THE (IL)LEGITIMACY OF BANKRUPTCIES FOR THE BENEFIT OF SECURED CREDITORS

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The desirability of secured creditor bankruptcies is undoubtedly a polarized issue. On one hand, some argue that secured creditor bankruptcies should be dismissed outright. On the other, others assert that secured creditor bankruptcies should not be automatically dismissed because they can be beneficial in certain circumstances. This Article explores this tension by initializing a dialog between the advocates and the critics of secured creditor bankruptcies. Through this dialectic approach, this Article concludes that, even though secured creditor bankruptcies may have the capacity for mischief, they should still be permitted so long as they are governed by carefully drawn limitations.

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I. INTRODUCTION AND BACKGROUND

This Article explores the legitimacy—or illegitimacy—of filing and maintaining a case under the Bankruptcy Code[1] when the sole or principal beneficiary or beneficiaries of the case would be a secured creditor or secured creditors.[2] In the situation posited here, the application of the usual distributional priority rules would not produce any distribution for the general, unsecured creditors of the debtor. In the prototypical case virtually all of the assets of the debtor would be subject to secured claims securing obligations that exceed the value of the collateral, i.e., the secured creditor would be undersecured and there would be no equity in the collateral for the benefit of the debtor's estate. I refer here to such a bankruptcy case as a "secured creditor bankruptcy."

I note at the outset that this project originally was conceived as a joint effort with Professor Bruce A. Markell.[3] Sadly, scheduling issues eventually prevented our formal collaboration.[4] While I assume full responsibility for the final product, I am indebted to Professor Markell for his enormously helpful input. Professor Markell and I have differing views on how bankruptcy law should deal with secured party bankruptcies.[5] My views generally fall into the legitimacy side of the argument and Professor Markell's on the other side. Although my goal here is to set out the best policy arguments on each side, I have no doubt that Professor Markell would have provided a more cogent and articulate account of the illegitimacy point of view than I have managed to offer.

Following this Introduction, Part II of this Article offers a brief overview of several bankruptcy-law-related settings and contexts in which the appropriateness of a secured creditor bankruptcy might be questioned. One typical situation involves a proposed sale of substantial-

1. 11 U.S.C. §§ 101–1532 (2012). Unless otherwise noted, citations to "section" or "§" are to sections of the Bankruptcy Code.

2. Unless the context requires otherwise, I refer throughout to the beneficiary "secured creditor" for convenience. But this reference should be understood to refer to the situation in which there are multiple secured creditors as well.

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4. I have tried to remain faithful to our original goal of setting out the strongest policy arguments both for and against the legitimacy of secured creditor bankruptcies.

5. While we certainly share some common ground, our views differ substantially in several respects (albeit more sharply on some issues than others).

ly all of a debtor's assets under Bankruptcy Code section 363[6] (a "363 sale"), often relatively early in a Chapter 11 case.[7] Typically, the sale would be free and clear of the secured creditor's security interest (with the secured creditor's consent) and with the security interest attaching to the proceeds for subsequent distribution to the secured creditor.[8] Part II. A. of this Article deals with 363 sales. Part II.B of this Article then addresses sales under a Chapter 11 plan of reorganization. Part II.C then examines the circumstances under which a secured creditor bankruptcy might be converted to a Chapter 7 case or dismissed. Next, Part II.D considers the practice of "gifting" in a secured creditor bankruptcy. Under this practice, with the secured creditor's consent a distribution is made to or set aside for a person whose claim or interest is junior to the secured creditor's claim. The distribution or set aside ostensibly is made from the secured creditor's collateral, the benefit of which otherwise would be received by the secured creditor alone (hence, the "gifting" of the collateral). Finally, Part II.E of this Article offers a brief summary of the (often inconsistent) treatment of secured party bankruptcies by the courts. Part II.E also addresses in this context secured creditor "carve-outs" from collateral.

I appreciate that under the current Bankruptcy Code and existing case law many courts have the flexibility to embrace a wide variety of approaches toward secured creditor bankruptcies and toward the doctrinal issues of bankruptcy law that those cases implicate.[9] In general, I recognize that case law and secondary authority exist that both support and oppose the appropriateness of secured creditor bankruptcies. For that reason, Part III focuses primarily on the *bankruptcy policy implications* of secured party bankruptcies—primarily policies that underpin Chapter 11.[10] Part III asks and offers a range of answers to the question: How *should* bankruptcy law treat secured creditor bankruptcies? Part III first sets out two competing visions of secured party bankruptcies. One view is generally critical and opposed, the "Against" position, and the other generally supportive, the "For" position. Part III then proceeds to provide rebuttals and surrebuttals of the Against and For positions and to discuss and critique the issues that they raise.

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6. 11 U.S.C. § 363(b)(1) (2012); *see* CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY 94–95 (2d ed. 2009).

7. *See* 11 U.S.C. § 363(b)(1) (authorizing the use, sale, or lease of property of the estate outside the ordinary course of business). Although section 363(b)(1) also applies to the use and lease of property, for present purposes, sales under section 363 are most relevant. Consequently, this Article generally refers to "363 sales."

8. 11 U.S.C. § 363(f) (permitting the sale of property of the estate "free and clear of any interest").

9. Of course, any court may be bound by controlling precedent. *See, e.g.*, United States v. Aguiar, 737 F.3d 251, 261 (2d Cir. 2013) ("'[B]inding precedent' refers to the precedent of this Circuit and the Supreme Court.").

10. Accordingly, I generally eschew a detailed exploration of the best or strongest "doctrinal" analyses and solutions.

Throughout this Article, the focus is trained on the issues raised by secured party bankruptcies. Thorough examinations of the broader themes of sales under section 363 or under reorganization plans, dismissal, and gifting, for example, are beyond this Article's scope.

II. THE CURRENT LEGAL LANDSCAPE FOR SECURED CREDITOR BANKRUPTCIES

A. 363 Sales

Section 363(b)(1) of the Bankruptcy Code authorizes the trustee (or debtor in possession[11]) to use, sell, or lease property of the estate "other than in the ordinary course of business."[12] This right to dispose is permitted only "after notice and a hearing."[13] But the statute itself provides no guidance as to the applicable standards that courts are to apply for approving or disapproving a 363 sale.[14] Not surprisingly, a substantial body of case law has filled in the gaps, although not always consistently. In general, the court considers aspects of the transaction such as the adequacy and reasonableness of notice, the adequacy of the price, and the good faith of the transferee.[15]

Most controversial are the 363 sales of all, or substantially all, of a debtor estate's assets. In many situations, there may be good reasons for conducting such a 363 sale instead of providing for a sale under a confirmed Chapter 11 plan. But there also is cause for skepticism and caution in this context. In *In re Lionel Corporation*, the Second Circuit held that there must be "a good business reason" for approval of the sale of a substantial asset of a debtor outside of a plan of reorganization.[16] In *Lionel*, the debtor proposed to sell a controlling stake in another corporation, which was Lionel's "most important asset."[17] The *Lionel* Creditors' Committee's insistence on the sale, the court reasoned, was "insufficient as a matter of fact because it is not a sound business reason and insufficient as a matter of law because it ignores the equity interests re-

11. Subject to exceptions not relevant here, a debtor in possession has the rights and powers of a trustee in Chapter 11. 11 U.S.C. § 1107(a) (2012).

12. 11 U.S.C. § 363(b)(1); *see* TABB, *supra* note 6, at 99.

13. 11 U.S.C. § 102(1) (explaining the meaning of "after notice and a hearing").

14. Section 363(b)(1) does not by its terms require a court order approving a nonordinary course disposition, but such an order is normally obtained in practice in order to provide necessary comfort to a transferee. 3 COLLIER ON BANKRUPTCY ¶ 363.02[1] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013) [hereinafter 3 COLLIER].

15. *See id.* at ¶ 363.02.

16. 722 F.2d 1063, 1071 (2d Cir. 1983).

17. *Id.* at 1065.

quired to be weighed and considered under Chapter 11."[18] Other circuits have followed *Lionel*.[19]

More recently the Second Circuit revisited the substantial asset 363 sale issue in a case in which the court upheld the bankruptcy court's approval of the sale over the objections of certain creditors. The Second Circuit discussed and cited *Lionel* with approval in *In re Chrysler LLC*.[20] There, the court noted:

> In the twenty-five years since *Lionel*, § 363(b) asset sales have become common practice in large-scale corporate bankruptcies . . . . Resort to § 363(b) has been driven by efficiency, from the perspectives of sellers and buyers alike. The speed of the process can maximize asset value by sale of the debtor's business as a going concern.[21]

Chief among the factors motivating the bankruptcy court's approval (and the Second Circuit's affirmance) of the sale of the assets by Old Chrysler (the Chapter 11 debtor in possession) to New Chrysler was the need to preserve going concern value and to dispose of the assets before any further deterioration occurred—the "melting ice cube" theory.[22]

The objecting secured creditors argued that the 363 sale was "an impermissible [so-called] *sub rosa* plan of reorganization" because certain unsecured creditors of Old Chrysler were ending up with value (an ownership interest in New Chrysler), ostensibly violating the "absolute priority" rule because the secured creditors were not being paid in full.[23] But the court pointed out that the bankruptcy court had made clear that *all* of the value of the debtor's assets was being distributed to the secured creditors. The court further noted that the bankruptcy court found that all of the equity ownership in New Chrysler was "entirely attributable to

18. *Id.* at 1071. Subsequent history illustrates the risks that are inherent in a substantial asset sale. Lionel eventually sold the asset and received about $20 million more than it would have received under the proposed sale for which approval was originally sought. *Lionel Agrees to Sell Its 82% Stake in Dale for $76.9 Million*, WALL ST. J., Sept. 20, 1985, at 37.

19. *See, e.g.*, Stephens Indus. v. McClung, 789 F.2d 386, 389–90 (6th Cir. 1986); Inst. Creditors of Cont'l Air Lines, Inc. v. Cont'l Air Lines, Inc. (*In re* Cont'l Air Lines, Inc.), 780 F.2d 1223, 1226 (5th Cir. 1986).

20. Ind. State Police Pension Trust v. Chrysler LLC (*In re* Chrysler LLC), 576 F.3d 108, 113–17 (2d Cir. 2009), *vacated as moot*, 558 U.S. 1087 (2009).

21. *Id.* at 115–16.

