Chapter 11's Inclusivity Problem

Sarah Paterson* & Adrian Walters**

This Article rests on four premises: (i) that modern market participants frequently seek legal tools to compromise selected liabilities and not all the liabilities of the firm; (ii) that it is difficult to achieve a selective corporate restructuring in Chapter 11 given its inclusivity; (iii) that selective corporate restructuring strategies are normatively desirable but must only be permitted within strict boundaries; and (iv) that U.S. practitioners have worked around the challenges which Chapter 11's inclusivity poses to selective strategies but sufficient boundaries have not been placed around these workarounds. While restructuring of long-term financial liabilities is the prime example of a selective restructuring strategy, the Article demonstrates that it is far from being the only one. Thus, the Article represents the first attempt to join currently siloed debates about financial restructuring, landlord restructuring, and restructuring of tort liabilities into a single debate about selective strategies and the need for formal selective restructuring tools alongside traditionally inclusive bankruptcy tools. Having reframed the understanding of modern restructuring practice in the United States by reference to selectivity, we argue that, in line with developments in other countries, notably the United Kingdom, it is high time that the Bankruptcy Code is reformed to accommodate selective restructuring while providing safeguards against its abuse. In other words, it is time to tackle Chapter 11's inclusivity problem head on.

---

* Professor of Law, the London School of Economics and Political Science.

** Professor of Law, Chicago-Kent College of Law, Illinois Institute of Technology; Professor, Nottingham Law School, Nottingham Trent University.

For helpful feedback, thought-provoking questions, and constructive critique, we thank participants in the Corporate Restructuring and Insolvency Seminar, the INSOL Academics' Colloquium (London, June 2022), the 4th International and Comparative Insolvency Symposium (Chicago, November 2022), and the Financial Restructuring Roundtable (New York, April 2023) including, in particular, Barry Adler, Douglas Baird, Tim Barnes, Vince Buccola, Daniel Bussel, Robert Rasmussen, Mark Roe, Jonathan Seymour, and Ray Warner. Thanks also to Mandy Lee and Jean Wenger for helpful advice and assistance. Any errors are ours alone.

INTRODUCTION 1229

I. IN DEFENSE OF SELECTIVE CORPORATE RESTRUCTURING 1238

II. CHAPTER 11'S INCLUSIVITY PROBLEM OUTLINED 1245
- *A.* Chapter 11's (Over)-Inclusivity 1245
- *B.* Non-Consensual Plans: Chapter 11's Classification and Distributional Rules 1247
  1. Unfair Discrimination 1248
  2. The "Fair and Equitable" Requirement and the Absolute Priority Rule 1252
- *C.* The Mandatory Automatic Stay 1253
- *D.* The Vexed Issue of Third-Party Releases 1254

III. WORKING AROUND THE INCLUSIVITY PROBLEM OR AVOIDING CORPORATE REORGANIZATION ALTOGETHER 1255
- *A.* Workarounds 1256
  1. Prepackaged Bankruptcies 1256
  2. Plan "Unimpairment" of Target Claims 1260
  3. Section 363 Sales 1266
  4. Divisional Mergers (Texas Two-Steps) 1267
- *B.* Avoiding Corporate Restructuring Altogether 1269

IV. SELECTIVE CORPORATE RESTRUCTURING IN THE UNITED KINGDOM AND EUROPE 1270
- *A.* UK Schemes of Arrangement 1271
- *B.* UK Restructuring Plans 1277
- *C.* A Note of Caution About the UK 1282
- *D.* Emerging European Variants 1283

V. TACKLING CHAPTER 11'S INCLUSIVITY PROBLEM HEAD ON 1286

VI. CONCLUSION 1290

INTRODUCTION

In the last half century, there has been a worldwide paradigm shift in corporate bankruptcy law away from *liquidation* regimes in which the debtor's business ceases, its assets are sold off piecemeal, and the proceeds distributed among creditors, towards *reorganization* or *restructuring* regimes.[1] Underlying this shift is the theory (broadly) that preservation and maximization of the going concern value of distressed but viable firms that would otherwise be broken up better promotes creditor welfare and, via positive spillover effects, wider stakeholder welfare.[2] Chapter 11 of the Bankruptcy Code has featured prominently in this shift and has been a source of inspiration for bankruptcy law reform worldwide. Building blocks of Chapter 11 law and practice—debtor in possession financing,[3] the ability to confirm plans that cram down entire dissenting classes,[4] the treatment of executory contracts and unexpired leases,[5] and the Bankruptcy Code's aversion to *ipso facto* clauses in contracts that permit debtor counterparties to terminate on the occurrence of a bankruptcy event[6]—have been especially influential.[7]

---

1. JAY L. WESTBROOK ET AL., A GLOBAL VIEW OF BUSINESS INSOLVENCY SYSTEMS §§ 4.0–4.1 (2010).

2. *See* U.N. COMM'N ON INT'L TRADE L., LEGISLATIVE GUIDE ON INSOLVENCY LAW (PARTS 1 & 2), U.N. Sales No. E.05.V.10 11 (2005) ("An insolvency law needs to balance the advantages of near-term debt collection through liquidation . . . against preserving the value of the debtor's business through reorganization . . . . Achieving that balance may have implications for other social policy considerations, such as encouraging the development of an entrepreneurial class and protecting employment. Insolvency law should include the possibility of reorganization of the debtor as an alternative to liquidation, where creditors would not involuntarily receive less than in liquidation and the value of the debtor to society and to creditors may be maximized by allowing it to continue. This is predicated on the basic economic theory that greater value may be obtained from keeping the essential components of a business together, rather than breaking them up and disposing of them in fragments."). We use "creditor welfare" here in a narrow sense to denote the optimal enhancement of creditors' interests in the particular distressed firm rather than any general, non-firm specific improvement in their economic circumstances. *See* Douglas G. Baird et al., *The Bankruptcy Partition*, 166 U. PA. L. REV. 1675, 1676–77 (2018). Spillover benefits to other stakeholders include preservation of employment and continuity of supply chain and customer relationships.

3. 11 U.S.C. § 364.

4. § 1129(b).

5. §§ 365(e), 541(c)(B).

6. *See* § 365(e).

7. For the role of U.S. influence and interests on international standard setting through international financial institutions such as the World Bank, the International Monetary Fund, and the Asian Development Bank and international organizations such as the United Nations Commission on International Trade Law, see Terence C. Halliday & Bruce G. Carruthers, *The Recursivity of Law: Global Norm Making and National Lawmaking in the Globalization of*

Key to preserving viable firms that are in distress, or at risk of distress, is early intervention, whether formal or informal.[8] A useful model for thinking about the importance of early intervention to successful restructuring is the demise curve which charts the decline of a firm from a healthy state at one extreme to an unsalvageable state at the other extreme.[9] All financially distressed debtors lie somewhere on the demise curve. Those high on the curve have only just started to experience real pressure on cash. Moreover, some debtors high on the demise curve will have a sound underlying business but a specific problem which is putting pressure on their cash position. For example, the debtor may have long term borrowings from financial creditors which have become unsustainable because of a changing trading environment. It may be a retailer, casual dining operator, or hospitality business which is paying above-market rents on a portfolio of leased properties that made sense based on revenue projections when the leases were entered into but are now a problem because of a revenue squeeze arising from changing consumer habits. Or it could be increased competition, or the impact of the global pandemic; or it may face significant tort liabilities as a result of historical business practices which it no longer pursues in its current operations.

The important point for these debtors is that if the specific problem—whether it be an over-leveraged balance sheet; a particularly burdensome tranche of operating liabilities; or substantial tort liabilities—can be resolved by swift and early intervention, the debtor will slide no further down the demise curve. Lower down the curve the debtor's distress is no longer causally linked to a specific bundle of liabilities. Rather, it has become generalized. Even debtors who start their journey with an identifiable cash-draining issue and a sound underlying business are likely to descend into a

---

Corporate Insolvency Regimes, 112 AM. J. SOCIO. 1135, 1187 (2007) ("The United States leads the world in its experience with reorganization of corporations through bankruptcy law . . . and its philosophy of corporate rehabilitation has been incorporated in all the global standards by [international financial institutions]. To this degree, the global template for reforms that has emerged from international organizations bears more than a little resemblance to a 'globalized localism,' namely, an elevation of certain principles in U.S. law to the world at large.").

8. WESTBROOK ET AL., *supra* note 1, § 4.6, at 161 ("One cannot overemphasize the importance of providing a system under which debtors are encouraged to seek the help of the protective rehabilitation regime early enough to ensure that the maximum benefit can be achieved . . . ."); *id.* § 5.3, at 170 ("There can be little doubt that early action in the form of consultation between a debtor that is insolvent, or nearing insolvency, and major creditors substantially increases the chances of a successful informal outcome for all who have an interest in the debtor's business.").

9. *See* Irit Mevorach & Adrian Walters, *The Characterization of Pre-Insolvency Proceedings in Private International Law*, 21 EUR. BUS. ORG. L. REV. 855, 857 (2020).

condition of general default if they are unable to fix their problems earlier at a higher point on the demise curve. This is because the longer debtors spend on the demise curve, the more news of their difficulties will spread so that other suppliers and customers begin to adjust their behavior, and the cash position steadily deteriorates. In other words, there is a relationship between the time which has elapsed since the debtor began its descent down the curve and the debtor's cash position. Thus, the main objective of many debtors high on the demise curve is to limit their restructuring negotiations to the specific contracts they need to renegotiate or liabilities they need to deal with and to achieve a restructuring as quickly as possible before they slide further down the curve.[10]

However, debtors face challenges in persuading the relevant creditors to renegotiate the specific contracts or liabilities that are causing the problem. Some creditors may hold out in the hope that by actively refusing to concede issues in the renegotiation they will be paid off in full; hold up (delay or string out) the negotiations in the hope that this will result in a better deal; free ride in the hope that the sacrifice of other creditors who consent to revised terms will be sufficient to enable the company to emerge from distress and repay them in full; or simply misjudge the severity of the situation.[11] At the same time, if the debtor cannot renegotiate the specific contracts or liabilities, it will slide down the demise curve with the result that everyone, including the target creditors, will be worse off. It is for this reason that the debtor will turn to corporate reorganization law tools which allow it, high on the curve, to *select* specific contracts or liabilities to compromise while everyone else rides through the case wholly unscathed. We call this process whereby formal reorganization procedures are used to renegotiate the claims of a narrow group of creditors while everybody else simply rides through unaffected *selective corporate restructuring*.

---

10. We do not posit the demise curve as a "one size fits all" model of reality. There will be firms that fall off a cliff edge and plummet fast, especially where the cause of failure is an exogenous shock such as a pandemic or an endogenous problem such as accounting fraud. But we do think it is a useful way to think about managerial and professional advisory decision making in real-time. Where you are, what kind of problem you have, and the current cash position of the business will determine what tools you need and what tools are still available to you. Higher up the curve, you may still be able to make use of the kind of formal pre-bankruptcy restructuring tool that is now prevalent in the United Kingdom ("UK") and Europe. *See infra* Part IV. Lower down the curve, you may need a full-blown bankruptcy proceeding to have any chance of stabilizing the business and creating liquidity.

11. For a discussion of these terms, see Sara Comin, *Strategic Behaviours and Priority Rules in Debt Restructuring*, 2022 EUR. INSOLVENCY & RESTRUCTURING J. 1, 4, 7 (2022).

Of course, imposing losses on selected creditors when the debtor is unable to pay all of its liabilities in full, rather than mandating that all creditors share in the loss, raises obvious legitimacy concerns. We return to this important point below when we consider the normative foundations of selective corporate restructuring. For the moment, we simply note that selectivity goes hand in hand with early intervention. If the policy objective is a corporate reorganization system that incentivizes early intervention, then it makes sense to complement formal bankruptcy procedures, which require the debtor to put the whole firm up for grabs and bring all creditor and equity claims into the resolution equation, with formal restructuring procedures that facilitate more targeted intervention higher up the curve in circumstances where an informal workout—requiring unanimous creditor support—is simply unfeasible. At the same time, the demise curve compellingly illustrates why early intervention is highly desirable.

Despite its undeniable influence on global trends in bankruptcy law reform, Chapter 11 does not measure up well as a tool for this kind of targeted intervention. More specifically, Chapter 11 was not designed to facilitate a selective corporate restructuring strategy that requires the plan of reorganization to be crammed down on an entire dissenting class or classes while the majority of creditors ride through or stay entirely outside the case.[12] Four self-reinforcing design features of Chapter 11 operate in tandem to make it difficult for debtors to pursue selective restructuring by means of such a non-consensual plan,[13] and this, in turn, has important implications for the

---

12. To be clear, the focus of the Article is on reorganization as it affects large corporates. We do not consider law and practice as it affects small business debtors eligible to file a so-called subchapter V case in accordance with 11 U.S.C. §§ 101(51D), 1181–1195, which provisions were introduced by the Small Business Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079. To be eligible for subchapter V, a debtor must be engaged in commercial or business activities and have aggregate noncontingent liquidated secured and unsecured debts of not more than $7,500,000. *See* The Bankruptcy Threshold Adjustment and Technical Corrections Act of 2022, Pub. L. No. 117-151, 136 Stat. 1298.

