businesses and preservation of going concern value through confirmed plans of reorganization,<sup>51</sup> chapter 11 has been used as a mechanism to stave off foreclosure in single asset real estate cases while waiting for the real estate market to rebound or prevailing interest rates to fall and to promote efficient<sup>52</sup> --or at least unified<sup>53</sup> --foreclosure in large corporate cases.<sup>54</sup> Its success in reorganizing small and middle market businesses has been both questioned and critiqued.<sup>55</sup>

**\*30** If meaningful understanding or reform of chapter 11 is to be had, those participating in the process must face facts<sup>56</sup> and look beyond and through platitudes and incantations about benefits to unsecured creditors, and even equity holders, that echo every day from the Bankruptcy Code's legislative history, and bankruptcy pleadings and courtrooms.<sup>57</sup> It may have taken some time, but the lending industry and the insolvency community found the holes and handles in chapter 11 and have used them to their advantage. Perhaps it would be best to note the market-driven ingenuity of this effort and embrace its purpose, amending the statutes and rules that can regulate and moderate its excesses while also serving its goals.<sup>58</sup> **\*31** The case can also be made for simply repealing chapter 11,<sup>59</sup> perhaps while amending chapter 7 to make trustee operation, structured as management's overseer rather than its replacement, of a business's pending sale, more routine so as to appease those that aim to preserve going concern value (although this value generally accrues in favor of secured creditors and administrative claimants).<sup>60</sup> In either event, or any other, the debate should focus on a frank examination of what chapter 11 is really used for today, whether this is something worthy of continuing or improving at taxpayer expense, and, if not, deciding what chapter 11 should be doing and

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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how to make it do that. In short, to evaluate or reform chapter 11, it is necessary to return to first principles and ask, “what is this legislation actually supposed to accomplish and is it accomplishing that purpose?”

Part I of this Article reviews two fundamental changes to the bankruptcy system wrought by the Bankruptcy Code: limiting bankruptcy judges' administrative control over debtors, their estates, and cases; and encouraging more competitive fee awards in order to draw in a higher--or at least broader-- caliber of bankruptcy professionals. This Article posits that those developments set the stage for the rise of secured creditor strategies and tactics to gain control of the case. Part II examines in a detailed manner the features of debtor-in-possession (“DIP”) financing and related transactions that combine with the other tactics mentioned in this Article to benefit secured creditors and allow them to use their legal priority position to gain practical control. Parts III and IV, \*32 respectively, provide a detailed examination of insider retention programs and releases of liability, each a technique that can be an incentive for the debtor's and estate's agents to act to benefit the parties exercising control. Part V provides a brief overview of the use of sales either under a plan or preplan to liquidate collateral and maximize value--value that is generally to be received by secured creditors and those they allow to participate in the distribution. Part VI then outlines the process through which these tactics are often orchestrated into an overall pro-secured creditor strategy and the ramifications of that development. Secured creditors have been very effective in capturing and capitalizing upon what is often and erroneously perceived as a pro-debtor or pro-unsecured creditor process. Rather than serving the oft stated goals of benefit to the estate, benefit to unsecured creditors, rehabilitation of troubled businesses, and preservation of jobs and established enterprises, the chapter 11 process is often used by secured creditors and those that they influence as a federally<sup>61</sup> (and unsecured creditor)<sup>62</sup> funded process to control the liquidation of their collateral.<sup>63</sup> Hijacking of chapter 11 goes on regularly, in plain view.<sup>64</sup>

**\*33 I. Setting the Stage: The Bankruptcy Code's Key Administrative Changes to the Previous Bankruptcy System**

The enactment of the Bankruptcy Code in 1978 wrought many fundamental changes to the federal bankruptcy system. Among those changes, two are addressed in this Part: (1) The evolution of the bankruptcy referee, a sometimes partisan administrator, into the bankruptcy judge, an almost pure adjudicator with few administrative duties and responsibilities,<sup>65</sup> and (2) the encouragement of higher fee awards for bankruptcy professionals, which drew in, and some would say drew back, elite law firms and their networks of professionals into the bankruptcy system.<sup>66</sup> This resulted in a shift in control over the administration of a case away from an appointed official and toward a group of profit-driven professionals, including some of the most sophisticated law and accounting firms in the country.

**A. From Administrator to Adjudicator: The Demise and Rise of the Bankruptcy Judge**

After World War II, the bankruptcy courts saw a huge influx of consumer bankruptcy cases.<sup>67</sup> The inefficiency and ineffectiveness \*34 of the bankruptcy court system became apparent and the insolvency community sought change in the bankruptcy system.<sup>68</sup> Change was necessary because the office of the bankruptcy referee, the precursor to the bankruptcy judge, had evolved. The original role of the bankruptcy referee was as an administrative assistant to the district court judge. The referee saw to the day-to-day task of the administration of a bankrupt's estate.<sup>69</sup> The referee's judicial role was normally minimal but, if controversies arose during the administration of the estate, the referee would decide those matters subject to district court review.<sup>70</sup> If actual substantive bankruptcy law controversies arose, the federal district or state court would decide those issues.<sup>71</sup>

In 1938, the Chandler Act<sup>72</sup> began the major reformation of the bankruptcy referee and created a more convoluted role. The Chandler Act stripped the referee of some administrative functions, giving those to other non-judicial officials such as trustees

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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and \*35 clerks, and increased the referee's judicial standing while not stripping the referee of all administrative duties.<sup>73</sup> As an administrator, the referee's duties were numerous. The referee would “give notice to creditors,”<sup>74</sup> “prepare and file the schedules of property and lists of creditors,”<sup>75</sup> “examine all schedules of property, lists of creditors, and statements of affairs,”<sup>76</sup> “furnish or cause to be furnished such information concerning proceedings before them as may be requested by parties in interest,”<sup>77</sup> and “preserve the evidence” among other things.<sup>78</sup> As a judge, the referee had many of the same powers and the appearance of a modern bankruptcy judge. For example, the referee's decisions were subject to appellate review,<sup>79</sup> and, later, the referee became a salaried officer like other judicial officials.<sup>80</sup>

It came as no surprise that the dual roles of the referee created conflict among other bankruptcy participants. The individual who read the debtor's petition, scheduled the meetings, and met with the creditors<sup>81</sup> was the same individual who would adjudicate any disputes that arose. It was the referee's duty to decide whether a debtor would be discharged.<sup>82</sup> The referee also appointed or approved the appointment of the trustee.<sup>83</sup> A sense of bias was created; bankruptcy case participants felt that the referee could not perform these dual roles and remain impartial.<sup>84</sup> This was especially \*36 true in the metropolitan areas where specialist bankruptcy bars had begun to emerge.<sup>85</sup> The Commission stated it best:

The involvement of the referee in the administration of estates entails numerous conferences and communications that are informal and ex parte. The responsibility resting on a conscientious referee under the present Act is thus conducive to the development of what appears to attorneys who are not included among the specialists, to their clients, and to the public generally, as an unseemingly and continuing relationship between the referee and the members of the specialist bar. He is thus vulnerable to being linked by imputation to the so-called “bankruptcy ring,” which is the opprobrious label frequently given to the specialized bankruptcy bar in a community.<sup>86</sup> The Commission also pointed out that the proper role of a judicial official in the American judicial system was to deal with judicial functions and not those that were administrative in nature.<sup>87</sup> Since the role of the referee had been elevated from that of an administrative assistant to a judicial official, the Commission on Bankruptcy Law concluded that to maintain the integrity of the court and its functions, the best solution would be to separate the administrative and judicial functions of the bankruptcy referee. After studying the Commission's recommendation, Congress agreed,<sup>88</sup> and thus, when enacting the Bankruptcy Code, Congress separated the administrative and judicial roles of the bankruptcy referee. In doing so, it merged the office of bankruptcy referee and bankruptcy judge, removed the bankruptcy judge's administrative duties, and enacted several changes to the existing bankruptcy law to ensure the successful severance of the dual roles.<sup>89</sup>

\*37 Although the office of bankruptcy referee was eliminated, the administrative duties that the referee performed were not. Early revisions of House Bill 8200<sup>90</sup> proposed the creation of the United States Trustee system. Under the system, the United States Trustee would serve as supervisor and administrator in lieu of the bankruptcy judge.<sup>91</sup> For example, the United States Trustee would appoint and supervise trustees, whereas previously, the bankruptcy judge had done so.<sup>92</sup> Yet the United States Trustee system was not adopted in the final bill. Instead, Congress opted to run the United States Trustee System as a pilot program for five years in select districts;<sup>93</sup> meanwhile, the remaining non-pilot district trustees were appointed and supervised by the Administrative Office of the United States Courts.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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Although the offices that performed the administrative duties in the pilot and non-pilot districts were different, Congress made several more significant changes in the Bankruptcy Code that applied to both types of districts to ensure the successful severance of the referee/bankruptcy judge's dual roles as administrator/judicial official. Under § 341, the court, i.e., the bankruptcy judge, could no longer preside at or attend creditors' meetings.<sup>94</sup> The Bankruptcy Commission had noted, [w]hen litigation does arise, there are substantial reasons for not entrusting its determination to bankruptcy judges involved in the prior administration of these litigated estates. It is necessary and \*38 important that the adversaries have confidence that their controversy will be determined by evidence adduced by . . . the trier of the law and the facts.<sup>95</sup> The evolving role of the bankruptcy referee over the course of the twentieth century created minor chaos in the insolvency world. The dual roles created conflict among bankruptcy system participants causing some to lose faith in the integrity of the court. Congress realized the time for change had come. With the guidance of the Commission on the Bankruptcy Laws and after a study and input period of many decades, Congress made several changes that ultimately led to the elimination of the bankruptcy judge as the lead administrator. Congress merged the role of referee with that of the bankruptcy judge, lodged the bankruptcy judge's administrative role elsewhere, and seemingly eliminated the possibility for the re-emergence of the dual roles, creating an unbiased atmosphere and protecting the integrity of the bankruptcy court.<sup>96</sup> Chapter 11's general presumption that the debtor would manage its estate as a DIP,<sup>97</sup> and the withdrawal of the bankruptcy \*39 judge from case administration--despite later erosion of this separation in the 1994 amendments to the Code --<sup>98</sup> coupled with the United States Trustee's frequent reliance upon debtors, debtors' counsel, the creditors' committee, and creditors' committee counsel in active chapter 11 cases,<sup>99</sup> set the stage for a debtor's management to pursue its own agenda through cooperation with the debtor's major creditors (often the secured ones) that possess the most leverage over the debtor in terms of both financial realities and bankruptcy powers and protections.<sup>100</sup>

## B. Encouraging Higher Fees and Incentivizing Professionals

Prior to the 1978 Bankruptcy Code, courts limited fees recoverable by attorneys and other bankruptcy professionals on the \*40 theory that limiting fees conserved the value of the debtor's estate.<sup>101</sup> Although the 1898 Act gave the trial judge great discretion in setting fees,<sup>102</sup> it also instructed that “[i]n fixing any such allowances, the judge shall give consideration only to the services which contributed to the plan confirmed or to the refusal of confirmation of a plan, or which were beneficial in the administration of the estate, and to the proper costs and expenses incidental thereto.”<sup>103</sup>

Many courts interpreted this provision as placing a limit on fees recoverable and held that bankruptcy attorneys and other professionals could not “always expect to be compensated at the same rate as in litigation of the usual kind.”<sup>104</sup> Moreover, courts interpreted the statute as limiting compensable services to only those that enhanced the value of the debtor's estate.<sup>105</sup> Indeed, the Supreme Court went so far as to hold that “[f]ee claimants are either officers of the court or fiduciaries, such as members of committees, whose claims for allowance from the estate are based only on service rendered to and benefits received by the estate.”<sup>106</sup> Courts held that one of the reasons for the enactment of the bankruptcy statute was the desire to reduce the costs of corporate reorganizations.<sup>107</sup> Consequently, one of the purposes of the Act was to “place those fees under more effective control.”<sup>108</sup> The Second Circuit's attitude was typical:

\*41 We are not disposed to question the reasonableness of such fees by metropolitan practitioners for services of this kind when performed in the course of ordinary litigation. But in a reorganization proceeding, where the lawyers look for compensation to the debtor's estate which may belong, in equity, largely to others than those who have requested their services, they should have in mind the fact that the total aggregate of fees must bear some reasonable relation to the estate's value. Under these

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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circumstances they cannot always expect to be compensated at the same rate as in litigation of the usual kind.<sup>109</sup> During the debate over enactment of the Bankruptcy Code, the House and Senate split over the standard for compensation of bankruptcy professionals. The Senate endorsed the courts' view under the Bankruptcy Act, believing that “[o]ne of the major reforms in 1938, especially for reorganization cases, was centralized control over fees in the bankruptcy courts.”<sup>110</sup> These reforms were intended “to guard against a recurrence of ‘the many sordid chapters’ in ‘the history of fees in corporate reorganization.’”<sup>111</sup> The Senate noted that in the intervening years after the passage of the Chandler Act, the bankruptcy bar had “flourished and prospered.”<sup>112</sup> The Senate thought there was no reason to assume that “in generations to come, their successors will be less persuaded by the need to serve in the public interest because of stronger allures of private gain elsewhere.”<sup>113</sup> Ultimately, however, this was not the prevailing view.

By the 1970s, the attitude of the courts toward the compensation of bankruptcy professionals had come to seem dated. The existing standard, one of economy, discouraged many talented professionals from entering the practice. Congress ultimately declared, “[n]otions of economy of the estate in fixing fees are outdated and have no place in a bankruptcy code” and “bankruptcy legal services are entitled to command the same competency of \*42 counsel as other cases.”<sup>114</sup> [Section 330\(a\) of the Bankruptcy Code](#), as enacted, provided:

After notice to any parties in interest and to the United States Trustee and a hearing, and subject to sections 326, 328, and 329 of this title, the court may award to a trustee, to an examiner, to a professional person employed under section 327 or 1103 of this title, or to the debtor's attorney-

(1) reasonable compensation for actual, necessary services rendered by such trustee, examiner, professional person, or attorney, as the case may be, and by any paraprofessional persons employed by such trustee, professional person, or attorney, as the case may be, based on the nature, the extent, and the value of such services, the time spent on such services, and the cost of comparable services other than in a case under this title; and

(2) reimbursement for actual, necessary expenses.<sup>115</sup> Congress declared “the policy of this section [330(a)] is to compensate attorneys and other professionals serving in a case under Title 11 at the same rate as the attorney or other professional would be compensated for performing comparable services other than in a case under Title 11.”<sup>116</sup> Commentators concluded,

the mandate of [11 U.S.C. § 330\(a\)](#) . . . is an effort to ensure that bankruptcy specialists, who enable the system to operate smoothly, efficiently, and expeditiously, will not be required to accept fees in all of their cases that are consistently lower than fees they could receive elsewhere, thereby forcing them to forego the practice of bankruptcy law. The effect of this consideration is to overrule a line of cases which, under the Bankruptcy Act of 1898, established a lower standard of fees in the bankruptcy context than elsewhere, based on \*43 notions of conservation of the estate and economy of administration.<sup>117</sup> The standard was revised in 1994.<sup>118</sup> [11 U.S.C § 330\(a\)](#) now reads, in pertinent part:

(a)(1) After notice to the parties in interest and the United States Trustee and a hearing, and subject to sections 326, 328, and 329, the court may award to a trustee, an examiner, a professional person employed under section 327 or 1103-

(A) reasonable compensation for actual, necessary services rendered by the trustee, examiner, professional person, or attorney and by any paraprofessional person employed by any such person; and

(B) reimbursement for actual, necessary expenses.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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(2) The court may, on its own motion or on the motion of the United States Trustee, the United States Trustee for the District or Region, the trustee for the estate, or any other party in interest, award compensation that is less than the amount of compensation that is requested.

(3)(A) In determining the amount of reasonable compensation to be awarded, the court shall consider the nature, the extent, and the value of such services, taking into account all relevant factors, including-

(A) the time spent on such services;

(B) the rates charged for such services;

(C) whether the services were necessary to the administration of, or beneficial at the time at which the service was rendered toward the completion of, a case under this title;

(D) whether the services were performed within a reasonable amount of time commensurate with the complexity, importance, and nature of the problem, issue, or task addressed; and

(E) whether the compensation is reasonable based on the customary compensation charged by comparably skilled practitioners in cases other than cases under this title.

\*44 (4)(A) Except as provided in subparagraph (B), the court shall not allow compensation for --

(i) unnecessary duplication of services; or

(ii) services that were not --

(I) reasonably likely to benefit the debtor's estate; or

(II) necessary to the administration of the case.<sup>119</sup> Courts now ask whether the fee applicant's efforts resulted in actual and demonstrable benefit to the debtor's estate and creditors. Thus, the current standard is to compensate bankruptcy professionals for reasonable and necessary services at rates comparable to what they would receive in the non-bankruptcy arena.

Congress was successful in its effort to attract high caliber professionals to handle bankruptcy cases. Looking at large chapter 11 cases, one regularly sees some of the most elite firms in the country participating in the process and in the distributions from estates based upon their fee applications and administrative claims.<sup>120</sup> Some would argue that Congress was too successful in this regard and created a process that is the site of a professional fee feeding frenzy.<sup>121</sup> At the same time that Congress decreased the \*45 administrative control of the bankruptcy judge, it increased the incentives for sophisticated attorneys and other professionals to enter the chapter 11 arena and to act in their own enlightened self-interest and that of their clients (or at least those who authorized them to act on behalf of the clients, i.e., insiders, including directors of officers).

**C. The Stage Is Set for the Hijacking: Diverting the Process from Benefit to Unsecured Creditors and Equity to Secured Creditors, Insiders, and Professionals**



HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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The enactment of the Code accomplished two distinct structural changes in corporate reorganization practice. It withdrew the bankruptcy judge from the position of central administrator in the case, replacing the judge with a combination of the United States Trustee and, if appointed, the unsecured creditors' committee and its counsel, and it liberalized the standards for professional compensation, thus drawing in the blue chip lawyers and law firms that had, in earlier times, created the equity receivership--the original method of federal reorganization to reorganize the railroads.<sup>122</sup> Then, as now, it was the secured creditors' need to maximize recovery from collateral located in multiple jurisdictions that gave rise to the reorganization process.<sup>123</sup> \*46 The next part of this Article details how secured creditors use their security interests' priority and debtor-in-possession and cash collateral financing to exert control over a debtor and its case.

## II. Secured Creditor DIP Financing Provisions and Techniques

Secured creditors may acquire substantial control of a chapter 11 case by providing postpetition financing--also known as DIP financing--and consent to use of their cash collateral<sup>124</sup> by the debtor-in-possession.<sup>125</sup> As debtors typically require financing to reorganize, secured creditors willing to allow use of their cash collateral--which may encompass all of the debtor's liquid assets--or offering additional financing possess substantial bargaining power. Lenders may secure preferential treatment of both their prepetition and postpetition debts, while collecting high rates of interest and large fees and effectively gaining control over the \*47 debtor, its management, and the chapter 11 case itself. What follows is an examination of the methods used by DIP lenders to benefit their interests.

### A. DIP Financing Under § 364 of the Bankruptcy Code

The Bankruptcy Code specifically provides that a debtor-in-possession may obtain additional financing for operating in, and ultimately emerging from, chapter 11.<sup>126</sup> Under § 364 of the Bankruptcy Code, unsecured financing obtained in the ordinary course of business--such as trade credit-- does not even require bankruptcy court approval.<sup>127</sup> Additionally, a debtor may obtain unsecured credit outside of the ordinary course of business by order of the bankruptcy court after notice and a hearing.<sup>128</sup> Credit obtained under either of these conditions merely has general administrative priority.<sup>129</sup> In most cases, only trade creditors are willing to extend unsecured credit, if at all, under these circumstances.<sup>130</sup>

Given either the perception of high risks involved<sup>131</sup> or knowledge that better treatment is available,<sup>132</sup> lenders generally \*48 refuse to extend substantial financing on an unsecured basis with just administrative priority.<sup>133</sup> Rather, most lenders demand at least administrative priority over all other administrative claims, known as superpriority,<sup>134</sup> and either senior liens on unencumbered assets<sup>135</sup> or junior liens on encumbered property<sup>136</sup> to secure the debt. The court may award a lender these protections, provided the debtor can show that credit is unavailable on an unsecured basis.<sup>137</sup> As the necessary DIP financing is generally shown to be unavailable, bankruptcy courts routinely enter orders granting lenders these priorities.<sup>138</sup>

\*49 In extraordinary circumstances, the bankruptcy court may grant a DIP lender a lien on encumbered bankruptcy property equal or senior to that of the prepetition secured creditors.<sup>139</sup> The debtor, however, must show that (a) the debtor is unable to secure DIP financing from any other source and (b) the interests of the prepetition creditors are adequately protected before the bankruptcy court may authorize such priority.<sup>140</sup> Although possible, \*50 this form of DIP financing is rare due to the stringent requirement of adequate protection.<sup>141</sup>

## B. The Structure of DIP Financing

In addition to any protections or priority received under the Bankruptcy Code, DIP lenders generally require greater consideration for any amount loaned to the debtor because of the perceived,<sup>142</sup> or advertised,<sup>143</sup> risks of lending to a chapter 11 debtor.<sup>144</sup> Therefore, a DIP loan is generally a relatively short-term, restrictive loan that contains more stringent covenants and features higher interest rates and fees.

### 1. Short-Term, Restrictive DIP Financing

As the majority of chapter 11 debtors do not reorganize under a chapter 11 plan,<sup>145</sup> DIP lenders understandably are unwilling to offer long-term financing with competitive interest rates.<sup>146</sup> Exit financing to fund implementation of a chapter 11 plan is left to be dealt with separately, and as such is industry practice.<sup>147</sup> Most DIP \*51 financing consists of short-term loans, the majority of which mature within two years of issuance or upon confirmation of a chapter 11 reorganization plan.<sup>148</sup> The majority of DIP loans consist entirely or partially of revolving lines of credit,<sup>149</sup> as opposed to term loans,<sup>150</sup> that utilize the debtor's inventory or inventory and accounts receivable as the borrowing base.<sup>151</sup>

In addition, DIP financing almost universally contains restrictions on the debtor's use of the loan proceeds.<sup>152</sup> Normally, the lenders require that the debtor use the proceeds specifically as \*52 working capital,<sup>153</sup> for general corporate purposes,<sup>154</sup> allowed operating expenses,<sup>155</sup> or a specific real estate development or acquisition.<sup>156</sup>

Both the short term nature of DIP financing--which necessitates a debtor maintaining good relations with its DIP lender absent an alternative source of refinancing--and the basic restrictions built into the loans generate a high degree of control over the debtor by the DIP lender. The next subpart examines DIP loan covenants that further this DIP lender control.

### 2. Covenants in DIP Financing

As additional protection, DIP lenders include stringent affirmative and negative covenants in their loans. These affirmative covenants normally require the debtor to periodically disclose financial records and information so that the DIP lender can easily monitor the debtor's performance.<sup>157</sup> The DIP lender may require the debtor to submit operating budget proposals to the lender for approval prior to making expenditures, as well as proposals for any significant transactions outside the debtor's ordinary course of business.<sup>158</sup> The financing agreement may require that the debtor collect all of its accounts receivable through a lock box<sup>159</sup> or deposit account controlled by the DIP lender.<sup>160</sup> Finally, these financing \*53 agreements also include standard non-DIP loan provisions such as terms requiring the debtor to pay any applicable taxes, insurance premiums, or other obligations during the loan term.<sup>161</sup>

• DIP financing agreements usually include a number of negative covenants, including:

• Restrictions on operating activities;<sup>162</sup>

• Restrictions on capital expenditures;<sup>163</sup>

\*54 • Restrictions on disposition of assets;<sup>164</sup>

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- Restrictions on financing activities;<sup>165</sup>
- \*55 • Maintenance of specific financial ratios;<sup>166</sup>
- Restrictions on cash payouts;<sup>167</sup>
- Preservation of DIP lender's collateral and seniority;<sup>168</sup>
- \*56 • Prohibitions on changes in management, control, or ownership (including appointment of a bankruptcy trustee or conversion of the case to chapter 7);<sup>169</sup> and
- Restrictions on parent-subsidiary transactions.<sup>170</sup> These negative covenants greatly restrict the debtor's operating decisions, providing the DIP lender with both control and protection in the transaction. A violation of these covenants is typically an event of default under the DIP loan documents entitling the lender to relief from the stay and the ability to immediately realize upon its security, begin assessing default interest rates and penalty fees, and terminate any further financing.<sup>171</sup> The overall effect of these covenants is to give the DIP lender almost complete control over the debtor's reorganization.

### 3. Pricing and Fees Associated with DIP Financing

The one feature that almost all forms of DIP financing share is an interest rate significantly higher than that of similar loans provided to non-debtors.<sup>172</sup> A study of 106 DIP loans and 186 similar, non-DIP loans found that the DIP loans had a median interest rate of approximately two hundred basis points higher than \*57 “matching” non-DIP loans.<sup>173</sup> Additionally, DIP loans include provisions demanding significantly higher default rate interest, fees, and other monetary penalties for defaults and late payment.<sup>174</sup> DIP lenders justify these increased rates and harsh default penalties because of the additional “risk” of nonpayment by a chapter 11 debtor.<sup>175</sup> In reality, however, this increased rate appears to be a windfall for banks willing to provide DIP financing based on the additional protections and benefits the bankruptcy court grants DIP lenders.<sup>176</sup> The “risk” cited by lending institutions appears to be nonexistent as the principal of nearly every DIP loan is paid back in full, regardless of whether the chapter 11 debtor reorganizes or liquidates.<sup>177</sup>

### C. Controversial DIP Lender Protections

In addition to the DIP lender protections codified in § 364 of the Bankruptcy Code and the somewhat standard loan document provisions discussed above, insolvency professionals have fashioned a number of other, not-so-standard incentives to induce and protect DIP financing and have convinced bankruptcy judges to approve them.<sup>178</sup> These provisions include waivers of claims against the DIP lender,<sup>179</sup> grants of superpriority claims in cases later converted to chapter 7,<sup>180</sup> limitations on carve-outs for professional fees,<sup>181</sup> \*58 enhanced default provisions coupled with automatic relief from the stay,<sup>182</sup> prohibitions on changes controlled by the debtor,<sup>183</sup> prohibitions on plans not approved by the lender,<sup>184</sup> enhancement fees for lenders when a debtor's business attains certain performance levels,<sup>185</sup> cross-collateralization,<sup>186</sup> rollups of pre and postpetition debts,<sup>187</sup> and grants of liens on avoidance actions and their proceeds.<sup>188</sup> Although often deferring to the debtor's business judgment when obtaining postpetition financing, bankruptcy courts assert that they carefully scrutinize DIP loans containing these controversial

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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incentives, recognizing that debtors are in a weak bargaining position.<sup>189</sup> Thus, some courts require as a matter of course that any proposed order specifically and conspicuously request these types of relief.<sup>190</sup> Nonetheless, bankruptcy judges will order these additional incentives and protections upon a showing that they are “necessary” to attract DIP lenders.<sup>191</sup> Given the \*59 protections authorized by § 364 and high interest rates typical of DIP loans, however, these additional protections and incentives appear unnecessary and, in conjunction with the less controversial loan document terms discussed earlier,<sup>192</sup> more likely have the effect of giving DIP lenders explicit and perhaps unnecessary control over much of the chapter 11 case. As discussed earlier, the Bankruptcy Code removed bankruptcy judges from most of the job of administering the estate.<sup>193</sup> This set the stage for domination and control of the chapter 11 process by the monied interests--in the large chapter 11 case, the secured creditors and DIP lenders--regardless of how much process, how many duties, and how many powers were granted or thrust upon unsecured creditors, their committees, or the office of the United States Trustee.<sup>194</sup> The next ten subparts discuss controversial but not uncommon DIP lender protections negotiated into court-approved DIP financing agreements in corporate chapter 11 cases.

**\*60** 1. Cross-Collateralization and Rollups

One often discussed method of inducing DIP financing is cross-collateralization. Cross-collateralization occurs when the lender obtains additional security not only for postpetition loans, but also for its prepetition claims.<sup>195</sup> These provisions are especially attractive to DIP lenders holding either unsecured or undersecured prepetition claims. The Second Circuit defined cross-collateralization in the seminal case of *In re Texlon Corporation* as occurring where, in return for making new loans to a debtor in possession under Chapter XI, a financing institution obtains a security interest on all assets of the debtor, both those existing at the date of the order and those created in the course of the Chapter XI proceeding, not only for the new loans, . . . , but [also] for existing indebtedness to it.<sup>196</sup> No Bankruptcy Code provision specifically authorizes the bankruptcy court to approve this type of relief.<sup>197</sup> Indeed, the *Texlon* court did not endorse or prohibit cross-collateralization; rather, it merely stated that cross-collateralization may be appropriate in \*61 certain circumstances and refused to uphold the financing order at issue as unsupported by the record.<sup>198</sup>

Some courts have issued financing orders authorizing DIP loans with cross-collateralization provisions.<sup>199</sup> Still, even these courts have acknowledged that cross-collateralization is a disfavored means of DIP financing and should be approved only in limited circumstances.<sup>200</sup> Since Congress has not explicitly authorized cross-collateralization, other courts have declined to enforce such provisions, even in so-called exceptional circumstances.<sup>201</sup> However, \*62 more recent cases suggest that cross-collateralization is not completely unavailable.<sup>202</sup> It remains another tool in the secured \*63 creditor's tool belt with which to extract value from the estate to the detriment of more junior interests.

A “rollup” provision is another term that may appear in a DIP financing agreement that is substantially similar to cross-collateralization but avoids that *Texlon*-tainted term. “Rollups include the use of postpetition financing to pay, in whole or in part, prepetition secured debt.”<sup>203</sup> These provisions are said to be only available in the most unusual circumstances.<sup>204</sup>

**\*64** 2. Waiver of the Debtor's Claims Against the DIP Lender

Bankruptcy courts have allowed chapter 11 debtors to waive their rights against lenders providing DIP financing.<sup>205</sup> As consideration for DIP financing, debtors may, for example, waive the right to object to the validity, priority, and amount of

## HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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the lender's prepetition claims.<sup>206</sup> These waivers are routinely included in the DIP loan documents to provide an incentive to loan.<sup>207</sup>

Additionally, bankruptcy courts have permitted debtors-in-possession to waive prepetition claims that the estate may have against a lender as added consideration for DIP financing.<sup>208</sup> In some cases, courts have even allowed the debtor to cancel prepetition obligations owed by the lender to the debtor.<sup>209</sup> Since \*65 these waivers are potentially harmful to other parties in interest, commentators suggest that bankruptcy courts should at least provide the official committees with an opportunity to object before issuing this order.<sup>210</sup>

Although waivers of the debtor's ability to sue a lender for prepetition conduct are considered extraordinary provisions,<sup>211</sup> other waivers entered into by a debtor are not.<sup>212</sup> For example, when properly disclosed, the following waivers are not considered extraordinary:

- (1) waiver of the automatic stay--i.e. immediate relief from stay--as it applies to actions related to the DIP financing;<sup>213</sup>
  - (2) waiver provisions that contain reasonable limitations and conditions regarding future borrowings under § 364 or use of cash collateral under § 363;<sup>214</sup> and
  - (3) waiver terms providing that the DIP lender does not have to fund certain activities of counsel for the debtor or the official unsecured creditors' committee, provided that such waiver does not prohibit either party from engaging in those activities.<sup>215</sup>
- \*66 Waivers like these are characterized as “not extraordinary” because they are said not to materially alter either the rights or powers of the bankruptcy court, the debtor, or any other party in interest.

### 3. Superpriority in a Converted Chapter 7 Case

Absent a court order otherwise, when a reorganization case is converted to a chapter 7 liquidation, claims originally granted administrative priority in chapter 11 are subordinated to later chapter 7 administrative claims.<sup>216</sup> Further, if the chapter 11 case is converted to a chapter 7 after plan confirmation, the pre-confirmation administrative claimants, such as a DIP lender, will lose their administrative priority status entirely.<sup>217</sup> Thus, if the DIP lender's administrative claims are not to be paid in full on the effective date of the confirmed plan,<sup>218</sup> they are at risk of losing priority.<sup>219</sup> DIP lenders understandably want not only to obtain superpriority in the current case, but also to retain that priority should the case be converted to a chapter 7 case after the chapter 11 plan has been confirmed,<sup>220</sup> or if a second (or third) chapter 11 case \*67 is commenced.<sup>221</sup> For added protection, therefore, DIP lenders often require that the DIP loan documents contain language granting the lender superpriority post-conversion to chapter 7 and requiring matching language in the plan.<sup>222</sup>

### 4. Carve-Outs

A “carve-out” is an order or part of a financing order that specifically reserves a portion of the DIP's loan proceeds for the payment of professional fees of the debtor's or committee's counsel and other advisors as postpetition, administrative expenses.<sup>223</sup> Carve-outs are consistent with the Bankruptcy Code's policy of ensuring quality professional representation, i.e., representation equal to that available outside of bankruptcy, for debtors in bankruptcy.<sup>224</sup> For this reason,

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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[c]ourts generally insist that financing arrangements provide for a carve out from a super-priority status and postpetition lien in a reasonable amount designed to provide for payment of the fees of debtor's and the committees' counsel and possible trustee's counsel in order to protect the interests of the debtor, the unsecured creditors and to preserve the adversary system.<sup>225</sup> Nonetheless, some lenders have included provisions that attempt to eliminate these carve-outs and/or prevent the debtor from using bankruptcy estate assets to fund claims or defenses brought against the lender.<sup>226</sup> As with the other shackles that DIP loan provisions place on debtors and professionals in the case, these provisions \*68 undermine debtor and committee independence and options, and allow the lender to control the reorganization either directly or by constraining the conduct of the other actors in the case.