22. As the *Chrysler* court observed, "[w]ith its revenues sinking, its factories dark, and its massive debts growing, Chrysler fit the paradigm of the melting ice cube." *Id.* at 119. The sale in *Chrysler* yielded $2 billion, which was distributed to the secured creditors, against the backdrop of unrefuted evidence of a liquidation value of only $800 million. *Id.* at 118. Moreover, "Chrysler was losing going concern value of nearly $100 million each day." *Id.* at 119. Relying on the Bankruptcy Court's opinion and the Second Circuit's oral affirmance in *Chrysler*, as well as other Second Circuit 363 sale cases, the Bankruptcy Court subsequently approved the 363 sale of the assets of General Motors. *In re* General Motors Corp., 407 B.R. 463, 491 (Bankr. S.D.N.Y. 2009). Following the Second Circuit's issuance of its written opinion in *Chrysler* the Supreme Court granted certiorari, vacated the judgment, and remanded to the Second Circuit to dismiss the appeal as moot. *Chrysler*, 558 U.S. at 1087 (2009); *In re Chrysler*, 592 F.3d 370, 372 (2d Cir. 2010).

23. *In re Chrysler*, 576 F.3d at 118. Concerning the absolute priority rule and cramdown, see 11 U.S.C. § 1129(b)(2) (2012). I address these issues primarily in connection with the discussion of gifting in *infra* Part II.D.

new value—including governmental loans, new technology and new management—which were not assets of the debtor's estate."[24]

The *Chrysler* court also distinguished the *Braniff Airways* case.[25] In *Braniff*, the Fifth Circuit reversed the district court's approval (and affirmance of the bankruptcy court) of an asset sale because the debtor "should not be able to short circuit the requirements of Chapter 11 for confirmation of a reorganization plan by establishing the terms of the plan *sub rosa* in connection with a sale of assets."[26] For example, the transfer agreement in *Braniff* would have dictated "some of the terms of a[ny] future reorganization plan[s]" and would have required a particular allocation of proceeds under such a plan or else a valuable asset would have been forfeited.[27] In order to "specify the terms whereby a reorganization plan is to be adopted, the parties and the district court must scale the hurdles erected in Chapter 11."[28] The *Chrysler* court acknowledged that a sale of "substantially all of a debtor's assets . . . may well be a reorganization in effect without being the kind of plan rejected in *Braniff*."[29] Applying the *Lionel* analysis, courts in the Second Circuit may approve 363 sales of substantially all of a debtor's assets provided that there is a "good business reason for the sale."[30]

Two commentators outlined the pre-*Chrysler* case law on substantial asset 363 sales as follows:

> Bankruptcy law, based on leading 1980s decisions in the Second and Fifth Circuits, was largely in good shape doctrinally before *Chrysler*. These decisions established that there must be an appropriate business justification for the sale, as exemplified by a business emergency or a deteriorating business situation best handled by a sale; the sale cannot be a sub rosa plan of reorganization that de facto determines core terms more properly determined under section 1129 via its creditor protections; and if the plan does determine core section 1129 features, it can do so only if the court fashions a makeshift

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24. *In re Chrysler*, 576 F.3d at 118.

25. Pension Benefit Guar. Corp. v. Braniff Airways, Inc. (*In re* Braniff Airways, Inc.), 700 F.2d 935 (5th Cir. 1983).

26. *Id.* at 940.

27. *Id.* at 939–40.

28. *Id.* at 940. As examples of these "hurdles," the court cited 11 U.S.C. § 1125 (2012) (governing disclosure requirements), 11 U.S.C. § 1126 (2012) (concerning voting), 11 U.S.C. § 1129(a)(7) (2012) (providing the best interest of creditors test), and 11 U.S.C. § 1129(b)(2)(B) (2012) (setting forth the absolute priority rule).

29. *In re Chrysler*, 576 F.3d at 117. Notwithstanding the court's conclusions, *Chrysler* has been severely criticized. *See generally* Ralph Brubaker & Charles Jordan Tabb, *Bankruptcy Reorganization and the Troubling Legacy of* Chrysler *and* GM, 2010 U. ILL. L. REV. 1375; Mark J. Roe & David A. Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727 (2010); Todd L. Friedman, Note, *The Unjustified Business Justification Rule: A Reexamination of the* Lionel *Canon in Light of the Bankruptcies of Lehman, Chrysler, and General Motors*, 11 U.C. DAVIS BUS. L.J. 181 (2010). For a contrary view, see generally Stephen J. Lubben, *No Big Deal: The* GM *and* Chrysler *Cases in Context*, 83 AM. BANKR. L.J. 531 (2009). I do not engage this criticism here inasmuch as the only present purpose is to outline the current state of the case law as necessary to set the stage for our consideration of secured creditor bankruptcies.

30. *In re Chrysler*, 576 F.3d at 117.

safeguard—a substitute that's overall consistent with the mandates of section 1129.[31]

It remains to be seen whether *Chrysler* and *General Motors* will have a lasting and significant impact on the development of the law of substantial asset 363 sales.[32]

An important aspect of most substantial asset 363 sales is the sale "free and clear of any interest in such property of an entity other than the estate" pursuant to section 363(f).[33] In sales free and clear an important issue is whether one of the five conditions of such a sale have been met.[34] For present purposes of considering secured creditor bankruptcies, the most important condition is the consent of the entity whose interest will be cut off—the relevant secured creditor.[35] Given the assumption that the secured creditor is the principal beneficiary of the bankruptcy case, we can further assume that the secured creditor will consent.[36] Another important issue is the type of "interest" that can be cut off in a sale free and clear.[37] Again, for present purposes the relevant point is that a sale free and clear may be an important factor in the secured creditor's preference for a sale in bankruptcy as opposed to enforcement outside bankruptcy.[38]

B. Sales Pursuant to Plans of Reorganization

Section 1123(b)(4) of the Bankruptcy Code provides that "a plan may . . . provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests."[39] Thus, Chapter 11 clearly permits liquidation plans. A plan in a secured creditor bankruptcy that provides for a liquidation is, in legal contemplation, quite unremarkable. But, wealth con-

31. Roe & Skeel, *supra* note 29, at 736.

32. *See* Melissa B. Jacoby & Edward Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 871 (2014) (proposing a reserve to be set aside from sales price at the time of a 363 sale, preserving postsale resolution of potential disputes about valuation and priority).

33. 11 U.S.C. § 363(f) (2012). *See generally* TABB, *supra* note 6, at 94–95.

34. 11 U.S.C. § 363(f)(1)–(5); *see* 3 COLLIER, *supra* note 14, at ¶ 363.06[2]–[6].

35. 11 U.S.C. § 363(f)(2) (providing that a trustee may sell property under section 363(b) or section 363(c) if "such entity consents").

36. However, if a senior secured creditor consents but a junior secured creditor does not, then the court must find that another condition has been satisfied as to the junior. In one interesting case, on appeal the conditions held applicable to the junior creditor were determined to be not applicable. The senior creditor who purchased at the sale cut off its own senior lien (through its consent) but took *subject to* the junior lien! Although the bankruptcy court's sale order was not stayed during the appeal, the Ninth Circuit Bankruptcy Appellate Panel held that mootness protection of section 363(m) applied only to the sale and not to the "lien-stripping" (*i.e.*, the "free and clear") aspect of the sale). Clear Channel Outdoor, Inc. v. Knupfer (*In re* PW), 391 B.R. 25, 37 (B.A.P. 9th Cir. 2008).

37. *See* 3 COLLIER, *supra note* 14, at ¶ 363.06[1], [7].

38. For example, a broad interpretation of "interest" (as the term is used in section 363(f)), which would allow the sale to be free and clear of future claims under a successor liability theory, could be very attractive to the buyer, and consequently to the secured creditor. With such protection for a buyer the collateral may fetch a substantially higher sales price. *See Id.* at ¶ 363.06[7].

39. 11 U.S.C. § 1123(b)(4); *see* TABB, *supra* note 6, at 98.

servation may dictate an early disposition (the "melting ice cube," for example) in a substantial asset 363 sale, as discussed above.[40] As evidenced by section 1123(b)(4), such a liquidation under section 363 is not necessarily inconsistent with the goals and purposes of Chapter 11.

C. Conversion or Dismissal

In addition to objections to substantial asset 363 sales in secured creditor bankruptcies, a party in interest (or a court, *sua sponte*) may seek to have a Chapter 11 case converted to a Chapter 7 liquidation case or dismissed. In this connection, section 1112(b)(1) provides, in pertinent part:

> [O]n request of a party in interest, and after notice and a hearing, the court shall convert a case under this chapter to a case under chapter 7 or dismiss a case under this chapter, whichever is in the best interests of creditors and the estate, for cause unless the court determines that the appointment under section 1104(a) of a trustee or an examiner is in the best interests of creditors and the estate.[41]

Section 1112(b)(4), then, provides that "'cause' includes" a lengthy list of examples.[42] None of the enumerated examples suggest that the mere fact of a secured creditor bankruptcy is of itself sufficient "cause" for conversion or dismissal. However, one example of cause may be particularly pertinent in a secured creditor bankruptcy. Subsection (b)(4)(A) holds that "'cause' includes . . . substantial or continuing loss to or diminution of the estate *and* the absence of a reasonable likelihood of rehabilitation."[43] Note that this is a two-prong test—loss or diminution and unlikelihood of rehabilitation.

The ground for dismissal that probably is most relevant in a secured creditor bankruptcy is the lack of good faith. Whether the absence of good faith in the filing or maintenance of a Chapter 11 case constitutes "cause" under section 1112(b)(1) or is an independent judge-made ground, dismissal for lack of good faith (or, as alternatively described, for bad faith) is well established in the case law.[44] In assessing the absence of good faith (or existence of bad faith) the courts generally focus on whether there is an abuse of the Chapter 11 process or some form of misconduct.[45]

The subjective bad faith inquiry is designed to insure that the petitioner actually intends "to use the provisions of Chapter 11 . . . to reor-

40. *See supra* notes 22–23 and accompanying text.
41. 11 U.S.C. § 1112(b)(1).
42. 11 U.S.C. § 1112(b)(4)(A)–(P).
43. 11 U.S.C. § 1112(b)(4)(A) (emphasis added).
44. On dismissal for lack of good faith, see generally 7 COLLIER ON BANKRUPTCY ¶ 1112.07 (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2013) [hereinafter 7 COLLIER].
45. *See, e.g.*, Carolin Corp. v. Miller, 886 F.2d 693, 702 (4th Cir. 1989).

ganize or rehabilitate an existing enterprise, or to preserve going concern values of a viable or existing business."[46] Put conversely,

> its aim is to determine whether the petitioner's real motivation is "to abuse the reorganization process" and "to cause hardship or to delay creditors by resort to the Chapter 11 device merely for the purpose of invoking the automatic stay, without an intent or ability to reorganize his financial activities."[47]

There is some authority supporting a dismissal for lack of good faith because a reorganization is not likely, but these cases generally involve additional factors bearing on good or bad faith.[48] Otherwise, the first prong of the two-prong test of section 1112(b)(4)(A) would be read out of existence and superfluous.