13. We distinguish *non-consensual* plans from *quasi-consensual* plans. A *non-consensual* plan is one which is confirmed and becomes binding even where at least one class dissents. To use now commonplace European parlance, such a plan may also be characterized as a *cross-class cramdown* plan because it is imposed by the debtor and the accepting classes on a dissenting class or classes without their consent. We identify two types of *quasi-consensual* plan. The first is one which is approved by the relevant majorities of *all* the classes under the applicable voting rules even though there are dissenting minorities in some or all classes. This first type of plan still involves cramdown in that it is imposed by the debtor and the requisite majorities in each class on dissenting minorities in each class without their consent. But here the cramdown is *intra-class* and not *cross-class*. In the second type of quasi-consensual plan, the debtor constructs a class which is treated as unimpaired for the purposes of 11 U.S.C. § 1126(f) and is therefore deemed to accept the plan but the Bankruptcy Code nevertheless interferes with pre-bankruptcy

conduct of restructuring negotiations in the shadow of the entire Chapter 11 regime. First, as regards assets and claims, Chapter 11 is fundamentally *inclusive.* The entire firm is brought into the financial resolution. Second, Chapter 11 has guardrails in the form of the distributional rules in section 1129(b) of the Bankruptcy Code that are designed to test the overall fairness of a non-consensual plan but that also constrain the debtor's room for maneuver. These guardrails are important because they protect dissenting creditors from opportunistic debtors who might otherwise transfer too much enterprise value to other creditors and/or to equity. But they also serve as roadblocks to a selective restructuring strategy designed to compromise some claims while keeping similarly situated claims or junior claims and interests intact. Third, the stay in Chapter 11 is not only automatic, but it is also extraordinarily powerful. The stay prevents the debtor from paying most pre-bankruptcy liabilities.[14] This poses obvious challenges for a selective restructuring plan in which the objective is for most creditors to ride through the case unscathed. And finally, courts take different approaches to third party claims in Chapter 11 which can make it difficult to release guarantees provided by operating companies in a finance holding company's Chapter 11 case, so that the whole group must be placed into Chapter 11 proceedings even where the restructuring plan only implicates financial liabilities.

The core claim of this Article is that Chapter 11's inclusivity problem gives rise to two troubling implications for modern U.S. corporate reorganization law and practice.

First, ingenious lawyers have used the Bankruptcy Code's complex mesh of rules to engineer solutions to Chapter 11's inclusivity problem in a highly problematic way. We identify four ways in which practitioners have engineered selective restructurings: (i) prepackaged plans; (ii) plan "unimpairment," a strategy for selective restructuring of commercial real estate lease portfolios that, to date, has not attracted much attention from academics; (iii) section 363 sales; and (iv) divisional mergers (so-called Texas Two-Steps). What all four strategies have in common is that they circumvent the distributional guardrails in Chapter 11 that are designed to test the overall fairness of the plan and replace them with technical grounds

---

entitlements of creditors in the class. An example is landlords whose claim outside of bankruptcy would exceed the cap in 11 U.S.C. § 502(b)(6). In this second type of quasi-consensual plan, many creditors may object to their treatment in the plan because their prebankruptcy entitlements are affected by it, but they do not have a vote. We prefer *quasi-consensual* to *consensual* as a descriptor because a debtor who can restructure with the unanimous consent of all the creditors whose claims it wishes to compromise usually has no need of a formal bankruptcy or restructuring procedure: they can achieve an informal workout instead.

14. 11 U.S.C. § 362(a).

of objection which operate in a piecemeal and disjointed fashion. Thus, selective restructuring involves complex strategic maneuvers that have the unintended pathological effect of limiting comprehensive review of the plan in one of the situations in which it is arguably needed most. For sure, the court must always be satisfied that the plan has been proposed in good faith[15] but, for reasons we expand on later, we are largely skeptical that this can serve as a mandate to review the overall shape of the plan.

Secondly, if the debtor worries that strategic maneuvers within Chapter 11 will not work to achieve the desired outcome or will push the envelope too far, they may engage in another type of legal engineering: using the flexibility created by contract terms in their finance documents to raise more debt to address their cash flow difficulties and so opt out of corporate reorganization altogether. In a recent, agenda-setting article, Vincent Buccola has shown how private equity sponsors may engage in this strategy,[16] and, in our view, Chapter 11's inclusivity problem offers one explanation for the phenomenon. The problem with staving off corporate reorganization by raising further debt is that, without renegotiation of the problematic liabilities, the debtor may continue to slide down the demise curve with the result that it simply enters Chapter 11 too late, with even more liabilities, and after an unnecessary further decline.[17]

Our normative position is that selective restructuring is useful and defensible. This is likely anathema to scholars who think that if the firm is unable to pay all its liabilities in full, losses should be shared by all creditors in accordance with their priority position in liquidation.[18] Hostility to our position is understandable if one starts from the proposition, as much U.S. scholarship does, that a Chapter 11 corporate reorganization is a "better" form of enforcement than compulsory collection by creditors from the debtor's estate under state law,[19] in which the firm is effectively "sold" to its existing

---

15. *Id.* § 1129(a)(3).

16. Vincent S.J. Buccola, *Sponsor Control: A New Paradigm for Corporate Reorganization*, 90 U. CHI. L. REV. 1, 4 (2023).

17. Barry E. Adler, *Accelerated Resolution of Financial Distress*, 76 WASH. U.L.Q. 1169, 1169 (1998).

18. *See, e.g.*, Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 VA. L. REV. 1235, 1236 (2013) ("Because a firm in bankruptcy lacks sufficient value to repay all its creditors, priority rules determine the order of payment.").

19. *See* Raymond T. Nimmer, *Executory Contracts in Bankruptcy: Protecting the Fundamental Terms of the Bargain*, 54 U. COLO. L. REV. 507, 510 (1983) ("[B]ankruptcy provides a central forum to resolve multiple claims by channeling all collection activities and assets into a single court. The assets (or their value) are distributed under a structure that provides equal treatment for creditors of a similar type . . . ."); Douglas G. Baird, *Loss Distribution, Forum*

creditors.[20] However, we build on a different normative foundation to argue instead that selective corporate restructuring is justified by its role in resolving a failure of rational bargaining. Unless the debtor can renegotiate with the target creditors, the debtor will slide down the demise curve, and everyone, including the target creditors, will be worse off. It is therefore rational for the target creditors to renegotiate. Moreover, they should be prepared to agree voluntarily to revised terms that make them better off, bargaining rationally. Yet, because of the hold out, hold up, free rider, and misjudgment risks we referred to earlier, rational bargaining has not proved possible. Thus, selective corporate restructuring tools solve the failure of rational bargaining with target creditors by imposing a deal on them involuntarily which they ought to have been prepared to agree to voluntarily.[21] At the same time, however, guardrails need to be in place to

---

Shopping, and Bankruptcy: A Reply to Warren, 54 U. CHI. L. REV. 815, 827, 829 (1987) ("Bankruptcy law creates another avenue of enforcement . . . the existence of bankruptcy's avenue of enforcement springs from the collective action problem."); Ralph Brubaker, *On the Nature of Federal Bankruptcy Jurisdiction: A General Statutory and Constitutional Theory*, 41 WM. & MARY L. REV. 743, 807–08 (2000) ("[B]ankruptcy 'Law,' for the most part, functions not to create distinct federal grounds for recovery or relief, but to create an alternative means for enforcing existing substantive rights, most of which are grounded in state law."); Charles W. Mooney, Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy as (Is) Civil Procedure*, 61 WASH. & LEE L. REV. 931, 952 (2004) ("[O]ne can see bankruptcy as a class action enforcement proceeding for rightsholders; it provides a single proceeding in a single court in which the affairs of the debtor and its rightsholders are sorted out.").

20. For the classic description of corporate reorganization as enforcement, see Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 893 (1982) ("A reorganization, at least as a start, may be viewed as a *form* of liquidation. The business entity, however, is sold to the creditors themselves rather than to third parties." (emphasis added)); *see also* Edward R. Morrison, *Introduction*, *in* 1 ECONOMICS OF BANKRUPTCY, at xi (Edward R. Morrison ed., 2013) ("Reorganization is effectively a 'hypothetical sale' of a firm to its creditors. Instead of selling to third parties for cash or securities, the reorganization process sells the firm to existing creditors, who exchange old claims for new interests (debt or equity) in the reorganized firm.").

21. Anthony Casey has also suggested that Chapter 11 reorganization is better conceived of as a framework for renegotiation. *See* Anthony J. Casey, *Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy*, 120 COLUM. L. REV. 1709, 1711 (2020). Some European scholars have also located restructuring closer to contract law. *See* Stephan Madaus, *Leaving the Shadows of US Bankruptcy Law: A Proposal To Divide the Realms of Insolvency and Restructuring Law*, 19 EUR. BUS. ORG. L. REV. 615, 618 (2018) (outlining a contractual approach to restructuring proceedings, which are conceived of as resolving an anti-commons problem, in contrast to insolvency proceedings, which resolve a common pool problem); Horst Eidenmüller, *What Is an Insolvency Proceeding?*, 92 AM. BANKR. L.J. 53, 61, 66 (2018) (distinguishing between "fully collective" proceedings such as U.S. Chapter 11, which are characterized as insolvency proceedings, and proceedings which affect only the interests of some creditors or creditor classes which are not).

ensure that debtors (and senior creditors with leverage to dictate debtors' strategic choices) do not abuse these powerful tools.

Given the desirability of selective restructuring, it is hardly surprising that the market has found ways to work around Chapter 11's inclusivity problem. However, as in our view none of the workarounds generated by market innovation provide sufficient protections for target creditors, we believe it is high time that the Bankruptcy Code was reformed to accommodate the market's demand for selective restructuring while providing sufficient safeguards against its abuse, thus tackling the inclusivity problem head on. We are reinforced in this conclusion by evidence that certain types of large corporate debtors may be avoiding corporate reorganization altogether.[22]

To shed further light on Chapter 11's inclusivity problem, our Article takes a comparative turn. The United Kingdom and other European jurisdictions have developed procedures that are more conducive to selective restructuring than Chapter 11. The UK's principal tools for large corporate restructuring are the Part 26 scheme of arrangement and the Part 26A restructuring plan.[23] Debtors are free to propose a Part 26 scheme of arrangement or Part 26A restructuring plan to whichever creditors they choose.[24] Unlike Chapter 11, these procedures are not designed to be inclusive procedures, and it is routine for schemes and plans to compromise only selected liabilities. Importantly, selectivity is not just *possible* in Part 26 or Part 26A; it is the *norm*. There is a long history, in the London market, of attempts to contain restructuring negotiations within manageable bounds to reduce the risk of escalating distress in which the debtor will slide further down the demise curve.[25] Moreover, there is no automatic stay in Part 26 and 26A. Debtors that need the protection of a moratorium can opt for it by first entering either a moratorium proceeding[26] or an administration proceeding[27] and then proposing a scheme of arrangement or restructuring plan from within the shelter of one of these other proceedings. But debtors can equally choose to propose their scheme of arrangement or restructuring plan on a free standing basis without the protection afforded by an administration or moratorium proceeding. As a result, it is much more straightforward to pay

---

22. Buccola, *supra* note 16, at 37–39.

23. Companies Act 2006, c. 46, §§ 895–901 (Part 26) & §§ 901A–901L (Part 26A) (c. 46) (UK). Part 26A was introduced by the Corporate Insolvency and Governance Act 2020 (c. 12) (UK).

24. *See infra* Part IV.

25. JOHN FLOOD ET AL., THE PROFESSIONAL RESTRUCTURING OF CORPORATE RESCUE: COMPANY VOLUNTARY ARRANGEMENTS AND THE LONDON APPROACH 7 (1995).

26. Insolvency Act 1986, c. 45, §§ A1–A55 (UK).

27. Insolvency Act 1986, c.45, sch. B1.

ride through creditors during the case and, even if moratorium protection is invoked, it is easier to chart a course to facilitate payment.[28] And there is a tried and tested approach to the release of third-party claims in both Part 26 and Part 26A. While both procedures facilitate selective restructuring, they also require the UK court to undertake a holistic review of the fairness of the scheme or restructuring plan (as the case may be). Other jurisdictions in the British common law world are already developing similar tools and adding their own twist.[29] Moreover, the European Union's Restructuring Directive,[30] and the new restructuring procedures which E.U. member states are developing to implement it, typically follow the same selective approach as the UK.

The Article proceeds as follows. In Part I we explain and defend selective restructuring's usefulness while acknowledging the obvious concern that if bankruptcy and restructuring laws become too permissive of selectivity, they will be exploited by opportunistic debtors.

In Part II we demonstrate how the Bankruptcy Code obstructs the proposal and confirmation of non-consensual selective plans: in our view, the essence of Chapter 11's inclusivity problem.

In Part III we discuss (i) the market innovations identified above, focusing particular attention on the "unimpairment" strategy used to restructure commercial real estate portfolios which, compared to the other workarounds we will consider, has traveled somewhat under the radar; and (ii) how Chapter 11's inclusivity problem helps to explain why some large corporate debtors may be avoiding corporate reorganization altogether, and raising more debt to address cash flow difficulties instead.

Part IV draws the contrast between Chapter 11 and the emerging Anglo-European model for selective restructuring of financial and operating contracts and liabilities. Dwelling on the UK's Part 26A restructuring plan, we highlight how European lawmakers have fashioned flexible tools which permit the straightforward separation of creditors included in and excluded from the plan and apply different norms for the purposes of determining whether (i) the decision to include some creditors and exclude others is legitimate; and (ii) the plan's treatment of creditors who are included is fair.

---

28. *See infra* Part IV.

29. A case in point is Singapore which has introduced a cross-cram down feature into its equivalent of the UK scheme of arrangement. *See* Wee Meng Seng, *The Singapore Story of Injecting US Chapter 11 into the Commonwealth Scheme*, 15 EUR. COMP. & FIN. L.R. 553, 555 (2018).