### 5. Immediate Relief from the Stay

DIP financing agreements generally include a provision lifting or providing for a future lifting of the stay and authorizing the lender to exercise its rights and remedies upon the debtor's default under the DIP loan documents without the need to gain bankruptcy approval at the time of a default.<sup>227</sup> These provisions are sometimes referred to as “drop-dead clauses” and ensure that the lender is able to effectively enforce its DIP loan covenants.<sup>228</sup> The name is indicative of their effect. Bankruptcy courts normally refuse to approve drop-dead clauses that authorize an automatic lift of the stay.<sup>229</sup> On the other hand, most courts will authorize drop-dead clauses providing for a rapid lifting of the stay, but only after notice and a hearing—or at least an opportunity to be heard.<sup>230</sup> These \*69 clauses are structured so that previously approved recitals and stipulations in the loan documents limit the issues to be litigated to whether the debtor in fact defaulted under the terms of the agreement.<sup>231</sup> Reasonable notice of the default and the imminent enforcement of a drop-dead clause are required ostensibly to protect not only the debtor but also other parties in interest in the bankruptcy case.<sup>232</sup> If these clauses are enforced, however, notice provides limited protection because the debtor may only litigate the fact of default question and cannot make arguments for excusing the default based upon changed circumstances, imminent harm, impending success, or adequate protection. Presumably other parties in interest might still be heard to raise these non-fact-of-default arguments.<sup>233</sup>

### 6. Change in Control

As in all forms of asset-based financing, lenders will almost always include a change in control provision.<sup>234</sup> A “change in control” term provides that the debtor will default on the loan if the persons managing the debtor change.<sup>235</sup> Upon such an event, the DIP loan typically is accelerated and the entire outstanding amount of the loan becomes immediately due.<sup>236</sup> “[T]hese clauses seem \*70 perfectly reasonable because a lender [will] often have a certain confidence in existing management and any change of key officers may dramatically affect how comfortable they are in continuing to lend.”<sup>237</sup> Change in control provisions further protect the DIP lender by acting as or supplementing an anti-assignment provision.<sup>238</sup>

Although these provisions are routinely included and enforced outside of bankruptcy, courts do not uniformly enforce change in control provisions inside bankruptcy. While some courts have approved provisions accelerating the DIP loan obligations upon any change in control,<sup>239</sup> others have been reluctant to do so, fearing that the clause would wrongfully secure the position of the current management.<sup>240</sup> Similarly, while some courts have authorized clauses triggering default upon the appointment of a trustee,<sup>241</sup> other courts have declined to enforce these provisions.<sup>242</sup> Courts refusing to approve or enforce limited change in control clauses reason that they impermissibly limit a party in interest's ability to remedy fraud or mismanagement by seeking appointment of a trustee.<sup>243</sup> These decisions recognize that when change of control provisions are approved, the lender gains

## HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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substantial power and influence over the chapter 11 case and can use this power and influence to serve its own enlightened self-interest.

### 7. Plan Approval Provisions

Lenders may also attempt to protect their investments by including provisions that restrict a debtor's ability to confirm a chapter 11 plan that is unfavorable to them or of which they do not approve. For example, a lender may attempt to include a covenant \*71 from the debtor that it will not seek confirmation of a chapter 11 plan over the DIP lender's objection.<sup>244</sup> A "cram down"<sup>245</sup> or attempted cram down may be listed as an event of default in its loan documents or the financing order.<sup>246</sup>

Some courts hold that these provisions are generally not enforceable as they abrogate statutory rights of the debtor and other parties in interest provided under § 1129 of the Bankruptcy Code.<sup>247</sup> Others go so far as to recognize that acceptance of these provisions may violate the debtor's fiduciary duty to the estate and its creditors because the bankruptcy process may be transformed from a collective proceeding into a proceeding that benefits only one creditor.<sup>248</sup>

Other courts, however, have enforced provisions that are somewhat less restrictive on the debtor's ability to reorganize, although they may have the same practical effect: to increase the likelihood that the case will be conducted substantially for the benefit of the DIP lender. For example, in *In re Western Pacific Airlines*, the Bankruptcy Court for the District of Colorado validated a DIP loan requiring written consent from the DIP lender before the debtor could obtain an order "confirming a plan [that would] alter or impair the rights of the [DIP lender] . . . ." <sup>249</sup> The agreement also provided that the DIP lender's rights would remain intact regardless of whether the case was converted to chapter 7.<sup>250</sup> The Western Pacific court noted that the terms of the DIP loan gave the DIP lender a "not insignificant amount of control over the Debtor [and] may well impede another party's attempt to propose a \*72 competing plan on a level playing field."<sup>251</sup> However, given the circumstances of the case --where apparently no other comparable financing was available--the court found that the debtor's acceptance of these less restrictive terms was not a breach of its fiduciary duties.<sup>252</sup>

### 8. Enhancement Fees

Debtors may endorse, and a bankruptcy court may approve, enhancement fee provisions awarding DIP lenders additional compensation should the debtor's business performance satisfy certain goals.<sup>253</sup> Enhancement fees allow lenders to realize a portion of any increase in value experienced by the debtor resulting from the DIP loan or the debtor's operations, acting as an "equity kicker" to enhance the deal.<sup>254</sup> This compensation is similar to that awarded both inside and outside of bankruptcy to corporate directors or officers, or to consultant or investment banking institutions, for services that presumably contribute to a business's success.<sup>255</sup> Nonetheless, few reported cases have enforced an enhancement fee contained in a DIP loan.<sup>256</sup> Bankruptcy courts will likely approve enhancement fee provisions only in the most limited \*73 circumstances.<sup>257</sup> To the extent an enhancement fee is employed, it increases the benefits of the chapter 11 case enjoyed by the DIP lender.

### 9. Liens on Avoidance Actions

DIP lenders may also include a provision that places a lien on the debtor's right to bring avoidance actions such as fraudulent conveyance and preference actions or the proceeds of these actions.<sup>258</sup> Under these provisions, the debtor pledges any possible monetary award or settlement that the debtor might receive from a fraudulent conveyance or preference suit as security for a DIP loan. However, some courts have pushed back at the DIP lender's attempt to sweep more collateral into their basket and have

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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declined to approve financing orders granting the DIP lender security interests in these actions.<sup>259</sup> These courts have--some would claim in a rather ipse dixit<sup>260</sup> fashion-- held that avoidance actions cannot be used as collateral for a DIP loan under § 364 because they belong solely to the debtor-in-possession or trustee.<sup>261</sup> This conclusion makes some sense as both the debtor-in-possession and the trustee owe fiduciary duties to all parties in interest to the bankruptcy case--not just the DIP lender--although in the course of a case many decisions must be made that necessarily prefer one or more creditors over others.<sup>262</sup> \*74 Thus, the proceeds of avoidance actions, which are property of the estate and in many cases are created or preserved solely by the filing of the bankruptcy petition, entry of the order for relief, and creation of the estate, arguably belong to all creditors and equity interest holders of the estate and should not be summarily encumbered by a § 364 financing order for the benefit of a single creditor--the DIP lender.<sup>263</sup>

#### 10. Summary of DIP Lender Protections

As shown above, DIP lenders and their counsel have taken the sparse authorizing language of [Bankruptcy Code § 364](#) and used it to perfect a transaction that garners them high fees, good return on investment, substantial control over the debtor's management and operations, and enhanced prospects for repayment of their prepetition debt. All these effects come at the expense of lower priority unsecured creditors and equity holders. Part III of this Article details the next strategy--using this control and leverage to exploit agency problems and incentivize the debtor's insiders with retention programs and ensure further cooperation in both the granting of DIP financing on creditor favorable terms and in using the chapter 11 case as a unified foreclosure process.

### III. Insider Retention Programs

When a corporation files a chapter 11 petition, in many cases one of its most important considerations is the retention of its employees. No corporation can operate, let alone perform any action, on its own behalf, despite being defined as a "person" under the Code and Constitution.<sup>264</sup> Certainly a corporate debtor--especially one wishing to reorganize--requires directors, officers, \*75 and employees to operate. This creates an opportunity to exploit an agency problem to obtain control over the debtor and its estate.

However, because employees are creditors of the bankruptcy estate,<sup>265</sup> the debtor is generally prohibited from paying them for work performed prepetition.<sup>266</sup> Because a debtor-in-possession--and the lenders seeking to realize upon their collateral--almost always require the employees of the business to continue to operate, and because many of its employees depend on their paychecks to pay their basic living expenses,<sup>267</sup> a debtor will move the bankruptcy court for permission to pay its employees almost immediately after filing its petition.<sup>268</sup> In its first-day motions, the debtor-in-possession typically requests authorization to pay its employees their normal salaries for work completed prepetition.<sup>269</sup> Additionally, the debtor normally will request that the bankruptcy court allow it to pay employees' normal salaries for postpetition work and to pay and \*76 honor employee benefits--such as accrued vacation and sick leave--in the ordinary course of business.<sup>270</sup> Since these first-day motions are essential to retain employees,<sup>271</sup> bankruptcy courts normally approve such requests--provided, it is said, that they are reasonable.<sup>272</sup> These motions and the relief sought are not particularly controversial, at least within the insolvency community, although they have recently come under additional scrutiny.<sup>273</sup>

In addition to receiving their normal salary under a court approved first-day motion, management, directors, and officers of the debtor often receive additional compensatory consideration \*77 from the debtor in the form of retention plans.<sup>274</sup> Insiders negotiate these deals to limit the risk of financial loss from their termination. To retain these insiders, the "key



HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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employees,” debtors sometimes propose that they receive golden parachutes, severance packages, and retention incentives.<sup>275</sup> More commonly, however, the debtor will provide insiders with significant, up-front bonuses as an incentive to continue working for the debtor-corporation.<sup>276</sup> The debtor often justifies this additional compensation by arguing--some might say “threatening”--that a retention plan is vital for an effective reorganization.<sup>277</sup> The following subpart examines the different types of substantial compensation that debtors provide insiders to entice these people to continue to work for the debtor-in-possession.

### A. Payments to Employees and Retention Plans

Under § 363(c)(1), a chapter 11 trustee or debtor-in-possession may freely use, sell, or lease property of the estate--including money--as necessary to operate in the ordinary course of business without court approval.<sup>278</sup> However, § 363(b)(1) states that a trustee or debtor-in-possession may not use, sell, or lease property of the estate outside of the ordinary course of business without a court order approving the use after notice and a hearing.<sup>279</sup> Section \*78 363(b)(1) prevents the debtor from completing any transaction that would harm the estate by negating any transfer made outside the ordinary scope of business without prior notice and a hearing.<sup>280</sup> Furthermore, the trustee or debtor-in-possession may only use, sell, or lease property of the estate which is considered “cash collateral”<sup>281</sup> in two circumstances: (a) where each entity with an interest in the cash collateral consents or (b) where the bankruptcy court authorizes the use after notice and a hearing.<sup>282</sup>

Bankruptcy courts have enunciated a general two-pronged test for determining whether to approve a retention plan.<sup>283</sup> Retention \*79 plans will be approved where (i) the debtor has formulated the plan after using proper business judgment<sup>284</sup> and (ii) the court finds the retention plan to be “fair and reasonable.”<sup>285</sup> With a test as ephemeral as this, approval of a retention plan will turn on the particular facts and circumstances of each case and the attitude--perhaps even the mood--of the court involved.<sup>286</sup> However, as the Aerovox court noted, the bankruptcy court should defer to the judgment of the debtor-in-possession operating its business “unless it is shown to be ‘so manifestly unreasonable that it could not be based upon sound business judgment, but only on bad faith, or whim or caprice.’”<sup>287</sup> In reality, this two-prong test is a single fuzzy \*80 prong: good faith business judgment--something that one presumably knows when one sees it.<sup>288</sup>

Nevertheless, the debtor bears the burden of producing evidence supporting any claim that the retention plan is based on sound business judgment and is reasonable.<sup>289</sup> “[S]uch a showing can be made by demonstrating that there is a significant risk that the debtor will lose valued employees without such a program, and that the program is reasonably designed to achieve desired results without unduly burdening the estate.”<sup>290</sup> However, the debtor's production of evidence supporting sound business judgment and reasonableness is accorded only a presumption of validity, which an objector may rebut by producing evidence showing otherwise.<sup>291</sup> The ease with which retention plans gain approval differs based upon the eye of the beholder. For critics of retention plans, they are too often routinely granted,<sup>292</sup> and for those that favor them, the standards and restrictions imposed by courts may appear excessive. Further, the results do not have to be the same just because an announced standard is applied by the same court faced with the \*81 same facts.<sup>293</sup> One thing, however, is clear: Because the debtor must obtain secured creditor consent or prove adequate protection of the secured creditor's interest in cash collateral, the secured creditor's cooperation is critical in gaining approval of the plan. This fact provides the lender or secured creditor with additional leverage with which to affect the direction of the case and to negotiate secured creditor protections into cash collateral agreements, loan agreements, and even plans.

## B. Terms Contained in Retention Plans: Golden Parachutes, Severance Packages, and Bonuses

As stated earlier, bankruptcy courts are less likely to approve first-day motions requesting permission to pay prepetition bonuses and other incentives over and above an employee's normal wages.<sup>294</sup> Thus, insiders seeking additional benefits and protections--and secured creditors and DIP lenders seeking to incentivize these insiders--must turn to methods of compensation that focus on postpetition actions and events. These include golden parachutes, severance packages, and bonuses. Each is discussed in turn below.

### \*82 1. Golden Parachutes

A debtor may include a "golden parachute" provision in a retention plan.<sup>295</sup> A golden parachute agreement provides an employee with a specific payment or benefit upon a change in control of the company and subsequent termination of employment:<sup>296</sup>

A "golden parachute" is a provision in an executive's contract that provides for payment in the event of termination or a defined loss in status after a defined change in control of the company. "Golden parachute" provisions have become common in the corporate world and are designed, in part to protect against changes in control of a corporation and to compensate the executive in the event that a change of control does occur.<sup>297</sup> Golden parachute provisions may be extremely enticing to a beneficiary where the chapter 11 debtor's main objective is to sell all or substantially all of its business. Golden parachutes negotiated and put into effect prepetition do not receive administrative priority, but those put in place and approved by the court postpetition do.<sup>298</sup> These provisions normally are available only to insiders, who generally have individually negotiated employment contracts.<sup>299</sup>

### \*83 2. Severance Packages

Severance packages differ from golden parachutes in that the beneficiary-employee's payment under the agreement depends on the circumstances of the person's termination rather than being triggered by a change in control or management.<sup>300</sup> Typically, the beneficiary receives nothing under a severance package if the employee is terminated for cause--including bad faith--or for voluntary separation from the debtor.<sup>301</sup> Although severance packages may provide less protection to individual employees,<sup>302</sup> these provisions may provide a greater benefit to the debtor-corporation and its creditors. Beneficiaries of a severance package have an incentive to perform their jobs well--theoretically increasing the debtor's chances of a successful reorganization and creditors' chances of receiving a larger percentage of their claims--because they will receive nothing should their employment be terminated for cause. At the same time, severance packages are still good incentives for retaining employees in the face of a failed or failing reorganization by placing the employee in a win/win situation: If the debtor reorganizes, the employee retains his or her job, but if the case converts to a chapter 7 and the employee is terminated, the employee receives severance pay.

#### \*84 a. Terms of Severance Packages

The terms of severance packages normally provide that a monetary payment will be made to a discharged employee-beneficiary, provided that the corporation has not terminated the employee for cause.<sup>303</sup> The monetary payment may consist of a lump sum payment immediately due after termination or periodic payments made over the course of a set period of time.<sup>304</sup> Typically, the total of these payments consists of either a percentage or multiple of the beneficiary-employee's annual salary.<sup>305</sup>

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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b. Treatment of Severance Claims in Chapter 11

In most cases, for payment(s) under a severance package to receive administrative status,<sup>306</sup> they must derive from a postpetition court order approving the severance package.<sup>307</sup> Although § 503(b)(1)(A) does not specifically provide that employee severance may be an administrative expense,<sup>308</sup> severance payments \*85 arising from postpetition transactions may nonetheless obtain this priority status if these payments are actual and necessary costs of preserving the debtor's estate.<sup>309</sup> In contrast, severance payments arising from a prepetition employment contract normally do not receive administrative status even if the debtor has assumed the contract and the payments are due postpetition.<sup>310</sup> Severance payments arising from prepetition agreements are excluded from administrative priority because the corporation gave the benefit to the employee as a condition for employing that person prepetition.<sup>311</sup> Thus, prepetition severance agreements do not benefit the estate or its creditors because the debtor did not enter into them in order to retain the employee postpetition.<sup>312</sup> Nonetheless, insiders may attempt to convert prepetition severance benefits into a postpetition severance package to ensure \*86 administrative priority. It is said “[c]ourts will closely scrutinize such arrangements, and will most likely nullify [them] . . . .”<sup>313</sup>

3. Bonuses

The most common terms included in a retention plan are bonuses paid to “key” employees, often insiders, in addition to their normal salaries. Retention plans may award the beneficiary a bonus with cash payments, stock options, or other property designed to retain key employees. Additionally, retention plans may contain terms that are conditioned on the debtor's economic performance.

a. Lump Sum Bonuses

Monetary bonuses normally consist of a percentage of an employee's normal annual salary.<sup>314</sup> In most cases, retention bonuses award directors, officers, and managers, who receive relatively large cash bonuses in comparison to those received (if at all) by other employees.<sup>315</sup> Although lump sum bonuses are popular with their recipients, their effectiveness as a retention or motivation management tool is dubious because the beneficiary has no incentive to help the debtor emerge from chapter 11--because the employee has already received his or her compensation for remaining with the debtor.<sup>316</sup> Furthermore, lump sum bonuses \*87 appear unfair to many observers, including the debtor's creditors, stockholders, and other employees, and the public who often view the beneficiaries, i.e., insiders, as the original cause of the debtor's financial situation in the first place.<sup>317</sup>

b. Stock and Stock Options

A retention plan may also award key employees stock or stock options as a retention bonus.<sup>318</sup> This type of provision differs from lump sum monetary bonuses only in that the property transferred is stock or stock options.<sup>319</sup> However, a bonus consisting of stock or stock options is most likely far more desirable--at least from the standpoint of the creditors-- than a simple monetary award. Because the value of the stock or the stock option depends on the performance of the debtor, the beneficiaries of the retention plan have a direct incentive to work toward a successful reorganization of the debtor. Additionally, stock and stock options may arouse much \*88 less anger in persons blaming insiders for the debtor's financial instability.

c. Performance-Based Compensation

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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Performance-based bonuses reward the beneficiary-employee for the increased and improved performance of the debtor's business.<sup>320</sup> Typically, these retention plans provide that the employee's bonus--whether it be monetary or stock related--is either (i) entirely contingent on the debtor reaching a preset financial position<sup>321</sup> or (ii) determined by the financial performance of the debtor.<sup>322</sup> In some cases, the retention plan will combine a lump sum monetary or stock related bonus with a performance-based bonus component so that the employee has the opportunity to receive an enhancement fee should the debtor meet certain preset financial criteria.<sup>323</sup> In comparison to lump-sum monetary and stock option rewards, a performance-<sup>\*89</sup> based bonus is perhaps the most effective and desirable type of retention bonus. Because the employee's compensation for remaining with the debtor is determined by the debtor's--and presumably the employee's-- performance, beneficiary-employees have a greater incentive to work hard for the benefit of the estate.

#### 4. Conclusion: Compensation for "Key" Employees

The most obvious reason for a debtor to implement an employee retention plan is to maintain an operable business in chapter 11. Without its workforce, the company cannot operate. Likewise, if a large number of its managers quit at once, the disruption could be so devastating as to cause a complete business failure and plunge the debtor into liquidation. Thus, debtors implement retention plans to entice who they consider "key" employees to remain in their employ so that they may continue to operate the business, which presumably<sup>324</sup> is worth more to unsecured creditors as a going concern than it would be in an auction or other liquidation.

Although this reasoning for retention plans is logical, the implementation of retention plans in practice is questionable. First, in nearly every employee retention plan examined above, the "key" employees receiving the benefits are the debtor's upper management and directors.<sup>325</sup> Certainly, these managers and directors are the people most familiar with the debtor and its business overall--especially with regard to its financial arrangements--and new employees could not assume their positions effectively without first learning the debtor's operations (from lower echelon employees) and financial arrangements. Yet in some cases--especially where the debtor's financial woes are due to poor performance by upper management, not mere illiquidity--it<sup>\*90</sup> appears counterintuitive to label the people who rode the company into chapter 11 as "key" employees and to request special permission to retain them. It seems even more counterintuitive, indeed irrational, to award these persons with lump sum monetary bonuses just to get them to stay with the company--the company that they mismanaged. Rather, it appears more likely that a company's middle management and below represent the true "key" employees when thinking about maintaining going concern value--after all, they perform the functions of operating the business on a day-to-day basis--as well as those most likely to be economically unstable and in need of payments and reassurances to prevent them from seeking other employment opportunities.<sup>326</sup> Top end "macro" management to lead the reorganization may be more effectively replaced en masse than those working on the "micro" level.<sup>327</sup>

### IV. Liability Releases for Insiders

Along with additional compensation, in another example of a classic "agency problem," insiders often seek to limit or eliminate the risk of liability that they may incur while employed by the debtor.<sup>328</sup> The debtor may request that the bankruptcy court issue an order releasing or otherwise barring all claims and enjoining all suits against insiders relating to their employment with the debtor either temporarily or permanently. These are generally termed "third party releases."<sup>329</sup> Alternatively, the debtor may ask the bankruptcy court to issue an order--a "channeling" injunction--directing all or part of the litigation against the debtor or insiders toward a single fund or group of assets. Not unusually, the provisions typically provide shelter from liability to the debtor, its insiders, and members of the insolvency community involved in the<sup>\*91</sup> case. These methods of liability protection and how insiders use these tools to their advantage are discussed below.

### A. Third Party Releases

A directors and officers insurance policy (“D&O policy”) naming the insiders as sole beneficiaries is an uncontroversial method of protecting insiders from personal liability, but a third party release, if available, is a better option. A third party release is an order issued by the bankruptcy court that eliminates liability and enjoins potential plaintiffs from initiating or continuing all or certain types of litigation related to a bankruptcy case against non-debtor third parties, such as the debtor's insiders and their (and the debtor's) accountants, lawyers, and other professionals.<sup>330</sup> Generally, this type of release is an order issued as part of the plan confirmation. In essence, a third party release extends the coverage of the automatic stay--often permanently--so that it not only prohibits suits against the debtor, but also the specified non-debtors.<sup>331</sup>

**\*92** These third party releases provide better protection to insiders than the typical D&O policy for at least three reasons. First, D&O policies are expensive and insure the insiders only against certain legal types of claims and normally do not insure against intentional or fraudulent misconduct.<sup>332</sup> Third party releases require no more than an order from a bankruptcy judge--not premium dollars--and cover all claims relating to a broadly described set of facts.<sup>333</sup> Second, these releases prevent the initiation or continuation of any action against the released party. Thus, a beneficiary of a third party release is protected against any expense that might be related to the litigation of those released or enjoined claims except for the minimal expenses of obtaining a permanent injunction through summary procedures in the home bankruptcy court if needed to subsequently enforce the release. In contrast, the comparable D&O policy will normally only compensate for claims, settlements, and **\*93** litigation expenses brought against the beneficiaries, not prevent them.<sup>334</sup> Third, these releases may shield insiders against all past and future personal liability, whereas D&O policies only insure beneficiaries during the policy term, up to the policy limits, and while the corporation remains current in paying premiums.<sup>335</sup>

Like D&O policies, insiders may obtain a variety of protections from a third party release. Generally, bankruptcy courts will issue three types of third party releases: (1) temporary or preliminary injunctions that shield insiders during the course of the bankruptcy case; (2) permanent injunctions that may shield insiders indefinitely from personal liability; and (3) “channeling” injunctions that permanently release non-debtors who contribute to a finite fund of assets that is created as the sole source of relief for potential plaintiffs.

#### 1. Temporary Injunctions

Although plaintiffs may not bring suits directly against a debtor based upon prepetition events absent relief from the automatic stay,<sup>336</sup> the debtor nevertheless may be harmed indirectly by suits **\*94** initiated and litigated against certain third parties. Even if the debtor is not joined as a defendant in an action against a non-debtor insider,<sup>337</sup> the debtor's reorganization may be impaired. Insiders, who, it is said, should be focusing on the restructuring of the debtor, may be forced to spend substantial amounts of time meeting with their personal counsel, responding to discovery requests, and participating in depositions--all of which would distract them. Thus, it is argued, the strain of the litigation may ultimately prevent, or at least hinder, the debtor's reorganization.<sup>338</sup> Additionally, where the debtor's charter or state law requires the corporation to indemnify insiders for their litigation expenses, costs, and/or losses, allowing the litigation against the insiders to proceed arguably creates unnecessary additional claims that dilute the rights of other creditors in the debtor's case.<sup>339</sup>

**\*95** Because suits against insiders may hinder the reorganization process, some courts have extended the automatic stay to enjoin suits against particular insiders.<sup>340</sup> Although no Bankruptcy Code provision explicitly authorizes injunctions for the

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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benefit of third party non-debtors,<sup>341</sup> most bankruptcy courts<sup>342</sup> rely on their § 105(a)<sup>343</sup> equity powers as authority for enjoining suits against non-debtors--at least under certain circumstances.<sup>344</sup> Thus, bankruptcy **\*96** courts have enjoined suits against non-debtors in “limited” or “unusual” circumstances where the court has deemed an injunction to further an effective reorganization.<sup>345</sup>

**\*97** Expansions of the automatic stay granted mid-case under § 105 normally are valid only for a limited period of time, however.<sup>346</sup> Bankruptcy courts granting this type of relief do not intend such orders to act as permanent injunctions.<sup>347</sup> Rather, the stay on litigation is lifted after these temporary orders no longer serve their purpose of effectuating the debtor's reorganization.<sup>348</sup> Therefore, expanded stays under § 105(a) do not limit insiders' liability; they merely delay litigation. Unless the reorganized debtor satisfies the claim, at the end of the day, the insider will be pursued by the affected creditor. Third party non-debtors can obtain permanent injunctions against their liability only through an order confirming a plan of reorganization or approving a sale of substantially all the assets of a business. By supporting a two step process of releasing insiders from liability, secured creditors can, first, retain talent to maintain the value of a business and, second, induce cooperation in the process of disposing of their collateral. A temporary restraining order, preliminary injunction, or expanded stay under § 105 **\*98** accomplishes the first step. A permanent release or injunction in a plan or sale order accomplishes the second.

## 2. Permanent Injunctions

Because releases granted independently of a confirmed chapter 11 plan may not be permanent,<sup>349</sup> third party releases obtained as part of a confirmation order are far more attractive to insiders and other beneficiaries. Third party releases entered as part of a confirmation order may relieve non-debtors of their liability and permanently enjoin suits against them.<sup>350</sup> Although a majority of courts recognize that these releases are “necessary and appropriate” in certain circumstances,<sup>351</sup> third party releases contained in a confirmation order are not explicitly authorized under the Bankruptcy Code.<sup>352</sup> In fact, under § 524(e), only the debtor in the bankruptcy case at issue may receive a discharge of its debts from a confirmation order--non-debtors may not.<sup>353</sup> Thus, courts approving chapter 11 reorganization plans containing third party releases rely on either § 105(a)<sup>354</sup> or § 1123(b)(6),<sup>355</sup> which authorize the bankruptcy court to include in a chapter 11 plan any provision not inconsistent with the Bankruptcy Code.<sup>356</sup>

**\*99** Still, courts are not in uniform agreement that these releases are authorized under the Bankruptcy Code.<sup>357</sup> A substantial minority of jurisdictions, including those in the Ninth and Tenth Circuits (representing the western half of the country), refuse to authorize or enforce permanent third party releases,<sup>358</sup> holding that the bankruptcy courts are unable to issue orders releasing non-debtors from liability. These courts hold that relief such as this is beyond their jurisdiction and neither § 105 nor § 1123(b) (6) allow the court to contravene the prohibition of non-debtor discharges of § 524(e).<sup>359</sup> These courts find a release and permanent injunction to be indistinguishable from a bankruptcy discharge.<sup>360</sup> Thus, because § 524(e) states that only a debtor may receive a discharge, a permanent injunction and release would be inconsistent with the Bankruptcy Code.<sup>361</sup>

In a majority of jurisdictions, however, including the important eastern corporate jurisdictions of Delaware, Illinois, and New York, third party releases are enforceable under “appropriate” circumstances.<sup>362</sup> Unlike the Ninth and Tenth Circuits, courts in **\*100** these jurisdictions find that third party releases are “not inconsistent” with § 524(e)--or any other Bankruptcy Code provision.<sup>363</sup> As the Sixth Circuit noted in *In re Dow Corning*:

[S]ome courts have found that the Bankruptcy Code does not permit enjoining a non-consenting creditor's claims against a non-debtor. These courts primarily rely on section 524(e) of the Code, which provides that “the discharge of the debt of the

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.” However, this language explains the effect of a debtor's discharge. It does not prohibit the release of a non-debtor.<sup>364</sup> Under this theory, because permanent third party releases are not inconsistent with § 524(e), they may be included in a confirmation order under § 1123(b)(6).<sup>365</sup>

Of the courts willing to order permanent third party releases, some refuse to enforce them against parties who have not affirmatively consented to the terms by voting in favor of the plan.<sup>366</sup> Courts adopting this view have held that non-consenting creditors, i.e., those voting against a chapter 11 plan and/or the permanent third party release, cannot be bound by a third party release because they have not received consideration.<sup>367</sup> Yet other courts will enforce third party releases against all parties, including those that did not vote in favor of confirmation.<sup>368</sup> Relying on the cram down power \*101 provision,<sup>369</sup> these courts have reasoned that creditors voting against a chapter 11 plan may be forced to accept permanent third party release terms just as they are forced to accept all other terms of a plan of reorganization in a cram down.<sup>370</sup>

Nonetheless, many courts that allow these permanent releases against non-consenting parties only do so under so-called “unusual circumstances,” and require close scrutiny of each third party release contained in the plan.<sup>371</sup> In *Dow Corning*, the Sixth Circuit held the following seven factors must be present for a bankruptcy court to order a third party release:

(1) There is an identity of interests between the debtor and the third party, usually an indemnity relationship, such that a suit against the non-debtor is, in essence, a suit against the debtor or will deplete the assets of the estate; (2) The non-debtor has contributed substantial assets to the reorganization; (3) The injunction is essential to reorganization, namely, the reorganization hinges on the debtor being free from indirect suits against parties who would have indemnity or contribution claims against the debtor; (4) The impacted class, or classes, has overwhelmingly voted to accept the plan; (5) The plan provides a mechanism to pay for all, or substantially all, of the class or classes affected by the injunction; \*102 (6) The plan provides an opportunity for those claimants who choose not to settle to recover in full; and (7) The bankruptcy court made a record of specific factual findings that support its conclusions.<sup>372</sup> Thus, to obtain confirmation of a plan containing third party releases, the debtor must show that the release is fair and necessary (using the seven factor standard above) and that unusual circumstances exist requiring the issuance of a permanent injunction of claims against certain non-debtors.<sup>373</sup> In jurisdictions allowing third party releases, this showing, however, is fairly routine, and the language indicating satisfaction of the factors set forth above becomes boilerplate in the debtor's counsel's plans, disclosure statements, and briefs in support of confirmation.

## B. Channeling Injunctions

A channeling injunction is a type of permanent third party release. Generally, these injunctions direct or “channel” all suits against certain non-debtors to a settlement fund created by these third parties to satisfy any actual or potential claims.<sup>374</sup> These potential litigants agree (1) that their claims will be satisfied by a finite fund and (2) to become permanently enjoined from initiating or continuing any suits against the non-debtors who have contributed to the settlement fund after the assets in the fund are exhausted.<sup>375</sup> The overarching purpose of a channeling injunction \*103 is to facilitate an efficient and successful confirmation of a chapter 11 debtor's reorganization plan.<sup>376</sup> However, channeling injunctions are considered extraordinary relief, and bankruptcy courts order them only in the rarest circumstances.<sup>377</sup>

As with permanent third party injunctions, the circuits are split as to whether channeling injunctions are permitted under the Bankruptcy Code.<sup>378</sup> Courts rejecting any issuance of channeling injunctions hold that either § 524(g)<sup>379</sup> or (e)<sup>380</sup> of the Bankruptcy \*104 Code preclude the issuance of this relief except in asbestos litigation cases.<sup>381</sup> Other courts permit the issuance of channeling injunctions under varying circumstances, relying on § 105(a) and § 1123(a)(5) as authority for issuing this relief.<sup>382</sup> Just as with most other types of third party releases--with the exception of asbestos litigation claims--the Bankruptcy Code does not specifically authorize the use of channeling injunctions.<sup>383</sup> Thus, courts ordering channeling injunctions have cited § 105(a) of the Bankruptcy Code as authority for fashioning this relief.<sup>384</sup>

### **\*105 C. Conclusion: Use of Liability Protections for Insiders**

Insiders may benefit from the liability protecting devices discussed above by limiting, temporarily enjoining, or permanently enjoining any claims by potential plaintiffs arising from their prepetition or postpetition relationship with the debtor. These tools allow insiders, as well as DIP lenders and members of the insolvency community,<sup>385</sup> to further limit their risk when working with and for the debtor. Combined with “stick” provisions giving DIP lenders the power to veto proposed plans, budgets, sales, and other dispositive actions, third party releases and insider compensation programs are “carrots” that secured and DIP lenders can use to incentivize insiders and, perhaps to a lesser extent, professionals, and exert control over large chapter 11 cases for their own benefit. Their aim in using this carrot-and-stick approach is to control the debtor in the use of chapter 11 to accomplish a unified foreclosure sale and hence realize upon and retain as much of the value of their collateral as possible. This induces DIP lenders to use the tools described above to increase the size of their claims both pre and postpetition and then to arrange for the disposition of their collateral to satisfy claims. There are few remaining incentives for creation of reorganization value for general unsecured creditors and those of lower priority.