D. Gifting

Both gifting and carveouts in Chapter 11, whether in connection with a plan of reorganization or a substantial asset 363 sale, raise several potential conflicts with either the letter or the policies of Bankruptcy Code, and in particular Chapter 11. I summarize these aspects of Chapter 11 at the outset of the discussion in this Subpart.[49]

Consider first certain relevant conditions for confirmation of a plan in Chapter 11.[50] For a plan to be confirmed each holder of a claim or interest in an impaired class[51] who has not accepted the plan must receive value of not less than the amount the holder would receive in a liquidation of the debtor under Chapter 7.[52] This is colloquially referred to as the "best interest of creditors" test (although it applies to holders of interests as well). Note that the best interests test applies to each *holder*. Another requirement of confirmation applies to each *class* of claims or interests. Each class must either accept the plan or not be impaired by

46. *Id.* (quoting *In re* Victory Constr. Co., 9 B.R. 549, 564 (Bankr. C.D. Cal. 1981)).

47. *Id.* (quoting *In re* Thirtieth Place, Inc. v. Thirtieth Place, Inc., 30 B.R. 503, 505 (B.A.P. 9th Cir. 1983)). In *Carolin* the Fourth Circuit also held that dismissal for bad faith requires not only a determination of subjective bad faith but also of "objective futility"—that a reorganization is not realistically possible. *Id.* at 700–01. The Eleventh Circuit, however, has held that bad faith alone is sufficient for dismissal and that the potential for a successful reorganization does not override the determination of bad faith. Phoenix Piccadilly, Ltd. v. Life Ins. Co. of Va., 849 F.2d 1393, 1394 (11th Cir. 1988).

48. *See, e.g.*, C-TC 9th Ave. P'ship v. Norton Co., 113 F3d 1304, 1310 (2d Cir. 1997). As the *C-TC 9th* court observed, "[w]hen it is clear that, from the date of filing, the debtor has no reasonable probability of emerging from the bankruptcy proceedings and no realistic chance of reorganizing, then the Chapter 11 petition may be frivolous." *Id.* But there were other factors supporting the determination of bad faith. For example, the Chapter 11 case essentially involved a two-party dispute and was in effect a litigation tactic. *Id.* at 1309.

49. I address other potential inconsistencies in our presentation of the cases for and against secured creditor bankruptcies in *infra* Part III.

50. *See generally* TABB, *supra* note 6, at 1132 (providing an overview of confirmation requirements).

51. *See* 11 U.S.C. § 1122 (2012) (regarding classification); 11 U.S.C. § 1124 (concerning impairment).

52. 11 U.S.C. § 1129(a)(7).

the plan.[53] In addition, if a class of claims is impaired, at least one impaired class must accept the plan (without taking into account any insider acceptances).[54]

The so-called "cramdown" requirements are also relevant here. The cramdown can be invoked if section 1129(a)(8) has not been satisfied because an impaired class of claims or interests has not accepted a plan. In that situation the plan can be confirmed nevertheless under section 1129(b) "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."[55] The statute does not define or explain the concept of unfair discrimination, although case law provides guidance.[56] However, the statute does address what is "fair and equitable with respect to a class" in section 1129(b)(2), which incorporates what is known as the "absolute priority rule."[57] With respect to a class of secured claims a plan is fair and equitable if the holders receive, essentially, the value of their secured claims.[58] Of more interest in the context of gifting and carveouts, however, it is the fair and equitable treatment of a nonaccepting class of unsecured claims. A plan provides fair and equitable treatment of a class of unsecured claims if either the holders receive value equal to the allowed amount of their claims or if the holders of claims or interests junior to the holders of the unsecured claims do not receive "on account of such junior claim or interest any property."[59] For example, in a debtor's simple capital structure, imagine an accepting class of impaired secured creditors, a nonaccepting class of unsecured creditors, and common shareholders. So long as the shareholders receive nothing "on account of" their junior claims, the plan is fair and equitable for the class of unsecured creditors.[60] Hence the moniker "absolute priority" is evoked—junior classes get nothing unless senior classes receive a full recovery, the senior classes' priorities being "absolute."[61]

53. 11 U.S.C. § 1129(a)(8).

54. 11 U.S.C. § 1129(a)(10).

55. 11 U.S.C. § 1129(b)(1).

56. For a succinct overview of the judicial treatment of unfair discrimination, see Harvey R. Miller & Ronit J. Berkovich, *The Implications of the Third Circuit's* Armstrong *Decision on Creative Corporate Restructuring: Will Strict Construction of the Absolute Priority Rule Make Chapter 11 Consensus Less Likely?*, 55 AM. U. L. REV. 1345, 1387–90 (2006).

57. 11 U.S.C. § 1129(b)(2); *see also* Miller & Berkovich, *supra* note 56, at 1347.

58. This can be achieved by the holder's retention of liens and receipt of cash payments at least equal to the amount of the allowed claim and with a present value at least equal to the collateral value. 11 U.S.C. § 1129(b)(2)(A)(i). Alternatively, fair and equitable treatment can consist of the holders' realization "of the indubitable equivalent" of their claims. 11 U.S.C. § 1129(b)(2)(A)(iii). Another alternative is for the collateral to be sold free and clear of the liens with the liens attaching to the proceeds, followed by treatment of the proceeds in accordance with clauses (i) or (iii) mentioned above.

59. 11 U.S.C. § 1129(b)(2)(B)(ii). There is an exception for individuals, which is not relevant here.

60. Recall that by the time the issue of cramdown is reached, the court already has determined that the best interests test under section 1129(a)(7) has been met for all of the holders in the nonaccepting class. *See supra* note 55 and accompanying text.

61. *See* Miller & Berkovich, *supra* note 56, at 1347.

Consider next absolute priority and unfair discrimination in the context of secured creditor gifting.[62] For example, if the secured creditor gifts a portion of its bankruptcy distribution to the old equity (interest holders), leaving the unsecured creditors to take nothing, does this violate absolute priority? Similarly, if the secured creditor gifts some unsecured creditors but provides nothing to other unsecured creditors of equal rank, does this amount to unfair discrimination? Cases dealing with these and related issues turn on the factual and procedural settings and many cannot be reconciled.[63]

Most would mark the beginning of the golden (or not) era of gifting with a decision by the First Circuit more than twenty years ago in *Official Unsecured Creditors' Committee v. Stern (In re SPM Manufacturing Corp).*[64] *SPM* involved an agreement by a secured creditor with a Chapter 11 creditors' committee to share with the debtor's general unsecured creditors proceeds of the collateral recovered by the secured creditor.[65] The result of this agreement meant that a priority tax claim (for which the debtor's former management members were personally liable) would not be paid. Following a sale of the collateral, the secured creditor sought to recover the proceeds, a portion of which it proposed to distribute to the committee for the benefit of the unsecured creditors. The bankruptcy court denied the secured creditor's request and ordered that the portion of the proceeds intended for the unsecured creditors be paid instead to the trustee for distribution according to the applicable priorities.[66] This meant that the priority tax claimant would receive those proceeds. The district court affirmed the bankruptcy court's ruling.[67]

The First Circuit reversed the district court. It explained:

> [T]he distribution scheme of section 726 (and, by implication, the priorities of section 507) does not come into play until all valid liens

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62. Because my focus here is on secured creditor bankruptcies, I primarily address gifting by a secured creditor as a tool for enhancing its recovery. However, cases involving gifting by unsecured creditors, some of which I mention in the following discussion, also may bear on secured creditor gifting.

63. On gifting and associated issues, see generally Hollace T. Cohen, In re Armstrong World Industries, Inc.*: Absolute Priority Reigns Supreme*, *in* NORTON ANNUAL SURVEY OF BANKRUPTCY LAW (2005); Michael Carnevale, Comment, *Is Gifting Dead in Chapter 11 Reorganizations? Examining Absolute Priority in the Wake of the Second Circuit's No-Gift Rule in In Re* DBSD, 15 U. PA. J. BUS. L. 225 (2012); Richard L. Ferrell, *Gifting Carve-Outs in Asset Sales Under § 363 Still Controversial*, AM. BANKR. INST. J., Nov. 2009, at 16; Lauren E. McDivitt, Comment, *What Do You Mean There Won't Be Gifts This Year? Why Practitioners Cannot Rely upon Gifting Provisions in Chapter 11 Reorganization Plans in the Fifth Circuit*, 44 TEX. TECH L. REV. 1019 (2012); Miller & Berkovich, *supra* note 56; Thomas E. Patterson, *Chapter 11 Business Reorganizations: You Can't Give it Away: Gifts, Carveouts, Settlements and Other Incursions into Absolute Priority*, SS029 ALI-ABA 531 (Am. Law. Inst.–Am. Bar. Assoc. Course of Study), Apr. 28, 2011; Norman L. Pernick et al., *Beware of Creditors Bearing Gifts: A Primer on Sharing Property in Chapter 11*, 22 NORTON J. BANKR. L. & PRAC. 725 (2013); Damian S. Schaible & Eli J. Vonnegut, *SPM Manufacturing* to *Journal Register: Indicators of a Successful "Gift Plan,"* AM. BANKR. INST. J., Oct. 2009, at 14.

64. 984 F.2d 1305 (1st Cir. 1993).

65. *See* TABB, *supra* note 6, at 728 n.4.

66. *In re SPM Mfg.*, 984 F.2d at 1310.