30. Council Directive 2019/1023, art. 1, 2019 O.J. (L172/18) ¶ 4 (discussing preventive restructuring frameworks).

Relatedly, in Part IV, we show how the UK's test for determining whether or not a Part 26A restructuring plan treats the creditors selected for inclusion fairly—the relevant alternative test[31]—and the residual judicial discretion to sanction the plan together address both rational bargaining failure and the concern that selectivity encourages debtor opportunism. We also outline the benefits of both optional stay protection and flexible release of third-party claims for a selective corporate restructuring strategy.

In Part V we sketch a proposal for reform building on an earlier proposal from the National Bankruptcy Conference ("NBC") for a new Chapter 16 of the Bankruptcy Code.[32] The NBC proposal sought to provide a halfway house for bond restructuring between the extremes of an out-of-court workout and a full blown Chapter 11 case.[33] We suggest a broader and more foundational approach that would be designed explicitly to address Chapter 11's inclusivity problem, provide tools for selective restructuring coupled with appropriate safeguards, and channel selective restructuring cases out of Chapter 11 into a bespoke restructuring chapter. We close with a brief conclusion.

I. In Defense of Selective Corporate Restructuring

Bankruptcy and restructuring laws provide formal mechanisms that financially distressed debtors can use to accomplish resolutions ranging from a restructuring of some or all of their liabilities to a going concern sale of their assets to the liquidation of their assets on a piecemeal basis. In many jurisdictions, resolution mechanisms that facilitate asset sales have evolved from outright liquidation (or, in British common law parlance, winding-up) regimes whereas procedures to restructure or reorganize liabilities have been developed with voting mechanisms of various specifications, the purpose of which is to overcome holdout problems associated with the general law of debt composition by enabling majorities to bind minorities without the need for unanimous consent.[34] A familiar legislative pattern is for jurisdictions to enact over time a menu of formal tools, some of which are predominantly restructuring tools, others of which are bankruptcy tools, to accomplish a

---

31. Companies Act 2006 c. 46, § 901G(3)–(4) (UK).

32. *See* Tobias Wetlitzky, *Water Under the Bridge? A Look at the Proposal for a New Chapter 16 of the Bankruptcy Code from a Comparative Law Perspective*, 37 EMORY BANKR. DEV. J. 255, 264 (2021).

33. *Id.* at 264–65.

34. *See* Sarah Paterson & Adrian Walters, *Selective Corporate Restructuring Strategy*, 86 MODERN L. REV. 436, 438 (2023).

going concern or liquidating asset sale.[35] Chapter 11 is much more of a "one stop shop": a single portal through which debtors can restructure through a classic plan of reorganization process,[36] or sell their assets as a going concern,[37] with the fallback of conversion to a Chapter 7 liquidation[38] should resolution in Chapter 11 prove unsuccessful.

That the law and practice have evolved along these lines reflects the needs of debtors in the market for debt resolution. Debtors that are high on the demise curve frequently need restructuring tools that enable them to address an isolated problem before their financial situation worsens. Without early intervention, distress may spread to a point where the debtor lacks the liquidity to meet a wide range of its financial and operating liabilities. At this lower point on the curve, restructuring its liabilities may be a tall order. For firms that have reached this point and are in, or approaching, a condition of general default, the legal and market response is to provide bankruptcy tools that can stabilize and salvage their businesses. These tools will usually combine a stay on creditor enforcement that prevents the break-up of the firm[39] with mechanisms that can facilitate a going concern sale.

Where the debtor has identified a specific problem, it makes sense to intervene early to prevent it from spreading and having contagion effects on other parts of the business and operations. As a rule of thumb, the sooner you move to contain and address a problem, the easier it is to fix. This is where selective restructuring comes in. Tools which allow debtors high on the demise curve to select specific contracts or liabilities (call them "target claims") to renegotiate while everyone else rides through the case, have at least two advantages.

First, selective restructuring reduces direct process costs. We know that multilateral bargaining with multiple constituencies of stakeholders is costly.[40] The further you slide down the curve and the closer you get to a

---

35. For example, at the latest count, the UK has at least six formal procedures: Part 26 schemes of arrangement, Part 26A restructuring plans, company voluntary arrangements, and a stand-alone moratorium (all broadly designed to promote restructuring); and administration and winding-up (which typically function as business or asset sale regimes). *See* Companies Act 2006 c. 46, §§ 895–901 (UK) (Part 26); §§ 901A–901L (Part 26A); Insolvency Act 1986 c. 45, §§ A–1A55 (UK) (Part A1 moratorium); §§ 1–7B (Part 1 company voluntary arrangements); § 8, sch. B1 (administration); §§ 73–229 (Parts IV & V winding-up).

36. 11 U.S.C. §§ 1121–1129.

37. § 363; *see* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 756 (2002).

38. 11 U.S.C. § 1112.

39. Such as the automatic stay in 11 U.S.C. § 362.

40. *See* Paul M. Goldschmid, *More Phoenix than Vulture: The Case for Distressed Investor Presence in the Bankruptcy Reorganization Process*, 2005 COLUM. BUS. L. REV. 191 (2005).

condition of general default, the larger and wider the group becomes with which you need to negotiate. An effective way for debtors with scarce resources to reduce direct process costs is to narrow what the military historian and theorist of strategy Lawrence Freedman calls the "circle of cooperation."[41] In other words, the fewer folks you have to negotiate with, the less costly the process will be.[42]

Second, selective restructuring reduces indirect costs[43] by enabling debtors to keep on board, and create confidence among, those parties who will be unaffected by the restructuring endeavor. The signal to these constituents is resoundingly "business as usual": suppliers and employees will continue to be paid; customers will continue to be serviced. Moreover, the signal carries with it the reassurance that suppliers, customers, and employees will be able to deal with the debtor in confidence once the restructuring is done.[44] Because it avoids adverse signaling, selective restructuring can therefore reduce the risk that suppliers and customers will desert the firm or otherwise adjust their behavior in ways that squeeze profits and increase costs of supply and credit, thus jeopardizing firm value.

A fundamental criticism of selective corporate restructuring is that it is illegitimate for a specific constituency to bear the loss once the debtor is unable to pay all its liabilities in full.[45] If we conceive of corporate reorganization as a method of enforcement, this criticism has some force. Chapter 11 has its origins in the railroad receiverships of the nineteenth century.[46] Railroad receiverships were substantively a reorganization of the railroad but took the form of an enforcement process in which the railroad was "sold" to existing creditors and equity holders.[47] Corporate

---

41. LAWRENCE FREEDMAN, STRATEGY: A HISTORY 612 (2013).

42. *See* Paterson & Walters, *supra* note 34, at 440. On the benefits of lower cost restructuring procedures for debtors who would gain little from a costly full-blown Chapter 11 reorganization, see Kenneth Ayotte & David A. Skeel, Jr., *An Efficiency-Based Explanation for Current Corporate Reorganization Practice*, 73 U. CHI. L. REV. 425, 437–41 (2006).

43. *See* Edward I. Altman, *A Further Empirical Investigation of the Bankruptcy Cost Question*, 39 J. FIN. 1067, 1070–72 (1984) (classifying as indirect costs lost sales, lost opportunities, higher cost of credit, and higher costs of supply attributable to adverse market perceptions of a distressed firm's prospects).

44. On the signaling and information processing benefits of a selective restructuring's "business as usual" message to suppliers and customers faced with uncertainty about the debtor's prospects, see Sarah Paterson, *Restructuring Moratoriums Through an Information-Processing Lens*, 23 J. CORP. L. STUD. 37, 42–43 (2023).

45. *See, e.g.*, Paterson & Walters, *supra* note 34, at 436.

46. *Chapter 11 Bankruptcy: An Overview*, KPBB L. (Nov. 14, 2017), https://www.kppblaw.com/chapter-11-bankruptcy-overview/ [https://perma.cc/SZX2-R6Q8].

47. The literature describing the equity receivership is voluminous. *See, e.g.*, Albro Martin, *Railroads and the Equity Receivership: An Essay on Institutional Change*, 34 J. ECON. HIST. 685,

reorganization is still conceptualized in this way in the modern literature.[48] Essentially, all of the firm's assets are treated as having been sold to the creditors themselves, at a price which could be achieved in normal market conditions between a willing seller and a willing buyer,[49] and the proceeds of the sale are allocated to the creditors and shareholders in accordance with distributional rules which reflect creditors' liquidation priorities.[50] Viewed through this lens, there would seem to be no justification for distinguishing between different types of creditors who would otherwise rank equally in the distributional order of priority in liquidation. As Bruce Markell has put it, any difference "dissolve[s] when you realize that both types of indebtedness are treated the same in state court enforcement."[51] In short, there is simply no justification for imposing losses unevenly between otherwise equally ranking creditors.

However, we do not conceptualize a selective corporate restructuring as an enforcement event. Indeed, we consider it is better theorized as a mechanism to *avoid* an enforcement event. The starting assumption is that the target creditor is party to a contract which does not reflect current market terms or is owed a substantial liability. In each case this threatens the viability of the firm. If the target creditor renegotiates the contract or agrees terms to settle the liability, then the firm will no longer face distress and will no longer be on the demise curve. On the other hand, if the target creditor does not renegotiate or settle, the firm will descend the demise curve and may eventually reach a point of crisis at which it can no longer be saved. If the target creditor can be persuaded to negotiate, everyone (including the target creditor) will be no worse off than they would be without negotiation and at

---

686–708 (1974); Peter Tufano, *Business Failure, Judicial Intervention, and Financial Innovation: Restructuring U.S. Railroads in the Nineteenth Century*, 71 BUS. HIST. REV. 1, 4–37 (1997); David A. Skeel, Jr., *An Evolutionary Theory of Corporate Law and Corporate Bankruptcy*, 51 VAND. L. REV. 1325, 1351–71 (1998); DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 59–74 (2001); DOUGLAS G. BAIRD, THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS 26–45 (2022).

48. *See, e.g.*, Bruce A. Markell, *Fair Equivalents and Market Prices: Bankruptcy Cramdown Interest Rate*s, 33 EMORY BANKR. DEV. J. 91, 96 (2016) (showing how statutory reorganization law mirrored prior receivership practice).

49. Edwin L. Sterne, *The Absolute Priority Rule in Corporate Reorganization*, 1 CUMB. SAMFORD L. REV. 35, 37 (1970). We consider the "purchase price" for the "sale" transaction in more detail in Part II below, when we discuss the "fair and equitable" requirement and the absolute priority rule.

50. For the classic description of reorganization proceedings as a sale of the enterprise to the creditors themselves, see Jackson, *supra* note 20.

51. Bruce A. Markell, *The Clock Strikes Thirteen: The Blight of Horizontal Gifting*, 38 BANKR. L. LETTER 1, 4 (2018).

least some (may be all) of the firm's creditors will be better off (negotiation is *Pareto superior*). However, crucially, selective corporate restructuring is not normatively defensible solely on efficiency or utilitarian grounds. In most jurisdictions that provide selective corporate reorganization tools, the target creditors must also receive a deal which they could reasonably be expected to accept, if rational bargaining had been possible.[52] Viewed from this perspective, in cases where, say, one constituency has a long-term off market contract or is owed an outsized liability, the decision to target them rather than the claims of other creditors with whom they would rank equally in liquidation is more readily understandable.

Another familiar criticism of selective corporate restructuring is that it does not address wider operational issues.[53] All that these cases achieve, so the charge goes, is to kick the proverbial can down the proverbial road. Kenneth Ayotte and David Skeel have offered one possible line of defense. In conditions of uncertainty, it may be more efficient for the debtor to undertake a rapid, less costly workout than a full-blown Chapter 11 case, even if that means that the debtor is forced to return for a second restructuring later (a so-called Chapter 22).[54] We offer another explanation. For many, although by no means all, firms high on the demise curve financial stress is caused by a specific problem which, if it can be cauterized, will not affect the debtor's wider business and operations. This is, we argue, the rightful place of selective corporate reorganization strategies in the corporate bankruptcy toolbox: there simply is no wider problem which corporate reorganization law is required to solve.

It follows that for many firms high on the demise curve, a full-blown bankruptcy or reorganization procedure which encompasses *all* creditor claims and equity interests and captures and reallocates the *entirety* of the firm's enterprise value[55] is a proverbial sledgehammer to crack a nut. The direct and indirect costs of engaging the entire creditor body in a comprehensive resolution will outweigh the benefits if the cause of the company's financial difficulties can be isolated and addressed. Conversely, debtors high on the curve who cannot address the specific cause of their distress without recourse to a formal procedure, because of holdouts who will not agree to an out-of-court "workout," face a dilemma if selective

52. *See infra* Part IV.

53. *See* Harvey Miller, *Chapter 11 Reorganization Cases and the Delaware Myth*, 55 VAND. L. REV. 1987, 2004–05 (2002); *see also* Lynn M. LoPucki, *Chapter 11's Descent into Lawlessness*, 96 AM. BANKR. L.J. 247, 300–01 (2022).

54. Ayotte & Skeel, *supra* note 42.

55. Which is how we would characterize Chapter 11. *See infra* Part II.

restructuring tools are unavailable. These debtors may delay filing for fear of the sledgehammer with the consequence that their isolated problem escalates, and they slide down the curve.