## **V. Sales of Substantially All the Assets of a Business**

The last step in this unified foreclosure process is the use of a streamlined sales process without first confirming a plan of reorganization. By selling all or substantially all of the debtor's business or businesses preconfirmation under § 363, these parties may avoid the lengthy process of negotiating, proposing, confirming, and consummating a plan of reorganization-- not to mention the potential for more pervasive scrutiny of transactions at multiple junctures by the court, creditors, the United States Trustee, and other parties in interest.<sup>386</sup> Assets may be transferred from the \*106 debtor's estate free and clear of both interests and claims, perhaps enhancing their marketability.<sup>387</sup> All or some of these benefits can thus be obtained without having to satisfy the requirements for plan acceptance contained in §§ 1121 through 1129 of the Bankruptcy Code.<sup>388</sup> Taken together with the other techniques and strategies discussed above, the non-plan sale process provides the final step in the overall phenomenon addressed in this Article: use of chapter 11 to effect a federal unified foreclosure process orchestrated by secured creditors who are assisted by insiders of the debtor and the insolvency community.

### **A. Sales of Estate Assets Under the Bankruptcy Code**

A debtor may sell its interests in assets in two ways while in chapter 11: (1) under a confirmed plan of reorganization or (2) in a pre-confirmation sale under § 363. The traditional way for a debtor to transfer all or substantially all of its assets is said to be under a confirmed chapter 11 reorganization plan, which results from an often lengthy and expensive process.<sup>389</sup> However, precisely because \*107 of the significant amount of process and court supervision accompanying the confirmation of a chapter



HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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11 plan, in practice, many debtors, along with other similarly situated parties, such as DIP lenders, choose to reorganize by free-and-clear sales under § 363(f) rather than by plan confirmation.<sup>390</sup>

In contrast to sales made under a chapter 11 plan, transfers of assets made under § 363 require no more process or court supervision than notice and a hearing,<sup>391</sup> making this route of **\*108** reorganization much faster than the traditional confirmation process. No disclosure statement is required,<sup>392</sup> nor must the notice or the sale motion itself contain all of the information that a plan must contain under § 1123 or that a disclosure statement must contain under § 1125.<sup>393</sup> Additionally, the sale proponent need not obtain the super-majority consent of each class of creditors and interest holders.<sup>394</sup> In sum, a debtor may essentially sell its entire business under § 363(f) with no more than a simple motion, notice, and a hearing--although in large corporate cases, multiple hearings are common--a far cry from the extensive disclosure and acceptance processes required in a traditional plan confirmation setting.

### **B. Section 363(f) Sales Favor Purchasers and Secured Creditors**

The broad interpretation of the word “interest” in § 363(f) to include “claims” provides extraordinary benefits to DIP lenders, prepetition secured creditors, purchasers of assets in § 363(f) sales, and insiders to the detriment of voluntary general unsecured creditors and involuntary creditors such as tort claimants. These free and clear sales allow the debtor to attract the interest of potential purchasers that might not otherwise be interested in the transaction or, if they would have been, to command a higher purchase price.

Often, DIP lenders will condition their loans on a quick sale.<sup>395</sup> Likewise, prepetition secured creditors may restrict the debtor's use of its cash collateral unless a reorganization-by-sale program is adopted.<sup>396</sup> Both of these actions result in inducing--or even forcing--the debtor to sell all or substantially all of its assets as a going concern via a fast § 363(f) sale.<sup>397</sup> These lenders benefit from **\*109** this result by realizing on their interests<sup>398</sup> more quickly by avoiding a lengthy confirmation process and controlling the process so as to avoid further risk. Furthermore, because the business is transferred as a going concern, lenders have the opportunity to extend new lines of credit to the purchasers, who are presumably in a better financial position than the debtor.<sup>399</sup>

Purchasers receive probably the most tangible benefits from the expanded interpretation of § 363(f).<sup>400</sup> These parties are able to acquire entire businesses unencumbered by unsecured debts, successor liability, or property interests.<sup>401</sup> Likewise, insiders may benefit from these sales, especially when the majority of their postpetition compensation is tied to the sale of the corporation or where they expect to be employed by the purchaser post sale.<sup>402</sup> These benefits, however, may be realized at the expense of the unsecured creditors and other parties in interest, who can do little more than object to a § 363(f) sale.<sup>403</sup>

### **\*110 VI. Conclusion: A Federal Unified Foreclosure System Run by Incentivizing Insiders and Professionals**

Five distinct legal developments have combined to metamorphose chapter 11 in many cases from its original, stated purpose of reorganization to benefit unsecured creditors (and maybe equity too) through confirmation of a plan of reorganization into a federal unified foreclosure mechanism. In these unified foreclosure cases, the debtor and its fate are controlled by secured creditors aided by insiders and insolvency professionals motivated by substantial inducements--personal profit and shelter from liability.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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By removing bankruptcy judges from much of the administrative duties in a bankruptcy case and encouraging higher compensation of professionals and insiders in the form of fee awards and retention programs, Congress assigned administrative control of cases to the parties, who could secure representation from the elite of bankruptcy professionals encouraged to enter the field.<sup>404</sup> These professionals quickly organized themselves to protect and advance their interests. The circle of those representing the key players in large corporate bankruptcy cases is a tight one indeed.<sup>405</sup>

After flailing around with the new Code a bit in the early 1980s,<sup>406</sup> secured creditors and their professionals began, whether with foresight or by happenstance, to weave together their powers of control based upon their cash collateral and adequate protection rights, the use of blanket lien financing, and DIP financing with provisions wresting all but the last bit of control over chapter 11 cases from the debtor and unsecured creditors.<sup>407</sup> Inducing insiders to cooperate through retention programs, temporary stays of litigation against them, and promises of inclusion in a permanent **\*111** blanket release of liability, they began increasingly to use § 363(b) and (f) to sell substantially all the assets of the debtor's businesses in a non-plan or preplan reorganization.<sup>408</sup> The result is a massive, federally funded, unified foreclosure system for corporate lenders that primarily serves the interests of secured creditors and their assistants-- insiders and the insolvency professionals at the center of the case.<sup>409</sup>

The law of unintended consequences<sup>410</sup> has thus led to a reshuffling of the players that made up the so-called "bankruptcy rings"<sup>411</sup> of the past and encouraged the development of a circle of creditor interests and professionals that is wider, deeper, and more sophisticated than any of the old rings.<sup>412</sup> We are back at equity receivership practice--except now there are no (or few) railroads to save for the national interest. Modern asset and capital markets are so much more efficient than they were in the 1870s that the use of the Bankruptcy Code to save even the closest analogous business to a railroad--an airline--appears questionable at best.<sup>413</sup>

**\*112** When the costs of the system are stacked next to the benefits that accrue to those it was purported to serve--those other than secured creditors-- it appears that chapter 11 may have largely missed its intended mark. Efforts to evaluate or reform chapter 11 should focus on whether that mark is achievable and desirable and if so, whether the statute can be modified to hit that mark, or whether a different goal--perhaps a formally recognized, enacted, and more efficient federal unified foreclosure system to benefit secured creditors--is in order. That will allow those suggesting reform to tailor their efforts to best hit the target and minimize unintended results like the hijacking of chapter 11.

Footnotes

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<sup>1</sup> Carl Bernstein & Bob Woodward, *All the President's Men* 34 (1974). "The law has changed to the extent that there's a higher recognition of this objective of maximizing creditor recoveries. Whereas in 1979 [when the Bankruptcy Reform Act went into effect], you would have said the highest objective is reorganization and rehabilitation of the debtor, and credit recoveries were down here, now it's like this .... If the creditors come in and say, 'We can realize value here by selling these assets,' most bankruptcy courts will

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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agree with them.” Matt Miller & Terry Brennan, Creditors in Possession, TheDeal.Com, Jan. 12, 2004, at <http://www.thedeal.com/NASApp/cs/CS?pagename=Home&c=Page&cid=1011714706980> [hereinafter Miller Interview] (quoting Harvey R. Miller).

2 Throughout this Article, the terms “Bankruptcy Code” or “Code” refer to the Bankruptcy Act of 1978, 11 U.S.C. §§ 101-1330 (2000). The terms “Bankruptcy Rules,” “Rules,” or “Rule” refer to the Federal Rules of Bankruptcy Procedure. Fed. R. Bankr. P. §§ 1001-9036.

3 The bankruptcy laws of the United States underwent a wholesale revision culminating in 1978 with the enactment of the Bankruptcy Code. See Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978) (codified at 11 U.S.C. §§ 101-1330).

4 Charles Jordan Tabb, *The Law of Bankruptcy* § 1.1, at 1-3 (1997); see also Thomas H. Jackson, *The Logic and Limits of Bankruptcy Law* 225-52 (1986) (detailing the fresh start policy of bankruptcy law).

5 See generally Tabb, *supra* note 4, § 1.2, at 6-8 (discussing the reorganizational goals of chapter 11 as well as providing critical analysis of whether those goals are realistic or have been achieved).

6 “Going-concern value” is “[t]he value of a commercial enterprise’s assets or the enterprise itself as an active business with future earning power, as opposed to the liquidation value of the business or its assets.” Black’s Law Dictionary 1549 (7th ed. 1999). “Bankruptcy law can and should help a firm stay in business when it is worth more to its owners alive than dead.” Jackson, *supra* note 4, at 2.

7 See Tabb, *supra* note 4, § 1.1, at 2-4.

8 See Stephen J. Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 *Am. Bankr. L.J.* 509 (2000) (examining prior studies exposing the costliness of chapter 11).

9 See generally A. Mechele Dickerson, *Bankruptcy Reform: Does the End Justify the Means?*, 75 *Am. Bankr. L.J.* 243 (2001) (analyzing the consumer bankruptcy system as a part of the federal public assistance system to explain the rise of a “means-testing” requirement in proposed bankruptcy reform legislation).

10 See Gerald P. Buccino & Steven M. Golub, *Turnaround Topics: Reflecting on Business Bankruptcies from the Pre-Code Era into the New Millennium*, 18 *Am. Bankr. Inst. J.* 36 (Dec. 1999/Jan. 2000); Theodore Eisenberg & Stefan Sundgren, *Is Chapter 11 Too Favorable to Debtors? Evidence from Abroad*, 82 *Cornell L. Rev.* 1532, 1533 (1997); Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom*, 83 *Iowa L. Rev.* 569, 629 (1998); Steve H. Nickles, *Consider Process Before Substance: Commercial Law Consequences of the Bankruptcy System: Urging the Merger of the Article 9 Drafting Committee and the Bankruptcy Commission*, 69 *Am. Bankr. L.J.* 589, 590 (1995).

11 See Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 *Yale L.J.* 857, 861-62 (1996); Lynn M. LoPucki, *A General Theory of the Dynamics of the State Remedies/Bankruptcy System*, 1982 *Wis. L. Rev.* 311, 311-12 (1982); see also *In re Stromberg*, 161 B.R. 510, 517 (Bankr. D. Colo. 1993) (noting the distribution to unsecured creditors is generally inconsequential).

12 Lynn M. LoPucki, *Chapter 11: An Agenda for Basic Reform*, 69 *Am. Bankr. L.J.* 573 (1995). But see Kenneth N. Klee, *A Brief Rejoinder to Professor LoPucki*, 69 *Am. Bankr. L.J.* 583 (1995) (analyzing, inter alia, the criticism advanced by Professor LoPucki that chapter 11 takes too long).

13 See John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 *Mich. L. Rev.* 963, 966-99 (1989). See generally Kenneth N. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 *Am. Bankr. L.J.* 133 (1979) (discussing cram down requirements as codified in the then-new Bankruptcy Code); Kenneth N. Klee, *Cram Down II*, 64 *Am. Bankr. L.J.* 229 (1990) (exploring the uncodified aspects of the fair and equitable cram down requirement).

14 See Elizabeth Warren & Jay Lawrence Westbrook, *Secured Party in Possession*, 22 *Am. Bankr. Inst. J.* 12 (Sept. 2003) (noting the ironic emergence of the dominant secured party in possession in the wake of years of bitter complaints to Congress that secured

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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creditors, especially in single asset cases, are abused by debtors and the bankruptcy system); see also Miller Interview, *supra* note 1 (discussing erroneous perceptions of bias).

- 15 See Mark D. Collins, [Why Delaware?](#), 15 *Del. Law.* 38, 38 (1997); see also Bryan T. Camp, [Bound by the BAP: The Stare Decisis Effects of BAP Decisions](#), 34 *San Diego L. Rev.* 1643, 1683-84 (1997) (“While the problem in today’s world is often thought to be that bankruptcy judges are too pro-debtor, they have not always been so.”).
- 16 See generally Soma Biswas, [Chicago Fire](#), *TheDeal.Com*, Feb. 5, 2003, at <http://bkinformation.com/Test/NewsView5.cfm?SAID=47865> (“In fact, the fee examiner isn’t the only issue stirring up [Judge] Sonderby critics. Some KMart [sic] creditors believe she has been too inclined to rule in favor of [the] nation’s second-largest discount retailer and its aggressive counsel, Jack Butler of Skadden, Arps, Slate, Meagher & Flom LLP. ‘What Kmart wants, Kmart gets,’ snaps one creditor representative.”). The best example of the perception that a pro-debtor judiciary is aiding debtors in ripping off the system may be the credit card companies’ arguments in the current debates regarding proposed reforms to the Code. See Richard H. Gibson, [Credit Card Dischargeability: Two Cheers for the Common Law and Some Modest Proposals for Legislative Reform](#), 74 *Am. Bankr. L.J.* 129, 129-30 (2000); Lawrence Ponoroff, [The Dubious Role of Precedent in the Quest for First Principles in the Reform of the Bankruptcy Code: Some Lessons from the Civil Law and Realist Traditions](#), 74 *Am. Bankr. L.J.* 173, 214 (2000).
- 17 See Bruce A. Markell, [Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claims Classification](#), 11 *Bankr. Dev. J.* 1 (1994-95) (collecting and discussing authorities on classification of deficiency claims). Compare [In re Woodbrook Ass’n](#), 19 F.3d 312 (7th Cir. 1994) (the classification of unsecured deficiency claim separately from general unsecured claims deemed impermissible), with [Resolution Trust Corp. v. Swedeland Dev. Group, Inc. \(In re Swedeland Dev. Group, Inc.\)](#), 16 F.3d 552 (3d Cir. 1994), and [Steelcase Inc. v. Johnston \(In re Johnston\)](#), 21 F.3d 323 (9th Cir. 1994) (allowing separate classification of unsecured claim when it arose differently from other claims and could be entitled to payment priority), amended by 94 A.D.R. 6203 (9th Cir. 1994).
- 18 See, e.g., [Dewsnup v. Timm](#), 502 U.S. 410 (1992); Margaret Howard, [Stripping Down Liens: Section 506\(d\) and the Theory of Bankruptcy](#), 65 *Am. Bankr. L.J.* 373 (1991) (surveying and analyzing the pre-Dewsnup cases involving strip down).
- 19 See, e.g., [Bank of Am. v. 203 N. LaSalle St. P’ship](#), 526 U.S. 434 (1999); [U.S. Bancorp Mortgage Co. v. Bonner Mall P’ship](#), 513 U.S. 18 (1994); [Norwest Bank Worthington v. Ahlers](#), 485 U.S. 197 (1988).
- 20 See, e.g., [United Sav. Ass’n v. Timbers of Inwood Forest Ass’n](#), 484 U.S. 365 (1988); [Grundy Nat’l Bank v. Tandem Mining Corp.](#), 754 F.2d 1436 (4th Cir. 1985); [In re Am. Mariner Indus., Inc.](#), 734 F.2d 426 (9th Cir. 1984), superceded by 824 F.2d 725 (9th Cir. 1987).
- 21 See, e.g., [In re Fortney](#), 36 F.3d 701 (7th Cir. 1994); [Pac. First Bank v. Boulders on the River, Inc. \(In re Boulders on the River, Inc.\)](#), 164 B.R. 99 (B.A.P. 9th Cir. 1994).
- 22 See Robert K. Rasmussen, [The Uneasy Case Against the Uniform Commercial Code](#), 62 *La. L. Rev.* 1097, 1125 (2002). Back in 1998, commentators still saw some hope of redemption. See Janger, *supra* note 10, at 629. By 2002, the willingness of creditors to spend large sums of money to further their interests was relatively clear. See Rasmussen, [supra](#), at 1144. Yet efforts by creditors to amend the Bankruptcy Code to suit their interests are nothing new, or at least seem to predate the most recent bankruptcy reform act. See Janger, *supra* note 10, at 629; Nickles, *supra* note 10, at 592.
- 23 See Rasmussen, *supra* note 22, at 1144; see also G. Ray Warner, [The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy](#), 9 *Am. Bankr. Inst. L. Rev.* 3, 16-17 (2001) (discussing why the Article 9 revision adopted such a pro-secured creditor approach); Elizabeth Warren, [Making Policy with Imperfect Information: The Article 9 Full Priority Debates](#), 82 *Cornell L. Rev.* 1373, 1374, 1394 (1997) (observing “the revision process evidently proceeds apace to make Article 9 safer for secured creditors, ensuring that secured creditors sweep in more of the debtors’ assets and leave less for the unsecured creditors”). Note that, in the author’s view, none of the changes in chapter 11 practice since 1979 can be blamed on revised Article 9. The changes to Article 9 are largely to prevent lenders from being penalized for slip-ups--or “gotchas” as one of his colleagues likes to say--and ensures that the secured creditor gets the benefit of its bargain. While this does take value off the table that would otherwise be available to unsecured creditors, absent evidence that the unsecured creditors extended credit because they found and relied upon a faulty U.C.C.-1 filing, for instance, does not seem inequitable. Further examination of Article 9, the revision to Article 9, or the wisdom or desirability of even having secured credit at all are important questions that are beyond the scope of this Article.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 24 See, e.g., C. Scott Pryor, [How Revised Article 9 Will Turn the Trustee's Strong-Arm into a Weak Finger: A Potpourri of Cases](#), 9 *Am. Bankr. Inst. L. Rev.* 229 (2001); C. Scott Pryor, [Revised Uniform Commercial Code Article 9: Impact in Bankruptcy](#), 7 *Am. Bankr. Inst. L. Rev.* 465 (1999); see also Kenneth N. Klee, [Barbarians at the Trough: Riposte in Defense of the Warren Carve-Out Proposal](#), 82 *Cornell L. Rev.* 1466 (1997) (discussing efforts of commercial lenders to expand Article 9 protections to their benefit).
- 25 “Corporate cases” refer to the bankruptcy cases of entities other than individual people, including those of corporations, partnerships, and limited liability companies, that are recognized as “persons” under the Bankruptcy Code. See generally Report of the Subcommittee on Venue-Related Matters of the Judicial Conference Committee on the Administration of the Bankruptcy System, Conference on Large Chapter 11 Cases, at [http://www.fjc.gov/public/pdf.nsf/lookup/LargCh11.pdf/\\$File/LargCh11.pdf](http://www.fjc.gov/public/pdf.nsf/lookup/LargCh11.pdf/$File/LargCh11.pdf) (2003) [hereinafter Large Chapter 11 Conference Report] (examining some of the practices discussed in this Article in terms of how judicial acceptance of one or more of those practices may influence choice of venue for a particular case).
- 26 See Robert K. Rasmussen, [The Ex Ante Effects of Bankruptcy Reform on Investment Incentives](#), 72 *Wash. U. L.Q.* 1159, 1166-67 (1994) (explaining how a firm's decisions are affected by both the division of ownership interests among diverse claimants and the delegation of responsibility for the day-to-day operation of the firm to their agents and identifying the agency problem or agency costs); see also Martin Lipton & Steven A. Rosenblum, [Election Contests in the Company's Proxy: An Idea Whose Time Has Not Come](#), 59 *Bus. Law.* 67, 74-76, 74 nn.18-24 (2003) (describing in detail the agency problem and minimizing its impact on corporate governance: “Managers do not need to be ‘disciplined’; [sic] they need to be helped to run the company successfully.”). Even if agency problems are minimal, insolvent corporations and the current wave of corporate scandals are an anomaly. In chapter 11, with its high failure rate, management may need additional “discipline” as their hope of running the company successfully dwindles.
- 27 “Hijack” means “to stop in transit and steal the cargo of.” Webster's Third New International Dictionary 1069 (Merriam-Webster, 3d ed. 1966). The word is used in this Article to indicate the diversion of chapter 11 from a plan oriented, collective benefit process to one controlled by secured creditors and used primarily for their all-but-sole benefit. See Barry E. Adler, [Bankruptcy Primitives](#), 12 *Am. Bankr. Inst. L. Rev.* 219, 227 (2004) (“When a free-and-clear sale does not occur, there is reason for suspicion. Not only managers can hijack the reorganization process.”) (emphasis added).
- 28 “Federal” refers to the United States Code, United States Bankruptcy Court, and United States Bankruptcy Judge components. “Unified foreclosure mechanism” means a judicially supervised process where mixed collateral (real, personal, and other property) can be sold in a single process. Various state laws allow for unified foreclosure of collateral within their jurisdiction under a “mixed collateral statute.” See, e.g., [Cal. Com. Code § 9501\(4\) \(West Supp. 1988\)](#) (as amended by 1985 Cal. Stat. 974 & 1368, which took effect Jan. 1, 1986) (setting out three methods for a secured creditor to realize upon its real and personal property collateral: (1) separate foreclosure of each type under real property and personal property foreclosure procedures, (2) sale of real and personal property under real property law (“unified foreclosure”), or (3) sale of some personal property under personal property law followed by unified foreclosure of the balance of real and personal property under real property law). The benefit from a creditor's perspective of a federal unified foreclosure system lies in its simplicity and the breadth of federal bankruptcy court jurisdiction, which extends to all property of the estate wherever located--indicating a national and even international scope. See [In re Artimm](#), 278 B.R. 832, 840 (Bankr. C.D. Cal. 2002); [In re Chiles Power Supply Co., Inc.](#), 264 B.R. 533, 542-43 (Bankr. W.D. Mo. 2001); see also David M. Green & Walter Benzija, [Spanning the Globe: The Intended Extraterritorial Reach of the Bankruptcy Code](#), 10 *Am. Bankr. Inst. L. Rev.* 85, 86-87 (2002) (Arguing through the Bankruptcy Code's “broad and borderless definition of what constitutes property of the estate, Congress intended to enable bankruptcy courts to safeguard interests of a debtor's estate regardless of their physical location.”). It appears that the bankruptcy courts, largely with the approval of the Article III courts that review their decisions, have at least partially taken Professor Klee up on his suggestion to Congress that it may have been time in the late 1990s to federalize the law of commercial transactions. See Klee, *supra* note 24, at 1482 (noting “there is a remote possibility that Congress might exercise its prerogative under the Commerce Clause and the Supremacy Clause to federalize the laws of commercial transactions”) (internal citations omitted). Another emerging secured creditor strategy is the “reverse cramdown” in which the secured creditor, insiders, and equity contract around the absolute priority rule in a cooperative or collusive chapter 11 plan setting. David D. Farrell, [Reverse Cramdown: Another Option in the Secured Creditor's Playbook?](#), 23 *Am. Bankr. Inst. J.* 22 (Sept. 2004).

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 29 See Allan Sloan, Proposed Changes in Bankruptcy Law Twist Meaning of ‘Reform’ Beyond Recognition, Wash. Post, Feb. 3, 2004, at E3 (describing efforts to amend the Bankruptcy Code’s disinterestedness standard to allow increased participation by investment bankers in the restructuring of companies whose securities they underwrote and that are still outstanding).
- 30 See discussion *infra* Part I.A.
- 31 See discussion *infra* Part I.B. In 1978 Congress declared that the policy of [Bankruptcy Code § 330\(a\)](#) was to “compensate attorneys and other professionals serving in a case under Title 11 at the same rate as the attorney or other professional would be compensated for performing comparable services other than in a case under Title 11.” 124 Cong. Rec. S17403, 17408 (Oct. 6, 1978) (remarks of Sen. DeConcini). The result of this policy has been to make chapter 11 cases extremely lucrative for professionals. See Robert K. Rasmussen & Randall S. Thomas, [Timing Matters: Promoting Forum Shopping by Insolvent Corporations](#), 94 Nw. U. L. Rev. 1357, 1361 (2000).
- 32 The term “DIP” refers to the debtor-in-possession in a chapter 11 case. The DIP has most of the powers of a trustee under the Bankruptcy Code. See [11 U.S.C. § 1107\(a\)](#) (2000).
- 33 See discussion *infra* Part II.
- 34 See discussion *infra* Part II.C.4.
- 35 See discussion *infra* Part II.C.1.
- 36 See *infra* notes 208-10 and accompanying text.
- 37 See *infra* notes 171, 211-18 and accompanying text.
- 38 See discussion *infra* Part II.C.1.
- 39 “Insider” is defined in a non-exclusive manner to include--if the debtor is a corporation--directors, officers, and persons in control of the debtor. [11 U.S.C. § 101\(31\)\(B\)\(i\)-\(iii\)](#) (2000). Similar definitions apply for partnerships. [Id. § 101\(31\)\(C\)\(i\)-\(v\)](#).
- 40 See discussion *infra* Part III.B.3-4.
- 41 See discussion *infra* Part V.
- 42 See discussion *infra* Part IV.A-B.
- 43 See generally Warren & Westbrook, *supra* note 14, at 12 (discussing creditors that hold blanket liens over most estate property); Jay Lawrence Westbrook, [The Control of Wealth in Bankruptcy](#), 82 Tex. L. Rev. 795 (2004) (describing asset constraints or business plan constraints that prevent major changes in a debtor’s business).
- 44 See *infra* notes 277-387 and accompanying text regarding benefits to insiders; see also Michael Bradley & Michael Rosenzweig, [The Untenable Case for Chapter 11](#), 101 Yale L.J. 1043, 1049-50 (1992) (“[T]he principal beneficiaries of Chapter 11 (excluding the legions of lawyers, accountants and financial advisors who earn substantial fees from bankruptcy reorganizations) are corporate managers .... Chapter 11 preserves and protects the jobs of corporate managers, not corporate assets.”).
- 45 Adam Smith coined the concept of an invisible hand in the marketplace in 1776:  
By preferring the support of domestic to that of foreign industry, he intends only his own security; and by directing that industry in such a manner as its produce may be of the greatest value, he intends only his own gain, and he is in this, as in many other cases, led by an invisible hand to promote an end which was no part of his intention. Nor is it always the worse for the society that it was no part of it. By pursuing his own interest he frequently promotes that of the society more effectually than when he really intends to promote it. I have never known much good done by those who affected to trade for the public good.  
Adam Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* 351-52 (Prometheus Books 1991) (1776) (emphasis added).

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 46 For instance, the firm Weil, Gotshal & Manges, LLP, represents the debtors in the Enron, WorldCom, and Adelphia bankruptcies. See Motion of WorldCom (I) for Authorization to Obtain Postpetition Secured Super-Priority Financing Pursuant to [Sections 105, 362, 364\(c\)\(1\), 364\(c\)\(2\), 364\(c\)\(3\), and 507 of the Bankruptcy Code](#), (II) for Authorization to Grant Intercompany Super-Priority Claims and Junior Liens Pursuant to [Sections 361, 363\(e\), 364\(c\)\(1\), 364\(c\)\(3\), and 507 of the Bankruptcy Code](#), and (III) Scheduling a Final Hearing Pursuant to Bankruptcy Rule 4001 at 1, 17, In re WorldCom, Inc., No. 02-13533 (Bankr. S.D.N.Y. July 21, 2002) [hereinafter WorldCom Motion]; Danilo R. Munoz, Jr. et al. Adelphia Bankr. News 2 (June 26, 2002), available at <http://bankrupt.com/adelphia/adelphia8.txt> [hereinafter Adelphia]. But see Lubben, *supra* note 8, at 531 (observing there is less firm duplication than might be expected with large debtors).
- 47 “Other professionals” includes accountants, appraisers, auctioneers, turnaround specialists, and innumerable consultants that together comprise the insolvency community.
- 48 See In re SGL Carbon Corp., 233 B.R. 285, 288 (Bankr. D. Del. 1999); see also [Vancouver Women's Health Collective Soc'y v. A.H. Robins Co.](#), 820 F.2d 1359 (4th Cir. 1987) (discussing to whom the bankruptcy court owes obligations); In re Rusty Jones Inc., 110 B.R. 362, 375 (Bankr. N.D. Ill. 1990) (addressing the fundamental purpose of chapter 11); In re Aurora Cord & Cable Co., 2 B.R. 342, 346-47 (Bankr. N.D. Ill. 1980) (espousing the essence of chapter 11 and the bankruptcy court's duties to debtors and creditors); Christopher W. Frost, [The Theory, Reality and Pragmatism of Corporate Governance in Bankruptcy Reorganizations](#), 72 Am. Bankr. L.J. 103, 105 (1998) (noting business rehabilitation serves the dual goals of the creditors, and employees and other noninvestor stakeholders); Elizabeth Warren & Jay Lawrence Westbrook, [Financial Characteristics of Businesses in Bankruptcy](#), 73 Am. Bankr. L.J. 499, 553 (1999) (observing Congress's “awareness of how bankruptcy law may affect jobs and local communities”). The idea that bankruptcy exists at least in part to protect the little people has a long lineage. See In re Mortgage Sec. Corp., 75 F.2d 261, 262 (2d Cir. 1935) (per curiam). This concept is alive and well today. See [Cedar Shore Resort, Inc. v. Mueller](#) (In re Cedar Shore Resort, Inc.), 235 F.3d 375, 379 (8th Cir. 2000).
- 49 George W. Kuney, [Misinterpreting Bankruptcy Code Section 363\(f\) and Undermining the Chapter 11 Process](#), 76 Am. Bankr. L.J. 235, 242 n.30 (2002) (collecting authorities, describing the rise of reorganization by preplan sale practice, and noting that legislative history suggests that chapter 11 cases were to produce plans of reorganization). It was after counsel, courts, and clients perceived chapter 11 failures to be caused by the delay and expense of plan centered reorganizations that preplan sale reorganizations began to win broad acceptance and even to be “in vogue.” *Id.*; see also Miller Interview, *supra* note 1.
- 50 Kuney, *supra* note 49, at 242 n.30.
- 51 For details on plan proposal see [11 U.S.C. §§ 1121, 1122, 1123, 1125, 1126](#) (2000). For details on plan confirmation see [§§ 1128 and 1129](#).
- 52 See Eric A. Posner, [The Political Economy of the Bankruptcy Reform Act of 1978](#), 96 Mich. L. Rev. 47, 50 (1997); see also Thomas E. Plank, [Why Bankruptcy Judges Need Not and Should Not Be Article III Judges](#), 72 Am. Bankr. L.J. 567, 611 (1998) (“The purpose of bankruptcy law is to provide an efficient way to adjust the relationship between an insolvent debtor and the debtor's creditors.”).
- 53 Unified foreclosure applies where “a debt is secured by collateral which consists of closely related elements of real property and personal property, such as business premises plus fixtures and inventory of the business located on the premises.” [Aspen Enters., Inc. v. Bodge](#), 44 Cal. Rptr. 2d 763, 767-68 (Cal. Ct. App. 1995).
- 54 Douglas G. Baird, [The New Face of Chapter 11](#), 12 Am. Bankr. L. Rev. 69, 71 (2004); see, e.g., [Mellon Bank v. Dick Corp.](#), 351 F.3d 290, 291 (7th Cir. 2003) (“Qualitech's equity was worthless. Secured debts exceeded the value of its assets. Most creditors, both secured and unsecured, agreed that the best step was to sell Qualitech promptly as a going concern to someone willing to take the risk of trying to turn the business around.”); In re Med. Software Solutions, 286 B.R. 431, 437 (Bankr. D. Utah 2002) (“With no white knight to rescue the company in the foreseeable future, the Debtor elected to file for relief under... the Bankruptcy Code ....”); In re Cummins Util., L.P., 279 B.R. 195, 198 (Bankr. N.D. Tex. 2002) (“Though this case was commenced under Chapter 11, from the outset it was the Debtor's plan-- in which the Banks concurred--to use the Chapter 11 process to liquidate the Debtor's assets in a going-concern mode.... The Court, based on its experience and the evidence, is convinced, and finds, that the liquidation procedure followed by Debtor resulted in substantially greater return to the estate than if the Debtor had attempted to continue its business

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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in the face of deteriorating revenues or if the Debtor had elected to liquidate under Chapter 7 of the Bankruptcy Code. The Court further finds the first and principle beneficiaries of the Debtor's strategy were clearly the Banks.”) (internal citations omitted); see also Douglas G. Baird & Robert K. Rasmussen, [The End of Bankruptcy](#), 55 *Stan. L. Rev.* 751, 787 (2002) (noting “[a] firm in financial distress that seeks to sell itself may thus turn to Chapter 11 not to rehabilitate a failing enterprise but rather to dispose of it”). Courts that first encountered such sales looked on them askance. See [In re Lionel Corp.](#), 722 F.2d 1063 (2d Cir. 1983) (reversing the bankruptcy court's allowance of a § 363(b) sale). In part because of the “good business reason” test for § 363(b) sales advanced by the court in *Lionel*, such sales have become increasingly common. See Craig A. Sloane, [The Sub Rosa Plan of Reorganization: Side-Stepping Creditor Protections in Chapter 11](#), 16 *Bankr. Dev. J.* 37, 51 (1999). This is not to say that § 363(b) sales are all well and good, however. See Kuney, *supra* note 49, at 272-82 (discussing effects of reorganization by sale compared to reorganization by plan or various constituencies in a chapter 11 case).