67. *Id.*

> on the property are satisfied. . . . If a lien is perfected and not otherwise invalidated by law, it must be satisfied out of the assets it encumbers before any proceeds of the assets are available to unsecured claimants, including those having priority (such as priority tax creditors) . . . . Citizens held a valid lien on all of the SPM assets; these were sold for $5 million. The bankruptcy court allowed Citizens' secured claim in that amount. Clearly, then, absent the order, the entire $5 million belonged to Citizens in satisfaction of its lien, leaving nothing for the estate to distribute to the other creditors, including the I.R.S. The bankruptcy court's order forced Citizens to transfer to the estate a portion of its own $5 million notwithstanding the court's recognition of Citizens' right to receive that sum in full.
>
> Because Citizens' secured claim absorbed all of SPM's assets, there was nothing left for any other creditor in this case . . . . [I]t is hard to see how the priority creditors lost anything owed them given the fact there would have been nothing left for the priority creditors after the $5 million was distributed to Citizens. The "syphoning" of the money to general, unsecured creditors came entirely from the $5 million belonging to Citizens, to which no one else had any claim of right under the Bankruptcy Code.[68]

Note that *SPM* was a Chapter 7 case (at the time of distribution) in which the absolute priority rule did not apply. However, the distributional scheme under Chapter 7 is every bit as rigid as that under Chapter 11. The relevant inquiry, then, is whether gifting is a permissible means of allowing a junior creditor's recovery to the exclusion of a senior creditor, notwithstanding the otherwise applicable distributional regime (regardless of the applicable chapter). Also note that the gifting distribution was to be made by the secured creditor, not by the trustee or under a plan. Moreover, there was no dispute as to the secured creditor's priority in *SPM*.

Relying to some extent on *SPM*, gifting under a plan of reorganization by a secured creditor for the benefit of some classes of unsecured creditors, to the exclusion of other creditors of equal rank, has been upheld over objections that it amounted to unfair discrimination.[69] Such selective gifting under a plan of a portion of what otherwise would be received by classes of unsecured creditors in favor of some, but not all, unsecured trade creditors also has been permitted as not unfairly discriminatory.[70] Other courts have taken opposing views, holding that se-

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68. *Id.* at 1312 (internal citations omitted).

69. *In re* Genesis Health Ventures, Inc., 266 B.R. 591, 611 (Bankr. D. Del. 2001); *In re* Parke Imperial Canton, Ltd., No. 93–61004, 1994 WL 842777, at *11 (Bankr. N.D. Ohio Nov. 14, 1994). In *Genesis* the gifting also was for the benefit of the debtor's former equity holders. *In re Genesis Health Ventures*, 266 B.R. at 611.

70. In *In re WorldCom, Inc.*, for example, the court stated that:

> Any enhanced value received by holders of [certain claims] on account of contributions from other Classes is not a treatment of these Claims under the plan and does not constitute unfair discrimination. The greater value received by [certain creditors] as a result of the Contributions does

cured creditor gifting in connection with plan of reorganization does not excuse disparate treatment of creditors of equal rank that otherwise would constitute unfair discrimination.[71]

Significant decisions in the Second and Third Circuits have substantially restricted the utility of gifting in those circuits. In *In re Armstrong World Industries, Inc.*,[72] the Third Circuit held that the proposed plan violated the absolute priority rule by allowing former equity holders to receive warrants for equity. The plan provided that if a particular class did not accept the plan, then the warrants would be issued to another class of creditors that would automatically gift them to the former equity holders.[73] The court distinguished *SPM* because it was a Chapter 7 case that did not implicate the absolute priority rule.[74] Moreover, the gifting secured creditor distributed property—its collateral—that was not distributable under the Bankruptcy Code's priority rules and the *SPM* gift was a carveout from the secured creditor's collateral.[75] The warrants in *Armstrong*, on the other hand, were *created* to end up in the hands of former equity holders. After *Armstrong*, the District of Delaware Bankruptcy Court has allowed gifting in connection with a 363 sale and not in the context of a plan or reorganization. In *In re World Health Alternatives, Inc.*,[76] the court approved a settlement in connection with an asset sale under which claims against the secured creditor were released and the secured creditor carved out of it collateral value for the benefit of unsecured creditors.

The Second Circuit also held that a plan violated the absolute priority rule in *In re DBSD North America, Inc.*[77] The *DBSD* plan allocated

> not violate the Bankruptcy Code, because the Contributions are the result of other creditors (holders of [certain claims]) voluntarily sharing their recoveries under the Plan with [certain other creditors] . . . . The greater value received by [those other creditors] is not the result of the Debtors' distribution of estate property to such creditors. Creditors are generally free to do whatever they wish with the bankruptcy dividends they receive, including sharing them with other creditors, so long as recoveries received under the Plan by other creditors are not impacted.

In re Worldcom, Inc., No. 02-13533 (AJG), 2003 WL 23861928, at *60-*61 (Bankr. S.D.N.Y. 2003) (internal citations omitted). ***See also In re Genesis Health Ventures***, 266 B.R. at 612; *In re* M Corp. Fin., Inc., 160 B.R. 941, 964 (Bankr. S.D. Tex. 1993) (permitting gifting by unsecured creditor under plan of reorganization).

71. *In re* Sentry Operating Co. of Tex, Inc., 264 B.R. 850, 864–66 (Bankr. S.D. Tex. 2001) (holding that disparate treatment that is funded and determined by secured creditor does not excuse unfair discrimination); *see also In re* Snyder's Drug Stores, Inc., 307 B.R. 889, 894–95 (Bankr. N.D. Ohio 2004) (stating that unfair discrimination was partially funded by anticipated litigation recoveries as well as gifting by secured creditor and consequently was a distribution of property of the estate; distinguishing *SPM* because *SPM* did not involve property of the estate or the confirmation process).

72. 432 F.3d 507, 509 (3d Cir. 2005).

73. For a sharp critique of the *Armstrong* court's efforts to distinguish *SPM* and other earlier cases and the court's analysis in general, see Miller & Berkovich, *supra* note 56, at 1415–25.

74. *In re Armstrong World Indus.*, 432 F.2d at 514.

75. *Id.*

76. 344 B.R. 291, 297–98 (Bankr. D. Del. 2006); *see also In re* TSIC Inc., 393 B.R. 71, 78 (Bankr. D. Del. 2008) (approving a settlement over U.S. Trustee's objection in which buyer in 363 sale funded a trust for benefit of general unsecured creditors).

77. Dish Network Corp. v. DBSD N. Am., Inc. (*In re* DBSD N. Am., Inc.), 634 F.3d 79, 97 (2d Cir. 2010).

about five percent of the equity in the reorganized debtor to the debtor's former equity holder. The debtor and first and second lien noteholders exhausted all of the assets and the unsecured creditors were not entitled to any distribution. Consequently, the former equity holder was receiving value gifted by the second lien noteholders. In the court's view, however, the former equity received "property," "under the plan," and "on account of" its junior interest.[78] Because the objecting creditor did not receive property of a value equal to the amount of its allowed claim, section 1129(b)(2)(B) was not satisfied.[79] The court effectively eliminates gifting under a plan as a permissible means of providing value to a junior class when an intervening class of claims is not fully satisfied.[80]

The absolute priority rule and the prohibition of unfair discrimination are not the only bankruptcy policies that could be offended by gifting. In *In re CGE Shattuck, LLC*, the bankruptcy court declined to approve a "disclosure" (urging rejection of the debtor's plan) of a secured creditor's "commitment" to provide a fifty percent dividend to certain unsecured creditors if the secured creditor was relieved of the automatic stay or the case was converted to a Chapter 7.[81] The secured creditor contended that it was merely offering to share the proceeds of its collateral if it were enabled to recover in a timely fashion, relying in part on *SPM*.[82] The court rejected that contention, concluding that the secured creditor's commitment and proposed disclosure was an attempt to avoid the requirements and protections that would accompany a plan proposal.[83] In *In re Goffena*, the bankruptcy court refused to approve an agreement between a secured creditor and the trustee under which the creditor would pay the trustee's fees out of proceeds of collateral while not providing for other administrative and priority claims.[84] Once proceeds were received by the trustee they would be property of the estate and distributable according to the distributional scheme of the Bankruptcy Code.[85] In *In re Scott Cable Communications, Inc.*,[86] the bankruptcy court held that a proposed liquidating plan violated section 1129(a)(9), which requires payment in full of administrative expenses at confirmation,[87] and section

78. *Id.* at 95–97.
79. *Id.* at 90–92.
80. *Id.* at 94–97. The court distinguished *SPM* as it was a Chapter 7 and because there is "clear 'statutory support' to reject gifting" under section 1129(b)(2)(B). *Id.* at 98. Moreover, because the secured creditor in *SPM* had obtained relief from the automatic stay, the court effectively treated the gifted property "as no longer part of the estate." *Id.* After *DBSD*, the *WorldCom* decision by the Bankruptcy Court in the Southern District of New York would not appear to have any continued vitality, at least not in the Second Circuit. *See supra* note 70. The Second Circuit had earlier reserved decision as to the efficacy and permissibility of gifting outside the plan context. *See* Motorola, Inc. v. Official Comm. of Unsecured Creditors (*In re* Iridium Operating LLC), 478 F.3d 452, 461 (2d Cir. 2007).
81. *In re* CGE Shattuck, LLC, 254 B.R. 5, 8 (Bankr. D. N.H. 2000).
82. *Id.* at 10.
83. *Id.* at 12–13.
84. *In re Goffena*, 175 B.R. 386, 392 (Bankr. D. Mont. 1994).
85. *Id.* at 392.
86. 227 B.R. 596 (Bankr. D. Conn. 1998).
87. 11 U.S.C. § 1129(a)(9)(A) (2012).

1129(d), which prohibits plans with the principal purpose of avoiding taxes.[88] The plan proposed to pay administrative and other priority claims and general unsecured claims from proceeds of secured creditors' collateral, but not the payment of capital gains taxes of the sale of the debtor's assets.[89] Because the sale was to occur postconfirmation, the debtor argued that such taxes (administrative expenses) were not required to be paid.[90] The court rejected the debtor's argument, finding that the administrative period extended to include the postconfirmation sale.[91]

E. Secured Creditor Bankruptcies and Carveouts

Some cases and commentary address directly the issue of a secured creditor bankruptcy, which is the principal focus of this Article.[92] However, the case law is sparse and it is safe to say that no consensus has emerged.

In *United States Trustee v. GPA Technical Consultants, Inc.*,[93] the court held that it was not appropriate to dismiss or convert the case notwithstanding that it appeared that the case was likely to benefit only the secured creditor.[94] Similarly, in *In re Western Pacific Airlines, Inc.*,[95] the court exercised its discretion not to dismiss even though the case was being directed by and for the benefit of the secured DIP financer.[96]

In contrast to these cases, consider *In re Encore Healthcare Associates*.[97] *Encore* involved a proposed 363 sale of all of a debtor's assets for $2.5 million.[98] The assets secured an obligation of more than $8 million.[99] The sale proceeds were to be used to pay the costs of sale with

88. 11 U.S.C. § 1129(d).