Of course, one question which our argument immediately raises is why corporate bankruptcy law is needed at all if the debtor is seeking to negotiate only with selected creditors. Many scholars have suggested different mechanisms by which businesses might agree to a system for resolving financial distress other than the U.S. federal system of Chapter 11.[56] As Alan Schwartz puts it, the call has been to "privatize bankruptcy."[57] If bankruptcy privatization seems implausible for cases implicating all of a debtor's financial, trade, and other creditors, it is surely more realistic where the reorganization implicates only a specific group.[58] Perhaps, then, the focus should be on removing limits such as those found in the Trust Indenture Act of 1939 ("TIA")[59] which restricts out-of-court bond workouts,[60] leaving debtors greater freedom to negotiate contract terms, such as collective action clauses, with the groups they may need to compromise with in the future.

Our response is twofold. First, we suggest that creditors are likely to want the assurance of independent, holistic review of the fairness of the plan in any situation where they are singled out to absorb the loss, unless there has been near-unanimous agreement to the debtor's proposal. Thus, exchange offers, which are effectively a contractual alternative to a reorganization of corporate bonds through a Chapter 11 plan, are typically only effective where an extremely high majority of bondholders agree to the offer,[61] while syndicated

---

56. *See, e.g.*, Steven L. Schwarcz, *Rethinking Freedom of Contract: A Bankruptcy Paradigm*, 77 TEX. L. REV. 515, 524–34 (1999); Alan Schwartz, *Bankruptcy Contracting Reviewed*, 109 YALE L.J. 343, 346–48 (1999); Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807, 1850–51 (1998) [hereinafter *Contract Theory Approach*]; Barry E. Adler, *Finance's Theoretical Divide and the Proper Role of Insolvency Rules*, 67 S. CAL. L. REV. 1107, 1110, 1118–20 (1994); Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 319–24 (1993); Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEX. L. REV. 51, 117 (1992); Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775, 776–77 (1988).

57. *Contract Theory Approach*, *supra* note 56, at 1851.

58. For an acknowledgment that criticism of private-law bankruptcy alternatives may not apply to all cases which are not complex business bankruptcies, see Susan Block-Lieb, *The Logic and Limits of Contract Bankruptcy*, 2001 U. ILL. L. REV. 503, 508 n.19 (2001) and accompanying text.

59. Pub. L. 76-253.

60. For a detailed discussion of the TIA's restrictions, see Mark J. Roe, *The Voting Prohibition in Bond Workouts*, 97 YALE L.J. 232, 250–69 (1987); William W. Bratton & Adam J. Levitin, *The New Bond Workouts,* 166 U. PA. L. REV. 1597, 1615–19 (2018).

61. Wetliztky, *supra* note 32, at 270.

loan agreements typically demand unanimous consent for amendments to principal terms such as payment terms and maturity dates.[62]

Secondly, contract bankruptcy leaves out creditor groups that could conceivably be selected to absorb loss. Some groups, such as landlords, are not cohesive and so it is difficult to see how a coordinated contract bankruptcy regime could be negotiated with them *ex ante*. Tort creditors never expect to be creditors of the debtor in the first place and would at least prefer their interests to be balanced against those of the debtor and other creditors under the supervision of the bankruptcy court, rather than binding themselves to a purely contractual process. In short, we do not believe that contractual solutions displace the need for selective corporate restructuring law tools.

Even so, an obvious objection to selective restructuring is that it could prove to be a charter for debtor opportunism. There is a very real risk that the debtor adopts a selective approach to wash off certain liabilities unfairly transferring too much value to all the other stakeholders. We take this risk seriously. Debtors should not be permitted to use selective restructuring to reduce or eliminate some of their costs when there is no genuine threat to firm viability. Debtors should only be able to use selective restructuring to promote *Pareto superior* outcomes, in other words outcomes that make everyone (including the target creditors) no worse off and many, if not all, stakeholders better off than they would have been in alternative states of the world. And debtors should not be able to favor one group of creditors over another for capricious reasons, especially where insiders are involved. Accordingly, we have proposed elsewhere that selective restructuring tools should be accompanied by safeguards: in particular, a credible threat of independent, quasi-inquisitorial court review of the debtor's overall strategy by reference to clear and transparent criteria that require debtors to justify thoroughly their decisions to differentiate between the target creditors and the unaffected "ride-through" stakeholders.[63]

In sum, selective restructuring with appropriate safeguards provides distressed firms high on the curve with a pathway to early intervention in the form of a low-cost containment strategy that can be used to address specific problems forensically before they get out of hand, and subject to safeguards, in a manner consistent with rational bargaining.

---

62. Letter from Richard Levin, Chair, Nat'l Bankr. Conf., to Reps. Marino and Johnson, and Sens. Grassley and Leahey (Dec. 18, 2015) (on file with author).

63. Paterson & Walters, *supra* note 34.

II. CHAPTER 11'S INCLUSIVITY PROBLEM OUTLINED

We start this Part by restating our premise. Chapter 11 has an inclusivity problem because it does not readily facilitate the proposal and confirmation of *non-consensual selective plans* that address a specific cause of distress, such as a problem in the firm's long-term financing (for example, a series of bonds that are approaching maturity); or a portfolio of over-market leases that has become unsustainable in a changed trading environment; or tort liabilities relating to historic business practices.[64]

Chapter 11 has four specific, self-reinforcing design features which, when combined, raise obstacles to the proposal and confirmation of non-consensual selective plans and therefore affect the ability of debtors to bargain for a selective restructuring in the shadow of the law. These design features are Chapter 11's all-encompassing *inclusivity* as regards assets and claims; the distributional rules with which a non-consensual plan must comply if it is to win confirmation; the mandatory automatic stay which prevents payment of pre-bankruptcy liabilities; and the challenge of third-party releases. We consider each in turn.

A. Chapter 11's (Over)-Inclusivity

Recall that the objective of selective restructuring is to contain and address the specific cause of distress and limit direct costs (by reducing the circle of cooperation) and indirect costs (by sending a "business as usual" signal to ride-through stakeholders).[65] Selective restructuring involves a radical partitioning of the target creditors with whom the debtor needs to negotiate from the rest of the firm's stakeholders. It demands a laser-focused procedure that enables the debtor to include and address only the target claims without either touching the firm's assets or bringing the claims and interests of ride-through stakeholders into its maw.

The first thing we notice about Chapter 11's design is that it simply does not contemplate this kind of partitioning of the "included" and the "excluded." Chapter 11 is fundamentally all-encompassing and highly

---

64. *See* Anthony Casey & Joshua Macey, *A Qualified Defense of Divisional Mergers*, BANKR. ROUNDTABLE (June 28, 2022), http://blogs.harvard.edu/bankruptcyroundtable/2022/06/28/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-a-qualified-defense-of-divisional-mergers/ [https://perma.cc/V6QL-BNXY] (noting the costs of an enterprise-wide proceeding for addressing tort liabilities).

65. *See supra* Part II.

inclusive. Virtually all the debtor's assets come into the bankruptcy estate[66] and are sheltered by the automatic stay[67] within the protective jurisdiction of a federal court.[68] Rights to payment included with the Bankruptcy Code's broad definition of claims[69] are affected by the bankruptcy case regardless of whether an individual creditor files a proof of claim.[70] Furthermore, all claims must be brought within and treated in some way by the plan of reorganization even if they are designated as unimpaired.[71] What is contemplated is a comprehensive resolution of the debtor's financial past that brings the entire firm into the bankruptcy reckoning. A Chapter 11 case is, as Casey and Macey have expressed it, an "enterprise-wide filing."[72]

Thus, while Chapter 11 is commonly held up as being uniquely conducive to early intervention because of its lack of any threshold insolvency requirement,[73] the design assumption baked into it is that debtors who need bankruptcy relief are in a situation of widespread default so that "[the] firm's entire capital structure becomes due and payable at a single instant."[74] It puts all the assets on the table; it encompasses all the liabilities; it requires the debtor in possession to engage with everyone: senior finance creditors, junior finance creditors, trade creditors, lease and long-term contract counterparties,

---

66. 11 U.S.C. § 541(a)(1) ("Such estate is comprised of . . . all legal or equitable interests of the debtor in property as of the commencement of the case."). Post-bankruptcy augmentations of various kinds, including proceeds of estate property, are also captured. 11 U.S.C. § 541(a)(5), (6), (7).

67. 11 U.S.C. § 362(a)(2)–(5). The estate is formed and the stay applies as soon as the debtor files a bankruptcy petition. 11 U.S.C. § 541(a) ("The commencement of a case under . . . this title creates an estate."); § 362(a) ("[A] petition filed under . . . this title . . . operates as a stay . . . .").

68. 28 U.S.C. § 1334(e)(1).

69. 11 U.S.C. § 101(5)(A) ("The term 'claim' means- right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured . . . .").

70. As a general rule, the *in rem* rights to collateral of mortgagees and other secured parties are unaffected and ride through the bankruptcy case. *See* Long v. Bullard, 117 U.S. 617, 619–21 (1886); Dewsnup v. Timm, 502 U.S. 410, 417 (1992). However, in the light of 11 U.S.C. § 1141(c), which provides that "except as otherwise provided in the plan or in the order confirming the plan, after confirmation of a plan, the property dealt with by the plan is free and clear of all claims and interests of creditors," any mortgage or lien will be extinguished on confirmation unless the plan or confirmation order expressly preserves it. *See In re* Penrod, 50 F.3d 459, 463 (7th Cir. 1995); JCB, Inc. v. Union Planters Bank, NA, 539 F.3d 862, 870 (8th Cir. 2008).

71. 11 U.S.C. § 1123.

72. Casey & Macey, *supra* note 64.

73. WESTBROOK ET AL., *supra* note 1, § 3.4.3 (noting the contrast between the U.S. and most other jurisdictions which typically condition formal eligibility on a showing of insolvency even in voluntary cases).

74. Stephen J. Lubben, *The Overstated Absolute Priority Rule*, 21 FORDHAM J. CORP. & FIN. L. 581, 584 (2016).

utility suppliers—the whole shebang. It was simply not designed as a restructuring tool for selective corporate restructuring.[75]

B. Non-Consensual Plans: Chapter 11's Classification and Distributional Rules

As we noted above, one implication of Chapter 11's all-encompassing inclusivity is that a plan of reorganization must necessarily be inclusive. All claims and interests must be classified. The Code is clear on the point. It states that "a plan shall . . . designate . . . classes of claims,"[76] provides further that "substantially similar" claims may be included in the same class,[77] and requires the plan to distinguish between impaired and unimpaired classes.[78] The plan therefore has to include and treat all claims in one way or another, the only exception being certain categories of priority unsecured claims which, as a general rule, have to be paid in full unless the holders of such claims consent to a different treatment.[79]

As well as permitting a debtor to designate a class as unimpaired, the Code also permits the allocation of unsecured claims to a separate class, designated as an administrative convenience class, where the costs of impairing those claims and paying them over time through the plan would exceed their value.[80] It follows then that the claims of ride-through creditors in a selective restructuring context must necessarily be classified either as unimpaired claims or as so-called "convenience" claims, or (counterintuitively) have their rights altered in some minimal way (for example, a modest change in payment terms) so that they can be classified as impaired claims. The Code offers no further illumination other than to provide that an unimpaired class, and each holder of a claim in such a class, are conclusively presumed to

---

75. It is widely acknowledged that the Bankruptcy Code was framed with industrial firms having relatively straightforward and under-leveraged capital structures in mind. *See* AM. BANKR. INST., COMM'N TO STUDY THE REFORM OF CHAPTER 11, 2012–2014, FINAL REPORT AND RECOMMENDATIONS 12 (2014).

76. 11 U.S.C. § 1123(a)(1).

77. § 1122(a).

78. § 1123(a)(2)–(3). A claim is unimpaired if the plan leaves unaltered the legal, equitable, and contractual rights to which such claim entitles the holder or cures all defaults, reinstates the original maturity of the claim, and compensates the holder of the claim for any damages. § 1124.

79. § 1123(a)(1); § 1129(a)(9) (expressly excluding claims specified in §507(a)(2), (3), and (8) from the classification requirement and providing for their treatment).

80. § 1122(b). Separate classification of unsecured claims in a "convenience class" must be "reasonable and necessary for administrative convenience." *See also In re* S&W Enterprises, 37 B.R. 153, 158 (Bankr. N.D. Ill. 1984).

accept the plan[81] and that an impaired class whose holders are offered no recovery in the plan on account of their claims is deemed to have rejected the plan.[82]

The key (if perhaps trite) point is that whichever way a class of claims is designated—impaired, unimpaired, or convenience—it is *within* the plan. Impaired classes must get a plan treatment that meets at least the minimum floor of the "best interests" test.[83] And for a non-consensual plan to be crammed down on a dissenting impaired class, there must be at least one impaired accepting class.[84] If we assume that a selective plan proponent can engineer an accepting impaired class and offer dissenting classes at least the minimum payout required by the "best interests" test, the non-consensual plan's proposed treatment of the dissenting class must also satisfy the distributional rules in section 1129(b)[85] if it is to win confirmation. Section 1129(b) has a twin mandate: the plan must not discriminate unfairly and must be fair and equitable with respect to each impaired class that has not accepted it.[86] Significantly, these distributional rules require the court to benchmark the treatment of the relevant impaired class against the proposed treatment of all the other classes within the plan to ensure that enterprise value is not allocated unfairly. As such, they serve as end-of-case guardrails against debtor opportunism.[87] We consider each below.

1. Unfair Discrimination

The Code states that a non-consensual plan must not discriminate unfairly with respect to non-accepting impaired classes, but it does not elaborate further on the meaning of unfair discrimination. Some points that have bearing on the phrase's meaning can be elicited from the Code's classification rules. Chapter 11's classification scheme is not purely binary. Claims can only be grouped together if they are substantially similar, with

---

81. 11 U.S.C. § 1126(f).

82. § 1126(g).