55 Warren & Westbrook, *supra* note 48, at 500. See Baird & Rasmussen, *supra* note 54, at 752; Lynn M. Lopucki, [The Trouble with Chapter 11](#), 1993 *Wis. L. Rev.* 729, 756 (1993); Ponoroff, *supra* note 16, at 192. The critique of chapter 11 is not limited to middle market businesses. See Jeffrey I. Werbalowsky, [Reforming Chapter 11: Building an International Restructuring Model](#), 8 *J. Bankr. L. & Prac.* 561, 561-62 (1999).

56 See Kenneth N. Klee, [One Size Fits Some: Single Asset Real Estate Bankruptcy Cases](#), 87 *Cornell L. Rev.* 1285 (2002); Warren, *supra* note 23, at 1373; Warren & Westbrook, *supra* note 48, at 500. Indeed these facts should be determined through empirical study. Great strides have been made in this regard by Professor LoPucki and his co-authors. See Theodore Eisenberg & Lynn M. LoPucki, [Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations](#), 84 *Cornell L. Rev.* 967 (1999); Lynn M. LoPucki & William C. Whitford, [Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies](#), 78 *Cornell L. Rev.* 597 (1993); see also Samuel L. Bufford, [Chapter 11 Case Management and Delay Reduction: An Empirical Study](#), 4 *Am. Bankr. Inst. L. Rev.* 85 (1996); Lisa Hill Fenning, [Chapter 11, The Real World of 500 Cases](#), 4 *Am. Bankr. Inst. L. Rev.* 119 (1996). More can and should be done to improve data collection and transparency in the bankruptcy system, although this is not necessarily in the interest of those that benefit from the system as it presently stands.

57 See, e.g., *WorldCom Motion*, *supra* note 46, at 15 (“Absent interim debtor in possession credit financing, WorldCom's objective of prosecuting their [sic] chapter 11 cases and restructuring its businesses as a going concern, while maintaining value for the benefit of creditors and employees, may fail without a fair opportunity to achieve the purposes of chapter 11.”). In large part, out of agreement with the position of Professor Gross, the author omits reference to the various theories that ring out in the academic literature about bankruptcy in general and chapter 11 in particular. See Karen Gross, [Finding Some Trees But Missing the Forest](#), 12 *Am. Bankr. Inst. L. Rev.* 203, 213 (2004) (suspecting while “academics do play a role in law making at some level ... the academic writing and studies about the nature and function of chapter 11 are [not] what move the bankruptcy judiciary”).

58 See George W. Kuney, [Let's Make It Official: Adding an Explicit Preplan Sale Process as an Alternative Exit from Bankruptcy](#), 40 *Hous. L. Rev.* 1265 (2004) (presenting proposed amendments to the Bankruptcy Code to accomplish this end and collecting, among other authorities, the national variety of local rules that bankruptcy courts have created in the absence of statutory guidance for the preplan sale process). As this Article was going to press, the American Bankruptcy Institute Law Review published a collection of views and counter-views on the Code and chapter 11 in particular. See *Symposium on the Code After 25 Years: 1978-2003*, 12 *Am. Bankr. Inst. L. R.* (2004).

59 See Bradley & Rosenzweig, *supra* note 44, at 1050. But see Elizabeth Warren, [The Untenable Case for Repeal of Chapter 11](#), 102 *Yale L.J.* 437 (1992).

60 See Miller Interview, *supra* note 1. Chapter 7 already contains a provision allowing the trustee to operate a debtor's business with court authorization. 11 U.S.C. § 721 (2000). This provision is rarely used, largely because of the practical problems posed in restarting a business that was shut down upon filing the petition once the trustee gathers sufficient information to determine if an operating order is warranted and obtains one from the court. See [Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery](#), 330 F.3d 548, 557, 557 n.9 (3d Cir. 2003); [In re Colorado-UTE Elec. Ass'n](#), 120 B.R. 164, 173 (Bankr. D. Colo. 1990); Harvey R. Miller, [The Changing Face of Chapter 11: A Reemergence of the Bankruptcy Judge as Producer, Director, and Sometimes Star of the Reorganization Passion Play](#), 69 *Am. Bankr. L.J.* 431, 442, 459 (1995); Raymond T. Nimmer & Richard B. Feinberg, [Chapter 11 Business Governance: Fiduciary Duties, Business Judgment, Trustees and Exclusivity](#), 6 *Bankr. Dev. J.* 1, 10-11 (1989). In most



HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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cases, the horse--going concern value--has left the barn before the trustee is or can be authorized to shut the door. One solution would be to amend § 721 to provide the trustee with the discretion to operate or shut down the business, with a procedure for judicial review and veto power over that decision upon challenge by creditors or parties in interest.

- 61 Federal funding comes in the form of the bankruptcy system itself, comprised of bankruptcy courts, clerks, judges, judicial assistants, the Department of Justice's United States Trustee Program, and the like. Their costs are not insubstantial. See United States Trustee Program, Salaries and Expenses, 86-89 available at <http://www.usdoj.gov/jmd/2005summary/xls/p86-89.xls> (last visited Dec. 20, 2004).
- 62 Unsecured creditors and other junior interests fund the process as value that could otherwise accrue to them in a straight liquidation is earned and transferred to insolvency professionals and other administrative elements over the course of the case. Kuney, *supra* note 58, at 1271 n.27.
- 63 See Warren, *supra* note 23, at 1389-90.
- 64 See Joshua A. Ehrenfeld, Comment, [Quieting the Rebellion: Eliminating Payment of Prepetition Debts Prior to Chapter 11 Reorganizations](#), 70 U. Chi. L. Rev. 621, 634-35 (2003) (observing “[t]he majority of corporate bankruptcy cases are handled in pre-packaged deals in which the various creditors determine the substance of the reorganization process before the bankruptcy petition is even filed. In these situations, major creditors determine how much each class of creditors will receive, which prepetition creditors will be paid in full, and the extent to which administrative costs will be paid.”) (internal citations omitted). If you are going to hijack something, out in plain view may be the best place to do it, as long as you are organized and consistent, keep doing it over and over again, and proceed in a manner that suggests it is the ordinary course of business. See Michael Moore, *Dude, Where's My Country?* 42 (2003) (“[I]f you tell a lie long enough and often enough, sooner or later it becomes the truth .... Keep repeating the lie over and over again until the American people are so worn down they'll scream ‘uncle’ and start believing it.”).
- 65 See discussion *infra* Part II.A. But see Lisa Hill Fenning, [Judicial Case Management Is No Hostile Takeover \(pt. 2\)](#), 15 Am. Bankr. Inst. J. 35 (Sept. 1996) (“By process of elimination, bankruptcy judges must manage chapter 11 cases. They are the only participants in the system with sufficient incentive, experience and authority to do the job. But bankruptcy judges have been reluctant to accept case management as part of their job definition.... The Bankruptcy Code's legislative history warns that bankruptcy judges are not supposed [to] be ‘administering’ cases any more. Concern about coming too close to the forbidden line has caused most judges to avoid actively working their chapter 11 cases.”); Miller, *supra* note 60, at 431 (arguing through later amendments to the Code and the fundamental needs of the process, bankruptcy judges have reversed some of this evolution).
- 66 See discussion *infra* Part I.B. One reviewer of an earlier draft of this Article, who prefers to remain anonymous, commented: The more appropriate emphasis is not on the sheer size of the fee awards, but rather that bankruptcy lawyers are not bankruptcy lawyers anymore, but rather extremely well-compensated M&A [merger and acquisition] lawyers who do corporate restructuring of a particular sort. The question that is completely consistent with your central thesis is not whether they are doing well [financially] (which they are), but rather whether chapter 11 should be used for M&A work. The author agrees completely. The availability of fees competitive with non-bankruptcy corporate work, including M&A work, drew in the lawyers that have transformed chapter 11 practice into its present form.
- 67 1 Comm'n on the Bankr. Laws of the United States, Report of the Comm'n on the Bankr. Laws of the United States, H.R. Doc. No. 93-137, pt. 1, at 33 (1973).
- 68 “The Subcommittee on Bankruptcy of the Senate Committee on the Judiciary held hearings on Senate Joint Resolution 100 in July 1968 ....” *Id.* at 2. A little more than a year later, “Subcommittee No. 4 of the House Committee on the Judiciary held hearings on Senate Joint Resolution 88 ....” *Id.* As a result of these hearings the Commission on the Bankruptcy Laws of the United States was created in 1970. Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468 (creating the Commission on the Bankruptcy Laws of the United States), amended by Act of Mar. 17, 1972, Pub. L. No. 92-251, 86 Stat. 63 (extending the term of the Commission); Act of July 1, 1973, [Pub. L. No. 93-56, 87 Stat. 140](#) (extending the term again). The Commission's charge was to “study, analyze, evaluate, and recommend changes to the [Bankruptcy] Act.” Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468. Specifically, the Commission was to address “the basic philosophy of bankruptcy, the causes of bankruptcy, the possible alternatives to the present system of bankruptcy administration, the applicability of advanced management techniques to achieve economies in the administration of the

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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Act, and all other matters which the Commission ... deem[ed] relevant.” Id. After two years of studying, analyzing, and evaluating, the Commission submitted the Commission Report, containing its major recommendations, one being the removal of the bankruptcy judge as the lead administrator in bankruptcy cases. H.R. Doc. No. 93-137, pt. 1, at 5-7.

- 69 J. Ronald Trost et al., *The Proposed Federal Bankruptcy Reform Act 7* (1979).
- 70 [H.R. Rep. No. 95-595](#), pt. 1, at 8 (1977). The concept of the bankruptcy referee was not synonymous with that of the bankruptcy judge. Instead, referees “only decided those matters relating to property over which they had direct control, matters referred to them as special masters by judges, and matters submitted by consent of the parties.” Id. It seems the referee had discretion in his administrative role to provide efficient and effective administration of the estate. See id. It was not until later, when the role evolved into more of a judicial office, that the role of the referee became complicated.
- 71 Id.
- 72 Chandler Act, ch. 575, 52 Stat. 840 (1938) (amending Bankruptcy Act of 1898, ch. 541, 30 Stat. 544) (repealed by Bankruptcy Reform Act of 1978, [Pub. L. No. 95-598](#), tit. IV, § 401(a), 92 Stat. 2549, 2682).
- 73 [H.R. Rep. No. 95-595](#), pt. 1, at 8-9.
- 74 Chandler Act, ch. 575, 52 Stat. 840, 858.
- 75 Id.
- 76 Id.
- 77 Id.
- 78 Id. § 39, 52 Stat. 840, 858.
- 79 Id. § 2(a)(10), 52 Stat. 840, 858. Before an order was entered, the district court judge reviewed the referee's decision and approved it, but under this section, the referee made the decision. Id. If either party was dissatisfied with the decision then that party would have to appeal the decision to the district court judge. Id.
- 80 Act of June 28, 1946, ch. 512, § 40, 60 Stat. 323, 323-24 (repealed 1978). Before, as an administrator, the referee received a fee for each estate administered. Id. In 1946, Congress recognized that the referee had taken on more of a judicial role and fee arrangements were not appropriate for judicial officials, thus, making him a salaried officer. Id.
- 81 1 Comm'n on the Bankr. Laws of the United States, Report of the Comm'n on the Bankr. Laws of the United States, H.R. Doc. No. 93-137, pt. 1, at 93 (1973).
- 82 Id.
- 83 Id.
- 84 Id. at 5.
- 85 Id. at 93.
- 86 Id.
- 87 Id. at 5-6 (stating the trier of fact should not be involved with the handling of paperwork, so the individuals involved in the adversarial system can be confident that the trier of fact is being presented evidence for the first time and would make a fair decision based on the presented evidence).
- 88 See [H.R. Rep. No. 95-595](#), pt. 1, at 90 (1977).

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 89 The merger of the bankruptcy judge and bankruptcy referee offices was probably inevitable. Several changes previously made to the bankruptcy act and procedure and bankruptcy practice itself were predictive of the merger. The Chandler Act removed many of the administrative duties of the referee and gave him more judicial functions. The Chandler Act provided that the definition of the court included both the referee and bankruptcy judge. Chandler Act, ch. 575, § 1(9), 52 Stat. 840 (1938). In 1973, the Rules of Bankruptcy Procedure titled the referee the “bankruptcy judge,” recognizing his judicial role as the bankruptcy judge. [H.R. Rep. No. 95-595](#), pt.1, at 9. At the same time, the role of the district judge in bankruptcy procedure had diminished as the area became more specialized. *Id.* In 1979, under the then newly enacted Bankruptcy Code, Congress merely caught up with the trend. Congress eliminated the office of the bankruptcy referee and renamed the “referee” the “bankruptcy judge.” See 11 U.S.C. § 404 (1979). Under the Bankruptcy Code, the judges of the Circuit Court, after consulting with a merit screening committee, would determine whether the bankruptcy referee had the necessary qualifications to be a bankruptcy judge. *Id.* If the referee qualified, he would have a position as a bankruptcy judge. *Id.*
- 90 11 U.S.C. § 408 (1979).
- 91 *Id.*
- 92 Collier Pamphlet Edition 631 (Asa S. Herzog & Lawrence P. King eds., 1979).
- 93 See *id.*
- 94 Previously, serving in an administrative role, the court had the responsibility of scheduling, attending, and presiding over the creditors’ meetings. Chandler Act, ch. 575, § 55, 52 Stat. 840 (1938). Being present at these meetings exposed the court to facts and evidence of all parties involved. If a dispute arose, the court had to adjudicate the dispute. *Id.* Yet the question would always remain as to whether a fair trial before an unbiased adjudicator existed.
- 95 1 Comm’n on the Bankr. Laws of the United States, Report of the Comm’n on the Bankr. Laws of the United States, H.R. Doc. No. 93-137, pt. 1, at 5 (1973). In a similar vein, under [11 U.S.C. § 321\(b\) \(1979\)](#), an individual who had served as an examiner could not serve as a trustee. Again, the possibility existed that the examiner had been predisposed to facts and evidence and from that would make administrative decisions and judgments that may prejudice those involved. The possibility also existed that, if the examiner were to be eligible to serve as trustee, this might bias the examiner to report findings that would lead to appointment of a trustee--a job for which the examiner would then be eligible. Bankruptcy referees had reported their perception that some trustees made decisions based on the economic benefit that they would receive. H.R. Doc. No. 93-137, pt. 1, at 109. Section 327(f) simply reiterated [§ 321](#) and prohibited a trustee from hiring an individual who had served as an examiner. [11 U.S.C. § 327\(f\) \(1979\)](#). The rule clearly indicated that none of the professionals employed could be interested in the bankruptcy estate. *Id.*
- 96 See Baird, *supra* note 54, at 92. But see Miller, *supra* note 60, at 433 (asserting “the role of the bankruptcy judge has come almost full circle to be equivalent to the role played by the judge under the Bankruptcy Act, augmented by the power to take numerous actions *sua sponte*”). Whether this power is being wielded effectively is an open question and the answer varies district-by-district and judge-by-judge. This leads to thoughts of forum shopping and the “Delawarification” of chapter 11 practice. See generally Eisenberg & LoPucki, *supra* note 56 (noting filing patterns favoring certain jurisdictions over others); David A. Skeel, Jr. [Lockups and Delaware Venue in Corporate Law and Bankruptcy](#), 68 U. Cin. L. Rev. 1243 (2000) (discussing advantages of selecting the District of Delaware as a reorganization forum). Those subjects are beyond the scope of this Article.
- 97 Daniel B. Bogart, [Unexpected Gifts of Chapter 11: The Breach of a Director's Duty of Loyalty Following Plan Confirmation and the Postconfirmation Jurisdiction of Bankruptcy Courts](#), 72 Am. Bankr. L.J. 303, 303 n.1 (1998); see also [In re iPCS, Inc.](#), 297 B.R. 283, 287 (Bankr. N.D. Ga. 2003) (recognizing “the appointment of a trustee is generally the exception, rather than the rule[;] the Bankruptcy Code vests a debtor-in-possession with the powers of a trustee in the event no trustee is appointed”) (internal citations omitted); [In re Justus Hospitality Properties Ltd.](#), 86 B.R. 261, 267 (Bankr. M.D. Fla. 1988) (noting the strong presumption “in favor of leaving a reorganizing debtor-in-possession in charge of its operations”).
- 98 Bankruptcy Reform Act of 1994, [Pub. L. No. 103-394](#), 108 Stat. 4111, reprinted in 1994 U.S.C.C.A.N. 3340.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 99 See Miller, *supra* note 60, at 454-55. In practice, the United States Trustee seems to appear most frequently in relation to the appointment of a creditors' committee or in the context of professionals and their fees. See, e.g., [Official Comm. Unsecured Creditors Cybergenics Corp. v. Chinery](#), 330 F.3d 548, 553 (3d Cir. 2003) (noting the United States trustee's appointment of a creditors' committee to represent the interests of unsecured creditors); Miller, *supra* note 60, at 456 (observing "the United States Trustees spend a disproportionate amount of time reviewing and objecting to applications for compensation and reimbursement of expenses"); Alan N. Resnick, Symposium Mass Torts: [Bankruptcy as a Vehicle for Resolving Enterprise-Threatening Mass Tort Liability](#), 148 U. Pa. L. Rev. 2045, 2051-54, 2062 (2000) ("[U]nsecured creditors are represented by at least one committee of creditors selected by the United States trustee.").
- 100 See Bogart, *supra* note 97, at 303, 384; Frost, *supra* note 48, at 119. Some commentators have argued that creditor influence on management will produce better corporate governance in the context of a chapter 11 proceeding. See Frost, *supra* note 48, at 114-15; Lubben, *supra* note 8, at 548. Courts, however, would probably find the above described relationship between management and creditors an unfortunate return to the past. See [In re Aspen Limousine Serv., Inc.](#), 187 B.R. 989 (Bankr. D. Colo. 1995) (citing [In re N. Redington Beach Assocs., Ltd.](#), 91 B.R. 166, 169 (Bankr. M.D. Fla. 1988)). See generally John D. Ayer, [Bankruptcy as an Essentially Contested Concept: The Case of the One-Asset Case](#), 44 S.C. L. Rev. 863, 888-89 (1993) (concluding "Congress may have intended the structure of chapter 11 to be muddy, precisely to avoid solving a problem that it did not wish to solve"); Miller, *supra* note 60, at 431 (observing after the 1978 reform, "the bankruptcy judge would no longer be actively and intimately involved in the administration of bankruptcy cases ... [but instead] would be a brooding presence limited to the role of an adjudicator of actual controversies requiring judicial intervention").
- 101 The Chandler Act allowed for the reasonable compensation for services rendered and reimbursement for proper costs and expenses incurred by creditors and stockholders, and the attorneys for any of them, in connection with the submission by them of suggestions for a plan or of proposals in the form of plans, or in connection with objections by them to the confirmation of a plan, or in connection with the administration of the estate. Ch. 575, § 643, 52 Stat. 840 (1938). See, e.g., [Mass. Mut. Life Ins. Co. v. Brock](#), 405 F.2d 429, 432 (5th Cir. 1968); [Calhoun v. Hertwig](#), 363 F.2d. 257 (5th Cir. 1966).
- 102 See, e.g., [Mass. Mut. Life Ins. Co.](#), 405 F.2d at 432 (observing the district court's broad discretion in awarding fees); [Calhoun](#), 363 F.2d. at 261-62 (noting chapter X gives the judge broad discretion).
- 103 Chandler Act, ch. 575, § 643, 52 Stat. 840 (1938). See also [Calhoun](#), 363 F.2d at 262 (citing 11 U.S.C.A. § 643 (1938)).
- 104 [Mass. Mut. Life Ins. Co.](#), 405 F.2d at 433 (citing [Finn v. Childs Co.](#), 181 F.2d 431, 436 (2d Cir. 1950)).
- 105 E.g., [Dickinson Indus. Site v. Cowan](#), 309 U.S. 382, 389 (1940); [Mass. Mut. Life Ins. Co.](#), 405 F.2d at 432; [Finn](#), 181 F.2d at 431.
- 106 [Dickinson Indus. Site](#), 309 U.S. at 389.
- 107 See *id.*; [Finn](#), 181 F.2d at 435.
- 108 [Dickinson Indus. Site](#), 309 U.S. at 388.
- 109 [Finn](#), 181 F.2d at 435-36 (citing [London v. Snyder](#), 163 F.2d 621 (8th Cir. 1947)); [In re Mt. Forest Fur Farms of Am.](#), 157 F.2d 640, 647 (6th Cir. 1946); [In re Std. Gas & Elec. Co.](#), 106 F.2d 215, 216-17 (3d Cir. 1939)).
- 110 S. Rep. No. 95-989, at 40 (1978).
- 111 *Id.* (alluding to Justice Douglas's remark that "[t]he history of fees in corporate reorganizations contains many sordid chapters" in [Dickinson Indus. Site](#), 309 U.S. at 388).
- 112 *Id.*
- 113 *Id.*

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 114 124 Cong. Rec. 33, 994 (1978), reprinted in 1978 U.S.C.C.A.N. 6505, 6511. This shift from a standard of economy to one more focused on what the market would bear came at the same time that lawyer and law firm compensation-- especially at large law firms-- was escalating at an accelerated pace.
- 115 11 U.S.C. § 330(a) (1978).
- 116 124 Cong. Rec. 33, 994 (1978), reprinted in 1978 U.S.C.C.A.N. 6505, 6511.
- 117 69 A.L.R. Fed. 645 (1984).
- 118 Pub. L. 103-394, 108 Stat. 4111 (1994).
- 119 11 U.S.C. § 330(a) (2000). See also Homer Drake, Jr., *Bankruptcy Practice for the General Practitioner* § 10:14, at 22 (2003) (noting the difficulty in attracting competent attorneys to perform bankruptcy services because of the attorney's possible preoccupation with the manner and amount which they will be paid). The hope of a brighter day, however, is offered by the current standard under the Code which is based on "the time, nature, extent, and the value of such services, and the costs of comparable services other than in a case under this title." *Id.* (emphasis omitted). Although the criteria for reasonableness remains largely the same, "of critical significance is the standard of comparable services which ... has thus been injected into the Code as a means of [e]nsuring to the greatest extent possible that bankruptcy specialists receive no less consideration for the value of their services than their counterparts in other areas of the law, such as securities, real estate, tax, and labor." *Id.* § 10:14, at 23, 25. Some might look at revised § 330(a) and its list of factors with some skepticism. See Ayer, *supra* note 100, at 874 ("The listing of 'factors' for decision certainly represents an admirable instinct for precision. But as anyone who has ever owned a Jaguar must know, the more complicated the machine, the more likely it is to break down. I know a judge/teacher who says that he tells his students: 'Whenever the Court of Appeals names more than three factors, you can ignore them all.'") (internal citations omitted).
- 120 See "Bloomberg Markets" Magazine Ranks Top U.S. Bankruptcy Law Firms, PR Newswire, Mar. 11, 2003, LEXIS, Nexis Library, All News File; see also Large Chapter 11 Conference Report, *supra* note 25, at 27 ("Certain issues related to the appointment and payment of attorneys and professionals may affect a debtor's choice of venue. Possible venue drivers include whether a court approves national rates for counsel and how the court handles the payments of financial advisors.").
- 121 See Eric Berger, *Legal Fees for Enron 'Shocking' in Stature*, Hous. Chron., Nov. 14, 2003, available at <http://bkinformation.com/Test/NewViews.cmf?SAID=69155>. One is reminded of the adage that bankruptcy lawyers often use to mollify their debtor and creditor clients alike: Little pigs get fed, big hogs get slaughtered. Perhaps this has been forgotten in the current economic environment, but it may prove true again. See Miller, *supra* note 60, at 462-63; Sharon D. Murray, *Letter from Delaware, The Deal*, Apr. 23, 2003, available at <http://bkinformation.com/Test/NewsView5.cfm?SAID=53917>; see also Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Cases*, 1 J. Empirical Leg. Stud. 111 (2003) (suggesting professional fees in large cases are steady or perhaps falling).
- 122 See Baird & Rasmussen, *supra* note 54, at 758-59. A fine description of equity receivership practice is found in Michael Gerber, *Business Reorganizations* 733 (2d ed. Lexis 2000).
- 123 See Baird & Rasmussen, *supra* note 54, at 779-80; see also Markell, *supra* note 17, at 9-10 ("As was the case with section 12 compositions, chapter XI had several drawbacks. The rights of secured creditors and the interests of equity holders could not be affected absent the unanimous consent of those involved. When the major railroads and other large companies of the day needed reorganization, however, they had to deal with diverse groups of secured creditors and equity holders. Before 1933, equity receiverships were the primary vehicle used to reorganize these entities. In these cases, courts adopted a more creditor-protective point of view.") (internal citations omitted). The contrived viability of the railroad reorganization model in the face of the twenty-first century's "new economy" has been questioned. Harvey R. Miller & Shair Y. Waisman, [Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century](#), 78 *Am. Bankr. L.J.* 153 (2004).
- 124 Use of cash collateral is discussed *infra* notes 282-83 and accompanying text in the context of insider retention programs. For purposes of this part regarding lender control through postpetition financing, the reader should understand that any of the techniques discussed in the context of DIP financing can also be used in a stipulation for use of cash collateral creating the same effect--control. The two

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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forms of financing are discussed here collectively as DIP financing for the sake of brevity. See generally Large Chapter 11 Conference Report, *supra* note 25, at 10 (“After further discussion ...[conference participants] concluded that because a lender can influence choice of venue, a court’s willingness to approve certain financing provisions can be a factor. Some courts will approve financing agreements containing provisions that roll a lender’s pre-petition debt into its post-petition debt or grant pre-petition debt cross-collateralization protection, whereas other courts will not. The issue of institutional fees can also be a factor. Moreover, participants agreed that courts with clear and predictable procedures and policies on DIP financing are preferred.”).

- 125 This method of gaining control over a debtor need not await the commencement of a bankruptcy case. Bank syndicates can and do engage in prepetition lending that may give them effective control over a soon-to-be debtor and allow them to dictate when and for how long a business will operate, what creditors will be paid, on what terms, and even when and where the bankruptcy case will be filed, using this control to protect their own interests and to insulate payments made to them from later avoidance and recovery. See *Official Comm. Unsecured Creditors v. Credit Suisse First Boston (In re Exide Tech., Inc.)*, 299 B.R. 732 (Bankr. D. Del. 2003) (denying bank group’s motion to dismiss counts (1) seeking to establish lenders as insiders of the debtor due to control, (2) for equitable subordination of the claims for insider preference avoidance, (3) for actual and constructive fraudulent conveyance avoidance, and (4) for actual fraud); see also *In re Clark Pipe & Supply Co., Inc.*, 893 F. 2d 693 (5th Cir. 1990) (involving lender that used lockbox involving credit facility to totally control debtor’s prepetition liquidation of collateral). See generally Baird, *supra* note 54, at 81 (describing the consolidation of senior lender under power in the run up to and early stages of a chapter 11 case).
- 126 See 11 U.S.C. § 364 (2000). See generally David A. Skeel, Jr., *The Past, Present and Future of Debtor-In-Possession Financing*, 25 *Cardozo L. Rev.* 1905 (2004).
- 127 11 U.S.C. § 364(a).
- 128 See Peter Antoszyk, *Trends in Debtor in Possession Financing*, \*1, 2 (2001) (discussing the financing options and procedures for debtors-in-possession) at <http://abiworld.org/abidata/online/conference/01wlc/Antoszyk.html> (last visited Nov. 26, 2004).
- 129 Section 503(b)(1)(A) grants administrative priority including all actual, necessary costs and expenses of preserving the debtor’s bankruptcy estate. Administrative priority is placed above all prepetition claims and equity interests on the bankruptcy priority ladder. See 11 U.S.C. § 503(b)(1)(A).
- 130 See Ayer, *supra* note 100, at 870-71; Markell, *supra* note 17, at 44; Bruce S. Nathan, *Advanced Issues in Bankruptcy*, 1, 10 (June 13, 2002) (presented at the NACM’s 106th Annual Credit Congress and Exposition).
- 131 See WorldCom Motion, *supra* note 46, at 7; Antoszyk, *supra* note 128, at \*22. The supposed high risk of lending to a chapter 11 debtor may very well be a matter of perception because the firms creditors are willing to provide with DIP financing seem to be the larger, healthier firms with a better chance of emergence from chapter 11. See Sris Chatterjee et al., *Debtor-in-Possession Financing*, 24 (May 31, 2001) (unpublished manuscript under 2nd revision at Fin. Mgmt. J.). Of course in a large chapter 11 case, the amount that the DIP seeks to borrow can be staggering, and this amount in and of itself may constitute a huge risk to lenders who could be out billions of dollars in the event that the DIP fails to pay the money back. See WorldCom Motion, *supra* note 46, at 5, 7; Adelpia, *supra* note 46, at 3.
- 132 John D. Ayer et al., *The Life Cycle of a Chapter 11 Debtor Through the Debtor’s Eyes* (pt. 1), 22 *Am. Bankr. Inst. J.* 20, 50 (Sept. 2003).
- 133 And with good reason. Failure to secure more than administrative priority opens a lender up to the “you have made your bed, now lie in it” defense. See *Hartford Underwriters Ins. Co. v. Union Planters Bank*, 530 U.S. 1, 12 (2000) (“And limiting § 506(c) to the trustee does not leave those who provide goods or services that benefit secured interests without other means of protecting themselves as against other creditors: They may insist on cash payment, or contract directly with the secured creditor, and may be able to obtain superpriority under § 364(c)(1) or a security interest under § 364(c)(2), (3) or § 364(d).”); see also WorldCom Motion, *supra* note 46, at 15; Antoszyk, *supra* note 128, at \*22; Chatterjee et al., *supra* note 131, at 5. For an example of what such a DIP loan agreement looks like in practice, see Adelpia, *supra* note 46, at 24.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 134 After the debtor has shown that it cannot obtain unsecured DIP financing, § 364(c)(1) allows a court to award a lender superpriority over all administrative claims allowed under § 503(b) and § 507(b). A lender seeking superpriority often will provide for a “carve-out” and place the DIP financing’s priority below that of certain administrative expenses, such as professionals’ fees.
- 135 Section 364(c)(2) allows the bankruptcy court to grant a lender liens on unencumbered bankruptcy property if the debtor shows that it is unable to obtain unsecured DIP financing or credit under § 364(c)(1).
- 136 Section 364(c)(3) authorizes the court to award a lender junior liens on encumbered bankruptcy assets if the debtor shows that it is unable to obtain DIP financing on an unsecured basis or under § 364(c)(1) or (c)(2).
- 137 The standard of proof necessary for showing that unsecured financing is unavailable is understandably low as almost every reputable lending institution requires some form of security before providing DIP financing--if at all. However, technically, to obtain financing under § 364(c), the debtor bears the burden of showing:  
first, that the proposed financing is an exercise of sound and reasonable business judgment; second, that no alternative financing is available on any other basis; third, that the financing is in the best interests of the estate and its creditors; and, as a corollary to the first three points, that no better offers, bids, or timely proposals are before the Court.  
*In re Phase-I Molecular Tech. Inc.*, 285 B.R. 494, 495 (Bankr. D. N.M. 2002) (quoting *In re W. Pac. Airlines, Inc.*, 223 B.R. 567, 572 (Bankr. D. Colo. 1997)).
- 138 See, e.g., *In re S. Soya Corp.*, 251 B.R. 302 (Bankr. D. S.C. 2000); *In re Caldor, Inc.-N.Y.*, 240 B.R. 180, 189 (Bankr. S.D.N.Y. 1999); *In re W. Pac. Airlines, Inc.*, 223 B.R. at 572. See generally Robert J. Keach, *Stalking Horse Lenders and Good Faith*, 23 *Am. Bankr. Inst. J.* 28 (June 2004) (describing the process of asset purchasers extending DIP financing and gaining approval of DIP financing early in a case).
- 139 11 U.S.C. § 364(d)(1).
- 140 *Id.* § 364(d)(1)(A)-(d)(1)(B). “Adequate protection” generally refers to protection of a party’s interest in property and is defined in § 361 of the Bankruptcy Code. The chapter 11 debtor is required to prove that creditors’ interests in property are adequately protected before the bankruptcy court may approve DIP financing under § 364(d). Section 361 states, in pertinent part:  
When adequate protection is required under section... 364 of this title of an interest of an entity in property, such adequate protection may be provided by --  
(1) requiring the trustee to make a cash payment or periodic cash payments to such entity, to the extent that... any grant of a lien under section 364 of this title results in a decrease in the value of such entity’s interest in such property;  
(2) providing to such entity an additional or replacement lien to the extent that such ... grant results in a decrease in the value of such entity’s interest in such property; or  
(3) granting such other relief, other than entitling such entity compensation allowable under section 503(b)(1) of this title as an administrative expense, as will result in the realization by such entity of the indubitable equivalent of such entity’s interest in such property.  
The concept of adequate protection allows the trustee or debtor-in-possession the flexibility necessary to operate the debtor’s business and reorganize while ensuring--at least theoretically--that the interests of secured creditors are protected. The right to adequate protection arises not only from the Fifth Amendment right of protection of property, but also the belief that secured creditors are not to be “deprived of the benefit of their bargain.” H.R. Rec. No. 95-595, pt. 1, at 338-40 (1977); see also *In re Qualitech Steel Corp.*, 276 F.3d 245, (7th Cir. 2001) (granting a postpetition replacement lien to prepetition secured creditors to the extent they were harmed by a postpetition loan granting DIP lenders superpriority under § 364(d)); *Resolution Trust Corp. v. Swedeland Dev. Group, Inc.* (*In re Swedeland Dev. Group, Inc.*), 16 F.3d 552, 564 (3d Cir. 1994) (“In other words, the proposal should provide the pre-petition secured creditor with the same level of protection it would have had if there had not been postpetition superpriority financing.”).  
Essentially, § 361 sanctions three types of adequate protection: (1) a lump-sum cash payment; (2) periodic cash payments; and (3) grants of additional security. Although § 361(3) also provides that the “indubitable equivalent” may also be given, bankruptcy courts almost universally order cash payments or additional grants of security for purposes of adequate protection. See *In re O’Quinn*, 98 B.R. 86, 89 (Bankr. M.D. Fla. 1989). One exception to this general practice, however, is when the bankruptcy judge determines that

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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the creditor has the “indubitable equivalent” of its security merely because the creditor’s equity cushion is so substantial. See *id.* But see *In re Grundstrom*, 14 B.R. 791, 794-95 (Bankr. D. Mass. 1981).