89. *In re Scott Cable Commc'ns*, 227 B.R. at 598.

90. *Id.* at 600.

91. *Id.* at 600–01.

92. *See generally* Ferrell, *supra* note 63; Andrew L. Turscak, Jr & Alan R. Lepene, *Must a Secured Creditor Pay to Play in Chapter 11?*, AM. BANKR. INST. J., Mar. 2009, at 36; Jay R. Indyke & Brent Weisenberg, *Committee Issues: Carve-Outs; Liquidations for Benefit of Banks; Liability; Inconvenient Delaware Issues; Liquidation for the Benefit of Secured Lenders: An Unsecured Creditor's Committee Prospective*, 041802 ABI-CLE 223 (Am. Bankr. Inst., Alexandria, VA), Apr. 18, 2002; Robert J. Keach et al., *A Chapter 11 Case Should Not Necessarily Be Dismissed Because It Principally or Solely Benefits the Secured Creditor*, 042006 ABI-CLE 7 (Am. Bankr. Inst., Alexandria, VA), Apr. 20, 2006; Judy A. O'Neill & John A. Simon, *A Chapter 11 Case Should Be Dismissed If It Would Only Benefit Secured Creditors*, ABI 24th Annual Meeting (Am. Bankr. Inst., Alexandria, VA), Apr. 21, 2006; Patterson, *supra* note 63.

93. U.S. Trustee v. GPA Technical Consultants, Inc (*In re* GPA Technical Consultants, Inc.), 106 B.R. 139 (Bankr. S.D. Ohio 1989).

94. *Id.* at 143 ("[T]here need not be any unsecured creditors in a bona fide reorganization, and thus the only creditor interests to be taken into account may sometimes be secured creditors.").

95. 218 B.R. 590 (Bankr. D. Colo. 1998).

96. *Id.* at 595–97 (citing *GPA* with approval); *see also* Mellon Bank, N.A. v. Dick Corp., 351 F.3d 290, 291–94 (7th Cir. 2003). In *Mellon*, the secured DIP financer was granted a security interest in the debtor's preference actions. Although only the secured creditor stood to benefit from the preference action, that was not a defense. "The operating business counts as an 'estate' without regard to the identity (and priority) of those who will receive distributions eventually." *Id.* at 293.

97. 312 B.R. 52 (Bankr. E.D. Pa. 2004).

98. *Id.* at 54–55.

99. *Id.* at 54.

the balance remitted to the secured creditor.[100] The court, *sua sponte*, denied approval of the sale procedures on the basis that the court would not approve the sale itself.[101] In the court's view, there was no business justification for the sale under the *Lionel* doctrine.[102] The court cited with approval a case reaching essentially the same result under similar circumstances.[103]

The *Encore* court distinguished (and apparently cited with approval) cases approving substantial asset 363 sales under different factual settings.[104] The 363 sale of substantially all of the debtor's assets was approved in *In re Medical Software Solutions*.[105] In that case, there were insufficient funds to continue operations, the assets were about to significantly decline in value, and there was a carveout from the secured creditor's collateral to cover both administrative claims and a distribution for general unsecured creditors.[106] The court in *In re Rausch Manufacturing Co.* also approved such a 363 sale.[107] The court reasoned that the sale would allow the buyer to continue the debtor's business as a viable firm with continuing employment of employees and continuing production.[108] In contrast, in *Encore* the debtor had "no operating business with employees that is preserved by reason of this [i.e., the proposed] sale as the Debtor does not operate a business but merely leases real property."[109]

It is not unusual for a secured creditor to carve out from proceeds of its collateral funds to cover professional fees and other administrative expenses, often in connection with the secured creditor's postpetition DIP financing order.[110] Similarly, a secured creditor may agree to a carveout from proceeds of a 363 sale to cover administrative expenses and to fund a distribution to unsecured creditors, as in *Medical Software* discussed above.[111] Commentators have noted that in a secured creditor

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100. *Id.*

101. *Id.* at 57–58.

102. *Id.* at 54–55, 57.

103. *Id.* at 56–57 (citing *In re* Fremont Battery Co., 73 B.R. 277 (Bankr. N.D. Ohio 1987)). In *Fremont*, the court held that there was no business justification for the sale because it effectively would terminate the debtor's existence and there would be no assets on which to base a plan. More relevant to present purposes, the court noted that "the proceeds from the proposed sale would, at most, benefit one creditor only. The sale would not create proceeds that would inure to the benefit of the unsecured creditors." *In re Fremont Battery*, 73 B.R. at 279.

104. *In re Encore Healthcare Assocs.*, 312 B.R. at 57.

105. 286 B.R. 431 (Bankr. D. Utah 2002); *see also In re* Channel One Commc'ns, Inc., 117 B.R. 493 (Bankr. E.D. Mo. 1990) (detailing why a quick sale was necessary to maximize going concern value and price was in excess of amounts secured by liens and encumbrances).

106. *In re Medical Software Solutions*, 286 B.R. at 440–42.

107. 59 B.R. 501, 503 (Bankr. D. Minn. 1985).

108. *Id.*

109. *In re Encore Healthcare Assocs.*, 312 B.R. at 57.

110. *See In re* Ames Dep't Stores, Inc., 115 B.R. 34, 38 (Bankr. S.D.N.Y. 1990) ("[I]t has been the uniform practice in this Court . . . to insist on a carve out from a super-priority status and post-petition 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 preserve the adversary system. Absent such protection, the collective rights and expectations of all parties-in-interest are sorely prejudiced.").

111. *In re Medical Software Solutions*, 286 B.R. at 442.

bankruptcy the secured creditor may be required to "pay to play"—i.e., to carve out of its collateral funds for the benefit of general unsecured creditors.

The question typically arises in the context of a preplan confirmation section 363 sale involving the proposed disposition of substantially all of a debtor's assets where sale proceeds will be less than the aggregate value of existing liens. One common method of appeasing an agitated creditors' committee under these circumstances is for the secured lender to carve out a portion of its recovery for the benefit of unsecured creditors.[112] In addition to appeasing a creditors' committee, such a carveout also may appease a court that otherwise might not tolerate a secured creditor bankruptcy.

III. SECURED CREDITOR BANKRUPTCIES: THE CASES FOR AND AGAINST

A. Overview

In this Part, I alternatively assume the roles of Against and For. Against first identifies particular aspects of secured creditor bankruptcies that plausibly are objectionable and attempts to lay out the strongest, most convincing, positive case for why such aspects actually are objectionable. For next identifies the aspects of secured creditor bankruptcies that plausibly are beneficial and not objectionable and, again, attempts to state the strongest, most convincing, positive case for why such aspects actually are not objectionable. Then For and Against provide rebuttals and surrebuttals of the cases against and for secured creditor bankruptcies. Most of the plausibly objectionable aspects of secured creditor bankruptcies are mentioned in Part II's discussion of the various relevant legal issues that have arisen.[113] For that reason, this Part proceeds to identify and analyze policy issues, but it is *not* a legal brief-like effort to make the best cases for and against based on current case law. Indeed, under existing law, a court (if not constrained by binding precedent) could reach the results favored by either Against or For. To be clear, the following statements of the cases for and against secured creditor bankruptcies and the corresponding rebuttals and surrebuttals do not necessarily reflect my views. Instead, my goal is to produce a thorough exposure of the various plausible policy positions that might persuade a willing, open-minded court to follow one path or the other.

My standard for whether an aspect of a secured creditor bankruptcy is objectionable—or not—is whether that aspect offends a substantial policy that underlies or is incorporated into the Bankruptcy Code. This is not an easy task for several reasons. For one thing, although there are

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112. Turscak & Lepene, *supra* note 92, at 36.
113. *See supra* Part II.

situations in which a secured creditor bankruptcy should not be tolerated, at least in some situations secured creditor bankruptcies should stand. Presenting a second difficulty, I must take care to hold as many variables as possible constant while maintaining the focus primarily on the secured creditor bankruptcy variable. Otherwise, I risk extending the debate to the whole of bankruptcy law. The goal is to concentrate on what may or may not be objectionable and not on the particular remedy or procedural posture (such as whether a substantial asset 363 sale should be approved, whether a case should be dismissed or converted, or whether a plan fails to meet the requirements for confirmation). A final difficulty is that I have not been allocated an unlimited number of pages to tell my story (or stories).

The paradigm is a Chapter 11 case in which most of the assets are subject to the secured creditor's claim, the secured creditor is undersecured, and a sale of the assets is proposed either in a 363 sale or under a liquidating plan of reorganization. While I realize that not all secured creditor bankruptcies have fallen into or will fall into this paradigm, most have and probably will.

B. The Case Against (or, "It's the Bankruptcy Code's Way or the Highway . . ."[114])

It is best first to identify what is not objectionable. Straight liquidation under Chapter 7, with collateral subject to secured creditors' claims handled by the trustee, certainly is appropriate.[115] Sales under section 363 are appropriate in a Chapter 7 or 11, but only if no incentives or inducements (*e.g.*, gifting or carveouts) are provided to professionals (as existing or future administrative claimants) or other creditors.[116] These qualifications imply that there would be some equity in the collateral, thereby making it worth the trustee's (or debtor in possession's) while to deal with and dispose of it. It follows that there would be at least some value available for application to administrative expenses and perhaps other priority and general unsecured claims. Thus, these circumstances would not amount to a secured creditor bankruptcy as conceived here.

The foregoing identification leaves much that *is* objectionable. A Chapter 11 filing as to which the debtor and secured creditor contemplate a sale or other disposition of assets that requires the application of principles found only in the Bankruptcy Code (such as a 363 sale free and clear of liens and encumbrances) is objectionable if two additional circumstances also are contemplated. The first is accomplishment of the disposition and other related arrangements without the benefit of a plan of reorganization or by methods not specifically authorized by the Bank-

114. *Cf.* RELIENT K, *My Way or the Highway . . .*, on THE ANATOMY OF THE TONGUE IN CHEEK (Gotee Records 2006).

115. 11 U.S.C. §§ 701–84 (2012).

116. *See supra* Part II.A, D–E.

ruptcy Code. The second has two alternative criteria—either the secured creditor pays or allocates collateral (or its proceeds) to professionals or creditors as part of an arrangement to induce participation and cooperation (i.e., gifting or carveouts) or the benefits of the case would inure solely (or nearly so) to the secured creditor. The objection here is based on policy, not preemption, and the objectionable Chapter 11 filing should not be permitted or the case should not be maintained.[117] The following discussion addresses the bases for the objection.