83. § 1129(a)(7). Each holder of a claim in an impaired class must either have accepted the plan or be projected to receive on account of their claim no less than they would have received had the debtor been liquidated in Chapter 7 on the effective date of the plan.

84. § 1129(a)(10), (b)(1).

85. § 1129(b).

86. § 1129(b)(1).

87. *See* Vincent S.J. Buccola, *The Janus Faces of Reorganization Law*, 44 J. CORP. L. 1, 2–9 (2019) (explaining how Chapter 11 instantiates a strict entitlement paradigm at the conclusion of a reorganization case which vindicates distributional expectations and guards against opportunistic non-repayment by debtors that would adversely affect the cost of credit *ex ante*).

the statutory implication that dissimilar claims (for example, secured claims and unsecured claims) must be separately classified.[88] But there is no prohibition on separate classification of substantially similar claims. To this extent the Code permits plan proponents to discriminate.

Courts generally interpret the requirement not to discriminate unfairly to mean that dissenting classes should receive roughly equal treatment in the restructuring plan compared with other similarly situated classes.[89] This means that the proposed payout on the claims in a dissenting impaired class of unsecured claims will be compared directly with the proposed payout to unsecured claims in other classes. Thus, the requirement seeks to achieve some rough "horizontal" equity among claims having the same priority[90] and to guard against unfair allocation of reorganization surplus in excess of baseline liquidation value.[91] The implication for selective restructuring is that the plan's differential treatment of the ride-through claims in the unimpaired and convenience classes and the impaired target claims that the debtor wishes to cram down will need to be fully justified.

As separate classification of substantially similar claims is not prohibited, it follows that discrimination *per se* among similarly situated classes is not of itself a bar to confirmation of a cramdown plan. Moreover, a plan does not unfairly discriminate merely because it does not offer equal treatment to claims that would rank equally and share *pro rata* in a liquidation. To this extent, the Code recognizes that the distribution of reorganization surplus through a plan need not precisely match the distribution of firm assets that would occur in a liquidation.[92]

---

88. 11 U.S.C. § 1122(a).

89. RODRIGO OLIVARES-CAMINAL ET AL., DEBT RESTRUCTURING 126 (3d ed. 2022).

90. David A. Skeel, Jr., *The Empty Idea of "Equality of Creditors*,*"* 166 U. PA. L. REV. 699, 713 (2017) ("The unfair discrimination requirement has been consistently construed as concerned primarily with the treatment of classes of creditors with the same priority—that is, with horizontal equity, and as reflecting the equality of creditors principle."); Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 AM. BANKR. L.J. 227, 227–28 (1998) (characterizing the requirement as a "horizontal limit on nonconsensual confirmation").

91. COLLIER ON BANKRUPTCY ¶ 1129.03[3] (Richard Levin & Henry J. Sommer eds., 16th ed. 2023).

92. *Id.* ("By including the 'unfair discrimination' test, Congress made it clear that . . . a reorganization surplus did not have to be allocated to creditors on the basis of liquidation preferences. There can be 'discrimination,' so long as it is not 'unfair.' This makes some practical sense: unsecured creditors under nonbankruptcy law include such diverse entities as tort claimants, trade creditors, bondholders and possibly nontax governmental claims. On liquidation, all of these claimants share *pro rata*. To hold . . . that all such creditors should share proportionately in the reorganization surplus, when each group does not contribute proportionately to its creation and maintenance, makes little sense.").

Courts have developed different tests for determining unfairness.[93] Some courts consider whether the discrimination has a reasonable basis and is necessary for reorganization.[94] Others, following Bruce Markell, apply a "rebuttable presumption" test, a presumption of unfair discrimination arising where there is:

> (1) a dissenting class; (2) another class of the same priority; and (3) a difference in the plan's treatment of the two classes that results in either (a) a materially lower percentage recovery for the dissenting class . . . , or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution.[95]

According to the court in *Dow Corning*:

> The plan proponent could rebut the presumption of unfairness established by a significant recovery differential by showing that, outside of bankruptcy, the dissenting class would similarly receive less than the class receiving a greater recovery, or that the alleged preferred class had infused new value into the reorganization which offset its gain. The plan proponent could overcome the presumption of unfair treatment based on different risk allocation by showing that such allocation was consistent with the risk assumed by parties before the bankruptcy.[96]

Importantly, line drawing between what is or is not a "materially" lower recovery or a "materially" greater risk is left at large for case-by-case determination.[97]

On one view, the commercial rationale underlying some varieties of selective restructuring strategy will be sufficient to justify 100% recoveries for a large unimpaired class of ride-through claims when the target class of similarly situated claims is suffering less favorable treatment.[98] For example,

---

93. *Id.* ¶ 1129.03[3][a].

94. *See In re* Dow Corning Corp., 244 B.R. 696, 701 (Bankr. E.D. Mich. 1999) ("[T]he prevailing view is that the minimum requirements for finding a chapter 11 plan does not unfairly discriminate are that it has 'a rational or legitimate basis for discrimination and the discrimination must be necessary for the reorganization.'").

95. Markell, *supra* note 90, at 228, 249; *see In re* Dow Corning Corp., 244 B.R. at 701–03 (adopting the rebuttable presumption test); *In re* Trib. Co., 972 F.3d 228, 241–44 (3d Cir. 2020) (giving guidance on the application of the rebuttable presumption test).

96. *In re* Dow Corning Corp., 244 B.R. at 702.

97. *In re* Tribune Co., 972 F.3d 228, 243 (3d Cir. 2020).

98. At one extreme, it would seem hard to justify a zero or small cents-on-the-dollar recovery for target unsecured claims compared to a one hundred percent recovery for ride-through unsecured claims. At the other extreme, where, for example, rejected lease claims are offered one

in the *Nuverra* case, secured debt was converted to equity; unsecured noteholders received between 4% and 6% of their debt; and unsecured trade creditors were paid in full.[99] One unsecured noteholder, sufficient to carry its class, voted against the plan. The decisions of both the bankruptcy court and the district court in this case turned on other issues besides unfair discrimination, but in his examination of the case, Markell observes that the debtor "did try to justify the disparity by arguing that Class A6 was financial debt, arising differently from trade debt, and that treating trade creditors through any other method than non-impairment would threaten the reorganization, both in the short and in the long term."[100]

Yet, it appears from the cases that debtors by and large eschew structuring a non-consensual selective plan in this way. Hynes and Walt give examples of difference in treatment between two classes of claims enjoying equal priority which courts have approved: higher distribution on union members' wage claims in the face of a threatened strike; discrimination in favor of credit card claims when the debtor needed access to cards to continue business; and discrimination in favor of a creditor with a claim partly secured by a car needed for the debtor's business.[101] What is striking about these examples is that they involve courts making exceptions from equal treatment for very specific and laser-focused reasons. This is a far cry from the type of selective corporate restructuring with which we are concerned which may well involve plans that specifically target some categories of unsecured claims held by finance creditors or landlords for write downs but leave equal priority trade claims wholly unimpaired. Markell's strident criticisms of *Nuverra* offer possible insights into the risks that confront non-consensual selective plan proponents. He argues that:

> [E]nforcement against the debtor outside of bankruptcy requires all unsecured debt – whether it be trade debt, deficiency claims, or unsecured loans – to be reduced to judgment, as only judgments can

---

hundred percent of damages for out-of-bankruptcy efficient breach payable over time (subject to the cap in 11 U.S.C. § 502(b)(6)) when the plan proposes to pay ride-through claims immediately in full in cash, the difference in payment terms may conceivably be justifiable on the basis that the ride-through creditors are critical to business continuity. *See* COLLIER ON BANKRUPTCY, *supra* note 91, ¶ 1129.03[3][b][i]–[ii].

99. *In re* Nuverra Env't Sols. Inc., 590 B.R. 75, 79–80 (D. Del. 2018); *accord* Markell, *supra* note 51, at 2–5.

100. Markell, *supra* note 51, at 4.

101. Richard M. Hynes & Steven D. Walt, *Inequality and Equity in Bankruptcy Reorganization*, 66 U. KAN. L. REV. 875, 879 (2018) (citing *In re* Kleigel Bros. Universal Elec. Stage Lighting Co., 149 B.R. 306, 308–09 (Bankr. E.D.N.Y. 1992); *In re* Perskin, 9 B.R. 626, 630–32 (Bankr. N.D. Tex. 1981); *In re* Ragsdale, 15 B.R. 668, 670–71 (Bankr. N.D. Ga. 1980)).

> serve as the basis for seizure and sale of debtor's property. If nonbankruptcy law essentially treats such debts as the same, it beggars justification to use this empty distinction [between funded debt and trade debt] against non-consenting lenders in bankruptcy.[102]

If selective corporate restructuring is viewed exclusively through an enforcement lens—the lens used by many U.S. scholars, practitioners, and judges[103]—then this is the natural conclusion. As a result, it would seem to be extraordinarily risky for debtors to rely on difference-in-type-of-claim arguments to justify unimpairment, where they may need to confirm a non-consensual plan.

2. The "Fair and Equitable" Requirement and the Absolute Priority Rule

To be "fair and equitable," it is well settled that the plan's allocation of value must comply with the absolute priority rule ("APR") which, expressed broadly, stipulates that no junior class should recover until a senior class has recovered in full and, as a corollary, that no senior class should recover more than it is owed.[104] In effect, the APR is a rule of vertical priority or equity[105] that, consistent with the enforcement analysis we have already highlighted, treats a corporate reorganization as a sale of the firm to the creditors.[106]

When viewed in this way, it becomes necessary to decide what the "purchase price" (representing the enterprise value of the firm) is and how it should be divided among creditors' claims and equity interests. Thus, the first step is to determine a single enterprise value for the firm.[107] How this should be done is fraught with controversy and valuation disputes are a common feature of non-consensual plan negotiations.[108] Experts for the parties commonly use the discounted cash flow method to calculate the enterprise

---

102. Markell, *supra* note 51, at 4.

103. *See generally* sources cited *supra* note 19.

104. OLIVARES-CAMINAL ET AL., *supra* note 89, at 127; *see also* COLLIER ON BANKRUPTCY, *supra* note 91, ¶ 1129.03[4][a][i].

105. *See* Skeel, *supra* note 90, at 711–12.

106. *See* sources cited *supra* note 20.

107. *See* Kenneth Ayotte & Edward R. Morrison, *Valuation Disputes in Corporate Bankruptcy*, 166 U. PA. L.R. 1819, 1830 (2018).

108. *Id.* at 1820; *see also* Douglas G. Baird, *Bankruptcy's Quiet Revolution*, 91 AM. BANKR. L.J. 593, 594 (2017) ("Chapter 11 vindicates priority rights through nonmarket valuations. Nonmarket valuations are necessarily imprecise, and the judge can do little more than find that any particular plan falls within a broad range of what is reasonable.").

value, although what Ayotte and Morrison call "more transparent approaches" may also be used (such as comparable transaction multiples or comparable company multiples).[109] This enterprise value is then distributed down the creditor priority waterfall so that value is allocated to the senior class until it has recovered in full, and so on until the value has been exhausted.[110]

The amounts which the plan proposes to pay the holders of a dissenting impaired class of target claims will be compared with the distributions down the creditor priority waterfall to determine whether it meets the fair and equitable standard. Thus, a secured creditor could object to a sizeable class of unimpaired unsecured claims where the APR indicates that unsecured claims are only entitled to receive cents on the dollar. And, significantly, in selective restructurings where target claims will receive less than a one hundred percent payout, holders of these claims could object to a plan that does not eliminate equity. Where the aim of a selective restructuring strategy is to pay the ride-through claims in full while leaving equity with some interest in the firm, the "fair and equitable" requirement presents perhaps an even greater obstacle to selective restructuring than does the opacity and fact dependency of the unfair discrimination requirement.

C. The Mandatory Automatic Stay

The third aspect of Chapter 11's inclusivity problem is the mandatory automatic stay. The filing of the Chapter 11 petition invokes the automatic stay, not only preventing a wide range of creditor action against the debtor but also preventing the debtor from paying pre-bankruptcy liabilities.[111] The inability to pay pre-bankruptcy liabilities is a serious challenge for a selective corporate restructuring strategy where a fundamental part of the strategy is to keep most creditors current. Furthermore, serious signaling and information-processing disadvantages exist for a debtor invoking a stay while pursuing a selective strategy high on the demise curve.[112] At the same time, there may be much less need to stay a creditor enforcement action in a selective corporate restructuring case. If most creditors are kept current, they may lack either the grounds or the incentives to commence enforcement action against the debtor while the target creditors may also lack incentives to go the enforcement route for fear of creating a run on the firm that ultimately does

109. Ayotte & Morrison, *supra* note 107, at 1822.
110. Buccola, *supra* note 87, at 7.
111. 11 U.S.C. § 362(a).
112. Paterson, *supra* note 44.

them no good. For example, where the case targets only financial creditors, Buccola has noted:

> Senior lenders' acceleration rights and security interests imply that they will be first in right to a large fraction of the debtor's assets should junior investors precipitate a run by seeking to withdraw their investments. . . . Because this dynamic is common knowledge, junior investors have correspondingly little reason to undermine the lender's effective control.[113]

The commercial realities facing landlords when they are the target of a selective corporate restructuring strategy may similarly disincentivize them from pursuing enforcement action during the case, a point we explore further in Section III.A.2. below.