141 See, e.g., *In re Shaw Indus., Inc.*, 300 B.R. 861 (Bankr. W.D. Penn. 2003) (debtor ineligible for priming financing despite over-secured status of existing secured creditors when the secured creditors equity cushion is rapidly eroding due to debtor’s history of operating losses in an industry suffering from a structural, not cyclical, downturn); *In re Seth Co.*, 281 B.R. 150 (Bankr. D. Conn. 2002) (holding § 364(d) DIP financing would not be granted where the debtor failed to prove that the interests of prepetition creditors would be protected).

142 See Chatterjee et al., *supra* note 131, at 13; see also *infra* notes 178-80 and accompanying text.

143 There may be good reason to advertise these risks. See Antoszyk, *supra* note 128, at \*21; Chatterjee et al., *supra* note 131, at 18.

144 Because of the high priority and other protections demanded by DIP lenders, discussed *infra*, DIP financing is likely to be no more--and probably less--risky than normal financing. See Chatterjee et al., *supra* note 131, at 12 (questioning the high rate of interest and large fees demanded by DIP lenders after examining over one hundred chapter 11 cases occurring between the late 1980s and late 1990s and discovering only one case in which the principal of a DIP loan was unpaid--and there the debtor cured the default after confirming its reorganization plan). In fact, due to the availability and active supervision of the debtor by the bankruptcy court, DIP lending may even be less risky than lending outside of bankruptcy.

145 See Baird & Rasmussen, *supra* note 54, at 751; Warren & Westbrook, *supra* note 48, at 523.

146 See WorldCom Motion, *supra* note 46, at 15; Adelpia, *supra* note 46, at 6; Chatterjee et al., *supra* note 131, at 9, 13, 23-24.

147 Of course, this industry practice provides a debtor with one more hurdle that must be cleared prior to plan confirmation--finding a potential creditor exit financier--and another incentive to pursue a preplan sale of substantially all the assets of the business rather than a plan of reorganization.

148 See WorldCom Motion, *supra* note 46, at 9 (detailing the term for the loan); Chatterjee et al., *supra* note 131, at 9 (noting seventy-eight percent of all the DIP loans analyzed in their study had a maturity date of two years or less).

149 See Baird & Rasmussen, *supra* note 54, at 784-85; Chatterjee et al., *supra* note 131, at 9; see also *Union Bank v. Wolas*, 502 U.S. 151, 152 n.1 (1991) (“The Bankruptcy Court found that the Bank and Debtor executed a revolving credit agreement on December 16, 1986, in which the Bank agreed to lend the Debtor \$7 million ....”); WorldCom Motion, *supra* note 46, at 9 (“[T]he total commitment will be a maximum of \$2 billion... broken down as follows: (i) a revolving credit facility... and (ii) a term loan facility....”).

150 See Chatterjee et al., *supra* note 131, at 9. That does not mean, of course, that sometimes term loans are not granted, even in large chapter 11 cases. See Adelpia, *supra* note 46, at 5. Sometimes a term loan and revolving credit facility are combined. See Chatterjee et al., *supra* note 131, at 9.

151 See Chatterjee et al., *supra* note 131, at 9 tbl.2 (noting eighty-five percent of the DIP loans analyzed provided revolving lines of credit for over a year or less, thirty-eight percent of all such loans used inventory as the borrowing base, and fifty-two percent used both inventory and accounts receivable as the borrowing base).

Term loans generally consist of a lump sum loan from a lender in exchange for a note, under which the borrower agrees to pay back the principal and interest in periodic payments within a specified time period or “term.” The common residential mortgage is an example of a term loan. Often the security for these obligations consists of a piece of real property or fixed assets, which the borrower purchased using the loan. Term loans made to corporations and other businesses, however, generally have shorter terms and are not fully amortized, requiring a “bullet” payment (i.e., the full balance of the principal) due at the end of the term.

In contrast, a revolving line of credit affords the borrower the ability to borrow funds periodically over a set period of time. Revolving lines of credit are often secured by fluid assets, such as inventory or accounts receivable, and borrowers normally utilize this credit to satisfy their operating expenses and other ordinary business costs. Because the value of its security fluctuates, the credit available under this type of financing also fluctuates during the specified period. Additionally, unlike a term loan, revolving lines of credit do not require a “bullet” payment; rather, borrowers repay the lender periodically for the funds drawn on the line of credit.



HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 152 See [Hartford Underwriters Ins. Co. v. Union Planters Bank](#), 530 U.S. 1, 3-4 (2000); WorldCom Motion, supra note 46, at 10; Adelpia, supra note 46, at 5; Chatterjee et al., supra note 131, at 9.
- 153 See Chatterjee et al., supra note 131 at 9 (noting sixty-three percent of the DIP loans examined required the debtor to use the proceeds only as working capital).
- 154 See, e.g., [In re Seth Co.](#), 281 B.R. 150, 152 (Bankr. D. Conn. 2002) (“The motion asserts that the debtor requires the loan to complete construction of the houses on the Lots; to ‘fund the Debtor’s ongoing working capital and general corporate needs’ (‘operating expenses’) ....”).
- 155 See, e.g., id.; [In re Lockwood Enter., Inc.](#), 52 B.R. 871 (Bankr. S.D.N.Y. 1985) (noting the debtor had obtained a loan for the purpose of satisfying only operating expenses).
- 156 See Chatterjee et al., supra note 131, at 10, 23-24.
- 157 See Chatterjee et al., supra note 131, at 10-11, 24; see also Antoszyk, supra note 128, at \*9.
- 158 See Antoszyk, supra note 128, at \*8-9; Adelpia, supra note 46, at 6.
- 159 See, e.g., [Marrs-Winn Co. v. Giberson Elec., Inc. \(In re Marrs-Winns Co.\)](#), 103 F.3d 584, 587, 588 (7th Cir. 1996); [Am. Sav. & Loan Ass’n v. Weber \(In re Weber\)](#), 99 B.R. 1001, 1006-07 (Bankr. C.D. Utah 1989); see also George G. Triantis, [Financial Slack Policy and the Laws of Secured Transactions](#), 29 J. Legal Stud. 35, 63 (2000) (observing the special case of inventory collateral and the possibility of a lockbox arrangement). Having a debtor deposit funds into a lock box is highly advantageous to a creditor. See Bruce A. Markell, [From Property to Contract and Back: An Examination of Deposit Accounts and Revised Article 9](#), 74 Chi.-Kent L. Rev. 963, 1027 (1999) (citing U.C.C. § 9-327).
- 160 See Antoszyk, supra note 128, at \*9.
- 161 See, e.g., [In re WorldCom, Inc.](#), No. 02-13533 (Bankr. S.D.N.Y. Oct. 15, 2002) (order approving a DIP financing agreement requiring the debtor to make certain cash payments). The DIP lenders in [In re WorldCom](#) required:  
[T]he Borrower, each Guarantor or any of their Subsidiaries (including all present and future debtors) shall make any Pre-petition Payment other than Pre-petition Payments authorized by the Bankruptcy Court in respect of: (i) accrued payroll and related expenses and employee benefits as of the Petition Date, (ii) the claims of common carriers and warehousemen in a total amount not in excess of \$250,000, and (iii)(A) sales and use taxes and (B) other similar regulatory fees or obligations the payment of which has been compelled by the Bankruptcy Court; provided, that, each Loan Party may make payments to such other claimants and in such amounts as may be consented to by the Agents, the Required Lenders, and approved by the Bankruptcy Court ....  
Id.
- 162 See, e.g., id. (order approving a DIP financing agreement restricting the debtor to operating its business as it did before the petition date). The restrictive provision prohibited the debtor from:  
[m]odify[ing] or alter[ing], or permit[ing] any of its Subsidiaries to modify or alter, in any material manner the nature and type of its business as conducted at or prior to the Petition Date or the manner in which such business is conducted (except as required by the Bankruptcy Code), it being understood that sales permitted by Section 5.02(i) and discontinuing operations expressly identified as operations to be discontinued in the DIP Budget shall not constitute such a material modification or alteration.  
Id.
- 163 See, e.g., [In re UAL Corp.](#), No. 02-B-48191 (Bankr. N.D. Ill. Dec. 30, 2002) (order approving a DIP financing agreement placing strict restrictions on the debtor’s ability to make capital expenditures). Under the DIP loan agreement, the DIP lender required the following: Borrower and the Credit Parties collectively shall not make Capital Expenditures, in the aggregate, for each fiscal quarter ending on the dates listed below in an aggregate amount in excess of the amount listed below opposite such date, provided, that if the amount of the actual Capital Expenditures that are made during any fiscal quarter is less than such amount, 50% of the unused portion thereof may be carried forward to and made only during the immediately following fiscal quarter and any such amount carried forward shall be deemed to be the first portion spent:

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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Fiscal Quarter Ending	Capital Expenditures
March 31, 2003	\$110,000,000
June 30, 2003	\$110,000,000
September 30, 2003	\$116,000,000
December 31, 2003	\$142,000,000
March 31, 2004	\$100,000,000
June 30, 2004	\$100,000,000

Id.

164 See, e.g., In re WorldCom, No. 0213533 (order approving a DIP financing agreement that restricted the debtor's ability to transfer its assets). The applicable provision prohibited the debtor and its subsidiaries from: [s]ell[ing] or otherwise dispos[ing] of, or permit[ting] any of its Subsidiaries to sell or otherwise dispose of, any assets (including, without limitation, the capital stock of any Subsidiary) except for (i) sales of inventory, fixtures and equipment in the ordinary course of business, (ii) sales of surplus equipment no longer used in the businesses of the Borrower or the Guarantors, (iii) sales of assets (other than those described in clause (i) or (ii) hereof) with an aggregate fair market value not to exceed \$10,000,000 as measured from the Prior Effective Date, (iv) sales of the assets set forth on Part A of Schedule 5.02(i), (v) sales of the assets set forth on Part B of Schedule 5.02(i) so long as the Net Cash Proceeds from any such sales shall be applied as set forth in section 2.06(b)(i) and (vi) sales of assets of Foreign Subsidiaries (including, without limitation, the capital stock of any Subsidiary held by a Foreign Subsidiary) so long as any such sale shall not have a material adverse effect on the assets, business, condition (financial or otherwise), operations, performance, properties or prospects of the Borrower and its Subsidiaries, taken as a whole; provided, that, in each of the above cases (x) the consideration received by the Borrower or the relevant Guarantor shall consist only of cash and readily marketable securities and shall not be less than the fair market value of the assets sold or disposed of, (y) where required by law, the sale or disposition shall have received the approval of the Bankruptcy Court and (z) with respect to sales permitted under clause (vi) above, the Net Cash Proceeds of any such sale shall be forthwith deposited into the Globenet Account and shall only be reinvested in the business of the Borrower and its Subsidiaries.

Id. The DIP loan agreement also prohibited the debtor from transferring assets to, from, and between its subsidiaries. Id.

165 See, e.g., In re UAL Corp., No. 02-B-48191 (ordering approval of a DIP financing agreement prohibiting the debtor from obtaining any additional DIP financing of higher or equal priority to that of the DIP lender). The term of default stated: [t]he occurrence of any one or more of the following events shall constitute a Default:

...

7.16 Bankruptcy Matters...

(c) The entry of an order in any of the chapter 11 Cases granting any other superpriority administrative claim or Lien equal or superior to that granted to Agent, on behalf of itself and Lenders (or the filing of an application by any Credit Party to approve any such superpriority administrative claim), other than (a) the permitted Liens granted to the Additional DIP Lenders in the Additional DIP Collateral and the priority claim granted to the Additional DIP Lenders under [Section 364\(c\)\(1\) of the Bankruptcy Code](#), (b) unless the proceeds of a new loan will repay in full all Obligations.

Id.

166 See, e.g., id. (order approving a DIP financing agreement requiring the debtor to maintain minimum EBITDAR levels). The relevant DIP loan provision required the following from the debtor:

(b) EBITDAR. (i) Borrower and the Credit Parties shall not permit cumulative consolidated EBITDAR for each fiscal period beginning on December 1, 2002 and ending in each case on the last day of each fiscal month ending on the dates listed below to be less than the amount specified opposite such date:

Month	EBITDAR
February 28, 2003	\$(964,000,000)
March 31, 2003	\$(881,000,000)
April 30, 2003	\$(849,000,000)
May 31, 2003	\$(738,000,000)

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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June 30, 2003	\$(585,000,000)
July 31, 2003	\$(448,000,000)
August 31, 2003	\$(219,000,000)
September 30, 2003	\$(98,000,000)
October 31, 2003	\$46,000,000
November 30, 2003	\$112,000,000

(ii) Borrower and the Credit Parties shall not permit cumulative consolidated EBITDAR for each rolling twelve (12) fiscal month period ending on the dates listed below to be less than the amount listed opposite such month:

Month	EBITDAR
December 31, 2003	\$575,000,000
January 31, 2004	\$901,000,000
February 28, 2004	\$1,084,000,000
March 31, 2004	\$1,196,000,000
April 30, 2004	\$1,297,000,000
May 31, 2004	\$1,383,000,000

Id.

- 167 See, e.g., In re WorldCom, No. 0213533 (ordering approval of a DIP financing agreement with a negative covenant under which the debtor promised not to pay out dividends to its shareholders).
- 168 See, e.g., id. (ordering approval of a DIP financing agreement that prohibited the debtor from obtaining DIP financing under § 364(c) and (d) from anyone other than the DIP lenders). The provision stated that the following was a default:  
(r) any Loan Party shall bring a motion in the Cases: (i) to obtain working capital financing from any Person other than Lenders under Section 364(d) of the Bankruptcy Code; or (ii) to obtain financing from any Person other than the Lenders under Section 364(c) of the Bankruptcy Code (other than with respect to a financing used, in whole or part, to repay in full the Obligations)... or (vi) to effect any other action or actions adverse to the Administrative Agent or Lenders or their rights and remedies hereunder or their interest in the Collateral that would, individually or in the aggregate, have a Material Adverse Effect....  
Id.; see also Adelpia, supra note 46, at 9-10 (citing the collateral value covenant).
- 169 See, e.g., In re UAL Corp., No. 02-B-48191 (ordering approval of a DIP financing agreement containing this default term: “The occurrence of any one or more of the following events shall constitute a Default:... 7.10 Change in Control. Any Change in Control shall occur ....”); see also Adelpia, supra note 46, at 9-10 (citing events of default).
- 170 See generally In re UAL Corp., No. 02-B-48191 (ordering approval of a DIP financing agreement that required the debtor to ensure that its guarantors and subsidiaries also complied with the loan agreement or face default); In re WorldCom, No. 0213533 (same); see also Adelpia, supra note 46, at 9 (citing events of default).
- 171 See infra Part II.C.5.
- 172 “Although § 364 does not specifically refer to the payment of interest on postpetition debt, courts have implicitly held that section 364 authorizes interest on postpetition loans as compensation for the use of the lender’s money and for the risk of nonpayment.” Resolution Trust Corp. v. Official Unsecured Creditors Comm. (In re Defender Drug Stores, Inc.), 145 B.R. 312, 316 (B.A.P. 9th Cir. 1992). One reviewer of an earlier draft of this Article, who prefers to remain anonymous, suggested that the market had probably eliminated super competitive rates by now. The author doubts it, but has no more current empirical evidence other than Chatterjee’s 2001 information. See Chatterjee et al., supra note 131. In addition to interest, institutional loan fees are another source of profit in DIP lending. See Large Chapter 11 Conference Report, supra note 25, at 12-13.
- 173 See Chatterjee et al., supra note 131, at 12-13 (referencing Table 4 whereby the DIP loans had a median interest rate of 9.75% and a mean rate of 9.63% while “matching” non-DIP loans had a median interest rate of 7.25% and a mean rate of 7.58%).

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 174 See, e.g., Chatterjee et al., supra note 131, at 13 (finding “[t]he median commitment and upfront fees are 0.50% and 1.06% for DIP loans and 0.38% and 0.33% for the matched sample [non-DIP loans] respectively”).
- 175 See supra Part III.B.1-2; infra Part III.C.
- 176 See Chatterjee et al., supra note 131, at 8, 12-14; see also supra notes 142-46 and accompanying text.
- 177 See supra note 176 (questioning whether DIP financing is actually a risky endeavor).
- 178 “Bankruptcy courts... have regularly authorized postpetition financing arrangements containing lender incentives beyond the explicit priorities and liens specified in [section 364](#).” *In re Defender Drug Stores, Inc.*, 145 B.R. 312, 316 (B.A.P. 9th Cir. 1992). Presumably, the validity of the remedies relies on the bankruptcy judge’s powers of equity arising inherently and from [§ 105\(a\) of the Bankruptcy Code](#). [Section 105\(a\)](#) states that “[t]he court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [Title 11]....” 11 U.S.C. § 105(a) (2000).
- 179 See discussion infra Part II.C.2.
- 180 See discussion infra Part II.C.3.
- 181 See discussion infra Part II.C.4.
- 182 See discussion infra Part II.C.5.
- 183 See discussion infra Part II.C.6.
- 184 See discussion infra Part II.C.7.
- 185 See discussion infra Part II.C.8.
- 186 See discussion infra Part II.C.1.
- 187 See infra notes 206-07 and accompanying text.
- 188 See discussion infra Part II.C.9.
- 189 See, e.g., *In re Defender Drug Stores, Inc.*, 145 B.R. 312, 317 (B.A.P. 9th Cir. 1992). As the title and text of this Article suggest, there is reason to believe that bankruptcy courts have, in fact, allowed just that.
- 190 See, e.g., Guidelines for Financing Requests: United States Bankruptcy Court for the Southern District of New York, Int’l Insolvency Inst. (Mar. 20, 2002) [hereinafter Guidelines for Financing Requests] (motion guidelines for cash collateral and financing requests under [§§ 363 and 364 of the Bankruptcy Code](#) in the Bankruptcy Court for the Southern District of New York). Requirements like these are a tacit admission by the bankruptcy bench that, due to its case load, it is not possible for the judge to effectively screen or review for these provisions themselves; that, without the requirement that they be specifically and conspicuously disclosed, counsel may include them, and the mere existence of other affected parties with competent counsel is insufficient to cause the adversary system to cause disclosure by itself. See Kuney, supra note 58, at 1314-22 (cataloging local rules of bankruptcy courts across the nation often requiring, among other things, disclosure of certain provisions in sale motion practice).
- 191 Courts often justify orders granting these controversial incentives upon the debtor’s showing that no other DIP financing is available and such loans are essential to the debtor’s reorganization. See, e.g., *In re Defender Drug Stores*, 145 B.R. at 316-17; *In re Ames Dep’t Stores*, 115 B.R. 34, 40-41 (Bankr. S.D.N.Y. 1990); *In re Crowthers McCalls Pattern, Inc.*, 114 B.R. 877, 888 (Bankr. S.D.N.Y. 1990). However, the bankruptcy court’s ability to order controversial terms is not “unfettered.” See *In re Defender Drug Stores*, 145 B.R. at 317 (noting the court should not order terms that provide one creditor with a benefit to the detriment of all other creditors or where the terms of DIP financing agreement essentially act as a chapter 11 reorganization plan). Viewing these incentives from afar, it is hard to see why there is any incentive for DIP lenders to begin a competitive “race to the bottom” that would result in lower fees, interest rates, or control.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 192 See discussion supra Part II.B.2.
- 193 See discussion supra Part I.A.
- 194 Fenning, supra note 65, at 35. See *In re Tenney Vill. Co.*, 104 B.R. 562, 568 (Bankr. D. N.H. 1989); Christopher W. Frost, [Running the Asylum: Governance Problems in Bankruptcy Reorganizations](#), 34 *Ariz. L. Rev.* 89, 89, 93, 94, 99 (1992); Charles Jordan Tabb, [Emergency Preferential Orders in Bankruptcy Reorganizations](#), 65 *Am. Bankr. L.J.* 75, 78-79 (1990). For an example of the sort of leverage over the debtor and by extension the chapter 11 process DIP lenders and secured creditors are able to achieve, see *Adelphia*, supra note 46, at 6, 7, 8; Soma Biswas, [Fleming Gets Only Part of DIP Funding](#), *TheDeal.Com*, April 23, 2003, at [http://bkinformation.com/Test/NewsView5/cmf? SAID=53827](http://bkinformation.com/Test/NewsView5/cmf?SAID=53827); supra notes 159-193 and accompanying text; infra notes 198-300 and accompanying text. Because of the great control that DIP financing provisions allow DIP lenders and secured creditors (who are often one and the same) to gain over the chapter 11 process, other groups of claimants are placed substantially at risk, and therefore, “[e]arly and ongoing judicial management of Chapter 11 cases is essential if the Chapter 11 process is to survive and if the goals of reorganizability on the one hand, and creditor protection, on the other, are to be achieved.” Miller, supra note 60, at 435 (quoting *United Sav. Ass'n v. Timbers of Inwood Forest Assocs. (In re Timbers of Inwood Forest Assocs.)*, 808 F.2d 363, 373 (5th Cir. 1987), *aff'd*, 484 U.S. 365 (1988)). Many courts, however, seem to have responded to the flaws in the chapter 11 system by seeking to expand the powers of the existing players beyond the statute. See [Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery](#), 330 F.3d 548, 573 (3d Cir. 2003); *In re iPCS Wireless, Inc.*, 297 B.R. 283, 290 (Bankr. N.D. Ga. 2003). The court's approach may be consistent with the spirit, if not the letter, of the Code. See Miller, supra note 60, at 431-32. Whether the court's approach is effective or desirable, the author leaves to the reader's judgment. The author, however, has a good deal of sympathy with the position taken by one of his former partners, who prefers to remain anonymous, who stated: “I'm okay with saying, ‘look, Scalia and Thomas can read the Code with the ease of a computer, but the Code as written doesn't always work.’”
- 195 See *Shapiro Mfg. Co. v. Saybrook Mfg. Co.*, (*In re Saybrook Mfg. Co.*), 963 F.2d 1490, 1491 (11th Cir. 1992); *Otte v. Mfr. Hanover Commercial Corp. (In re Texlon Corp.)*, 596 F.2d 1092, 1094 (2d Cir. 1979); Guidelines for Financing Requests, supra note 190, at 5-6; see also Large Chapter 11 Conference Report, supra note 25, at 11-12 (discussing cross-collateralization and rollups and the effect of their availability on venue choice).
- 196 *In re Texlon Corp.*, 596 F.2d at 1094. Although the Second Circuit decided *Texlon* under the former Bankruptcy Act, this holding is still applicable under the current Bankruptcy Code.
- 197 *In re Saybrook Mfg. Co.*, 963 F.2d at 1494 (citing *In re Beker Indus. Corp.*, 58 B.R. 725, 741 (Bankr. S.D.N.Y. 1986)). No provision under the former Bankruptcy Act authorized cross-collateralization either. See *In re Texlon Corp.*, 596 F.2d at 1094. Although § 364(d) authorizes the bankruptcy court to allow postpetition security interests of greater or equal priority on property encumbered prepetition, this section only explicitly allows security interests as collateral for postpetition loans. Section 364(c) and (d) does “not authorize the granting of liens to secure prepetition loans.” *In re Saybrook Mfg. Co.*, 963 F.2d at 1495; see also [Unsecured Creditors' Comm. v. First Nat'l Bank & Trust Co. of Escanaba \(In re Ellingsen MacLean Oil Co.\)](#), 834 F.2d 599, 601 (6th Cir. 1987) (“The express language of [§ 364] suggests that the priority or lien granted thereunder is limited to securing the newly incurred debt authorized by that provision.”); *In re Tenney Vill. Co.*, 104 B.R. at 570 (“Section 364(d) speaks only of the granting of liens as security for new credit authorized by the Court.”); *In re Monarch*, 41 B.R. 859, 862 (Bankr. E.D. Pa. 1984) (“[T]he terms of § 364(c) appear to limit the extent of the priority or lien to the amount of the credit obtained or debt incurred after court approval.”).
- 198 *In re Texlon Corp.*, 596 F.2d at 1094 (declining to uphold an order approving a cross-collateralization provision where the bankruptcy court relied merely on the debtor's assertion that the provision was essential to obtaining vital DIP financing).
- 199 See, e.g., *In re Beker Indus. Corp.*, 58 B.R. at 725; *In re Roblin Indus., Inc.*, 52 B.R. 241 (Bankr. W.D.N.Y. 1985); *In re Vanguard Diversified, Inc.*, 31 B.R. 364 (Bankr. E.D.N.Y. 1983).
- 200 See *In re Texlon Corp.*, 596 F.2d at 1098; *In re Roblin Indus., Inc.*, 52 B.R. at 244-45; *In re Vanguard Diversified, Inc.*, 31 B.R. at 366; see also *In re FCX, Inc.*, 54 B.R. 833, 840 (Bankr. E.D.N.C. 1985) (“Cross-collateralization should be discouraged because it can have the effect of giving the unsecured claim of one creditor priority over other unsecured claims.”). The court in *Vanguard* established a four-part test for determining whether a bankruptcy court should approve a DIP Loan containing a cross-collateralization

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

provision. 31 B.R. at 366. Under the Vanguard test, the debtor is required to show the following to obtain a financing order authorizing cross-collateralization: (1) its business operations would fail absent the proposed financing; (2) it is unable to obtain alternative financing on acceptable terms; (3) the proposed lender will not accept less preferential terms; and (4) the proposed financing is in the general creditor body's best interest. *Id.* Other courts have applied the Vanguard test, approving financing orders allowing cross-collateralization only in rare circumstances. See, e.g., *In re Roblin Indus., Inc.*, 52 B.R. at 244-45; *In re Antico Mfg.*, 31 B.R. 103, 105 (Bankr. C.D.N.Y. 1983). Similarly, in its proposed Guidelines for Financing Requests for the Bankruptcy Court for the Southern District of New York, the International Insolvency Institute stated the court should examine the following factors when determining whether to approve an order authorizing cross-collateralization:

- (i) the extent of the notice provided [to other creditors and parties in interest];
- (ii) the terms of the DIP financing and a comparison to the terms that would be available absent the Cross-Collateralization;
- (iii) the degree of consensus supportive of Cross-Collateralization;
- (iv) the extent and value of the prepetition liens held by the pre-petition lender (and in particular the amount of any “equity cushion” that the pre-petition lender may have); and
- (v) whether Cross-Collateralization will give an undue advantage to some pre-petition debt without a countervailing benefit to the estate.

Guidelines for Financing Requests, *supra* note 190, at 6. The Institute also stated orders granting cross-collateralization should reserve for the bankruptcy court the right to revoke the postpetition protection granted to prepetition debt should a timely and successful action be brought against the order. *Id.*

201 See, e.g., *In re Saybrook Mfg. Co.*, 963 F.2d at 1495; *In re Monarch Circuit Indus., Inc.*, 41 B.R. 859 (Bankr. E.D. Pa. 1984). In *Saybrook*, the Eleventh Circuit rejected a DIP financing agreement containing a cross-collateralization provision for two reasons. *In re Saybrook Mfg. Co.*, 963 F.2d at 1495 (citing Charles Jordan Tabb, *A Critical Reappraisal of Cross-Collateralization in Bankruptcy*, 60 S. Cal. L. Rev. 109 (1986)). First, the court noted cross-collateralization was not authorized under the specific language of § 364. *Id.* Second, although recognizing that bankruptcy courts are courts of equity, *id.* (citing *Young v. Higbee Co.*, 324 U.S. 204 (1945); *Pepper v. Litton*, 308 U.S. 295 (1939)), the *Saybrook* court noted that the bankruptcy judge's ability to fashion necessary relief under § 105(a) is not unlimited. *Id.* Specifically, the Eleventh Circuit noted that the bankruptcy court cannot use its equitable powers to change the priorities of claims, absent some showing of inequitable conduct and where the other creditors of the case will be harmed. *Id.* Section 507 of the Bankruptcy Code sets the priorities of claims against the estate and mandates that the bankruptcy court treat creditors in the same class of claims equally—the court cannot grant superpriority to one over all other creditors in a given class. *Id.* at 1496. The Eleventh Circuit found that cross-collateralization violates § 507 because the bankruptcy court is giving a prepetition claim priority over all other prepetition claims. *Id.* Ultimately, the *Saybrook* court concluded that, although DIP loans with cross-collateralization provisions may help a debtor reorganize, these provisions should not be enforced because they are inconsistent with the Bankruptcy Code's priority scheme. *Id.*

202 See *Antoszyk*, *supra* note 128, at \*14 (citing *In re Clinton St. Food Corp.*, 170 B.R. 216, 200-21 (Bankr. S.D.N.Y. 1994) (distinguishing *In re Saybrook Mfg. Co.*); *In re Sun Runner Marine, Inc.*, 945 F.2d 1089 (9th Cir. 1991) (noting cross-collateralization is probably not available to an undersecured or unsecured creditor)). For example, some courts have determined that cross-collateralization is available to DIP lenders possessing secured claims against the debtor. See, e.g., *In re Sun Runner Marine, Inc.*, 945 F.2d at 1089 (noting cross-collateralization is probably not available to an undersecured or unsecured creditor); *In re CoServ, LLC*, 273 B.R. 487, 495 (Bankr. N.D. Tex. 2002); *In re Tri-Union Dev. Corp.*, 253 B.R. 808, 814-15 (Bankr. S.D. Tex. 2000) (same). Notably, the Bankruptcy Court for the Southern District of Texas in *In re Equalnet Communications Corp.* recognized four exceptions to the general rule that cross-collateralization is prohibited. 258 B.R. 368, 369 (Bankr. S.D. Tex. 2000) (noting “[t]hese exceptions arise primarily out of common sense and the presence of a legal or factual inevitability of payment.”). The Fifth Circuit joined the Eleventh Circuit's position in *Saybrook* in *In re Equalnet Communications Corp.*, 258 B.R. at 369, holding payment of prepetition claims preconfirmation is prohibited. *Id.* (citing *Chiasson v. J. Louis Matherne & Assocs. (In re Oxford Mgmt. Inc.)*, 4 F.3d 1329 (5th Cir. 1993)). The *Equalnet* court noted, “in certain cases, courts in this district have found exception to [the] general rule on nonpayment. These exceptions arise primarily out of common sense and the presence of a factual inevitability of payment.” *In re Equalnet Communications Corp.*, 258 B.R. at 369. For instance, (i) turnover of cash collateral would be allowed where a properly noticed but unopposed motion for relief from stay would likely be granted; (ii) cure of arrearages of an assumed executory contract or lease, which would be allowed as “a proper and inevitable administrative expense;” and (iii) business transactions, which individually are small, but collectively, vital to the debtor's survival and reorganization; examples include the redemption of prepetition retail

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

coupons in a consumer products case, the honoring of credit card debits, credits and chargebacks in a retail department store case, or, as in the case at bar, the issuance of billing credits to retail customers in connection with prepetition telephone services and invoices. [In re Equalnet Communications Corp.](#), 258 B.R. at 369-70. The impact of the failure to allow payment of these sorts of “nuisance” items would be devastating to a proposed reorganization in the context of a retail market. *Id.* A quick corollary is that such a failure to pay and its consequent loss of customer base would impair value of the business on either a going concern or liquidation basis. Further, the prepetition claims in some cases might be subject to offset or recoupment or both. *Id.* This is often referred to as the “doctrine of necessity.” See [In re Payless Cashways, Inc.](#), 268 B.R. 543, 546 (Bankr. W.D. Mo. 2001); Tabb, *supra* note 194, at 98, 102; Catherine E. Vance & Paige Barr, The Facts and Fiction of Bankruptcy Reform, 1 DePaul Bus. & Comm. L.J. 361, 390-91 (2003). Moreover, the Code prescribes in no uncertain terms the order in which creditors are to be paid:

(iv) Priority claims critical to the ongoing nature of the business. For instance, employee wage claims and certain tax claims are both priority claims in whole or in part. The need to pay these claims in an ordinary course of business time frame is simple common sense. Employees are more likely to stay in place and to refrain from actions which could be detrimental to the case and/or the estate if their pay and benefits remain intact and uninterrupted. With respect to taxes, certain pre-petition tax claims, such as sales taxes, could be trust fund claims. Obviously the legal right to payment of such claims at any time appears irrefutable.