Bankruptcy has traditionally been a *collective* proceeding with the goal of enhancing recoveries for unsecured creditors beyond those that state court remedies could provide to the creditors as a body. The mandatory appointment of an unsecured creditors' committee reflects this policy.[118] Such a collective proceeding aided by the automatic stay also discourages destruction of a debtor's operations through the exercise of state-law collection remedies. A secured creditor bankruptcy lacks this collective aspect, which lies at the functional core of bankruptcy policy. A secured party bankruptcy seeks to co-opt what is intended to be a collective proceeding to resolve what is, essentially, a two-party dispute.

The Bankruptcy Code contemplates liquidation under Chapter 7 and reorganization under Chapter 11.[119] But many, perhaps most, secured creditor bankruptcies are functionally indistinguishable from a liquidation that employs the auspices (and tools) of Chapter 11. There is no value for equity holders or unsecured creditors and the secured creditor simply liquidates its collateral through a nonforeclosure sale in Chapter 11. While the Bankruptcy Code does contemplate liquidating plans, in many secured creditor bankruptcies a sale is conducted under section 363 as opposed to a liquidation pursuant to a plan of reorganization.[120] Moreover, in many cases the proceeds of the 363 sale are distributed outside a plan.[121] Having used the tools provided by the Bankruptcy Code (such as the automatic stay and 363 sales free and clear) in Chapter 11 (including operation of the debtor's business), the debtor is liquidated and the carefully crafted provisions relating to the proposal of a plan of reorganization and leading to ultimate confirmation of a plan are bypassed.[122]

The Bankruptcy Code provides a specific set of distributional priorities in section 507, with priority claimants (according to their rankings,

117. The objectionable case might support grounds for dismissal based on bad faith or conversion to Chapter 7. It might also support other remedies or the denial of requested relief. To reiterate the point made earlier, my goal in this Part is to identify what might (or might not) be objectionable based on bankruptcy policy and not to focus on particular doctrinal or procedural settings.

118. 11 U.S.C. § 1102(a)(1). An exception may be made, for cause, in the case of a small business debtor. *See* 11 U.S.C. § 1102(a)(3).

119. 11 U.S.C. §§ 701–84; 11 U.S.C. §§ 1101–74.

120. 11 U.S.C. § 363 (2012).

121. *See* Shari Siegal, *Acquiring All or Part of a Troubled Business,* PRAC. LAW., Aug. 2003, at 11, 12–13 (2003), *available at* http://files.ali-cle.org/thumbs/datastorage/lacidoirep/articles/PL_TPL0308-SIEGEL_thumb.pdf ("The advantage of the 363 sale . . . is that it is generally done outside of a plan of reorganization.").

122. *See id.*; 11 U.S.C. §§ 1101–74.

inter se) being awarded priority over general unsecured creditors.[123] These can be varied only pursuant to the Chapter 11 plan process. However, in secured creditor bankruptcies the debtor and secured party often seek to vary the priorities (as well as those among general unsecured creditors and equity interest holders) through gifting, carveouts, or both.[124] When successful, these private transfer schemes, unblessed and unregulated by Congress, serve to undermine the absolute priority rule or to unfairly discriminate,[125] thereby returning the process to the bad old days of pre-absolute priority rule federal equity receiverships.[126] The secured creditor reaps benefits from selective application of the Bankruptcy Code, without lobbying for relevant changes in the Bankruptcy Code and without paying for the use of the bankruptcy courts. By utilizing the bankruptcy court for its individual gains, the secured creditor effects a private taking of a public good.

Secured creditor bankruptcies produce results desired by the secured creditor but ignore the state courts, although it is primarily state law that confers on the secured creditor the benefits of the collateral. Under *Butner*, it is state law that generally determines the existence and nature of property rights.[127] But, in a secured creditor bankruptcy, matters of state law such as validity and priority are turned over to the bankruptcy courts.[128] Without specific authorization in the Bankruptcy Code for secured creditor bankruptcies, and given the detailed and specific reorganization provisions in Chapter 11, the power and jurisdiction of the bankruptcy courts to give effect to these cases is questionable.[129]

In addition to being objectionable as a matter of bankruptcy policy, secured creditor bankruptcies simply are not necessary. For collateral consisting of personal property or fixtures, Uniform Commercial Code ("UCC") section 9-617 provides a secured creditor with sufficient flexibility and protection.[130] Under that provision, a secured creditor's disposition of collateral to a transferee for value following default transfers the debtor's rights, discharges the secured creditor's security interest, and

123. 11 U.S.C. § 507(a). *See generally* TABB, *supra* note 6, at 674–86.

124. *See supra* Part II.D–E.

125. When a plan is involved, secured creditor gifting to a class of general unsecured creditors also could be employed to induce plan acceptance by an impaired class, thus undermining the safeguard provided by 11 U.S.C. § 1129(a)(10) (2012).

126. For a historical discussion concerning federal equity receiverships, see DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 56–70 (2001).

127. Butner v. United States, 440 U.S. 48, 54–55 (1979) ("Property interests are created and defined by state law.").

128. *Id.* at 54 n.9 ("The Federal Constitution, Article I, Sec. 8, gives Congress the powers to establish uniform laws on the subject of bankruptcy throughout the United States. In view of this grant of authority to the Congress it has been settled from an early date that state laws to the extent that they conflict with the laws of Congress, enacted under its constitutional authority, on the subject of bankruptcies are suspended.").

129. *See* Law v. Siegel, 134 S.Ct. 1188, 1194–98 (2014) (finding that a bankruptcy court exceeded its statutory and inherent powers by surcharging debtor's exempt property and that bankruptcy courts lack authority to deny an exemption on grounds not specified in Bankruptcy Code).

130. U.C.C. § 9-617 (2014).

discharges security interests and liens subordinate to that security interest.[131] Moreover, a good faith transferee in such a disposition takes free of such rights and interests (even if the secured creditor failed to comply with UCC Article 9).[132] It follows that a secured creditor can sell collateral free and clear outside bankruptcy and without relying on section 363.

If and to the extent that a secured creditor wishes or needs the assistance of a court, bear in mind that the bankruptcy courts are courts of limited jurisdiction[133]—and Article I courts to boot.[134] Bankruptcy courts can only enter orders consistent with and authorized by the Bankruptcy Code.[135] As argued above, bankruptcy courts may lack the power to effect a secured creditor bankruptcy.[136] In contrast, all states have courts of general jurisdiction, which have the power to deal comprehensively with the assets and parties before them.[137] Moreover, state court judgments are entitled to full faith and credit in other states and benefit from laws providing for the domestication and enforcement of foreign judgments.[138] Because bankruptcy courts, like state courts, may be limited by the doctrine of successor liability, it is not necessarily the case that a bankruptcy court's order or judgment is substantially superior to that of a state court.[139]

C. *The Case For (or, "It's Not Easy Being Secured"[140])*

A Chapter 11 case should be permitted and should not be dismissed solely because it benefits only or primarily a secured creditor. However, maintaining a secured creditor bankruptcy should be subject to appropriate limitations and conditions, which are discussed below.

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131. *Id.*

132. *Id.* § 9-617(b).

133. *Law*, 134 S. Ct. at 1194–98.

134. U.S. CONST. art. I, § 8, cl. 4. *See generally* TABB, *supra* note 6, at 57–58.

135. *See Law*, 134 S. Ct. at 1194–95.

136. *See supra* notes 130–32 and accompanying text.

137. Nev. v. Hicks, 533 U.S. 353, 367 (2001) ("A state court's jurisdiction is general, in that it lays hold of all subjects of litigation between parties within its jurisdiction . . . .").

138. U.S. CONST. art. IV, §1; 28 U.S.C. § 1738 (2012). *See generally*, 18B CHARLES ALAN WRIGHT ET AL., FEDERAL PRACTICE AND PROCEDURE: JURISDICTION AND RELATED MATTERS: RES JUDICATA, § 4467, at 16 (2d ed. 2002) ("The Full Faith and Credit Clause of the Constitution provides that the judicial proceedings of a state shall be given full faith and credit in every other state, and empowers Congress to prescribe the effect of such proceedings.").

139. Note as well that there is no reason that states could not replicate section 363(f) for sales free and clear with a broadly applicable statute that would be responsive to the needs of secured creditors. Special courts for the application of such a statute also could be created. *Cf. Court of Chancery Jurisdiction*, DEL. STATE COURTS, http://courts.delaware.gov/Chancery/jurisdiction.stm (last visited Nov. 10, 2014) ("In today's practice, the litigation in the Court of Chancery consists largely of corporate matters, trusts, estates, and other fiduciary matters, disputes involving the purchase and sale of land, questions of title to real estate, and commercial and contractual matters in general.").

140. *Cf.* Joe Raposo & Jim Henson, *Bein' Green*, *on* SESAME STREET (PBS Kids television broadcast Mar. 10, 1970), *available at* http://www.youtube.com/watch?v=RIOiwg2iHio.

Bankruptcy law is a subset of civil procedure that does, and should, vindicate the interests of the holders of legal entitlements in relation to a debtor in financial distress.[141] The principal relevant holders of legal entitlements are creditors and holders of equity interests.[142] Secured creditors are creditors.[143] If (1) the only creditor benefited by a Chapter 11 case is the secured creditor; (2) the secured creditor is better off in the bankruptcy case (e.g., pursuing a 363 sale free and clear); and (3) the treatment of the secured creditor in the case does not make worse off other creditors, interest holders, or parties in interest, then it is proper to vindicate the secured creditor's interest in the bankruptcy case. Otherwise, bankruptcy law would have failed that creditor and failed to achieve its proper goals. The guiding principle of a secured creditor bankruptcy is that the secured creditor's position must be improved and the positions of other parties in interest must not be worsened.

Consider the following paradigmatic hypothetical. Debtor's operation of its business in Chapter 11 has prevented the entire loss of the firm's going concern value (as would be the case in a Chapter 7 liquidation or secured creditor foreclosure sale). Through a court-approved auction process, the debtor has entered into an Asset Purchase Agreement ("APA") with a buyer. One of the terms of the APA, insisted upon by the buyer, is a 363 sale of substantially all of the debtor's assets free and clear of all interests. The buyer intends to continue operation of the business, including retention of some of the debtor's current employees. After satisfaction of all administrative expenses, however, the proceeds of the sale will be insufficient to permit any distributions to other creditors; all of the net proceeds will be allocated to the secured creditor (as would be the case in a Chapter 7 liquidation or foreclosure sale of the assets).