D. The Vexed Issue of Third-Party Releases

In a selective restructuring of the claims of the financial creditors of a corporate group that lie against the group holding company, it makes sense to keep operating subsidiaries and affiliates out of the resolution to avoid adverse signaling costs. But the operating companies will invariably have given guarantees supported by liens over their assets to secure the primary obligations of the holding company. If these guarantees and supporting security are not released and payment is demanded on them, the operating companies will be entitled to an indemnity against the principal debtor—a right of subrogation commonly referred to as a "ricochet" claim—the reimbursement of which will defeat the purpose of the restructuring.[114]

Consensual third party releases are available in Chapter 11, but there is some debate about whether creditors must affirmatively consent to them by opting in or if they can be deemed to consent by failing to opt out after receiving appropriate notice.[115] However, there is considerable uncertainty—fueled by high profile mass tort cases such as Purdue Pharma and Boy Scouts of America—about whether courts have constitutional and statutory authority to confirm plans containing non-consensual releases of third parties who are

---

113. Vincent S.J. Buccola, *Bankruptcy's Cathedral: Property Rules, Liability Rules, and Distress*, 114 NW. U. L. REV. 705, 718–19 (2019).

114. Ilya Kokorin, *Third-Party Releases in Insolvency of Multinational Enterprise Groups*, 18 EUR. CO. FIN. L. REV. 108, 115–16 (2021).

115. For discussion, see, for example, *In re* Arsenal Intermediate Holdings, LLC, No. 23-10097, slip op. at 1 (Bankr. D. Del. Mar. 27, 2023).

contributing funding for plan payments in return for these releases.[116] It remains to be seen whether the Supreme Court or Congress will intervene either to permit, restrict, or entirely outlaw non-consensual releases.[117]

In the face of this current uncertainty, debtors must choose between an inclusive group-wide procedurally consolidated filing or venue shopping for a jurisdiction that is conducive to this type of selective restructuring.[118] Perhaps ultimately the law will settle on a framework that shows less tolerance for aggressive releases of tort victims' claims against third parties that arouse understandable public policy concern than it does for releases of guarantee obligations owed to sophisticated lenders. But for the time being, doubts about the lawfulness of non-consensual third-party releases affect their practical utility for resolving both tort and contract claims against third parties as part of a global resolution.

III. WORKING AROUND THE INCLUSIVITY PROBLEM OR AVOIDING CORPORATE REORGANIZATION ALTOGETHER

To recap the argument so far: as all claims have to be included and treated in the plan; a non-consensual plan's allocation of enterprise value must be assessed by reference to section 1129(b)'s distributional rules; and the Chapter 11 stay is mandatory and automatic and prevents payment of pre-filing liabilities; debtors face considerable challenges in engineering, negotiating, and confirming selective non-consensual plans over the head of an impaired class of target claims.

Nevertheless, ingenious lawyers have used the Bankruptcy Code's complex mesh of detailed rules and settled folkways to engineer solutions to

---

116. *See*, *e.g.*, Ralph Brubaker, *Mandatory Aggregation of Mass Tort Litigation in Bankruptcy*, 131 YALE L.J.F. 960 (2022); Melissa B. Jacoby, *Sorting Bugs and Features of Mass Tort Bankruptcy*, 101 TEX. L. REV. 1745 (2023); Edward J. Janger, *Aggregation and Abuse: Mass Torts in Bankruptcy*, 91 FORDHAM L. REV. 361 (2022); Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 TEX. L. REV. 1079 (2022); Samir D. Parikh, *The New Mass Torts Bargain*, 91 FORDHAM L. REV. 447 (2022); Lindsey D. Simon, *Bankruptcy Grifters*, 131 YALE L.J. 1154 (2022).

117. Congressional attempts to amend the Bankruptcy Code to restrict third party releases have not yet been successful. *See* Nondebtor Release Prohibition Act, H.R. 4777 & S. 2497, 117th Cong. (2021). At the time of this writing, the Supreme Court has granted certiorari in Purdue Pharma's Chapter 11 case to address the question whether the Bankruptcy Code authorizes courts to approve non-consensual releases in plans of reorganization. *See* Harrington v. Purdue Pharma, L.P., No. 23-124, 2023 WL 5116031 (S. Ct. Aug. 10, 2023).

118. Which would likely shift the focus back onto venue reform. For a thoughtful review of the venue debate, see Anthony J. Casey & Joshua C. Macey, *Bankruptcy Shopping: Domestic Venue Races and Global Forum Wars*, 37 EMORY BANKR. DEV. J. 463, 470–82 (2021).

Chapter 11's inclusivity problem. In this Part, we discuss four innovations that practitioners have developed to accomplish selective restructurings, each of which targets a different group. The common thread is that these innovations all work around Chapter 11's distributional rules for non-consensual plans and enable debtors to pursue selective strategies without any comprehensive review of whether or not these strategies allocate value fairly. The results are pathological. Because selective restructuring is useful, practitioners push the envelope. But pushing the envelope involves disabling the distributional rules in Chapter 11 that safeguard creditors from debtor opportunism. Target creditors are left having to rely on narrow, technical challenges under the Code that courts approach in a piecemeal fashion. For sure, the court must always be satisfied that the plan has been "proposed in good faith and not by any means forbidden by law."[119] However, this mandates a relatively narrow inquiry into the debtor's probity which does not serve as a proxy for a comprehensive, holistic fairness review. What you end up with is selective restructuring without any independent review of the overall fairness of the plan.

Workarounds are one response. But if debtors cannot be persuaded to pursue one of these complex adaptations, or the facts of the specific case are not susceptible to such an adaptation, they may seek to avoid corporate reorganization altogether. Towards the end of this Part, we consider why Chapter 11's inclusivity problem may prompt debtors to resort to outright avoidance and why this may be less desirable than having Chapter 11 facilitate a selective strategy in the first place.

A. Workarounds

1. Prepackaged Bankruptcies

In a prepackaged Chapter 11 case (or "prepack" for short), the debtor negotiates the plan, solicits plan acceptances from classes of claims and interests that it proposes to impair before filing for bankruptcy, and then brings the bankruptcy case to implement the plan, filing the draft plan and disclosure statement with the petition.[120] The debtor and accepting creditors commonly enter into a restructuring support or "lock-up" agreement prior to the filing whereby the creditors consent to the modified terms and pledge to

---

119. 11 U.S.C. § 1129(a)(3).
120. COLLIER ON BANKRUPTCY, *supra* note 91, ¶ 1100.10.

vote in favor of the plan.[121] If the debtor can solicit sufficient acceptances to ensure that Chapter 11's voting thresholds are met,[122] a consensual plan binding in dissenters who would otherwise be an obstacle to an out-of-court workout can be confirmed. At this point, we should note that we prefer to call these plans quasi-consensual because the statutory majority (a majority in number and two-thirds in value of claims in a class) may be met while still leaving a significant dissenting minority in an accepting class.

Prepacks are a specific type of selective restructuring used predominantly to compromise long-term financing obligations within the debtor's capital structure.[123] They are a well-established tool that has become increasingly prevalent[124] and the Bankruptcy Code facilitates them in various ways.[125] The literature typically identifies speed as the overwhelming advantage of a prepackaged bankruptcy when compared with a traditional Chapter 11 case.[126] Indeed, a crucial aim of a prepack strategy is to minimize the time the debtor spends in Chapter 11 by completing the negotiations with the stakeholders who are critical to success beforehand. A prepack is streamlined in a manner that reduces the direct costs of the Chapter 11 proceeding and the adverse impact—and thus indirect costs—of a lingering Chapter 11 case on supplier and customer confidence and on business operations.[127]

But important though speed undoubtedly is, prepacks have more to recommend them than speed alone. They are a selective restructuring tool *par excellence*, enabling the debtor to engage only with target financial creditors,

---

121. *See* Baird, *supra* note 108, at 603–08.

122. 11 U.S.C. § 1126(c) (explaining that a class accepts the plan if holders of at least two-thirds in amount and more than half in number of the allowed claims of the class vote to accept the plan).

123. *See* Dennis F. Dunne et al., *Prepackaged Chapter 11 in the United States: An Overview*, *in* THE ART OF THE PRE-PACK 1–2 (Jacqueline Ingram & Ryan Cattle eds., 2d ed. 2022). In this respect, they share many similarities with the UK scheme of arrangement discussed *infra* Part IV.

124. *See* Dunne et al., *supra* note 123, at 29–30, 32 (citing data on the rising numbers of prepacks since the turn of the century and giving examples of cases filed).

125. 11 U.S.C. § 341(e) (permitting the U.S. Trustee to dispense with a first meeting of creditors); § 1102(b)(1) (permitting the U.S. Trustee to appoint an ad hoc prepetition creditors committee as the creditors committee in the case); § 1121(a) (authorizing the debtor to file a plan with the petition); § 1125(g) (authorizing vote solicitation before approval of the disclosure statement as long as the solicitation complies with applicable nonbankruptcy law and where the party being solicited was solicited prepetition in accordance with applicable nonbankruptcy law); § 1126(b) (allowing votes solicited prepetition to count subject to adequate disclosure); FED. R. BANKR. P. 3018(b) (expressly contemplating plan acceptance or rejection before commencement of the case).

126. *See* Baird, *supra* note 108, at 594 ("[M]odern debtors are interested in a speedy and successful exit from Chapter 11. . . . In crafting the plan, those controlling the debtor join forces first with those who can do most to help them exit bankruptcy quickly.").

127. *See* Dunne et al., *supra* note 123, at 37–40; *see also supra* Part II.

relying on achieving the statutory majority in each class to avoid Chapter 11's cram down distributional rules. The first challenge debtors face is assuring ride-through creditors of the operating business that they will be kept whole, notwithstanding the mandatory automatic stay, which restricts their ability to collect prepetition debts. In some recent cases, the debtor has asked the court to move to confirm the prepackaged plan with such speed that the automatic stay offers no practical limitation to the payment of outstanding debts.[128] If the assumption is that the exit from bankruptcy will follow hard on the heels of the petition, unsecured claims can be classified as unimpaired in the plan and paid in cash in full on the effective date of the plan. Where the debtor proposes a prepackaged plan that leaves ride-through creditors' claims unimpaired, the U.S. Trustee will be inclined not to appoint an official creditors committee, which will further reduce direct costs.[129] Where such a speedy confirmation has not proved possible, ingenious lawyers have deployed a variety of techniques to facilitate payment of ride-throughs. Prepetition debts to creditors designated as critical vendors can be settled during the case under a critical vendor order[130] or (if the predicates are made out) as administrative claims under section 503(b)(9).[131]

It will be readily apparent that if the plan treats the ride-through creditors as unimpaired and leaves the equity interests intact, dissenting creditors in the impaired target class(es) who will receive a haircut are treated less favorably relative to other unsecured claims (on the horizontal axis) and relative to equity (on the vertical axis). But if the debtor can engineer a quasi-consensual plan in which the impaired target class(es) accept by the requisite majority, the dissenters cannot object that the selective strategy unfairly discriminates against them and/or violates the APR. The distributional rules in section 1129(b) are simply not engaged because, while there are dissenting creditors, there is no dissenting class. If the plan at least meets the baseline

---

128. For a description of Belk's "one-day" Chapter 11 plan in which Belk filed on the evening of February 23, 2021, and the court confirmed the plan at 10:00 AM the next morning, see LoPucki, *supra* note 53; Robert K. Rasmussen & Roye Zur, *The Beauty of* Belk, 97 AM. BANKR. L.J. 438 (2023).

129. *See* Dunne et al., *supra* note 123, at 40.

130. *See* Elizabeth Shumejda, *Critical Vendor Trade Agreements in Chapter 11 Bankruptcy*, 24 AM. BANKR. INST. L.R. 159 (2016); Buccola, *supra* note 87, at 16–17. The operation of these mechanisms may not always be entirely straightforward. *See* Paterson & Walters, *supra* note 34, at 449–50.

131. 11 U.S.C. § 503(b)(9) (allowing as an administrative claim the value of unpaid goods sold to the debtor in the ordinary course of the debtor's business and received by the debtor within twenty days before commencement of the case).

of the "best interests" test,[132] dissenting creditors are left having to pursue costly technical objections to confirmation[133] under section 1129(a)—on grounds, for example, that the plan does not comply with the Code's plan, contents, and classification requirements.[134] Of course, as we have already noted, the court must also be satisfied that the plan has been proposed in good faith[135] and that the plan is feasible.[136] To date, courts appear generally inclined to defer to the debtor's business judgment and the wishes of the majority,[137] and to give these considerations relatively little weight. Douglas Baird has recently suggested that the good faith requirement could be reinvigorated, perhaps to do some of the work which we suggest needs to be done here.[138] Yet, in our view, a good faith requirement is no substitute for an overall, holistic review of the fairness of the plan. A debtor press-ganged by a powerful majority on which it is entirely dependent into washing off certain liabilities may be acting entirely in good faith and yet the selective plan may still not withstand wider fairness scrutiny.

Expressed differently, once the section 1129(b) guardrails are disengaged, the good faith requirement is left to do too much work, even if the courts felt inclined to flex it more, and the other grounds of objection operate in a piecemeal and unsatisfactory fashion. To be sure, if the target claims include a class of junior unsecured notes, dissenters could in theory object that separate classification of, say, trade creditor claims, in a class designated as unimpaired, violates the Code's plan classification and contents requirements,[139] which would prompt judicial consideration of the commercial justification for impairing the notes while leaving the trade creditors whole.[140] However, there is no straightforward way to ask the court

---

132. § 1129(a)(7). On the origins of the test and the limited scope of the protection it now provides see BAIRD, *supra* note 47, at 56–61.

133. Which as parties in interest they have standing under the Code to bring. 11 U.S.C. §§ 1109(b), 1128(b).

134. *See* § 1129(a)(1).

135. § 1129(a)(3).

136. *See* § 1129(a)(11).