[In re Equalnet Communications Corp.](#), 258 B.R. at 370 (citing [In re Al Copeland Enter., Inc.](#), 991 F.2d 233 (5th Cir. 1993)). Thus, cross-collateralization is still available upon a proper showing and there is nothing preventing the savvy DIP lender from seeking approval of these provisions or from making a suitably supporting evidentiary record under the appropriate circumstances.

203 Guidelines for Financing Requests, *supra* note 190, at 6. Thus, the main difference between cross-collateralization and a rollup is that the former allocates postpetition collateral to prepetition claims, and the latter pays prepetition claims with postpetition proceeds, substituting a postpetition administrative expense, which may or may not be secured, for the prepetition claims.

204 See, e.g., [In re Sun Runner Marine, Inc.](#), 945 F.2d at 1095 (“[T]he use of financing to pay a pre-petition unsecured debt is to be used only in extreme cases.”). Courts authorizing rollup provisions in DIP financing orders examine all of the same factors used to determine the validity of cross-collateralization provisions. Guidelines for Financing Requests, *supra* note 190, at 6-7. However, courts also examine the following additional factors before approving DIP financing agreements with rollup provisions:

- (a) the nature and amount of new credit to be extended, beyond the amount to be used to repay the pre-petition debt;
- (b) whether the advantages of the postpetition financing justify the loss to the estate of the opportunity to satisfy the pre-petition secured debt otherwise in accordance with applicable provisions of the Bankruptcy Code, and the burdens on the estate of incurring an administrative claim;
- (c) whether the rollup can be unwound, if necessary;
- (d) the extent to which the debtor would have availability in the absence of a rollup;
- (e) the extent to which pre-petition and postpetition collateral can, as a practical matter, be identified and/or segregated;
- (f) the extent to which difficult “priming” issues would have to be addressed in the absence of a rollup; and
- (g) whether the postpetition advances are used to repay a pre-bankruptcy, “emergency” liquidity facility secured by first priority liens on the same collateral as the postpetition financing, where the pre-petition facility was provided in anticipation of, or in an effort to avoid, a bankruptcy filing.

*Id.*

205 See Antoszyk, *supra* note 128, at \*13.

206 *Id.* at \*10 (citing [In re Defender Drug Stores, Inc.](#), 145 B.R. 312, 313 (B.A.P. 9th Cir. 1992) (Nelson, J. concurring); [In re Ellingsen MacClean Oil Co., Inc.](#), 834 F.2d 599, 606 (6th Cir. 1987); [In re FCX, Inc.](#), 54 B.R. 833, 836 (Bankr. E.D.N.C. 1985)).

207 See, e.g., [In re Defender Drug Stores, Inc.](#), 145 B.R. at 317 (noting waivers of the debtor's right to object to the validity of the security for a secured creditor's prepetition loan are proper incentives for obtaining DIP financing). Some courts and commentators have observed that in waiving these obligations the debtor must act in its fiduciary capacity to other creditors and, as a result, recommend or require that the debtor or the Official Committee of Unsecured Creditors first determine and disclose whether or not the debtors are waiving any claims that would have a substantial chance of success on the merits. Given the debtor's typically desperate need for financing, and the Committee counsel's reliance upon DIP financing and a carve-out, see *infra* Part II.C.4., one must at least note the conflicting motivations and diligence that are part of this process.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 208 See Antoszyk, *supra* note 128, at \*10.
- 209 See *In re Ellingsen MacClean Oil Co.*, 834 F.2d 599, 604 (6th Cir. 1987); *In re Fla. W. Gateway, Inc.*, 147 B.R. 817, 820 (Bankr. S.D. Fla. 1992); see also Antoszyk, *supra* note 128, at \*10 (noting such waivers appear to “abrogate the requirements of Bankruptcy Rule 9019 ... [which] requires a 20-day notice of compromise to be sent to all creditors, the US [sic] Trustee, the debtor, and indenture trustees as provided in Rule 2002, and to any other entity as the court may decide”). Although these waivers appear to be settlements and, thus, an abrogation of the procedural requirements of Bankruptcy Rule 9019, the Sixth Circuit has reasoned that this practice is not inconsistent with the Bankruptcy Code's characterization of these waivers as “terms or conditions” of DIP loan agreements--not settlements. See *In re Ellingsen MacClean Oil Co.*, 834 F.2d at 604. Because these waivers are not settlements, “the bankruptcy court should not be required to scrutinize carefully the legal arguments made and the position of the parties with respect to a new and amended loan agreement.” *Id.*
- 210 See, e.g., Tabb, *supra* note 194, at 87-88; David B. Young, Preferences and Fraudulent Transfers, 804 PLI/Comm 577, 681 (2000), Ray Warner et al., Concurrent Session: Selected DIP Loan Issues: Hot Topics, 120702 ABI-CLE 347 (2002); see also Guidelines for Financing Requests, *supra* note 190, at 8 (stating one of the following should be present before the court approves a waiver of the debtor's prepetition claims: (i) provide the Official Unsecured Creditors' Committee ninety days from the date of official appointment of its counsel to investigate the facts and bring any appropriate proceeding to light or (ii) if no committee is appointed, provide any party in interest with the same amount of time to investigate the case). But see Fenning, *supra* note 65, at 35, 38 (questioning whether affording the Official Creditors' Committee an opportunity to object is really an adequate protection for parties in interest, given that the counsel for the committee has an interest in debtor obtaining the financing so that he or she can be paid from the estate).
- 211 See Guidelines for Financing Requests, *supra* note 190, at 8. But see Tabb, *supra* note 194, at 89.
- 212 See Guidelines for Financing Requests, *supra* note 190, at 8.
- 213 See discussion *infra* Part II.C.5.
- 214 These limitations and conditions include: (i) consent of the lender; (ii) subordination of future borrowing to the priorities and liens given to the initial lender; and (iii) repayment of the initial loan with the proceeds of a subsequent borrowing. Guidelines for Financing Requests, *supra* note 190, at 9.
- 215 *Id.* at 8-9.
- 216 11 U.S.C. § 726(b) (2000). See Antoszyk, *supra* note 128, at \*3.
- 217 A claim possessing administrative status at the time when a chapter 11 case is converted to a chapter 7 case will retain its administrative status in the later chapter 7 case although it will be subordinate to the administrative claims of the chapter 7 case. *In re Benjamin Coal Co.*, 978 F.2d 823, 827 (3d Cir. 1992). If a plan is confirmed in the chapter 11 case before the conversion, however, the claim loses its administrative status. See, e.g., *id.* (holding a confirmation order of a chapter 11 plan serves as *res judicata* and a lender loses its superpriority after conversion to chapter 7); *In re Blanton Smith Corp.*, 81 B.R. 440, 444 (2d Cir. 1987) (same); see also Antoszyk, *supra* note 128, at \*11.
- 218 See Antoszyk, *supra* note 128, at \*11 (citing *In re Blanton Smith Corp.*, 81 B.R. 440, 444 (Bankr. N.D. Ill. 1987)). For an example of a lender that took the above advice, see *Adelphia*, *supra* note 46, at 6.
- 219 See Chatterjee et al., *supra* note 131, at 5, 11; see also *supra* note 216 and accompanying text.
- 220 Indeed, the plain language of § 364(a) states that the bankruptcy court may issue an order ratifying DIP financing only “[i]f the trustee is authorized to operate the business of the debtor under section 721, 1108, 1203, 1204, or 1304 of [title 11].” 11 U.S.C. § 364(a). Although § 364(a) refers only to unsecured DIP financing in the ordinary course of business, this language logically applies to § 364(b), (c), and (d) as well, given that only an operating entity in a chapter 7 case would have any need for additional financing. Furthermore, although the quoted language is followed immediately by the phrase “unless the court orders otherwise,” this phrase is separated by commas. *Id.* This grammatical separation implies that the phrase does not modify the quoted phrase. Thus, bankruptcy courts generally will not enforce orders granting superpriority under § 364(c)(1) in a case that has been converted to chapter 7



HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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postconfirmation, unless the confirmation order specifically states otherwise. See Antoszyk, *supra* note 128, at \*11 (citing *Gen. Elec. Credit Corp. v. Levin & Weintraub (In re Flagstaff Foodservice Corp.)*, 739 F.2d 73 (6th Cir. 1985)); see also *In re Benjamin Coal Co.*, 978 F.2d at 927; *In re Blanton Smith Corp.*, 81 B.R. at 444.

- 221 See generally LoPucki & Whitford, *supra* note 56, at 608 (discussing refiling rates in large corporate cases).
- 222 See Antoszyk, *supra* note 128, at \*11.
- 223 See *In re IBI Sec. Serv., Inc.*, 133 F.3d 205, 208 n.4 (2d Cir. 1998) (citing 3 Collier on Bankruptcy P 364.04[2][d] (Lawrence P. King ed., 15th ed. rev. 1997)).
- 224 See *In re Busy Beaver Bldg. Ctrs., Inc.*, 19 F.3d 833, 848 (3d Cir. 1994); discussion *supra* Part I.B.
- 225 Antoszyk, *supra* note 128, at \*11 (citing *In re Ames*, 115 B.R. 34, 38 (Bankr. S.D.N.Y. 1990)); Cf. *Harvis Trien & Beck, P.C. v. Fed. Home Loan Mortgage Corp. (In re Blackwood Assocs.)*, 153 F.3d 61, 67 (2d Cir. 1998) (noting carve-outs are normally enforceable provisions contained in cash collateral stipulations).
- 226 See Antoszyk, *supra* note 128, at \*11 (citing *In re Ames*, 115 B.R. at 38; *In re Tenney Vill. Co., Inc.*, 104 B.R. 562, 568-69 (Bankr. D.N.H. 1989)).
- 227 See Antoszyk, *supra* note 128, at \*11 (citing *In re FCX, Inc.*, 54 B.R. 833 (Bankr. E.D.N.C. 1985)); see also *supra* Part I.B.3. This is so although prudent DIP lenders will always seek court approval before yanking financing out from under a struggling reorganization. The alternative is the cost, delay, and uncertainty of the inevitable declaratory relief action and the request for a temporary restraining order that a debtor or committee will feel compelled to file upon notice of the default in order to demonstrate (and receive court approval of) their exercise of fiduciary duties.
- 228 See *In re Danny Thomas Prop. II L.P.*, 241 F.3d 959, 962 (8th Cir. 2001) (examining a DIP loan provision granting the DIP lender the right to immediate foreclosure and relief from the stay should the borrower fail to cure a default within a forty-five day grace period); see also Antoszyk, *supra* note 128, at \*11 (citing *In re Ames*, 115 B.R. at 38; *In re FCX, Inc.*, 54 B.R. 843).
- 229 See Antoszyk, *supra* note 128, at \*11 (citing *In re Ames*, 115 B.R. at 38). In one prominent jurisdiction, four types of drop-dead clauses are considered “extraordinary” provisions that will not normally be approved: (1) provisions that do not provide for at least five business days notice to the debtor and the Official Unsecured Creditors' Committee before automatic termination of the automatic stay; (2) provisions that do not provide at least three business days notice before terminating the debtor's use of cash collateral; (3) provisions that restrict the bankruptcy court's ability to reimpose the automatic stay or issue other relief for cause, or which saddle the party opposing the DIP lender with a higher than normal burden of proof; and (4) provisions that include foreclosure remedies not present in the lenders' normal loan documents or permitted under non-bankruptcy law. See *Guidelines for Financing Requests*, *supra* note 190.
- 230 See Antoszyk, *supra* note 128, at \*11 (citing *In re Ames*, 115 B.R. at 38). Bankruptcy courts seldom fail to enforce these drop-dead clauses. See Antoszyk, *supra* note 128, at \*9; see also *In re Lafayette Dial, Inc.*, 92 B.R. 798, 799-800 (Bankr. N.D. Ind. 1988) (holding courts generally enforce approved drop-dead clauses); *In re Prime, Inc.*, 26 B.R. 556, 559 (Bankr. W.D. Mo. 1983) (refusing to enforce an approved drop-dead clause upon default of the DIP loan where the DIP lender would be paid in full and unsecured creditors would receive a substantial return).
- 231 See Antoszyk, *supra* note 128, at \*11.
- 232 See *In re W. Pac. Airlines, Inc.*, 223 B.R. 567, 571 (Bankr. D. Colo. 1997) (enforcing a drop-dead clause terminating the automatic stay only after five business days notice); *In re FCX, Inc.*, 54 B.R. 833, 843 (Bankr. E.D.N.C. 1985) (enforcing a drop-dead clause providing ten days notice to parties in interest prior to termination of the stay).
- 233 See *In re FCX, Inc.*, 54 B.R. at 843; see also Tabb, *supra* note 194, at 115 (“The court in FCX... approved a drop-dead clause on the assumption that the debtor or another party in interest would have the opportunity to apply to the court for an extension of the

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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automatic stay ‘for cause.’ If Swift-type grounds will be the only permitted ‘cause,’ then the order is unexceptional; if, however, the court is inviting open-season attacks on the original order, then the decision should not be followed.”).

234 See Antoszyk, *supra* note 128, at \*8.

235 See *supra* note 168.

236 See, e.g., *In re Texaco Inc.*, 92 B.R. 38, 43 (Bankr. S.D.N.Y. 1988) (upholding a provision that accelerated a loan upon a change in control). The provision stated:

[A] ‘Change in Control’ shall be defined to occur if (a) directors in office on the date hereof and their nominees shall no longer constitute at least a majority of Texaco's Board of Directors or (b) any person or group (as defined in the Securities Exchange Act of 1934) acquires ownership of more than 30% of Texaco stock issued and outstanding.

*Id.* at 43.

237 See Antoszyk, *supra* note 128, at \*12.

238 See *In re Ames Dep't Stores, Inc.*, 127 B.R. 744, 749 (Bankr. S.D.N.Y. 1991) (noting “[t]he ordinary non-assignment clause, no matter how well drawn otherwise, may be circumvented in the case of a corporate tenant by a change in stock control” unless it also contains a change in control provision).

239 See, e.g., *In re Texaco Inc.*, 92 B.R. at 43-48.

240 See, e.g., *In re Tenney Vill. Co.*, 104 B.R. 562, 568-69 (Bankr. D.N.H. 1989).

241 See, e.g., *In re Eldar-Beerman Stores Corp.*, No. 95-33643 (Bankr. S.D. Ohio Nov. 2, 1995).

242 See, e.g., *In re Ames*, 127 B.R. at 749-50.

243 *Id.*

244 See, e.g., *In re Tenney Vill. Co.*, 104 B.R. at 568-69. A debtor may confirm a chapter 11 plan of reorganization over creditors' objections provided that such a plan meets certain criteria required under § 1129(b) of the Bankruptcy Code. Confirmation over the objection of one or more of the creditors is known as a “cram down.” *In re Tenney Vill. Co., Inc.*, 104 B.R. at 568.

245 See Markell, *supra* note 17, at 2; Antoszyk, *supra* note 128, at \*13.

246 See *In re Tenney Vill. Co.*, 104 B.R. at 568.

247 But see *id.* at 568-69; *In re Defender Drug Stores, Inc.*, 145 B.R. 312, 317 (B.A.P. 9th Cir. 1992) (citing *In re Chevy Devcom*, 78 B.R. 585, 589-90 (Bankr. C.D. Cal. 1987)).

248 *In re Tenney Vill. Co.*, 104 B.R. at 569 (noting a debtor's acceptance of a DIP financing agreement, under which the DIP lender essentially dominates the debtor and its reorganization, is a violation of such debtor's fiduciary obligations to its creditors, shareholders, and other parties in interest). Of course, this transformation is the focus of this Article.

249 *In re W. Pac. Airlines, Inc.*, 223 B.R. 567, 571 (Bankr. D. Colo. 1997).

250 *Id.*

251 *Id.* at 572.

252 *Id.* at 574. Rather, the court stated that rejection of the proposed DIP loan would have been closer to a violation of the debtor's fiduciary duty to the estate given the circumstances. *Id.* Additionally, it should not go unnoticed that the Official Unsecured Creditors' Committee in Western Pacific wholeheartedly endorsed the proposed DIP financing agreement, *id.*, whereas the Committee in *Tenney Village* was opposed to an agreement delegating so much control over the confirmation process to the DIP lender, 104 B.R. at 569.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 253 See, e.g., [In re Defender Drug Stores, Inc.](#), 145 B.R. 312, 317 (B.A.P. 9th Cir. 1992).
- 254 Id.
- 255 The Ninth Circuit Bankruptcy Appellate Panel in *Defender Drug* upheld the bankruptcy court's approval of a DIP loan provision granting an enhancement fee to the DIP lender in exchange for a one month extension of the credit arrangement so that the debtor could sell an asset. [Id. at 318](#). The enhancement fee awarded the DIP lender ten percent of the gross proceeds received by the debtor, if the debtor sold the assets within a month. *Id.* The panel held that, although the provision allowed the DIP lender to share in the debtor's economic success, this provision alone did not allow the DIP lender to control the debtor nor circumvent the [§ 1129](#) confirmation process. *Id.* The bankruptcy court had relied heavily on [§ 364\(d\)](#) to approve the enhancement fee provision as the debtor was able to show that no other less onerous financing was available. *Id.* The *Defender Drug* court found that bankruptcy courts may authorize lender incentives beyond the liens and rights specifically stated in [§ 364](#). *Id.*
- 256 Although still good law, *Defender Drug* and *Resolution Trust* are apparently the only reported decisions authorizing an enhancement fee.
- 257 See *supra* notes 136-40 and accompanying text (explaining postpetition financing under [§ 364\(d\) of the Bankruptcy Code](#) is only available after the debtor has shown that no DIP loans can reasonably be obtained under [§ 364\(a\), \(b\), or \(c\)](#)). Understandably, therefore, *Defender Drug* is the only reported decision involving a DIP lender enhancement fee.
- 258 See *Antoszyk*, *supra* note 128, at \*2.
- 259 See *id.* (citing *Official Comm. of Unsecured Creditors v. Gould Elecs. Corp. (In re Gould Elecs. Corp.)*, No. 93C4196, 1993 U.S. Dist. LEXIS 14318 (N.D. Ill. Sept. 20, 1993); *Mellon Bank (East), N.A. v. Glick (In re Integrated Testing Prods. Corp.)*, 69 B.R. 901 (D.N.J. 1987)).
- 260 “Ipse dixit” means conclusory, or without factual or substantive support. See *Webster's New Universal Unabridged Dictionary* 968 (Jean L. McKechnie ed., 2d ed. 1983). See Karl Oakes, *Courts and Judges*, 28 *N.Y. Jur. 2d. Courts and Judges* § 212 (2003).
- 261 Oakes, *supra* note 260, at [§ 212](#). An exception is, however, any lien on the debtor's right to recover under [§ 549\(a\)](#) for collateral in which the DIP lender has a postpetition lien. *Guidelines for Financing Requests*, *supra* note 190, at 9. Section 549(a) allows the trustee or debtor to avoid postpetition transfers of property that are only authorized under [§§ 303\(f\) or 542\(c\)](#) or are not otherwise authorized by the Bankruptcy Code or by order of the bankruptcy court. [11 U.S.C. § 549\(a\) \(2000\)](#).
- 262 See generally John D. Ayer & Michael L. Bernstein, *Bankruptcy in Practice* 137-45 (2002) (discussing inherent conflicts of interest faced by directors and officers of insolvent companies).
- 263 See *Antoszyk*, *supra* note 128, at \*2 (citing *In re Gould Elecs. Corp.*, No. 93C4196 1993 U.S. Dist. LEXIS 14318; [In re Integrated Testing Prods. Corp.](#), 69 B.R. at 901). Cf. [In re Tek-Aids Indus. Inc.](#), 145 B.R. 253 (Bankr. N.D. Ill. 1992)). But see *Official Comm. of Unsecured Creditors of Cybergenics Corp. v. Chinery*, 330 F.3d 548, 554 (3d Cir. 2003).
- 264 See [11 U.S.C. § 101\(a\)](#); *Metro. Life Ins. Corp. v. Ward*, 470 U.S. 869, 881 n.9 (1984); Linda Rusch, *Unintended Consequences of Unthinking Tinkering: The 1994 Amendments and the Chapter 11 Process*, 69 *Am. Bankr. L.J.* 349, 351 (1995); Ned W. Waxman, *The Bankruptcy Reform Act of 1994*, 11 *Bankr. Dev. J.* 311, 331 (1994-95).
- 265 Employees' work cycle and pay cycle normally are offset because corporations generally do not pay their employees until after the employees have completed a certain amount of work, and because of administrative delays in the payroll process. Thus, because the debtor generally pays its employees monthly, bi-weekly, or weekly for past work, employees possess a “right to payment.” [Section 101\(10\)](#) defines a creditor as any party holding a claim against the debtor's estate, which arises prior to the petition date. Additionally, [§ 101\(5\)](#) defines a claim as including a “right to payment.” Therefore, employees are creditors under the Bankruptcy Code. This result can be avoided if a soon-to-be debtor pays or prepays its employees or an escrow or payroll agent prior to filing its bankruptcy petition. This is impractical in large cases where the amount of cash necessary to make these payments is huge, as is the panic and

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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disruption that would occur if they were made. See James H. Sprayregen et al., [First Things First: A Primer on How to Obtain Appropriate “First Day” Relief in Chapter 11 Cases](#), 11 J. Bankr. L. & Prac. 275, 278 (2002).

- 266 Section 363(c)(2) prohibits a debtor-in-possession from using cash collateral unless: (1) each entity with an interest in the cash collateral consents or (2) the bankruptcy court authorizes the use after notice and hearing. “Cash collateral” generally includes cash and cash equivalents, and corporations normally compensate their employees with cash or cash equivalents. 11 U.S.C. 363(c)(2).
- 267 Many employees live paycheck to paycheck and will be substantially prejudiced--i.e., they will not be able to pay their bills--if the debtor-corporation fails to pay them. See Shari Siegel, *Perks & Parachutes: Severance, Bonuses and Other Employee Payments in Chapter 11*, 17 Bankr. Strategist 1, 1 (May 2000) (citing numerous reasons why employees “feel less than sanguine about their rights when [their employer] files its petition”). Furthermore, unlike other creditors, like trade creditors who can still sell their products to other buyers, employees in most cases only have one source of income--the debtor. Thus, if the debtor is unable to provide its workers with compensation, these people will be forced to seek employment elsewhere.
- 268 Motions filed immediately after a bankruptcy petition are called “first-day motions” for obvious reasons. A debtor typically files first-day motions so that business operations may continue with as little hindrance as possible. See Sprayregen, *supra* note 265, at 278.
- 269 Siegel, *supra* note 267, at 1.
- 270 *Id.* at 1 n.1.
- 271 The debtor has no way of retaining its workforce and managers other than by providing them with compensation. The debtor cannot use employment contracts to force workers to stay. See 11 U.S.C. § 365(c)(1) (prohibiting a debtor from assuming executory contracts which are personal services contracts). However, prepetition agreements limiting an employee's ability to compete against the debtor post-employment are enforceable and may dissuade certain employees from leaving. Additionally, mere assumption of an employee's employment contract, after obtaining the non-debtor's consent, may be enough to retain that person. To assume the employment contract, § 365(b)(1) of the Bankruptcy Code would require the debtor to satisfy all outstanding prepetition wages, cure any actual pecuniary loss experienced by the employee, and provide adequate assurance of future payments.
- 272 Many courts will allow the debtor to compensate employees for all of their normal prepetition wages and benefits, but typically will prohibit the payment of bonuses. Siegel, *supra* note 267, at 1 n.1. Some courts, however, will limit the payment of prepetition wages to \$4,300 and payments for benefits to \$4,300 for each person covered under an employee benefit plan--an amount matching the priority afforded to employee claims under § 507(a)(3) and (4). *Id.* Normally, courts restrict payments in this way when the debtor risks administrative insolvency.
- 273 William R. Fabrizio & L. Vanessa Abrahams-John, *The Deflation of the “Golden Parachute” in Bankruptcy*, 13 Am. Bankr. Inst. J. 1 (Nov. 2004). But see *In re Structurlite Plastics Corp.*, 86 B.R. 922, 931-33 (Bankr. S.D. Ohio 1988); *In re FCX Inc.*, 60 B.R. 405, 409, 410, 412 (Bankr. E.D.N.C. 1986); see also Ehrenfeld, *supra* note 70, at 628 n.47 (“Only six circuits have spoken on the issue, and no federal appellate court appears to have expressly permitted pre-petition payments except in the specific instance of a railroad reorganization.”); Russell A. Eisenberg & Frances F. Gecker, *The Doctrine of Necessity and Its Parameters*, 73 Marq. L. Rev. 1, 13-14 (1989) (“In *In re FCX, Inc.*, the Debtor was not authorized to permit payment of unpaid payroll expenses or taxes, except to the extent wages were entitled to subsection 507(a)(3) priority.”) (internal citations omitted); Daniel Keating, *The Fruits of Labor: Worker Priorities in Bankruptcy*, 35 Ariz. L. Rev. 905, 918-9 (1993) (“Not every court is willing to keep the debtor's employees happy at all costs. In *In re FCX*, the debtor requested permission to pay its employees some prepetition wages that had not been paid, alleging that the employees would quit if they were not made whole. The debtor also contended that in this case, a confirmed plan would probably result in full payment to the employees in any event. The district court, however, ultimately reversed a bankruptcy court order that had allowed such payments to be made by the debtor.”) (internal citations omitted).
- 274 See Siegel, *supra* note 267, at 1. Such retention plans are proposed by the debtor and approved by the bankruptcy court as a use of estate property under § 363.
- 275 See *id.* at 1 n.3. A debtor may also entice an insider with insurance policies and/or explicit releases of any liability that such insider may incur while working for the debtor. See discussion *infra* Part IV.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 276 See Siegel, *supra* note 267, at 1.
- 277 See, e.g., *In re Aerovox, Inc.*, 269 B.R. 74 (Bankr. D. Mass. 2001). The debtor in Aerovox listed the following reasons why the bankruptcy court should approve its proposed retention plan:
- (1) to keep the eligible employees... in the Debtor's employ;
  - (2) to compensate the eligible employees... for assuming "additional administrative and operational burdens imposed on the Debtor by its chapter 11 case;" and
  - (3) to allow the eligible employees, including the Key Employees, to use 'their best efforts to ensure the maximization of estate assets for the benefits of the creditors.'
- Aerovox*, 269 B.R. at 76.
- 278 Section 1108 provides that a trustee may operate a chapter 11 debtor unless the court orders otherwise. 11 U.S.C. § 1108 (2000).
- 279 Additionally, other requirements exist under § 363(c)(2) if notification is required under § 7A of the Clayton Act. 11 U.S.C. § 363(b)(2) (referencing 15 U.S.C. § 18(a)). The Bankruptcy Court for the Southern District of New York has stated, regarding § 363(b)(1): The purpose of requiring notice and hearing if a transaction is other than in the ordinary course of business is so that creditors, who have a vital interest in maximizing realization from assets of the estate, have an opportunity to review the terms of the proposed transaction and to object if they deem the terms and conditions are not in their best interest. *In re Crystal Apparel Inc.*, 220 B.R. 816, 830 (Bankr. S.D.N.Y. 1998) (citing *In re Caldor, Inc.*, 193 B.R. 182, 186 (Bankr. S.D.N.Y. 1996), *aff'd*, 117 F.3d 646 (2d Cir. 1997)).
- 280 See *In re The Leslie Fay Cos.*, 168 B.R. 294, 303 (Bankr. S.D.N.Y. 1994).
- 281 11 U.S.C. § 363(a). Section 363(a) defines "cash collateral" generally as any property of the estate in the form of cash or of a cash equivalent that is subject to a lien in favor of a creditor. *Id.*
- 282 *Id.* § 363(c)(2). Thus, the statute requires a chapter 11 debtor-in-possession to obtain an order from the bankruptcy court or consent from all parties with an interest in the debtor's cash collateral before instituting any sort of employee retention plan. This consent is often difficult for debtors to obtain as multiple parties may have an interest in the debtor's cash collateral and many of these parties will have concerns about adequate protection of those interests. However, in cases where a single secured creditor or a group of creditors are acting in concert, the ability to consent to the use of cash collateral and to obviate the expense and uncertainty of litigation necessary to obtain a court order is yet another arrow in the secured creditors' quiver. Under § 363(c)(1), the payment of employees in the ordinary course of business would be permissible. However, because corporations almost always pay their employees with cash collateral and most depend on working capital lines of credit secured by, among other things, funds on deposit, accounts receivable, inventory, and their proceeds, no payment may be made absent creditor consent or court approval. *Id.* Furthermore, payment of a bonus of any type of estate property as part of a retention plan would generally be outside the ordinary course of the debtor's business and, thus, would be prohibited under § 363(b)(1) unless there were notice or a hearing. *Bagus v. Clark (In re Buyer's Club Markets Inc.)*, 5 F.3d 455 (10th Cir. 1994); *In re Media Central Inc.*, 115 B.R. 119 (Bankr. E.D. Tenn. 1990). At a minimum, the non-debtor party that stands to benefit from the bonus should, if being prudent, want court approval as the "penalty" for an unapproved out-of-the-ordinary-course payment in disgorgement by the third party to the debtor. See *Land v. First Nat'l Bank of Alamosa (In re Land)*, 943 F.2d 1265, 1267 (10th Cir. 1991); *Wright v. United States (In re Placid Oil Co.)*, 158 B.R. 404, 412 (Bankr. N.D. Tex. 1993); Eisenberg & Gecker, *supra* note 273, at 27; Siegel, *supra* note 267, at 1.
- 283 See, e.g., *Dai-Ichi Kangyo Bank, Ltd. v. Montgomery Ward Holding Corp. (In re Montgomery Ward Holding Corp.)*, 242 B.R. 147, 154 (D. Del. 1999); *In re Aerovox, Inc.*, 269 B.R. 74, 80-81 (Bankr. D. Mass. 2002); *In re Am. W. Airlines, Inc.*, 171 B.R. 674, 678 (Bankr. D. Ariz. 1994); *In re Interco Inc.*, 128 B.R. 229, 234 (Bankr. E.D. Mo. 1991). "[The] bankruptcy court sits as an overseer of the wisdom with which the bankruptcy estate's property is being managed by the trustee or debtor-in-possession, and not, as it does in other circumstances, as the arbiter of disputes between creditors and the estate." *In re Orion Pictures Corp.*, 4 F.3d 1095, 1099 (2d Cir. 1993).
- 284 In general, before approving any motion to use, sell, or lease estate property outside the ordinary course of business, the bankruptcy court "require[s] the debtor to show that a sound business purpose justifies such actions." *Myers v. Martin (In re Martin)*, 91 F.3d 389,

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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395 (3d Cir. 1996) (citing *Fulton State Bank v. Schipper* (In re Schipper), 933 F.2d 513, 515 (7th Cir. 1991)); accord *Inst. Creditors of Cont'l Airlines, Inc. v. Cont'l Airlines, Inc.* (In re Cont'l Airlines, Inc.), 780 F.2d 1223, 1226 (5th Cir. 1986); *Stephens Indus., Inc. v. McClung*, 789 F.2d 386, 390 (6th Cir. 1986); *Montgomery Ward*, 242 B.R. at 153 (citing *In re Lionel Corp.*, 722 F.2d 1063, 1071 (2d Cir. 1983); *In re Delaware & Hudson Ry. Co.*, 124 B.R. 169, 176 (D. Del. 1991); *In re Lady H Coal Co.*, 193 B.R. 233, 243 (Bankr. S.D. W. Va. 1996); *In re WBQ P'ship*, 189 B.R. 97, 102 (Bankr. E.D. Va. 1995); *In re Indus. Valley Refrigeration & Air Conditioning Supplies, Inc.*, 77 B.R. 15, 21 (Bankr. E.D. Pa. 1987)).

285 See *Montgomery Ward*, 242 B.R. at 154; *Aerovox*, 269 B.R. at 80-81; *Am. W. Airlines*, 171 B.R. at 678; *Interco*, 128 B.R. at 234. The debtor, however, is not required to show that it possesses a reasonable prospect for a successful reorganization. *Montgomery Ward*, 242 B.R. at 154 (citing *In re Fremont Battery Co.*, 73 B.R. 277 (Bankr. N.D. Ohio 1987)).