Under this hypothetical, the secured creditor has recovered more that it would in a liquidation or foreclosure, the firm as a going concern has been preserved (with all of the related benefits, such as preservation of leases and executory contracts, enhanced benefits for the buyer, and continued employment), and the other creditors, interest holders, and parties in interests are not made worse off. Thus, this secured creditor bankruptcy should be permitted.

That the hypothetical case should be permitted does not mean that the debtor and secured creditor are entitled to ride roughshod over the Bankruptcy Code in general or Chapter 11 in particular. In the hypothetical, it simply means that the case should not be dismissed or converted merely because it is a secured creditor bankruptcy. For example, a 363 sale in a secured creditor bankruptcy should be required to satisfy the

141. Charles W. Mooney, Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure*, 61 WASH. & LEE L. REV. 931, 937–45 (2004).

142. *Id.* at 934 n.4.

143. J. Bradley Johnston, *The Bankruptcy Bargain*, 65 AM. BANKR. L.J. 213, 225 (1991).

generally applicable judicially adopted requirements for such a sale, including a business justification. Providing benefits to a secured creditor (or creditors) that would not be available outside of bankruptcy (e.g., protection of going concern value) should constitute a business justification. Or, perhaps the creditors' committee believes there is some chance for recoveries beyond the secured creditor's claim. The committee could argue that the debtor is not a "melting ice cube," contrary to the debtor's and secured creditors assertions, and that the assets should be sold pursuant to a liquidation plan instead of a 363 sale.[144] In a proper case that argument might well prevail.

Consistent with the guiding principle that a secured creditor bankruptcy should make no stakeholder worse off, a 363 sale or plan confirmation and consummation in a secured creditor bankruptcy should not render the estate administratively insolvent or increase any administrative insolvency that already might exist. The secured creditor to be benefited should bear the expenses or damages to the estate occasioned by maintenance of the case for its benefit.

In order to effect this guiding principle, the secured creditor should be permitted—indeed required—to provide carveouts or gifts to other parties in interest, so long as the carveout or gift derives from the secured creditor' distributions in the case or is deducted from distributions to which the secured creditor(s) otherwise would be entitled. Stated otherwise, it is the recovery of the secured creditor, and not any other party, that should be diminished. These carveouts or gifts could be made, for example, in order to cover administrative expenses (including fees and expenses of professionals retained by the debtor or committees) or to provide distributions to a class or type of creditor that otherwise would not be entitled to the distributions. Because such carveouts or gifts would derive solely from the entitlements of the secured creditor, the absolute priority rule would not be offended even if effected through a plan.[145]

In structuring permissible carveouts or gifts, form should not prevail over substance. Such arrangements should be permitted, for example, in connection with distributions of proceeds of a 363 sale or in connection with a confirmed plan of reorganization. If the secured creditor proposes to gift a portion of its distribution to another creditor or interest holder class wholly outside of the secured creditor bankruptcy, the secured creditor should be required to make full disclosure of such a proposal.

In a secured creditor bankruptcy the conduct of the secured creditor should be held to the same standards as any other party in interest. For example, proposed payments or gifting that would otherwise disqualify a plan or support designation for voting purposes would not be insulated because a case is a secured creditor bankruptcy. The status of a secured

144. *See* Jacoby & Janger, *supra* note 32, at 942–43 ("If the debtor is not a melting ice cube, the proponent will be encouraged to comply with the normal plan process rather than take a shortcut.").

145. *See* McDivitt, *supra* note 63, at 1032, 1036–37.

creditor bankruptcy as such, however, should not be considered abusive of bankruptcy policy *per se* if it otherwise would not be so characterized and assuming the guiding principles are observed. Of course, the leverage of a secured creditor in a secured creditor bankruptcy may position it favorably to exercise abusive conduct. But, it is the character of the conduct measured by neutral standards that should be determinative.

D. Rebuttals and Surrebuttals

1. Rebuttal of the Case Against and Surrebuttal of the Case For

For present purposes, it is fair to assume that bankruptcy, including Chapter 11 and its predecessor reorganization and arrangement chapters, typically has involved a collective proceeding with numerous creditors and stakeholders with differing priorities.[146] Certainly, that is the paradigm that Congress had in mind in providing for the appointment of various types of committees in Chapter 11.[147] As Against asserts, a secured creditor bankruptcy inherently is not that type of collective proceeding because virtually all of the assets are subject to the secured creditor's senior secured claim. However, For must point out that there is nothing in the Bankruptcy Code that clearly disqualifies such a case from being maintained. That a secured creditor bankruptcy does not "seem" like the "traditional" or "typical"[148] "collective proceeding" that some bankruptcy mavens may idolize does not provide a rigorous analytical framework for concluding that secured creditor bankruptcies should not be tolerated. A "no asset" Chapter 7 case also fails to resemble a traditional collective proceeding. There is no distribution to creditors in such a case because there are insufficient assets to result in a distribution. In a secured creditor bankruptcy there is no distribution to other creditors because the secured creditor has a first claim on the assets.

In response, Against notes that it is quite appropriate to rely on the clear legislative purposes of a statute in its interpretation or, when a court has been given substantial discretion, in its application. A secured creditor's enforcement of its lien against its collateral diverges substantially from the purposes of a collective proceeding. A bankruptcy court may properly take this into account in determining, for example, whether to dismiss or convert a case.

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146. CHARLES J. TABB & RALPH BRUBAKER, BANKRUPTCY LAW: PRINCIPLES, POLICIES, AND PRACTICE 452–53 (3d ed. 2010); Brenda Hacker Osborne, *Attorneys' Fees in Chapter 11 Reorganizations: A Case for Modified Procedures*, 69 IND. L.J. 581, 588 (1994) ("Because bankruptcy is a collective proceeding, representing the best interests of the estate means taking into consideration the competing interests of multiple parties involved in the bankruptcy.").

147. *See generally* Peter C. Blain & Diane Harrison O'Gawa, *Creditors' Committees Under Chapter 11 of the United States Bankruptcy Code: Creation, Composition, Powers, and Duties*, 73 MARQ. L. REV. 581 (1990).

148. Note, however, that some are of the view that secured creditor bankruptcies *have* become "typical" or at least not "unusual."

Against also points out that a secured creditor bankruptcy is the functional equivalent of a liquidation that utilizes the advantages of Chapter 11 without (often) complying with the plan process. The claim is that such a case utilizes Chapter 11 to address a two-party dispute. Responding, For points to the beneficial wealth enhancement that results when a Chapter 11 liquidation captures going concern value when compared to a Chapter 7 liquidation or nonbankruptcy foreclosure sale. It should be of no moment for bankruptcy policy that the wealth is enhanced for the benefit of the secured creditor.[149] It is *bankruptcy* law that mandates that secured claims be respected and *bankruptcy* law that recognizes the priority of the secured claim above others.[150] Bankruptcy law serves to vindicate the rights, *inter alia*, of creditors and the secured creditor is a creditor.[151] In many, perhaps most, cases a secured creditor will prefer to take its collateral and run, leaving a debtor's bankruptcy case behind. But, in a secured creditor bankruptcy, the secured creditor should be the best judge of the means of recovering the most value from the collateral. And if that judgment favors a disposition in Chapter 11, that normally should be respected. As to the bypassing of the Chapter 11 plan process, there is nothing special about a secured creditor bankruptcy. The evolving law on substantial asset 363 sales in Chapter 11 should treat such a case no differently from any others.

Against generally condemns gifting and carveouts as private agreements that amount to an unapproved-by-Congress scheme for selectively using the Bankruptcy Code for the secured creditor's benefit, and, in some instances, in a manner that offends the absolute priority rule and results in unfair discrimination. The point is that only Congress could authorize such arrangements and that the secured creditor is usurping a public good (bankruptcy courts) for private benefit. Again, For reiterates that nothing in the Bankruptcy Code prohibits or even discourages gifting or carveouts.[152] So long as creditors and other parties in interest who are not favored by gifting or carveout are no worse off, bankruptcy policy—including the absolute priority rule—is respected. For example, the reasoning behind the unsecured creditor class cramdown requirement that junior classes receive nothing unless the unsecured class is satisfied in full is the logical assumption that if a junior class receives some-

149. That the wealth enhancement may indirectly benefit existing and future employees and parties that may continue to do business with the debtor's successor should be of import for bankruptcy policy, however.

150. *See* Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy: Further Thoughts and a Reply to Critics*, 82 CORNELL L. REV. 1279, 1281 (1997) ("A longstanding and basic principle of U.S. bankruptcy law is that a secured creditor is entitled to receive the entire amount of its secured claim—the portion of its bankruptcy claim that is backed by collateral—before any unsecured claims are paid. This principle of full priority is generally reflected in the provisions of the U.S. Bankruptcy Code . . . .").

151. *See supra* note 143 and accompanying text.

152. Richard B. Levin, *Almost All You Ever Wanted to Know About Carve Out*, 76 AM. BANKR. L.J. 445, 445 (2002) (stating that the term "'carve out' does not derive its substance from any particular section of the Bankruptcy Code.").

thing it *necessarily* came out of value that should have been distributed to the unsecured class.[153] When it demonstrably is the case that the value received by the junior class is provided by the secured creditor, absolute priority is not offended.

Moreover, in considering the policies embodied in the Bankruptcy Code, it is important to keep in mind that absolute priority as established by *Boyd*[154] and its progeny[155] and under Chapter 10 of the Bankruptcy Act was abandoned by the enactment of Chapter 11 in favor of what might be dubbed "conditional priority."[156] Unlike prior law, under Chapter 11 the requirement of unanimous consent of a senior class to a deviation from absolute priority no longer applies.[157] If the requisite majorities of a class in amount and number accept a plan, then the minority class members are bound and need not be crammed-down and do not retain the power to hold out. Only *classes* (not *creditors*) that have not accepted a plan are entitled to such protection.[158] Thus, the notion that a senior class (such as the secured creditor in a secured creditor bankruptcy) may give away its entitlements in favor of a junior class is not novel and does not contravene any fundamental bankruptcy policy.

As for the argument by Against that a secured creditor bankruptcy offends bankruptcy (or any other) policy by employing the bankruptcy courts for its private benefit, For responds that the argument either proves too much or proves nothing. In our system of civil procedure, federal and state governments offer the courts to private parties for the vindication and satisfaction of their private entitlements.[159] There are rules of entry (e.g., jurisdiction and venue rules) and governments possess the

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153. 11 U.S.C. § 1129(b)(2)(B) (2012).