137. *In re* Aegerion Pharms., Inc., 605 B.R. 22, 32 (Bankr. S.D.N.Y. 2019) (where an impaired class votes overwhelmingly in favor of a plan that provides better treatment to a separate class of trade creditor claims, evidence that ongoing trade relationships are essential to a successful reorganization will support the debtor's business judgment to treat the trade claims more favorably).

138. BAIRD, *supra* note 47, at 149.

139. 11 U.S.C. §§ 1122–1123, 1129(a)(1).

140. *In re* Aegerion Pharms., 605 B.R. at 31–32 (reviewing separate classification of ongoing trade claims and concluding that there were good business reasons for it).

simply to step back and assess the overall fairness of the quasi-consensual plan.

Prepackaged plans work best where the specific liabilities to be compromised are financial rather than operating liabilities. Sophisticated finance creditors will readily appreciate the benefits of selective restructuring and that widening the compromise to encompass the claims of non-finance creditors could cost more than it is worth. Accordingly, they will often be prepared to accept impairment while claims that would be equal ranking or junior in the priority waterfall ride through unimpaired. Furthermore, financial creditors are well-placed to make *ex ante* adjustments to compensate themselves for these distributional consequences in bankruptcy.[141] For this reason, prepackaged bankruptcies compromising only financial liabilities may also be the least controversial of the selective corporate restructuring strategies which we consider in this section and the lack of an overall review of fairness may be of less concern than it is in other scenarios. Nonetheless, we note for the moment that where there is a significant minority of dissenting creditors within the plan's accepting classes, those minority creditors cannot straightforwardly demand that the court pause to consider the overall fairness of the plan, even if the court were minded, in the prepack context, to approach such a fairness review with a strong inclination to respect the will of the majority.

2. Plan "Unimpairment" of Target Claims

As we have said, prepackaged plans compromising specific financial liabilities can work well. But what if the debtor wants to selectively restructure a specific set of operating liabilities? Assume, for example, that the debtor, a nationwide chain retailer, wishes selectively to restructure its leasehold estate, retaining performing leases and dispensing with non-performing leases. To be sure, the debtor in possession can exercise the Code power in section 365[142] to assume the performing leases and reject the non-performing leases, leaving the holders of the rejected leases with a prepetition claim for damages.[143] But the plan proponent will still need to classify these rejected lease claims and provide some plan treatment.

Recall that the whole idea of the selective restructuring is to target *only* the holders of the non-performing leases while all the other unsecured claims

---

141. Baird et al., *supra* note 2, at 1682.
142. 11 U.S.C. § 365.
143. *See* § 365(g)(1).

(trade credit and the like) are either paid in the case (once again avoiding the problem of the mandatory automatic stay via a critical vendor order or an administrative claim treatment under section 509(b)(9)) or left unimpaired in the plan. Of course, if the target lease claims are classified in a single impaired class and enough of their holders agree to accept their lot,[144] the debtor can get a quasi-consensual plan confirmed subject to the "best interests" test and the other basic standards of section 1129(a). But let us further assume that the holders of the non-performing leases are unhappy with the direction of travel ("why are we being singled out?"). How then does the plan proponent craft a selective plan that impairs a dissenting class of target claims?[145]

Next, assume that the plan proponent can engineer an accepting impaired class as a pre-condition to plan confirmation[146] without running the gauntlet of a gerrymandering challenge.[147] And assume further: (i) that the target claims are impaired by the plan and cannot be classified as convenience claims; and (ii) that the target claims cannot be lumped together with, and swamped for voting purposes by, say, other minimally impaired unsecured claims to create an accepting impaired class because all claims within the same class must receive the same treatment.[148] Already, it is apparent that Chapter 11's requirement for all claims to be included and classified within the plan creates a threshold problem that requires delicate engineering. Even if the plan proponent can engineer acceptance by an impaired class, it would need to cram down the target lease claims at which point it would hit the roadblock of the distributional rules in section 1129(b). On top of all of this, if the debtor is trying to rebalance a nationwide commercial real estate

---

144. Two-thirds in amount and more than half in number. *Id.* § 1126(c).

145. We also assume for the purposes of the hypothetical that the non-performing leases threaten firm viability, and the debtor is targeting them to deal with the cause of its distress and to preserve value for other creditors such that the case would survive a motion to dismiss it as a bad faith filing under 11 U.S.C. § 1112. In other words, the debtor has not been screened out as an opportunistic abuser of bankruptcy process.

146. *Id.* § 1129(a)(10), (b)(1).

147. COLLIER ON BANKRUPTCY, *supra* note 91, ¶ P. 1129.02[10](a) (distinguishing cases that hold that artificial impairment to contrive an accepting class absent an economic imperative violates § 1129(a)(10) from cases that hold that artificial impairment, while not violating § 1129(a)(10), does raise an issue of whether the plan proponent is proposing the plan in good faith under § 1129(a)(3)).

148. 11 U.S.C. § 1123(a)(4). As well as a class of minimally impaired claims, another possibility might be a secured party's deficiency claim in circumstances where the senior lender is on board with the restructuring and has agreed to an "underwater" valuation of their collateral. This is conceivable in the case of an over-leveraged debtor with an oversized leasehold footprint where the two problems are mutually self-reinforcing, i.e., excess lease liabilities that make it hard to service senior debt and vice versa.

portfolio, there may be extensive issues that will have to be litigated under section 365, raising the specter of direct and indirect costs. At first blush, this is not the obvious case for a prepack.[149]

In a handful of cases,[150] practitioners have found a solution that purports to offer the speed benefits of a prepack while making full use of section 365 in both the case and plan to reduce the debtor's retail store footprint. The strategy in the lead up to the filing is for the debtor to organize its leases into three buckets: (i) non-performing leases it will definitely reject during the case; (ii) performing leases it definitely wishes to assume; (iii) leases it wishes to renegotiate on more favorable terms under threat of rejection. In a variation on the prepack theme, the debtor then files a petition together with a plan that addresses all three buckets and the ride-through creditors.

The problem of the mandatory automatic stay and payment of ride-through creditors is dealt with as in a regular prepack by some combination of a critical vendor order, section 503(b)(9) treatment, or designation as an unimpaired class in the plan. But pivotal to the strategy is what we call plan "unimpairment" of the rejected lease claims in the first and third buckets. Rather than classify these claims as impaired, the plan proponent offers to pay them in cash in full through the plan and classify them instead as *unimpaired*, with the convenient result that they are conclusively presumed to have accepted the plan.[151] The plan is quasi-consensual because there is no impaired class to vote against it, and the section 1129(b) guardrails are thereby disengaged.[152]

To explain further how this engineering works, let us take the example of a landlord who outside of bankruptcy would either be able to prevent the tenant from unilaterally breaking the lease or would have a claim against the debtor for breaking the lease that exceeds the bankruptcy cap in section

149. *See* Dunne et al., *supra* note 123, at 35 ("A prepackaged case is not a panacea for all cases of financial distress. This technique is practical only in those situations where the debtor's financial distress primarily is caused by burdensome funded debt levels and the company does not need a comprehensive restructuring of its business operations. All the other tools otherwise available under Chapter 11 for business restructuring are available to a prepackaged case debtor, but their use may result in time-consuming litigation that would frustrate the principal benefit of a prepackaged case – reduced time under court supervision.").

150. The standout is *In re Mattress Firm, Inc.*, No. 18-12241 (Bankr. D. Del. filed Oct. 5, 2018). The contours of our account in the text are largely derived from our study of the *Mattress Firm* docket, https://dm.epiq11.com/case/mattressfirm/info [https://perma.cc/X4SK-2H88].

151. 11 U.S.C. § 1126(f).

152. There being no impaired class of unsecured claims in the plan, there is also no need for a creditors committee. *See* Dunne et al., *supra* note 123, at 40.

502(b)(6).[153] One might be forgiven for thinking that such a claim must surely be impaired for Code purposes[154] because its holder's prepetition nonbankruptcy rights have been altered. Indeed, as in some states, such as New York and Pennsylvania, commercial real estate lessees have no unilateral right outside of bankruptcy to terminate the lease in the absence of a break clause and no express duty is imposed on the landlord to mitigate damages, the Bankruptcy Code's interference with landlords' entitlements goes further than just capping their damages claim.[155]

But Courts of Appeal in the Second, Third, and Fifth Circuits have held that where the plan proposes to pay the full amount of an allowed claim in bankruptcy, the claim is unimpaired even if 100 percent of the allowed claim is less than the amount that could have been collected on it under nonbankruptcy law.[156] These courts distinguish between *Code* impairment via the statutory limit on claims allowance in section 502(b)(6)[157] and *plan* impairment to conclude that disallowance of part of a claim under the Code's claims allowance provisions is not impairment for the purposes of plan treatment. Thus, in the example above, a rejection damages claim that will receive 100 cents on the dollar up to the section 502(b)(6) cap in cash on the effective date of the plan is unimpaired. It follows that plan "unimpairment"

---

153. 11 U.S.C. § 502(b)(6) (capping the lessor's damages resulting from termination of a lease of real property at the rent reserved by the lease, without acceleration, for the greater of one year, or 15 percent not to exceed three years, of the remaining term of the lease following the earlier of the petition date or the date on which the landlord repossessed or the lessee debtor surrendered the property). Courts generally treat the prepetition damages claim arising from lease rejection under § 365 as arising from lease termination and therefore subject to the § 502(b)(6) cap. *See* COLLIER ON BANKRUPTCY, *supra* note 91, ¶ P. 502.03[7][b]. This treatment appears to follow in part from § 502(g)(1) (which provides in pertinent part that a claim arising from rejection of an unexpired lease under § 365 or under a Chapter 11 plan shall be determined and allowed under § 502(b)).

154. *See* 11 U.S.C. § 1124(1) (distinguishing impaired and unimpaired claims).

155. *See* Dawn R. Barker, Note, *Commercial Landlords' Duty Upon Tenants' Abandonment – To Mitigate?*, 20 J. CORP. L. 627, 629–30 (1995); David Crump, *Should the Commercial Landlord Have a Duty To Mitigate Damages After the Tenant Abandons? A Legal and Economic Analysis*, 49 WAKE FOREST L. REV. 187 (2014); Holy Props. Ltd., L.P. v. Kenneth Cole Prods., Inc., 661 N.E.2d 694 (N.Y. 1995); Stonehedge Square Ltd. P'ship v. Movie Merchs., Inc., 715 A.2d 1082 (Pa. 1998).

156. *See, e.g.*, *In re* PPI Enters. (U.S.), Inc., 324 F.3d 197 (3d Cir. 2003); *In re* Ultra Petrol. Corp., 913 F.3d 533 (5th Cir. 2019); *In re* LATAM Airlines Grp. S.A., 55 F.4th 377 (2d Cir. 2022).

157. Section 365 federally preempts the landlord's right to refuse to accept the tenant's surrender of a commercial real estate lease in states that follow the old common law rule that landlords have no duty to mitigate their damages when their tenants abandon leased property. 11 U.S.C. § 365. This is a further Code impairment of landlords' rights in those states.

of lease rejection claims is a legally viable strategy, at the very least in these Circuits.

With the case commenced, the draft plan on the docket, and a standard package of first-day orders entered (including a critical vendor order) to allow the business to continue under court supervision, the debtor will then file omnibus motions to reject the leases in the first bucket. These will be adjudicated by the court under the prevailing and deferential business judgment standard.[158] The plan will then provide machinery for claims resolution of the rejection damages claims with a bar date for proofs and a claims objection deadline.

To complete the picture, the leases in the second and third buckets will be handled through the plan. Insofar as relevant, section 1123(b)(2) of the Code provides that a plan may "subject to section 365 of this title, provide for the assumption, rejection or assignment of any . . . unexpired lease of the debtor not previously rejected under such section."[159] There is no specific rule elaborating on the procedure to be followed where a debtor is assuming or rejecting a lease under a plan and so practice has developed through the cases.[160]

The practice that has emerged for assuming leases in the second bucket under a plan is for the debtor to give notice of intent to assume (seemingly via notice of the confirmation hearing) and individual notice of a proposed cure amount to each contract and lease counterparty during the case with the plan setting out a process whereby cure amounts can be resolved following objection.

For leases in the third bucket, the plan will set up a game of chicken in the form of a procedure that defers the "assume versus reject" decision for a fixed period after the plan's effective date with lessor consent. The debtor will then be at liberty to assume leases on such modified terms as may be agreed with a backstop threat of rejection at the end of the period if agreement has not been reached.

Given the present state of the retail market, the strategy can be executed in a reasonably short time frame.[161] Much of the leverage lies with debtors

---

158. *See* COLLIER ON BANKRUPTCY, *supra* note 91, ¶ P. 365.03[2].

159. 11 U.S.C. § 1123(b)(2).

160. FED. R. BANKR. P. 6006, 9014 (which read together carve assumption and rejection through the plan out of the usual requirement for court approval on motion after notice and a hearing); *see also* Irve J. Goldman, *Dealing with Executory Contracts: Notice of Intent Still Critical*, 26-FEB AM. BANKR. INST. J. 48, 48–49 (2007).