286 See *Montgomery Ward*, 242 B.R. at 154; *Am. W. Airlines*, 171 B.R. at 678 (citing *Interco*, 128 B.R. at 234).

287 *Aerovox*, 269 B.R. at 80 (quoting *In re Logical Software*, 66 B.R. 683, 686 (Bankr. D. Mass. 1986)); see also *Montgomery Ward*, 242 B.R. at 153-55 (noting the bankruptcy court's evaluation of the soundness of the debtor's business judgment is essentially identical to the "business judgment test") (citing *Lionel*, 722 F.2d at 1063; 3 Mark I. Bane et al., *Collier on Bankruptcy* § 363.02 (Alan N. Resnick et al. eds., 15th ed. 1997)). The *Montgomery Ward* court relied on the Second Circuit's decision in *Lionel*. 242 B.R. at 154-55. In *Lionel*, the court suggested several "guidelines" that bankruptcy judges should consider when evaluating the debtor's business judgment in the context of a § 363(b) motion:

- the value of the assets [to be used, sold, or leased] to the estate as a whole;
- the likelihood that a plan of reorganization will be proposed and confirmed in the near future;
- the effect of the proposed disposition on future plans of reorganization;
- the proceeds to be obtained from the disposition vis-à-vis any appraisals of the property;
- which of the alternatives of use, sale or lease the proposal envisions; and
- most importantly perhaps, whether the asset is increasing or decreasing in value.

*Montgomery Ward*, 242 B.R. at 154 (quoting *Lionel*, 722 F.2d at 1071). This list is not meant to be an exclusive list or firm test; rather, these "guidelines" are merely examples of relevant factors that a bankruptcy judge might consider in a § 363 motion. *Id.* Nevertheless, although examined by the *Montgomery Ward* court, these guidelines appear more applicable to a § 363(b) sale of assets as opposed to a retention plan.

288 Cf. *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) (concluding that "under the First and Fourteenth Amendments criminal laws in this area are constitutionally limited to hard-core pornography. I shall not today attempt further to define the kinds of material I understand to be embraced within that shorthand description; and perhaps I could never succeed in intelligibly doing so. But I know it when I see it, and the motion picture involved in this case is not that.") (internal citations omitted).

289 See *Montgomery Ward*, 242 B.R. at 155; *Aerovox*, 269 B.R. at 81-82.

290 Siegel, *supra* note 267, at 4.

291 See *Montgomery Ward*, 242 B.R. at 155 (affirming the bankruptcy court's approval of the debtor's proposed retention plan because the objectors failed to produce any evidence that rebutted the debtor's evidence, which showed that the plan was a result of a sound business judgment).

292 See A. Mechele Dickerson, *Approving Employee Retention and Severance Programs: Judicial Discretion Run Amuck?*, 11 *Amer. Bankr. Inst. L. Rev.* 93, 93 (2003); *Sprayregen et al.*, *supra* note 265, at 299; Rachel Beck, *All Business: Are Big Bonuses During Bankruptcy Greed or Need?*, *NewsFlash*, at <http://bkinformation.com/Test/NewsView5.cfm?SAID=46752> (last visited Dec. 20, 2004); Mary Deibel, *Paying the Fat Cats: Why Do Troubled Companies Give CEOs Big Bucks, Plenty of Perks?*, *KnoxNews.com*, at [http://www.knoxnews.com/kns/business/article/0,1406,KNS\\_376\\_2209124,00.html](http://www.knoxnews.com/kns/business/article/0,1406,KNS_376_2209124,00.html) (last visited Dec. 20, 2004); *Counting the Costs of Bankruptcy*, *EIU viewswire*, available at <http://bkinformation.com/Test/NewsView5.cfm?SAID=48946> (last visited Feb. 17, 2003).

293 Cf. *In re Walt Disney Co. Derivative Litig.*, 731 A.2d 342 (Del. Ch. 1998) *aff'd in part, rev'd in part*, 746 A.2d 244 (Del. Sup. Ct. 2000); with *In re Walt Disney Co. Derivative Litig.*, 825 A.2d 275 (Del. Ch. 2003); John Gibeaut, *Stock Responses: Shareholders*

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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[Ask for Changes in Corporate Governance, and the Courts Are Starting to See It Their Way](#), 89 A.B.A. J. 38 (Sept. 2003) (“Indeed, with the Disney denial and a series of other recent decisions leaning toward stockholders, some directors and officers are wondering whether Delaware has yanked the rug out from under them. Yes and no, says Chief Justice E. Norman Veasey, who cites Disney as an example of the new scrutiny his court is applying to defendants in derivative actions. ‘It’s the same chancellor; it’s the same law,’ Veasey says. ‘But we use the common law. The common law is always evolving. As so, the expectations of directors are evolving.’”). As any host knows, sometimes you have to put away the punch bowl or the party suffers.

294 Additionally, § 502(b)(7) limits any claim made by an employee for damages resulting from the termination of an employment contract to: (1) a year’s pay under the employment contract, this--year is measured from the earlier of (i) the date of the debtor’s petition or (ii) the date on which the employer terminated the employee--plus (2) any unpaid compensation due under the normal terms of the employment contract. 11 U.S.C. § 502(b)(7) (2000). Thus, employees will not receive any of their benefit plans or bonuses until after confirmation of a reorganization plan, and their severance claims will be limited by § 502(b)(7). In most scenarios, however, the debtor’s estate is insolvent, and employees will receive only a percentage of their prepetition, and sometimes postpetition, non-wage compensation.

295 Insiders, who generally have individually negotiated employment contracts with the debtor, are most likely to negotiate for this type of provision.

296 See Siegel, *supra* note 267, at 1 n.3 (citing [Schrieber v. Burlington N. Inc.](#), 472 U.S. 1, 3 n.2 (1985); *In re Forum Group Inc.*, 82 F.3d 159, 162 (7th Cir. 1996)); see also [Cline v. Comm’r of Internal Revenue](#), 34 F.3d 480, 486 (7th Cir. 1994)). For example, an employee of the debtor in *In re Forum Group* was party to the following golden parachute agreement: According to the terms of the agreements at issue, the executives are entitled to termination benefits if (a) an “acquisition of control” occurred, and (b) the executive left Forum’s employ within one year after the acquisition of control. An “acquisition of control” is defined in the contracts as “a change in a majority of the members of the Board of Directors of the Company during any two (2) year period unless the new directors were elected or recommended by two-thirds (2/3) of the members of the Board of Directors in office at the beginning of such period ....”  
82 F.3d at 162.

297 See Siegel, *supra* note 267, at 1.

298 See *In re Chrystal Apparel, Inc.*, 220 B.R. 816, 834 (Bankr. S.D.N.Y. 1998); Siegel, *supra* note 267, at 3-4.

299 See J. Benjamin Earthman, [Illusory Protection: The Treatment of Severance Packages in Business Bankruptcies](#), 5 U. Pa. J. Lab. & Emp. L. 33, 63-64 (2002) (citing [Cohen v. Drexel Burnham Lambert Group, Inc. \(In re Drexel Burnham Lambert Group, Inc.\)](#), 138 B.R. 687 (Bankr. S.D.N.Y. 1992)).

300 See Siegel, *supra* note 267, at 1 n.3 (Golden Parachutes are “distinct from ‘severance,’ which is generally payable in the event of any involuntary termination of employment other than for cause.”).

301 *Id.* See, e.g., Order Pursuant to [Section 363\(b\)\(1\) of the Bankruptcy Code](#) Approving and Authorizing Key Employee Retention Program and to Authorizing Administrative Expense Priority for Indemnification Claims Arising from Postpetition Services of Directors and Officers Pursuant to [Section 503\(b\)](#) and [507 of the Bankruptcy Code](#), *In re Enron*, No. 01-16034 (Mar. 29, 2002) [hereinafter Order Pursuant to [Section 363\(b\)\(1\)](#)] (providing an employee is ineligible for the Key Employee Retention Plan “upon the first to occur... with respect to such employee: (A) termination of employment for Cause, or (B) voluntary termination of employment by the employee for any reason”). The employee may also lose eligibility for severance payments if the employee obtains a similar position with similar benefits at another company. *Id.*

302 Golden parachutes or non-performance-based monetary bonuses compensate employees regardless of their performance, whereas severance packages normally do not result in payment if the employee is terminated for cause.

303 See Siegel, *supra* note 267, at 1 n.3.

304 See, e.g., Order Pursuant to [Section 363\(b\)\(1\)](#), *supra* note 301.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 305 See, e.g., *id.* The Enron severance package provides that employees receive the product of (x) two times the employee's weekly base salary and (y) the employee's credited years of service with Enron. *Id.* The maximum possible severance payment is set at eight times the amount of the terminated employee's weekly base salary. *Id.*
- 306 [Section 507 of the Bankruptcy Code](#) lists certain debts that have priority over most other prepetition unsecured claims. The first priority is that of administrative claims.
- 307 See Daniel A. Austin, [Payment of Prepetition and Postpetition Employee Severance Benefits \(pt. 2\)](#), 22 *Am. Bankr. Inst. J.* 14 (Apr. 2003) (noting most prepetition severance packages do not receive administrative status). Postpetition severance packages may receive administrative priority under [§ 503](#), but are not considered ordinary business transactions, and, thus, the debtor should obtain the bankruptcy court's approval to ensure administrative priority. *Id.* at 32 (citing *Bagus v. Clark (In re Buyer's Club Mkts.)*, 5 F.3d 455 (10th Cir. 1994); *In re Media Cent. Inc.*, 115 B.R. 119 (E.D. Tenn. 1990)); see also *supra* Part II.A.
- 308 [Section 503\(b\)](#) provides, in relevant part:  
After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under [section 502\(f\)](#) of this title, including --  
(1) (A) the actual, necessary costs and expenses of preserving the estate, including wages, salaries, or commissions for services rendered after the commencement of the case ....  
[11 U.S.C. § 503\(b\)\(1\)\(A\)](#) (2000). Although [§ 503\(b\)\(1\)\(A\)](#) specifically states that the debtor may compensate employees for postpetition work, it does not provide for severance payments. *In re Phones for All, Inc.*, 249 B.R. 426, 428-30 (Bankr. N.D. Tex. 2000) (noting [§ 507\(a\)\(3\)\(A\)](#) specifically provides for the priority for severance payments, not [§ 503\(b\)\(1\)](#)); see Austin, *supra* note 307, at 14. Unlike wages, salaries, and commissions, severance payments are not generally considered compensation for postpetition employment if they arise from a prepetition employment contract. See *id.*
- 309 See, e.g., Order Pursuant to [Section 363\(b\)\(1\)](#), *supra* note 301 (approving a postpetition employee retention plan with a severance component designed to retain key employees). Postpetition severance packages normally obtain administrative status because the severance provisions are part of a postpetition agreement, which the debtor presumably consented to for the purpose of (i) inducing the employee to work for the benefit of the estate and (ii) as compensation for postpetition work. See *NL Indus. Inc. v. GHR Energy Corp.*, 940 F.2d 957, 966 (5th Cir. 1991) (requiring severance payments benefit the debtor's creditors to receive administrative status); *In re Phones for All, Inc.*, 249 B.R. at 430 (Bankr. N.D. Tex. 2000) (“To meet this test, the expense must arise from a transaction with the debtor and the services supplied must enhance the ability of the debtor's business to function as a going concern.”) (citing *In re TransAmerican Natural Gas Corp.*, 978 F.2d 1409, 1416 (5th Cir. 1992)); see Austin, *supra* note 307, at 14.
- 310 See Austin, *supra* note 307, at 14 (citing *In re Commercial Fin. Servs. Inc.*, 233 B.R. 885 (Bankr. N.D. Okla. 1999); *In re Phones for All, Inc.*, 249 B.R. at 429-30). However, some courts have held that certain prepetition severance packages should be afforded priority status where the purpose of the severance is compensation for post-termination readjustment and economic loss. See Earthman, *supra* note 299, at 57-62 (citing *Straus-Duparquet, Inc. v. Int'l Bd. of Elec. Workers (In re Straus-Duparquet, Inc.)*, 386 F.2d at 649 (2d Cir. 1967)).
- 311 See Austin, *supra* note 307, at 14.
- 312 See *id.* However, in certain circumstances, employees hired prepetition may receive severance payments with administrative priority postpetition. See *id.* at 14, 32 (citing *In re Mammoth Mart Inc.*, 536 F.2d 950, 953, 955 n.4 (1st Cir. 1976) (noting postpetition payments from a prepetition severance package may receive administrative priority if employees were induced to stay with the corporation during the bankruptcy by the debtor's promise that these severance packages would be honored); *In re Levinson Steel Co.*, 117 B.R. 194, 196-97 (Bankr. W.D. Pa. 1990) (holding employees hired as turnaround managers prepetition--shortly before the petition was filed-- would receive postpetition severance payments with administrative priority)); see also Earthman, *supra* note 299, at 57-58 (discussing *In re Mammoth Mart Inc.*).
- 313 Austin, *supra* note 307, at 14 (citing *In re Cincinnati Cordage & Paper Co.*, 271 B.R. 264 (Bankr. S.D. Ohio 2001) (holding that, although the debtor had obtained court approval of the prepetition severance packages, the severance payments did not have administrative priority as no reason existed to transform prepetition debts into administrative expenses)).



HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 314 See Colleen A. Murphy, *Employment and Employee Benefit Issues 11-13* (2001) (Boston Bar Assoc., Bench Meets Bar Conference); see also Margaret Steen, *Retention Bonuses Help Firms Through Uneasy Times*, Mercury News, at <http://bkinformation.com/Test/NewsView5.cfm?SAID=54599> (last visited Dec. 13, 2004) (reporting Hewlett-Packard and Compaq employees received an average of 50% of their base pay as a retention bonus and 220 Pacific Gas and Electric managers received bonuses of 25 to 100% of their base salary).
- 315 See *In re Interco Inc.*, 128 B.R. 229, 232 (Bankr. E.D. Mo. 1991) (stating confirmation awards to directors, officers, and managers are common and often are very large); see also *In re Am. W. Airlines, Inc.*, 171 B.R. 674, 675-76 (Bankr. D. Ariz. 1994) (approving a retention plan that awarded general employees approximately \$1,000 each, while one officer receive a \$400,000 bonus and twenty-eight other officers and managers split a pool of \$1,170,706).
- 316 For an example of an agreement containing a lump sum bonus payable up front, see *In re Adelphia Communications Corp.*, 2003 WL 22316543, \*11, 18 (Bankr. S.D.N.Y. Mar. 4, 2003) (“[P]revious contracts had contemplated bonuses of \$3.6 million for Mr. Schleyer and \$2.4 million for Mr. Cooper, payable up front in a lump sum. Under the new Capellas scheme, these signing bonuses would be reduced....”). The problem with lump sum bonuses is that people are not inherently altruistic and might take advantage of a situation where their only incentive to work hard was given to them in advance. For this reason, commentators stress that “[r]etention and severance programs should be tailored to the reorganization process, rather than simply mimicking any incentive programs the debtor may have had prepetition.” Siegel, *supra* note 267, at 15. However, the problem of lack of altruism and surplus of self-interest plagues even performance-based compensation. See Susan J. Stabile, *Motivating Executives: Does Performance-Based Compensation Positively Affect Managerial Performance?*, 2 U. Pa. J. Lab. & Emp. L. 227, 265 (1999).
- 317 See, e.g., Heather Draper, *Pay Incentives Draw Criticism*, Rocky Mountains News, Jan. 11, 2003, at 4C (reporting the Association of Flight Attendants criticize UAL Corporation's Key Employee Retention Program, which would provide managers with monetary bonuses, while flight attendants and other workers were asked to take a pay cut); *Enron Executive Retention Plan Stirs Up Firestorm of Objections*, 6 Andrews Enron Litig. Rep. 1 (Apr. 11, 2002) (reporting the SEC, Wiser Oil Company, the Official Employment-Related Issues Committee, the Florida State Board of Administration, and some ex-employees all objected to Enron's proposed Key Employee Retention Plan); Brenda Pedraza-Vidamour, *Kmart Workers Protesting*, Times-Herald (Feb. 14, 2002), at <http://www.times-herald.com/archives/news/2002/0214.html> (reporting the statement of a Kmart distribution worker made in response to Kmart's \$43 million employee retention bonus program: “If he can go out and ask money for the big guns, how come he didn't ask for something for the little guys who lost money in their 401k[?]”); Doug Campbell, *Execs to Get Bankruptcy Windfalls*, Bus. J. Greater Triad Area (Dec. 27, 2002) at <http://www.bizjournals.com/triad/stories/2002/12/30/story1.html> (criticizing a \$1.2 million bonus paid to Arthur Wiener, CEO of chapter 11 debtor Galey & Lord).
- 318 Campbell, *supra* note 317 (approving a retention plan awarding one senior executive \$250,000 shares of Class B stock as incentive to remain with the debtor).
- 319 Although in many cases a debtor's prepetition stock is next to worthless, in cases where the debtor is solvent or nearly solvent, possession of an equity interest may be significant to employees.
- 320 See Joshua A. Kreinberg, *Reaching Beyond Performance Compensation in Attempts to Own the Corporate Executive*, 45 Duke L.J. 138, 148-50, 153 (1995); Siegel, *supra* note 267, at 1; Luize E. Zubrow, *Rethinking Article 9 Remedies: Economic and Fiduciary Perspectives*, 42 UCLA L. Rev. 445, 561 (1994).
- 321 See, e.g., *In re Adelphia Communications Corp.*, 2003 WL 22316543 at \*11, 17. See generally Edward S. Adams, *Corporate Governance After Enron and Global Crossing: Comparative Lessons for Cross-National Improvement*, 78 Ind. L.J. 723, 745-46 (2003) (“Corporations such as Colgate, Palmolive, and AT&T include setting triggers for stock option rewards at higher stock price levels in their incentive programs. Other compensation schemes include performance units and performance shares; these link the proportion of units or shares to the extent performance goals are achieved over a designated period, usually four to five years.”) (internal citations omitted). This may not be a good idea. See Kreinberg, *supra* note 320, at 153.

- 322 See, e.g., Order Pursuant to [Section 363\(b\)\(1\)](#), supra note 301 (providing for a quarterly retention payment to eligible employees, which is determined by the quarterly performance of the debtor's business). The "Key Employee Retention Plan" used in Enron provided the following:  
Retention Payment. At the end of each Quarter, the Committee will determine, in its sole discretion, each Retention Participant's quarterly retention payment for that Quarter, based on the Quarterly Retention Target previously established for that Quarter, taking into account such Retention Participant's contribution and performance during that Quarter (each, a "Quarterly Retention Payment"). The fact that a Retention Participant may previously have been awarded a Quarterly Retention Payment at a greater percentage of his or her Base Salary will not obligate the Committee to award such Retention Participant the same percentage in subsequent Quarters. Distribution. A Retention Participant's Quarterly Retention Payment shall be distributed as follows: (a) twenty-five percent (25%) of the Quarterly Retention Payment shall be paid as soon as practicable following an award, and (b) seventy-five percent (75%) of the Quarterly Retention Payment shall be paid as soon as practicable following the earlier of (i) February 28, 2003, or (ii) the Retention Participant's death, Disability or involuntary termination of employment by the Company other than for Cause (the "Deferred Payment Date").  
Id.
- 323 See, e.g., supra note 320.
- 324 See Rusch, supra note 264, at 349; Simon London, Critics Say It Should Be End of Story for Chapter 11, FT.Com, Dec. 20, 2002, at <http://bkinformation.com/Test/NewsView5.cfm?SAID=63388>. But see Baird & Rasmussen, supra note 54, at 754-55.
- 325 See supra Part II.B.
- 326 See Baird & Rasmussen, supra note 54, at 775; see also Beck, supra note 292 (noting bonuses do have an impact in certain circumstances).
- 327 See Beck, supra note 292. But see Miller, supra note 60, at 463-64 ("Chapter 11 is premised primarily upon the concept of reorganization of an ongoing business enterprise. The operation of the business is best left to existing management in the absence of patent incompetence or fraudulent acts. Such management possesses the most familiarity with the business. The retention of current management should enhance the effectiveness of the debtor's business operations and reduce the costs of administration.").
- 328 Ralph Brubaker, [Non-Debtor Releases and Injunctions in Chapter 11: Revisiting Jurisdictional Precepts and the Forgotten Callaway v. Benton Case](#), 72 Am. Bankr. L.J. 1, 2-4 (1998).
- 329 Ralph Brubaker, [Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of Non-Debtor Releases in Chapter 11 Reorganizations](#), 1997 U. Ill. L. Rev. 959 (1997).
- 330 The bankruptcy court has jurisdiction over suits against third party non-debtors where such suits are "related to" the debtor's reorganization case. See [28 U.S.C. § 1334\(b\) \(2000\)](#); see also Brubaker, supra note 329, at 1054-56, 1055 n.362 (noting the bankruptcy court has "related to" jurisdiction to enjoin suits against non-debtors where "failure to enjoin would affect the bankruptcy estate and would adversely or detrimentally influence and pressure the debtor through that third party" (quoting [Otero Mills, Inc. v. Sec. Bank & Trust \(In re Otero Mills, Inc.\)](#), 25 B.R. 1018, 1020-21 (Bankr. D. N.M. 1982), aff'g, 21 B.R. 645, 646-47 (Bankr. D. N.M.), denying motion to amend, 21 B.R. 777, 778 (Bankr. D. N.M. 1982)). This is so because under Article I of the United States Constitution, Congress has the power to make uniform laws regarding the subject of bankruptcies. Congress has delegated original, but not exclusive, jurisdiction over cases arising under or relating to cases under Title 11 to the federal district courts. [28 U.S.C. § 1334\(b\)](#). The district courts then refer these cases and proceedings to the federal bankruptcy courts. Id. § 157.
- 331 In certain situations, a third party release may be tantamount to the discharge of claims received by debtors after a successful chapter 11 reorganization. See discussion *infra*, Part IV.A. A typical third party release provides:  
Neither the Debtor, the Reorganized Debtor, the Creditors' Committee, nor any of their respective present members, officers, directors, employees, advisors, attorneys, agents, or other representatives shall have or incur any liability to any Creditor, Interest Holder or any other party in interest, or any of their respective agents, employees, representatives, financial advisors, attorneys, or affiliates, or any of their successors or assigns, for any act or omission in connection with, relating to or arising out of the chapter 11 Cases, the pursuit of confirmation of the Plan, the consummation of the Plan, or the administration of the Plan or the property to be distributed

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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under the Plan, except for their willful misconduct, and in all respects shall be entitled to reasonably rely upon the advice of counsel with respect to their duties and responsibilities under the Plan.

... Notwithstanding any other provision of this Plan, all Creditors, Interest Holders, other parties in interest, and any of their respective agents, employees, representatives, financial advisors, attorneys, or affiliates, and any successors or assigns of the foregoing or any professionals retained by them, shall have no right of action against the Debtor, the Reorganized Debtor, the Creditors' Committee, or any of their respective present or former members, officers, directors, employees, advisors, attorneys, or agents, for any act or omission in connection with, relating to or arising out of the chapter 11 Cases, the pursuit of confirmation of the Plan, the consummation of the Plan, or the administration of the Plan or the property to be distributed under the Plan, except for their willful misconduct, and each such Person is expressly enjoined from asserting or commencing any such action.

... On the Effective Date, each of the Debtors and Reorganized Debtors shall be deemed to have settled, released and waived any and all claims, suits and/or causes of action of any nature whatsoever that any of the Debtors or Reorganized Debtors holds or might hold or assert against any officer, director, agent, employee, advisor, accountant or attorney of any Debtor serving in such capacity immediately prior to the Effective Date.

First Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code, Findings of Fact and Conclusions of Law and Order Confirming Modified Second Amended Joint Plan of Reorganization of FPA Medical Management Inc. and Certain of Its Subsidiaries and Affiliates, As Modified, In re APF, Co., No. 98-01596 (Bankr. D. Del. May 27, 1999) (section of plan boilerplate entitled "Exculpation and Limitation of Liability"). Non-debtor releases have been criticized as unsupported by sound bankruptcy policy and as being beyond the jurisdiction of the bankruptcy courts. Thomas E. Plank, *The Eire Doctrine and Bankruptcy*, 79 *Notre Dame L. Rev.* 633, 672 (2004) (citing Brubaker, supra note 328, at 10-11 & n.46; Brubaker, supra note 329, at 962-64).

332 See John Schneider, D&O Insurance: Will It Be Available After a Chapter 11 Filing?, (Dec. 11, 2002) at [http://www.goodwinproctor.com/publications/INS\\_Schneider\\_12\\_11\\_02.pdf](http://www.goodwinproctor.com/publications/INS_Schneider_12_11_02.pdf).

333 Brubaker, supra note 329, at 963-65.

334 Although D&O policies often have policy limits in the tens of millions of dollars, even the most generous policy may not cover all insider litigation costs and losses. For example, a D&O policy may be inadequate to insure insiders against mass tort claims, which have the potential of exceeding a billion dollars. See, e.g., In re Johns-Manville Corp., No. 82B 11656-676 (Bankr. S.D.N.Y. 1982) (where debtor's insurance coverage was insufficient to cover all past, present, and future asbestos claims brought against the estate).

335 Unlike a third party release, which is contained or incorporated in an order made by the bankruptcy judge, a D&O policy is a contract between the debtor-corporation and an insurance company (i.e., the insurer agrees to pay any claims covered by the policy, which the debtor-corporation incurs). Under this contractual agreement, the insurer is only obligated to satisfy claims incurred by beneficiaries during a set period of time. Although possible, insurers seldom will provide insurance coverage for an indefinite period of time, such as "all future claims," as they probably will not be able to accurately calculate their risk. Furthermore, even should the insurer agree to provide coverage indefinitely, the D&O policy is only valid as long as the debtor-corporation pays the insurance premiums. In contrast, a third party release is simply an order issued by the judge that acts as a stay, which may easily last for an indefinite period of time, and which does not require any additional action from the debtor apart from obtaining an order enforcing the release in any particular action.

336 See 11 U.S.C. § 362(a) (2000) (enjoining the initiation or continuation of suits against the debtor). The Bankruptcy Court will also enjoin suits against non-debtors, who are co-defendants of the action with the debtor, where the plaintiff appears to be attempting to circumvent the automatic stay to reach estate assets. "[T]here is such identity between the debtor and the third party defendant that the debtor may be said to be the real party defendant and that a judgment against the third party defendant will in effect be a judgment or finding against the debtor." *A.H. Robins Co., Inc. v. Piccinin (In re A.H. Robins Co.)*, 788 F.2d 994, 999 (4th Cir. 1998), cert. denied, 479 U.S. 876 (1986) (relying on both the automatic stay provision and the bankruptcy court's equitable powers under 11 U.S.C. § 105 to enjoin actions against non-debtor co-defendants in the Dalkon Shield products liability litigation because of the potential impact on the estate and the availability of insurance proceeds to satisfy the claims); see also *In re Am. Film Techs., Inc.*, 175 B.R. 847, 855 (Bankr. D. Del. 1994) (staying prosecution of wrongful discharge claims against former and present directors of debtor corporation because of debtor's indemnification obligations and its possible exposure to collateral estoppel prejudice); *In re*

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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[Family Health Servs., Inc.](#), 105 B.R. 937, 942-43 (Bankr. C.D. Cal. 1989) (staying collection actions against non-debtor members of debtor HMO because judgments against non-debtors would trigger claims for indemnification from the debtor HMO).

- 337 11 U.S.C. § 362(a)(1) prevents plaintiffs from suing the debtor directly absent an order for relief from the stay from the bankruptcy court. However, the bankruptcy court may also issue an order for limited relief from stay, allowing a plaintiff to bring a suit against a third party--even where the debtor is a necessary party--provided that the plaintiff does not seek damages or other relief directly from the debtor. See generally *In re A.H. Robins Co.*, 788 F.2d at 994 (discussing at length suits against defendants that are co-liable with the debtor and when it is appropriate for the bankruptcy court to extend the automatic stay to encompass those suits as well as those against the debtor).
- 338 Although the general rule is that non-debtors may not benefit from the § 362 automatic stay, the bankruptcy court may extend the stay to enjoin suits against non-debtor insiders if this litigation is harmful to the reorganization process. See, e.g., *In re Carabetta Enters., Inc.*, 162 B.R. 399, 405-06 (Bankr. D. Conn. 1993) (noting a stay of actions against non-debtors may be appropriate “because the action would detract from the invaluable time and attention the non-debtor third party would otherwise devote to the continued operation of the debtor’s business or the reorganization effort ....”) (citing *Chase Manhattan Bank (Nat’l Ass’n) v. Third Eighty-Ninth Assocs. (In re Third Eighty-Ninth Assocs.)*, 138 B.R. 144, 147 (S.D.N.Y. 1992)); *In re Zenith Labs., Inc.*, 104 B.R. 659 (D.N.J. 1989) (finding a stay on suits against non-debtor insiders was appropriate because “to involve employees in time-consuming depositions and burdensome document requests at that time would work to distract key personnel from the important business of getting the debtor back on its feet”).
- 339 See *In re N. Star Contracting Corp.*, 125 B.R. 368 (S.D.N.Y. 1991) (enjoining a suit against a debtor’s president whom the debtor was obligated to indemnify because the plaintiff was attempting to circumvent the automatic stay to obtain relief); *In re Lomas Fin. Corp.*, 117 B.R. 64 (S.D.N.Y. 1990). But see *CAE Indus. Ltd. v. Aerospace Holdings Co.*, 116 B.R. 31 (S.D.N.Y. 1991) (refusing to enjoin a suit against an insider, who the debtor had to indemnify, because the suit against this third party was sufficiently independent of the bankruptcy case).
- 340 See, e.g., *In re Baldwin-United Corp. Litig.*, 765 F.2d 343, 348 (2d Cir.1985) (holding the bankruptcy court power under § 105(a) to issue injunctive relief is broader than that specifically authorized under § 362 and, thus, the bankruptcy judge may stay proceedings against non-debtors if necessary to effectuate a successful reorganization); *SAS Overseas Consultants v. Benoit*, 2000 WL 140611 at \*4 (E.D. La. Feb. 7, 2000); *In re Neuman*, 71 B.R. 567, 571 (S.D.N.Y. 1987) (“The fact that the automatic stay may not apply does not mean that the Bankruptcy Court is without power to issue an injunction.”); *In re Ionosphere Clubs, Inc.*, 111 B.R. 423, 430 (Bankr. S.D.N.Y. 1990) (“This Court must also look to its powers pursuant to § 105(a) of the Code to expand the scope of the automatic stay provisions in order to effectively administer the assets of the Eastern estate.”), *aff’d in part*, 124 B.R. 635 (S.D.N.Y. 1991); see also 11 U.S.C. § 105(a); *In re Elec. Theatre Rests. Corp.*, 53 B.R. 458, 462 (Bankr. N.D. Ohio 1985) (“[T]he granting of injunctive relief through the broad equitable powers of § 105 must be governed by the traditional requirements for granting of preliminary injunctions ....”).
- 341 Whereas § 362(a) explicitly provides for the automatic stay and § 524(e) enjoins all claims against a debtor post-confirmation, no Code section explicitly provides for any form of injunctive relief to protect the interests of non-debtor insiders. The only Code section explicitly providing injunctive relief to non-debtors is § 524(g), which provides a procedure for resolving asbestos claims that validates, post hoc, with some modifications, the John-Mansville asbestos trust “solution.” See *infra* note 384 and accompanying text.
- 342 See Andrew Goldman, *Litigation, Third Party Releases, D&O Claims, and Subordination of Securities Law Claims*, 846 *Prac. L. Inst.* 523, 527 (2003) (noting a majority of bankruptcy courts will enjoin suits against non-debtors under certain circumstances).
- 343 11 U.S.C. § 105(a) provides:  
The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.
- 344 See, e.g., *In re Lazarus Burman Assocs.*, 161 B.R. 891, 899-900 (Bankr. E.D.N.Y. 1993) (enjoining guaranty actions against non-debtor principals of debtor partnerships because principals were the only persons who could effectively formulate, fund, and carry

out debtors' plans of reorganization); *In re Steven P. Nelson*, 140 B.R. 814, 816-17 (Bankr. M.D. Fla. 1992) (enjoining actions against non-debtor guarantor of debtor corporation's obligations where guarantor was president of debtor and president's services, expertise and attention were essential to the reorganization of the debtor); see also Paul H. Deutch, *Expanding the Automatic Stay: Protecting Non-Debtors in Single Assets Bankruptcies*, 2 Am. Bankr. Inst. L. Rev. 453 (1994). Section 105(a) of the Bankruptcy Code provides that the bankruptcy court "may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of [the Bankruptcy Code]." 11 U.S.C. § 105(a). Although broad, § 105(a) does not provide the bankruptcy judge with unbridled discretion. Rather, Congress intended § 105(a) to be a "filler" provision, allowing Bankruptcy Courts to fashion appropriate relief for issues not explicitly covered in the Bankruptcy Code. See *In re Cont'l Airlines*, 203 F.3d 203, 211 (3d Cir. 2000) ("Section 105(a) of the Bankruptcy Code supplements courts' specifically enumerated bankruptcy powers by authorizing orders necessary or appropriate to carry out provisions of the Bankruptcy Code.") (emphasis added); *IRS v. Kaplan (In re Kaplan)*, 104 F.3d 589, 597 (3d Cir. 1997); *United States v. Pepperman*, 976 F.2d 123, 131 (3d Cir. 1992) ("[Section 105 does not] create substantive rights that would otherwise be unavailable under the Bankruptcy Code."); see also *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988) ("[Section 105] must and can only be exercised within the confines of the Bankruptcy Code.").