154. N. Pac. Ry. Co. v. Boyd, 228 U.S. 482, 507 (1913) (articulating and applying the absolute priority rule for the first time). *See generally* TABB, *supra* note 6, at 1154–55 (discussing *Boyd*).

155. Case v. L.A. Lumber Prods. Co., 308 U.S. 106, 119 (1939) (applying the fair and equitable test (the absolute priority rule) on a creditor-by-creditor basis). *Case* was an example of the old Chapter X holdout problem. In *Case*, the Supreme Court reversed the confirmation of a reorganization plan even though it had been approved by more than ninety percent of the creditors. *Id.* at 132.

156. *See* Pamela Foohey, *Chapter 11 Reorganization and the Fair and Equitable Standard: How the Absolute Priority Rule Applies to All Nonprofit Entities*, ST. JOHN'S L. REV. 31, 45–47 (2012).

157. Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 88 (1991) ("The compromise . . . proposed that only *classes* of creditors could invoke the [absolute priority] rule. . . . [T]he compromise sought to overrule the procedural protections afforded by *Case*: under the compromise, an individual creditor who had been outvoted could not challenge a plan on absolute priority grounds."). For a brief summary of the history of absolute priority and the holdout problem, see Judge Easterbrook's opinion in *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1360–61 (7th Cir. 1990). There, Judge Easterbrook stated:

> The Bankruptcy Act of 1898 required plans of reorganization to be "fair and equitable" but did not define that phrase. It also allowed creditors to consent to plans that impaired their interests, but the consent had to be unanimous. The absolute priority rule came into being as a cross between the interpretation of "fair and equitable" and a rule of contract law. . . . .
>
> Everything changed with the adoption of the Code in 1978. The definition of "fair and equitable" is no longer a matter of common law; § 1129(b)(2) defines it expressly.

Id.

158. *See* Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930, 1948 n.47 (2006).

159. *See* Mooney, *supra* note 141, at 939, 1025.

ability to (and do) assess costs on parties for the use of the courts.[160] This is not merely an observation about our courts, it is the *whole point* of the courts. In a bankruptcy case, the private rights of stakeholders such as interest holders and creditors—general unsecured, priority, and secured—are front and center. Their interests are the main point of the case. A secured creditor in a secured creditor bankruptcy no more usurps a public good for private gain than any other creditor in a bankruptcy case or, for that matter, any civil litigant.

In response, Against calls attention to the contrast between an actual distribution of value to a secured creditor and the creditor's subsequent, voluntary transfer of some of the value to another person outside of the bankruptcy process, on the one hand, and the distribution to the other person (facially in violation of the absolute priority rule) under a plan *in the Chapter 11 case*, on the other. In the former situation, one can take comfort that the actual rules of the road in Chapter 11 have been observed, assuming no other impropriety is involved. The latter may depend on *ad hoc* allocations and valuations that have been less fully tested.

As to a secured creditor's use of the bankruptcy courts for its own gain, Against would emphasize that it is not the use of a court for private gain in general that is objectionable. Instead, the problem is the use of the *bankruptcy* courts, under a statutory framework designed and intended for a collective proceeding, for what is functionally a foreclosure sale.

The point just made relates in part to the complaint by Against that secured creditor bankruptcies fail to utilize the more appropriate fora of state courts to deal with enforcement of security arrangements that are governed by state law. As a result, secured creditor bankruptcies require the (federal) bankruptcy courts to deal with and determine issues of state law that would be better handled by the state courts. Indeed, Against even questions the power of bankruptcy courts to preside over a secured creditor bankruptcy.

The argument that, in the abstract, state courts are better suited to handle enforcement of secured transactions ignores the wealth-enhancement virtues of secured creditor bankruptcies that can capture going concern value. Sales free and clear under section 363(f) offer greater cleansing power, at least in some jurisdictions.[161] A broad interpretation of the "interests" that are cut off in such a sale can serve to en-

160. *See id.* at 979 n.220 (citing 28 U.S.C. § 1334 (2012) (concerning jurisdiction in bankruptcy proceedings); 28 U.S.C. § 1408 (2012) (establishing venue in bankruptcy cases); 28 U.S.C. § 1409 (2012) (governing venue of proceedings under, arising in, or related to bankruptcy cases)).

161. *See* Thomas D. Goldberg, *On the Edge: New Decisions Protecting Purchasers of Assets Under § 363 of the Bankruptcy Code*, 22 AM. BANKR. INST. J., May 2003 at 1, 1, *available at* http://daypitney.com/news/docs/dbh/news.3299.pdf ("Section 363(f) permits a bankruptcy court to approve the sale of assets 'free and clear of any interest in such property of an entity other than the estate.' This provision is highly attractive to purchasers because it 'cleanses' the assets, making it more difficult for third parties to assert claims against the assets or the purchaser.").

hance the sales price for the assets. The same can be said of the ability to assume and assign leases and executory contracts in a bankruptcy case.[162] As to state courts being better suited, For would emphasize that contract and property—generally state law issues—are at the very core of any bankruptcy case. Bankruptcy courts deal with these matters every day. For rejects the idea that there is a competence gap between the bankruptcy courts and state courts. Indeed, if there is a gap, it is likely to be in favor of the competence of the bankruptcy courts because of the frequency with which they deal with issues involving secured claims when compared with state courts of general jurisdiction.[163] As to the bankruptcy courts' powers, in a secured creditor bankruptcy there are no unusual moves by a bankruptcy court such as surcharging exempt property. There is simply a 363 sale free and clear or a liquidating plan of reorganization or both.

In response, Against reiterates that the functional equivalent of a secured creditor foreclosure is an inappropriate role for a Chapter 11 case.

Finally, Against argues that secured creditor bankruptcies are not necessary because a sale free and clear can be accomplished under state law pursuant to UCC section 9-617.[164] As argued above, however, For contends that a sale free and clear under section 363(f) may have greater cleansing power and one plausibly can rely on the secured creditor to choose the approach that will maximize the value of the collateral. Also, section 9-617 applies only to personal property and fixtures, not to real property, and enforcement against real property, including assigned leases, is far more cumbersome.

In response, Against notes that if enforcement remedies for real property are inadequate then they should be reformed. *De facto* bankruptcy foreclosure is not the optimal, or even an appropriate, response.

2. *Rebuttal of the Case For and Surrebuttal of the Case Against*

The essence of For's position is that a secured creditor bankruptcy is justified if and when it results in a Pareto improvement—the secured creditor is made better off and no one is made worse off.[165] As in the going concern hypothetical posited by For, Against acknowledges that certainly it is *possible* for a secured creditor bankruptcy to have such a beneficial result. But this possibility does not, alone, mean that secured creditor bankruptcies necessarily reflect good policy.

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162. Valuable leases and executor contract can be assumed and assigned under section 365. 11 U.S.C. § 365(a)–(b), (f) (2012).

163. *See supra* note 137 and accompanying text.

164. U.C.C. § 9-617 (2014).

165. *Economic Definition of Pareto improvement. Defined.*, ECON. GLOSSARY, http://glossary.econguru.com/economic-term/Pareto+improvement (last visited Nov. 10, 2014).

Continuing with that hypothetical, Against suggests consideration of some additional hypothetical facts. As is typical, the buyer party to the APA was a stalking horse bidder and the APA was entered into before or early on in the case. The secured creditor and the (cooperative) debtor in possession assert that the terms of the APA (including the purchase price) are fair. A bidding procedure was established that could allow competing bids for the assets, but no competing bids are received. The bankruptcy court is confronted with the "melting ice cube" argument and consequently faces substantial pressure to approve the procedures, the APA, and the 363 sale. The court does so.

But what if this is *not* a secured creditor bankruptcy because the debtor is *not* a melting ice cube? Consistent with that, Against asks whether a substantially greater sales price could be negotiated by slowing the process and conducting a sale under a confirmed plan of reorganization? In the typical case of an early 363 sale, those possibilities will never be explored fully. Perhaps the central problem here is the *power* of a dominant secured creditor that asserts that there is a melting ice cube and no possibility of recoveries for the unsecured creditors coupled with a bankruptcy court that is unwilling to roll the dice by delaying the process. This may be exacerbated by the difficulties objecting creditors would face in blocking the sale or forcing a renegotiation. In this connection, a recent empirical study provides strong evidence that 363 sales fetch considerably smaller sales prices than sales under plans.[166] The authors demonstrate that the principal cause of the discounted prices in 363 sales is not the speed with which they are conducted early on in cases, but instead the creditors' lack of sufficient leverage when compared to plan sales involving mandatory disclosure and creditor acceptances of a plan.[167]

In response, For would note that the foregoing does not support the position of Against, which in the hypothetical would advocate dismissal or conversion and would not permit gifting in support of administrative expenses. The real point to be made here, perhaps, is that courts should be wary of substantial asset 363 sales. The recent study discussed above did not focus on secured creditor bankruptcies, however. If the secured creditor truly is under-secured, then absent collusion or self-dealing, the secured creditor would have incentives to seek the highest possible sales price. There would be no need, then, for the leverage of unsecured creditors in the plan process inasmuch as the secured creditor would already have an incentive to maximize its recovery.

166. Anne M. Anderson & Yung-Yu Ma, *Acquisitions in Bankruptcy: 363 Sales Versus Plan Sales and the Existence of Fire Sales*, 22 AM. BANKR. INST. L. REV. 1, 2–3, 13–17 (2014).
167. *Id.* at 3, 15–17.

IV. CONCLUSION

Against and For have had their say. Now it is my turn.

My conclusion is that the absolute bar on secured creditor bankruptcies advocated by Against is untenable. Secured creditor bankruptcies can preserve wealth in the form of going concern value and otherwise maximize recoveries for the beneficiary secured creditor, while imposing all costs of that preservation on the secured creditor and respecting the most important principles underlying Chapter 11. But secured creditor bankruptcies should be permitted only subject to carefully drawn limitations, as advocated by For.

Secured creditor bankruptcies have the potential to work great mischief by removing (in large part) various adversarial aspects of the Chapter 11 process. Courts have been and should be cautious about any substantial asset 363 sale early on in a case. Courts should be alert for potential abuses of the process. But the prohibition of *all* secured creditor bankruptcies based solely on the *potential* for abuse seems wholly unwarranted. Let us hope that through the developing case law courts will be up to the task of allowing bankruptcy law to realize its proper goals.