When determining whether such an order is "necessary or appropriate," courts examine a non-exclusive list of factors:

- (1) Whether the order is necessary to protect or preserve the court's bankruptcy jurisdiction over the reorganization, see Goldman, supra note 342, at 525-26 (citing *LTV Corp. v. Miller (In re Chateaugay Corp.)*, 109 B.R. 613, 621 (S.D.N.Y. 1990));
- (2) Whether the order would help the debtor's reorganization efforts, see id. (citing *Johns-Manville Corp. v. Asbestos Litig. Group (In re Johns-Manville Corp.)*, 33 B.R. 254, 263-64 (Bankr. S.D.N.Y. 1983));
- (3) Whether continuation of the nondebtor suit would embarrass, burden, delay or otherwise hinder the debtor's reorganization efforts, see id. (citing *In re Third Eighty-Ninth Assocs.*, 138 B.R. 144, 146-47 (S.D.N.Y. 1992));
- (4) The effect of the continuation of the nondebtor suit on the debtor, see id. (citing *In re Third Eighty-Ninth Assocs.*, 138 B.R. at 146-47); and
- (5) The identity of the interest between the third party, non-debtor and the debtor. See id. 25-26 (citing *In re A.H. Robins Co.*, 788 F.2d 994, 999 (4th Cir. 1986)).

345 See Goldman, supra note 342, at 525-26 (noting all the factors listed above are essentially portions of a single consideration, i.e., whether such an order would aid in effectuating the debtor's reorganization) (citing *In re A.H. Robins Co.*, 788 F.2d at 999; *In re Chateaugay Corp.*, 109 B.R. at 621).

In contrast to other, non-bankruptcy injunctions, injunctions authorized under § 105(a) need not meet the traditional criteria required by Federal Rule of Procedure 65(d), which is incorporated into the Bankruptcy Code via Bankruptcy Rule 7065. See *Greer v. Gaston & Snow (In re Gaston & Snow)*, 1996 WL 694421, \*5-6 (S.D.N.Y. Dec. 4, 1996) (noting a bankruptcy court may enter an injunction under § 105 without finding irreparable harm and that the court "need only make factual findings that demonstrate the need for the injunction"); *Myerson & Kuhn v. Brunswick Assocs. L.P. (In re Myerson & Kuhn)*, 121 B.R. 145, 153 n.12 (S.D.N.Y. 1990). But see *In re Seatco*, 257 B.R. 469 on reconsideration, 259 B.R. 279 (Bankr. N.D. Tex. 2001) (applying the traditional factors when determining whether to issue a preliminary injunction). The traditional factors for issuing an injunction outside of bankruptcy are: (1) a substantial likelihood of the movant's success on the merits; (2) a substantial threat that the movant will suffer irreparable harm absent the injunction; (3) the threatened harm outweighs the possible injury to the party opposing the motion; and (4) that issuance of the injunction will not "disserve the public interest." *In re Seatco*, 257 B.R. at 477.

346 See Goldman, supra note 342, at 526. But see infra Part V.B. (describing the expanded interpretation of § 363(f) of the Bankruptcy Code, which debtors have used to sell all or substantially all of their assets free and clear of all claims and interests).

347 See Goldman, supra note 342, at 526.

348 Third party releases granted under § 105(a) are necessarily limited by the bankruptcy court's jurisdiction. The bankruptcy court only has jurisdiction over suits against third party non-debtors where those suits are "related to" the debtor's reorganization case. See Brubaker, supra note 329, at 1054-56, 1055 n.362. Thus, when the debtor's chapter 11 case ends--either by confirmation, dismissal, or conversion--the bankruptcy court loses its "related to" jurisdiction over the suit and the order is no longer enforceable. Furthermore, § 524(e) only discharges the debtor--not third-party non-debtors.

The test for determining whether a bankruptcy court has "related to" jurisdiction is:

whether the outcome of that proceeding could conceivably have any effect on the estate being administered in bankruptcy.... Thus, the proceeding need no necessarily be against the debtor or against the debtor's property. An action is related to bankruptcy if the

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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outcome could alter the debtor's rights, liabilities, options, or freedom of action (either positively or negatively) and which in any way impacts upon the handling and administration of the bankrupt estate.

*Pacor, Inc. v. Higgins*, 743 F.2d 984, 994 (3d Cir. 1984) (internal citations omitted). The First, Third, Fourth, Fifth, Sixth, Eighth, Ninth, Tenth, and Eleventh Circuits have adopted this test. See *Celotex Corp. v. Edwards*, 514 U.S. 300, 308 n.6 (1995). The Second and Seventh Circuits have adopted an almost identical test. See, e.g., *Home Ins. Co. v. Cooper & Cooper, Ltd.*, 889 F.2d 746, 749 (7th Cir. 1989); *In re Turner*, 724 F.2d 338, 341 (2d Cir. 1983). Thus, bankruptcy courts have “related to” jurisdiction to issue third party releases where actions against these non-debtors threatens the administration of the chapter 11 reorganization case.

- 349 See *Vance & Barr*, supra note 202, at 392 (“However, extending the automatic stay to nondebtors is only a temporary solution, but the protection is often made permanent through the use of third party releases in plans of reorganization.”).
- 350 See, e.g., *Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.)*, 280 F.3d 648, 658 (6th Cir. 2002).
- 351 See *Goldman*, supra note 342, at 527 (citing *In re Dow Corning Corp.*, 280 F.3d at 658; *Gillman v. Cont'l Airlines (In re Cont'l Airlines)*, 203 F.3d 203, 211 (3d Cir. 2000)).
- 352 See *In re Cont'l Airlines*, 203 F.3d at 211 (noting only § 524(g) explicitly provides for a discharge of a non-debtor's liabilities in the context of asbestos claims).
- 353 See 11 U.S.C. § 524(e) (2000) (“Except as provided in subsection (a)(3) of this section, discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt.”).
- 354 See, e.g., *Shearson Lehman Bros., Inc. v. Munford, Inc.*, 97 F.3d 449, 455 (11th Cir. 1996); *SEC v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burham Lambert Group, Inc.)*, 960 F.2d 285, 293 (2d Cir. 1992); *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636, 640, 649 (2d Cir. 1988).
- 355 See, e.g., *In re Dow Corning Corp.*, 280 F.3d at 656 (holding a permanent injunction enjoining suits against third parties was permitted under § 1123(b)(6) because ordering this type of relief is not specifically prohibited by the Bankruptcy Code).
- 356 Section 1123(b)(6) states that “a plan may... (6) include any other appropriate provision not inconsistent with the applicable provisions of [Title 11] ....”
- 357 See Carrie Beth Lesser Baris, *Requirements for the Approval of Third-Party Non-Debtor Releases*, 22 *Am. Bankr. Inst. J.* 34, 34 (Apr. 2003) (contributing editor Jeffrey W. Warren) (noting the “disagreement among the circuits primarily centers around conflicting applications of the broad equitable powers found in [Bankruptcy] Code § 105(a) and the discharge provisions of § 524(e)”).
- 358 The Ninth and Tenth Circuits have determined that all third party releases, whether they be temporary or permanent, are impermissible. See *Resorts Int'l, Inc. v. Lowenschuss (In re Lowenschuss)*, 67 F.3d 1394, 1402 (9th Cir. 1995); *Lansing Diversified Props.-II v. First Nat'l Bank & Trust Co. of Tulsa (In re W. Real Estate Fund., Inc.)*, 922 F.2d 592, 601 (10th Cir. 1990); *Am. Hardwoods, Inc. v. Deutsche Credit Corp. (In re Am. Hardwoods Inc.)*, 885 F.2d 621, 625-26 (9th Cir. 1989).
- 359 See, e.g., *In re Lowenschuss*, 67 F.3d at 1402 (“[Section] 524(e) precludes bankruptcy courts from discharging the liabilities of non-debtors.”); *Underhill v. Royal*, 769 F.2d 1426, 1432 (9th Cir. 1985) (“[T]he bankruptcy court has no power to discharge the liabilities of a nondebtor pursuant to the consent of creditors as part of a reorganization plan.”). Combined with the Ninth Circuit decision in *Perlman v. Catapult Entertainment, Inc. (In re Catapult Entertainment, Inc.)*, 165 F. 3d 747 (9th Cir. 1999), rendering many intellectual property licenses unassumable even by the debtor itself, these decisions go a long way to contributing to the lack of a large case reorganization haven on the West Coast, unlike those found in Chicago, Delaware, and New York.
- 360 *In re Cont'l Airlines*, 203 F.3d 203, 212 (3d Cir. 2000) (citing *In re Am. Hardwoods, Inc.*, 885 F.2d 621, 626 (9th Cir. 1989)); *In re W. Real Estate Fund., Inc.*, 922 F.2d at 601.
- 361 Under this interpretation, a bankruptcy court cannot rely on § 105 for authority to issue a confirmation order granting non-debtors a release of liability and permanent injunction. See supra Part IV.A.2. (discussing the limitations of the bankruptcy court's equitable powers under § 105(a)).

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 362 See Baris, *supra* note 357, at 34.
- 363 See, e.g., *In re Dow Corning Corp. Inc.*, 280 F.3d 648, 656-57 (6th Cir. 2002).
- 364 *Id.* at 657 (internal citations omitted) (citing *In re Specialty Equip. Co.*, 3 F.3d 1043, 1047 (7th Cir. 1993) (“This language does not purport to limit or restrain the power of the bankruptcy court to otherwise grant a release to a third party.”)); *Republic Supply Co. v. Shoaf*, 815 F.2d 1046, 1050 (5th Cir. 1987); *Menard-Sanford v. Mabey (In re A.H. Robins Co.)*, 880 F.2d 694, 701 (4th Cir. 1989)); see also Baris, *supra* note 357, at 34 (concluding the Ninth and Tenth Circuit’s interpretation of § 524(e) is flawed because nothing in that section prevents a bankruptcy court from using its § 105(a) powers to issue a permanent third party release).
- 365 See *supra* note 356 (giving the text of § 1123(b)(6)); see also *In re Dow Corning Corp.*, 280 F.3d at 656.
- 366 See, e.g., *In re Zenith Elec. Corp.*, 241 B.R. 92, 111 (Bankr. D. Del. 1999); *In re Arrowmill Dev. Corp.*, 211 B.R. 497, 507 (Bankr. D.N.J. 1997).
- 367 See, e.g., *In re Digital Impact, Inc.*, 223 B.R. 1, 13 (Bankr. N.D. Okla. 1998) (holding non-consenting creditors were not bound by a permanent third party release provision contained in a chapter 11 plan because they received nothing from the plan in exchange for the cancellation of their interests).
- 368 See, e.g., *Shearson Lehman Bros., Inc. v. Munford, Inc. (In re Munford, Inc.)*, 97 F.3d 449, 455 (11th Cir. 1996) (enforcing a release of a nondebtor’s liability under a plan of reorganization over an affected creditor’s objection because a majority of the creditors voted in favor of confirmation and the release); *In re A.H. Robins Co.*, 880 F.2d at 702 (stating a third party release is enforceable over an affected creditor’s objection where such release is essential to effectuate a chapter 11 debtor’s reorganization objectives); *MacArthur Co. v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 837 F.2d 89, 93 (2d Cir. 1988) (same), cert. denied, 488 U.S. 868 (1988).
- 369 Section 1123(b)(1) provides that a chapter 11 plan of reorganization may be confirmed over certain creditors’ objections provided that certain criteria are satisfied. Confirmation of a plan under this section (over significant creditor objections) is often referred to as a “cram down.”
- 370 See, e.g., *In re Keck, Mahin & Cate*, 241 B.R. 583, 592 (Bankr. E.D. Ill. 1999) (holding a permanent third party release could be forced upon non-consenting creditors—regardless of whether they received actual consideration under the plan—because they were receiving no less under the plan than they would have in a chapter 7 liquidation).
- 371 See, e.g., *In re Dow Corning Corp.*, 280 F.3d 648, 658 (6th Cir. 2002) (involving nationwide products liability claims); *In re Drexel Burnham Lambert Group, Inc.*, 960 F.2d 285, 293 (2d Cir. 1992) (involving a settlement of federal securities claims with the United States Securities and Exchange Commission); *In re A.H. Robins Co.*, 880 F.2d at 702 (involving nationwide products liability actions); *In re Johns-Manville Corp.*, 837 F.2d at 93-94; *In re Transit Group Inc.*, 286 B.R. 811, 817 (Bankr. M.D. Fla. 2002) (approving a permanent third party release of a non-debtor who provided significant DIP financing and exit financing); see also Baris, *supra* note 357, at 34 (stating “‘pro-release’ courts require that the third-party non-debtor release be fair and necessary”).
- 372 *In re Dow Corning Corp.*, 280 F.2d at 658 (citing *In re Cont’l Airlines*, 203 F.3d 203, 212 (3d Cir. 2000); *In re A.H. Robins Co.*, 880 F.2d at 702; *In re Johns-Manville Corp.*, 837 F.2d at 93-94). Thus, even where permitted, insiders or other non-debtors may not be able to obtain a permanent third party release of actual and potential claims against them when voting parties in interest reject the debtor’s plan. Essentially, the Sixth Circuit’s test requires that all voting classes accept the permanent release unless these parties in interest will likely not face any prejudice as a result of the release—in which case the release itself is practically worthless.
- 373 *In re Transit Group Inc.*, 286 B.R. 811, 817 (Bankr. M.D. Fla. 2002). See Deborah A. Crabbe, *Are Non-Debtor Releases/Permanent Injunctions Authorized Under the Bankruptcy Code?*, 22 *Am. Bankr. Inst. J.* 34, 35 (May 2003) (“Many courts that follow the majority view now rely on these factors and § 105 to conduct their analysis of the appropriateness of a non-debtor release or injunction.”). However, courts’ acceptance of this language is problematic. See Vance & Barr, *supra* note 202, at 393-94.
- 374 See generally *In re Johns-Manville Corp.*, 837 F.2d at 94 (using a channeling injunction); *In re Drexel Burnham Lambert Group, Inc.*, 130 B.R. 910 (S.D.N.Y. 1991) (same), *aff’d*, 960 F.2d 285 (2d Cir. 1992).

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 375 See *In re Johns-Manville Corp.*, 837 F.2d at 94. Channeling injunctions differ from other third party releases in that potential litigants are not enjoined from continuing or initiating action against non-debtor third parties. Rather, these plaintiffs may bring actions against the non-debtors, but their possible damages are limited to the finite value of the property placed in a fund for the specific purpose of satisfying their claims and similar claims. See *In re Digital Impact, Inc.*, 223 B.R. 1, 9 (Bankr. N.D. Okla. 1998) (“[The channeling injunction’s] salient feature is that it does not result in claimants holding claims against non-debtor third-parties being denied a right to recovery.”). Once the fund’s assets are exhausted, the potential litigants are permanently enjoined from bringing further actions against these non-debtors who have contributed to the fund.
- 376 See *Kane v. Johns-Manville Corp. (In re Johns-Manville Corp.)*, 843 F.2d 636, 640, 651 (2d Cir. 1988) (granting a channeling injunction where there was “an onslaught of crippling lawsuits that could jeopardize the entire reorganization effort” and where, absent the order, the litigation would delay confirmation “beyond anybody’s reasonable expectations and probably lifetime”) (Miner, J. concurring); *In re Gaston & Snow*, 1996 WL 694421, at \*5 (S.D.N.Y. Dec. 4, 1996) (holding a channeling injunction which released non-debtors from liability where such releases induced “parties related to a debtor to agree to a settlement”); *LTV Corp. v. Aetna Cas. & Sur. Co. (In re Chateaugay Corp.)*, 167 B.R. 776, 780 (S.D.N.Y. 1994) (granting a channeling injunction which released non-debtors from liability where such relief was essential to the debtor’s successful reorganization); *In re Drexel Burnham Lambert Group, Inc.*, 130 B.R. at 928 (finding a channeling injunction facilitated reorganization by providing an exclusive source of recovery for potential claimants);
- 377 See *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930 (Bankr. W.D. Mo. 1994) (stating a channeling injunction should only be granted upon a showing of exceptional circumstances). For example, a channeling injunction may be appropriate where an unfathomable amount of mass tort litigation threatens to derail the debtor’s reorganization, unless a settlement can be reached, and non-debtor parties contributing to the settlement and financing the debtor’s estate refuse to do so without a channeling injunction that releases their liability. See, e.g., *In re Am. Family Enters.*, 256 B.R. 377, 407-08 (D.N.J. 2000) (authorizing a channeling order during a confirmation hearing because non-debtors, who were contributing \$70 million to the estate to effectuate a tort litigation settlement, would only do so if the court issued the channeling order). Likewise, bankruptcy courts have approved channeling orders where parties who would otherwise settle their claims and ratify a reorganization plan refuse to do so without protection against potential post-confirmation lawsuits arising from its prepetition relationship with the debtor. See, e.g., *Menard-Sanford v. Mabey (In re A.H. Robins Co.)*, 880 F.2d 694, 702 (4th Cir. 1989), cert. denied, 493 U.S. 959 (1989); *In re Master Mortgage Inv. Fund*, 168 B.R. at 935.
- 378 See Sally S. Neely, *The Continuing Debate Re: Non-Debtor Releases/Permanent Injunctions in Chapter 11*, WL SG001 A.L.I.-A.B.A. 689 (2001).
- 379 See, e.g., *In re Salem Suede, Inc.*, 219 B.R. 922 (Bankr. D. Mass. 1998) (suggesting the existence of § 524(g) implies that channeling injunctions are only permitted in the context of asbestos claims). But see *Greenblatt v. Richard Potasky Jeweler, Inc. (In re Richard Potasky Jeweler, Inc.)*, 222 B.R. 816, 827 n.19 (S.D. Ohio 1998) (noting that, given the rule of statutory construction contained in § 111(b), § 524(g) cannot “be construed to modify, impair, or supersede any other authority the court has to issue injunctions in connection with an order confirming a plan of reorganization”).
- 380 See Part IV.B.2. But see *In re Richard Potasky Jeweler, Inc.*, 222 B.R. at 825 (“[W]here a permanent injunction, regardless of the identity of its direct beneficiary, serves to protect the property or facilitate the administration of the debtor’s estate, § 524(e) will not stand in the way of the court issuing the injunction.”).
- 381 This is because the Bankruptcy Code specifically allows channeling injunctions for this type of litigation under § 524(g). Courts in the Ninth and Tenth Circuits, however, refuse to enforce channeling injunctions as both of these circuits have held that § 524(e) precludes a bankruptcy court from granting most non-debtors a release from liability. See supra note 358.
- 382 See, e.g., *In re Cont’l Airlines*, 203 F.3d 203 (3d Cir. 2000) (refusing to establish a test for determining when channeling injunctions and other third party releases other than that they may be acceptable in unusual circumstances); *In re Specialty Equip. Cos.*, 3 F.3d 1043 (7th Cir. 1993) (allowing channeling injunctions and third party releases where the affected creditors vote for the plan of reorganization); *In re A.H. Robins Co.*, 788 F.2d 994 (4th Cir. 1985) (permitting the issuance of channeling injunctions in context of global settlements of large amounts liability shared by the debtor and other non-debtors, which threatens the debtor’s reorganization).



HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 383 See supra notes 350-61 and accompanying text (discussing the lack of support for third party releases in the Bankruptcy Code except in the case of asbestos litigation).
- 384 See, e.g., *Monarch Life Ins. Co. v. Ropes & Gray*, 65 F.3d 973, 979 (1st Cir. 1995); *In re Drexel Burnham Lambert Group, Inc.*, 140 B.R. 347, 350 (S.D.N.Y. 1992). Relying on its § 105(a) powers, the Bankruptcy Court for the Western District of Missouri has articulated a non-exclusive five part test for determining whether a channeling injunction is appropriate: (1) Whether a suit against the non-debtor is essentially a suit against the debtor because of the identity of interest between the non-debtor and the debtor (e.g., where the non-debtor is a surety) or where the suit will deplete assets of the estate; (2) whether the non-debtor has contributed substantial funds to the reorganization; (3) whether the reorganization will likely fail absent the channeling injunction; (4) whether a substantial majority of the creditors consent to the channeling injunction, i.e., whether the vast majority of creditors in the affected classes have voted in favor of a channeling injunction; and (5) whether the reorganization will provide a mechanism to pay substantially all of the claims enjoined by the channeling injunction. *In re Master Mortgage Inv. Fund, Inc.*, 168 B.R. 930, 935-38 (Bankr. W.D. Mo. 1994); see also *In re Zenith Elecs. Corp.*, 241 B.R. 92 (Bankr. D. Del. 1999) (relying on the five part test outlined in *In re Master Mortgage* for issuance of a channeling injunction). Similarly, the Second Circuit has found that channeling injunctions are authorized where the injunction (1) is essential to the debtor's chapter 11 plan, i.e., is an order permitted under § 1123(a)(5), and reorganization; (2) confers a material benefit to the debtor's estate; and (3) is in the best interests of all creditors involved.
- 385 See, e.g., *In re Transit Group Inc.*, 286 B.R. 811, 817 (Bankr. M.D. Fla. 2002) (approving a permanent third party release of a non-debtor who provided significant DIP financing and exit financing).
- 386 See Kuney, supra note 49 at 238. The plan process generally requires filing and proposing a plan, gaining approval of a disclosure statement describing the plan, solicitation of acceptances, rejections and objections to confirmation of the plan, and a confirmation hearing itself. A preplan sale, by contrast, requires as few as one or two hearings. *Id.* The preplan sale note may have one disadvantage: it may not be as amenable to application of the equitable mootness doctrine to effectively squelch appeals by dissenting parties as is the plan process. See generally *Nordhoff Invs., Inc. v. Zenith Elecs. Corp.*, 258 F. 3d 180, 191-92 (3d Cir. 2001) (Alito, C.J., concurring) (“As this case shows, our court's equitable mootness doctrine can easily be used as a weapon to prevent any appellate review of bankruptcy court orders confirming reorganization plans. It thus places too much power in the hands of bankruptcy judges.”). But see Keach, supra note 138. If trends continue, however, the author predicts the evolution of the equitable mootness doctrine to apply equally to preplan sale orders that are the functional equivalent of a plan in addition to the statutory mootness protections that are described by Keach. See also Large Chapter 11 Conference Report, supra note 25, at 21-22 (discussing various jurisdictions' willingness to approve preplan sales of business and noting “[t]ension exists between the need for procedural flexibility to maximize the value of the estate and the need for predictability to ensure fairness and the integrity of the system”).
- 387 11 U.S.C. § 363(f).
- 388 “[G]ood faith’ is not an essential element of a § 363(b) sale motion and need not be determined at the time of sale ....” *Thomas v. Namba (In re Thomas)*, 287 B.R. 782, 786 (B.A.P. 9th Cir. 2002). This no doubt makes obtaining such benefits all the easier for insiders. See *id.* at 785 (“The difficulty with the factual determination is that evidence genuinely probative of ‘good faith’ is not commonly introduced, or even reasonably available, at the time a bankruptcy court approves a sale. To the contrary, the fact-intensive evidence regarding the buyer and relations with parties in interest that may indicate fraud, collusion, or unfair advantage--i.e. evidence suggesting lack of ‘good faith’--tends to emerge after the sale.”).
- 389 See Kuney, supra note 49, at 235-37 (noting the chapter 11 process “originally focused on confirmation of a plan of reorganization ....”); see generally Baird & Rasmussen, supra note 54 (examining how the traditional railroad-style reorganization case that gave rise to the model of reorganization by plan based upon a need to maintain the going concern value of a far flung enterprise of specialized assets is nearly non-existent in modern chapter 11 cases).  
First, the proposed plan must be prepared and filed containing all of the elements demanded by § 1123 and must be accompanied by an extensive disclosure statement. 11 U.S.C. § 1125 (requiring a postpetition disclosure statement before votes may be solicited for a plan). Then, after the court has approved the debtor or party in interest's disclosure statement, creditors must vote in favor of the plan. Section 1126 determines how creditors and equity interest holders may vote in favor or against a plan, and the bankruptcy court must hold hearings, and make a number of factual determinations. Section 1129(b) allows the debtor to obtain a confirmed plan when it would be otherwise rejected under § 1129(a) before it may issue an order confirming the plan.

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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Despite all of the process involved, confirmation has substantial benefits. See, e.g., 11 U.S.C. § 1141 (discharging most of the debtor's liabilities and rendering "property dealt with by the plan... free and clear of all claims and interests of creditors, equity security holders, and of general partners in the debtor" post-confirmation); id. § 1145 (exempting securities issued under a confirmed plan from securities laws); id. § 1146 (exempting certain transactions completed as part of a confirmed chapter 11 plan from some state and federal taxation). In particular, assets sold under reorganization plans are explicitly transferred free and clear of all interests and claims in them except as described in the plan or the confirmation order. See id. § 1141(c). This provision allows the debtor to sell any asset necessary for its reorganization free and clear of any interest under its chapter 11 plan.

- 390 See Kuney, supra note 49, at 236 (noting §§ 1123(a)(5)(D) and 1141(c) allow the debtor to sell property free and clear of interests and claims, whereas the literal language of § 363 only allows the debtor to sell assets free and clear of interests). The debtor or trustee may transfer its assets prior to a confirmed plan under § 363. 11 U.S.C. § 363(b), (c), (f). Section 363(f) may be used independently as authorization for sales of the debtor's assets outside of a reorganization plan. See Kuney, supra note 49, 239 (citing Fed. R. Bankr. P. 4001). For a more detailed discussion of when the debtor may sell property of the estate under § 363(b)-(c), see infra notes 54, 279, 282, 287. See also *In re Encore Healthcare Assocs.*, 312 B.R. 52 (Bankr. E.D. Pa. 2004) (The court sua sponte refused to approve the sale if the business failed to provide the lender with bankruptcy foreclosure sale and free and clear the order that lender had pre-approved.).
- 391 See 11 U.S.C. § 363; see also Kuney, supra note 49, at 235, 239 n.17 (noting a sale under § 363(f) may occur without an actual hearing). "Absent an objection, and assuming that the pleadings provide an evidentiary basis to support the sale, there is not even the need for a hearing." Id. at 239 n.17 (citing 11 U.S.C. § 102(1) (defining "after notice and a hearing" as including situations where the bankruptcy court issues an order after proper notice, but where no hearing has occurred because no party requested one or where there was no time to hold a hearing)). Note also that a sale under § 363(f) must only satisfy one of the five statutory requirements for the court to approve it. See 11 U.S.C. § 363(f) (using the word "or" to connect the last element of its listed requirements). In contrast, confirmation requires the debtor-transferor to satisfy multiple requirements before approval. See generally id. §§ 1121-1129.
- 392 See John J. Hurley, Chapter 11 Alternative: Section 363 Sale of All of the Debtor's Assets Outside a Plan of Reorganization, 58 Am. Bankr. L.J. 233, 235 (1984).
- 393 See id. at 235.
- 394 See 11 U.S.C. § 1125.
- 395 See Baird & Rasmussen, supra note 54, at 785.
- 396 See id. at 784.
- 397 See, e.g., *In re Qualitech Steel Corp.*, 276 F.3d 245 (7th Cir. 2001).
- 398 Under § 363(f)(3), the sale must be for more than the aggregate value of all liens on the assets. Thus, DIP lenders and secured creditors likely face little risk of losing the value of their interests in a § 363(f) sale, while unsecured creditors and other parties in interest have little to no protection. Furthermore, because courts often hold that § 363(f) transfers property free and clear of both claims and interests, buyers are not too difficult to locate, speeding up the process. See Baird & Rasmussen, supra note 54, at 786.
- 399 As one practitioner observed in a conversation with the author: "The buyer doesn't care about 363(f) distortions because the secured creditor is the guy pushing the debtor to do this sale. The secured creditor is actually going to finance the buyer. In these 363 sales pushed through within the first 90 days of the case (or later), it is very seldom the secured creditor who is objecting."
- 400 See Steve E. Fox & Adam H. Friedman, Is the Safe Harbor Afforded by 363(f) Not So Safe Anymore?, 16 No. 12 Bankr. Strategist 1 (1999); Hurley, supra note 392, at 248. Indeed, one advantage to purchasers--at least those within the jurisdiction of the Third Circuit--may be that they will be able to buy assets free and clear even in the absence of a cognizable interest in property. See *In re Trans World Airlines, Inc.*, 322 F.3d 283, 291 (3d Cir. 2003). ("Even were we to conclude that the claims at issue are not interests in property, the priority scheme of the Bankruptcy Code supports the transfer of TWA's assets free and clear of the claims.").

HIJACKING CHAPTER 11, 21 Emory Bankr. Dev. J. 19

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- 401 See Guidelines for Financing Requests, *supra* note 190, at 8 (“Waivers: Extraordinary Provisions are those that divest the Court of its power or discretion in a material way, or interfere with the exercise of the fiduciary duties of the debtor or Creditors’ Committee in connection with the operation of the business, administration of the estate, or the formation of a reorganization plan ....”). But see Tabb, *supra* note 194, at 87, 89.
- 402 11 U.S.C. § 726(b). See Antoszyk, *supra* note 128, at \*3.
- 403 See Antoszyk, *supra* note 128, at \*11; see also *In re Blanton Smith Corp.*, 81 B.R. 440, 444 (Bankr. N.D. Ill. 1987). In Blanton, the court held “an order confirming a chapter 11 plan was res judicata, and the provisions granting security interests to administrative claimants were not subject to reconsideration by the court upon conversion to chapter 7.” 81 B.R. at 445. For an example of a lender who took the above advice, see Adelpia, *supra* note 46, at 6.
- 404 See Chatterjee et al., *supra* note 131, at 4-5, 11.
- 405 See David A. Skeel, Jr., *Bankruptcy Lawyers and the Shape of American Bankruptcy Law*, 67 *Fordham L. Rev.* 497, 510 (1998); Shanon D. Murray, Letter From Delaware, The Deal.Com, Nov. 5, 2003, at [http:// www.thedeal.com/NASApp/cs/ContentServer?pagename=TheDeal/TDDArticle/TD](http://www.thedeal.com/NASApp/cs/ContentServer?pagename=TheDeal/TDDArticle/TD).
- 406 One commentator, who prefers to remain anonymous, has informally suggested to the author that it took until the United States Supreme Court decided *Timbers* for secured creditors to understand the implications of the Code’s provisions regarding cash collateral and adequate protection in terms of case control.
- 407 See Vance & Barr, *supra* note 202, at 390-91; Warren & Westbrook, *supra* note 14, at 12; see also discussion *supra* Parts II.-III.
- 408 See discussion *supra* Parts III.-V. For an example of just how beneficial to insiders these inducements can be, see John D. Ayer, 1992 Survey of Books Relating to the Law; VII. Tort and Commercial Law: *Down Bankruptcy Lane*, 90 *Mich. L. Rev.* 1584, 1597-98 (1992).
- 409 See discussion *supra* Parts IV.C.-V.; see also Harvey R. Miller & Shai Y. Waisman, The Creditor in Possession: Creditor Control of Chapter 11 Reorganization Cases, 21 *Bankr. Strategist* 1, 2 (2003) (“The question now arises as to whether the pendulum has swung so far in the favor of creditor rights and, in particular, the rights of secured creditors as to endanger the original objectives of the BRA to the point that secured creditors, in effect, may veto rehabilitation and force the sale of a debtor’s assets thereby converting chapter 11 primarily into a liquidation proceeding.”); David A. Skeel, *Bankruptcy Lawyers and the Shape of American Bankruptcy Law*, 67 *Fordham L. Rev.* 497, 518 (1998) (“Secured lender successes provide a convenient illustration of how interest group influence is often channeled in a lawyer-friendly direction.”); Vance & Barr, *supra* note 203, at 378 (“[T]he debtor’s management can so control the outcome of the bankruptcy case that these claimants have little ability to assert their rights.”); Westbrook & Warren, *supra* note 14, at 12 (“Having invented the DIP ..., American lawyers are now creating the SPIP (secured-party-in-possession). More and more chapter 11 cases seem to be no more than vehicles through which secured parties may enjoy their Article 9 rights under the umbrella, and the protective shield of the bankruptcy laws.”); see generally Ayer, *supra* note 408, at 1585.
- 410 See Rusch, *supra* note 264, at 350. Some commentators question whether these are really so unintended. See Vance & Barr, *supra* note 202, at 398.
- 411 See *In re Allard*, 23 B.R. 517, 517 (Bankr. E.D. Mich. 1982); Skeel, *supra* note 405, at 514.
- 412 See Ayer, *supra* note 408, at 1588, 1607; Charles M. Elson & Robert K. Rasmussen, Note, *Switching Priorities: Elevating the Status of Tort Claims in Bankruptcy in Pursuit of Optimal Deterrence*, 116 *Harv. L. Rev.* 2541, 2558 (2003); Vance & Barr, *supra* note 202, at 383; Miller & Waisman, *supra* note 409, at 8.
- 413 See Baird & Rasmussen, *supra* note 54, at 751 (arguing just that).