161. In *In re Mattress Firm Inc.*, No. 18-12241 (Bankr. D. Del. filed Oct. 5, 2018), the debtor filed its petition and plan on October 5, 2018, and confirmed the plan on November 16, 2018, some 42 days later. By the time the court confirmed the plan, the company had closed around 700

when it comes to negotiating cure amounts or more favorable terms. Landlords are better off with a rented property than being left with a capped rejection damages claim and confronted with trying to relet vacant premises in a moribund market. We have seen already that landlords whose leases are rejected cannot challenge their unimpairment solely because their non-bankruptcy entitlements are altered by the plan. With speed of the essence and the plan therefore postponing resolution of some rejection damages claims until after its effective date, landlords could conceivably raise technical objections to confirmation on the ground that they are impaired because, by definition, they will not be paid immediately in cash in full; their payment will be delayed.[162] There is then some measure of execution risk for a debtor who is in a hurry to exit bankruptcy and objections along these lines may have some nuisance potential that landlords can exploit to bid up the value of their allowed claim in the claims resolution process. But for landlords who face having their leases rejected in any event, and whose claims will be capped in any event, the costs of trying to construct a coalition that could credibly push for misclassification as a route to the added leverage of section 1129(b) likely outweigh the benefits. Crucially, to the extent then that there is any court review of the selective strategy, it happens in a disjointed and piecemeal fashion—on a motion to reject under section 365 or an objection under section 1129(a) at the confirmation hearing—and in a manner where target landlords are effectively disenfranchised through unimpairment. Once again, there is no overall, holistic fairness review of plans which target only a subset of unsecured creditors and which, given how unimpairment works around section 1129(b) to engineer a quasi-consensual plan, can be confirmed without eliminating equity.

---

stores, amended leases on a further 1,000 stores, and remained in negotiations relating to 500 other stores. *See* Becky Yerak, *Mattress Firm Wins Court Approval of Chapter 11 Plan*, WALL ST. J. (Nov. 16, 2018), https://www.wsj.com/articles/mattress-firm-wins-court-approval-of-chapter-11-plan-1542389945?mod=trending_now [https://perma.cc/3Y8V-PQAE].

162. This is particularly so in connection with leases in the third bucket that are kept open for assumption or rejection by the plan. Landlords might also object that the plan delays the "assume versus reject" decision beyond plan confirmation in a manner that violates 11 U.S.C. § 365(d)(4)(A)(ii). Though, to the extent § 365(d)(4)(A)(ii) overrides § 1123(b)(2), which merely states (albeit expressly subject to § 365) that the plan should *provide for* assumption or rejection, the upshot is that leases in the third bucket would be deemed rejected in any event. § 1123(b)(2). Furthermore, as part of the engineering, landlords with leases in the third bucket consent to deferral of the "assume versus reject" decision beyond the effective date of the plan, albeit under threat of having their leases rejected.

3. Section 363 Sales

The main alternative to a prepackaged plan for executing a speedy restructuring strategy that does not involve a long, drawn-out stay in Chapter 11 is a section 363 sale of all or substantially all of the debtor's assets as a going concern through a court approved auction.[163] A common rationale for section 363 sales is that they allow a quick, streamlined disposal of the business before its value deteriorates:[164] the so-called "melting ice cube" theory.[165] Where the firm's assets are subject to blanket security interests in favor of a senior lender, they are also used to conduct what, viewed again through an enforcement lens, is commonly characterized as a nationwide federal foreclosure that avoids the need for multiple state foreclosure proceedings and in so doing preempts state law.[166] A major attraction for buyers is that the court can approve the sale free and clear of non-debtor interests in the assets.[167] Once the sale is completed, any such interests will lie in the sale proceeds which will usually be distributed through a liquidating plan, a structured dismissal, or after conversion of the case to Chapter 7.[168]

Section 363 sales invariably involve a selective restructuring at the behest of the buyer. The buyer will determine which stakeholders it needs to keep on board to preserve the value of the business and which it can do without. As with the prepack and plan impairment strategies outlined above, critical vendor orders will be required to assure key suppliers that they will be kept whole, and the debtor in possession will need to resort to section 365 to sort between the contracts and leases the buyer wishes to retain and those it wishes to shed.[169]

The practice of conducting whole business sales under section 363 in a Chapter 11 case has been the subject of heavy criticism. Commentators worry about the increased risk of collusion between the debtor, its senior lenders,

---

163. COLLIER ON BANKRUPTCY, *supra* note 91, ¶ P. 363.02. 11 U.S.C. § 363(b)(1) authorizes the trustee or debtor in possession to use, sell or lease estate property other than in the ordinary course of business with court approval after notice and a hearing.

164. COLLIER ON BANKRUPTCY, *supra* note 91, ¶ P. 363.02[3].

165. *See* Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 865–86 (2014) (discussing the use of melting ice cube arguments to justify quick sales in Chapter 11).

166. *Id.*

167. 11 U.S.C. § 363(f); *see also* COLLIER ON BANKRUPTCY, *supra* note 91, ¶ P. 363.06.

168. Norman L. Pernick & G. David Dean, *Structured Chapter 11 Dismissals: A Viable and Growing Alternative After Asset Sales*, 29 AM. BANKR. INST. J. 1, 55–56 (2010).

169. COLLIER ON BANKRUPTCY, *supra* note 91, ¶ P. 363.02[3] (noting that courts have approved additional sales terms relating to the assumption of executory contracts and that buyers are commonly involved in designating critical vendors).

and the buyer and the associated potential for abuse.[170] They point to how sales circumvent the disclosure, voting, and fairness protections applicable to plans almost entirely.[171] The main safeguard lies in the requirement for court approval of the sale. But the tests that courts have developed for determining whether or not to approve sales—courts ask whether the sale is for a sound business reason and at a fair and reasonable price[172]—are designed to try and ensure that aggregate estate value is maximized and do not focus on the selectivity dimension. Selectivity is again addressed piecemeal through mechanisms such as critical vendor orders or the power to assume or reject executory contracts and unexpired leases that sort out who will ride through with the business and who will be left behind. There is no holistic consideration of whether the reallocation of enterprise value is fair from a distributional standpoint.

4. Divisional Mergers (Texas Two-Steps)

In the workarounds we have described so far, the target claims are all contract claims of various kinds. Our final example—pre-bankruptcy divisional mergers under state law (known pejoratively as Texas Two-Steps after a facilitative Texas statute)—targets mass tort claims. In a divisional merger, debtors separate their businesses into two entities, a "GoodCo" which retains the business assets and a "BadCo" which assumes the tort liabilities. With the tort liabilities thus detached from the assets, the BadCo files for bankruptcy specifically to resolve those liabilities[173] and without the underlying business itself—and the value it represents—coming under court supervision at all.[174] The business, now insulated from the liabilities, and with

---

170. Jacoby & Janger, *supra* note 165, at 866 (voicing the concern that quick sales may facilitate collusive deals between incumbent managers, senior creditors, and potential purchasers); *see also* Jessica Uziel, *Section 363(b) Restructuring Meets the Sound Business Purpose Test with Bite: An Opportunity To Rebalance the Competing Interests of Bankruptcy Law*, 159 U. PA. L. REV. 1189, 1214 (2011) ("Section 363 sales' expedited process and lesser disclosure requirements make investigation of the purchaser's behavior vital in order to protect creditors, equity holders, and debtors from exploitation. Increased potential for abuse threatens creditors' interests as well as the debtor's ability to maximize the value of the estate.").

171. AM. BANKR. INST., *supra* note 75, at 84 ("The primary concerns of courts and commentators with this practice are premised on the absence of stakeholder protections that are otherwise incorporated into the section 1129 plan process.").

172. COLLIER ON BANKRUPTCY, *supra* note 91, ¶ P. 363.02[3] (outlining the applicable tests).

173. *See* Casey & Macey, *supra* note 64.

174. *See* Jared Ellias, *Upending the Traditional Chapter 11 Bargain*, BANKR. ROUNDTABLE (June 21, 2022), http://blogs.harvard.edu/bankruptcyroundtable/2022/06/21/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-upending-the-traditional-chapter-11-bargain/

the rest of its stakeholders remaining on board, continues outside of bankruptcy. This has all the hallmarks of a selective strategy because it targets only the tort claims and works around the direct and indirect costs of bringing the business, its other creditors and equity holders into the bankruptcy process.[175]

Key to the strategy is the funding agreement that GoodCo enters into with BadCo to finance payouts on the tort claims.[176] If the funding agreement leaves tort claimants no worse off than they would have been had the original pre-merger entity filed for bankruptcy, the strategy is defensible.[177] But the obvious distributional concern is that the tort claimants will be shortchanged while other creditors and equity continue to enjoy the benefits of the business assets free and clear of the tort liabilities.[178] The counterbalance lies in challenges under the Code: either a motion to dismiss BadCo's bankruptcy case on the ground that the filing is in bad faith[179] or an action to avoid the merger as a fraudulent transfer,[180] with the latter, in particular, prone to result in costly litigation on technical points of law.[181]

[https://perma.cc/A2R9-5S6T] (describing Johnson & Johnson's first of two attempts to use a two-step to address tort liabilities arising from asbestos in its leading talcum product and criticizing the technique as "a way to obtain the benefits of Chapter 11 without accepting the burden of operating a business under court oversight").

175. Casey & Macey, *supra* note 64 (explaining how a divisional merger avoids the costs of an "enterprise-wide filing" and focuses the proceedings solely "on the specific mass tort resolution that is necessary for the preservation of value").

176. *See* Samir D. Parikh, *Mass Exploitation*, 170 U. PA. L. REV. ONLINE 53, 69 (2022).

177. Casey & Macey, *supra* note 64.

178. *See* Michael A. Francus, *Texas Two-Stepping Out of Bankruptcy*, 120 MICH. L. REV. 38, 40–41 (2022) (explaining how the use of cross-indemnification and third-party releases could combine to deprive tort claimants of value).

179. *Id.* at 44–48; *see also In re* LTL Mgmt., LLC, 58 F.4th 738 (3d Cir. 2023) (petition by BadCo entity dismissed as bad faith filing where on the facts BadCo was not in financial distress because of its valuable payment rights under the terms of the funding agreements with its corporate parent and the GoodCo entity). Following dismissal, LTL Management, LLC entered into a new funding agreement and filed a second Chapter 11 case with a view to consummating an improved settlement. This second petition was dismissed on the same ground. *See In re* LTL Mgmt., LLC, 652 B.R. 433 (Bankr. D.N.J. 2023).

180. Parikh, *supra* note 176, at 59, 68–70 (outlining the fraudulent transfer risks associated with "two-stepping").

181. *See* Mark Roe & William Organek, *The Texas Two-Step: The Code Says It's a Transfer*, BANKR. ROUNDTABLE (July 19, 2022), https://bankruptcyroundtable.law.harvard.edu/2022/07/19/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-the-texas-two-step-the-code-says-its-a-transfer/ [https://perma.cc/582P-Y7M4] (foreshadowing and rebutting arguments that divisional mergers do not involve a "transfer" for the purposes of the Code's fraudulent transfer avoidance statute); *cf.* Hon. Judith K. Fitzgerald & Adam J. Levitin, *The Texas Two-Step: A Different Look at Bankruptcy Code Section 548*, BANKR. ROUNDTABLE (Nov. 1, 2022),

Along with third party releases in the mass tort context,[182] divisional mergers are highly controversial. Advocates point to the comparative advantage of the bankruptcy system as a mechanism for resolving mass tort claims and getting money into the hands of tort victims – namely its ability to bind holdouts and future claimants.[183] Critics slam divisional mergers as maneuvers that shift leverage away from victims to debtors,[184] and serve no useful bankruptcy purpose given that BadCo has no going concern to reorganize.[185] Furthermore, the stakes in mass tort cases differ from cases involving only contract claims because of what Jonathan Lipson calls the "dignitary" interests of tort victims, by which he means non-economic interests, including the individual rights of victims to their day in court and to a jury trial.[186] Selective up-curve restructuring that targets only tort claims when no-one else is absorbing the loss therefore implicates a wider set of public policy concerns that may be *sui generis*. For now, we merely note that both third party releases and divisional mergers work around Chapter 11's inclusivity to accomplish selective ends in an uneasy fashion.

B. Avoiding Corporate Restructuring Altogether

In a paradigm-shifting contribution to the literature, Vincent Buccola has shown how private equity sponsors increasingly avoid Chapter 11 altogether, in favor of exploiting flexibility in acquisition finance documents to raise new debt to address cash crises.[187] At the core of his argument is the claim, with which we agree, that private equity sponsors have "powerful incentives to preserve the value of sponsor investments."[188] With this insight in hand, we

---

https://bankruptcyroundtable.law.harvard.edu/2022/11/01/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-a-different-look-at-sec-548-and-concluding-thoughts/ [https://perma.cc/DLP3-D6ST] (arguing that there is no transfer by the BadCo entity for the purposes of 11 U.S.C. § 548 but that BadCo's assumption of the tort liabilities is susceptible to possible avoidance under 11 U.S.C. § 548(a)(1)(B)).

182. *See supra* Section II.D.

183. Casey & Macey, *supra* note 64; Janger, *supra* note 116 ("Bankruptcy offers advantages over both [multidistrict litigation] and class actions: a confirmed Chapter 11 plan binds dissenters; a confirmed Chapter 11 plan can address future claims . . . .").

184. Francus, *supra* note 178, at 49.

185. *Id.* at 46.

186. Jonathan C. Lipson, *Vertical Forum Shopping in Bankruptcy*, BANKR. ROUNDTABLE (June 14, 2022), https://bankruptcyroundtable.law.harvard.edu/2022/06/14/texas-two-step-and-the-future-of-mass-tort-bankruptcy-series-vertical-forum-shopping-in-bankruptcy/ [https://perma.cc/X8UT-T3Q7].

187. Buccola, *supra* note 16, at 43–44.

188. *Id*. at 1.

can see that private equity sponsors have little incentive to file for Chapter 11 high on the demise curve if there is a risk that the absolute priority rule is engaged so that equity will, almost inevitably, lose its shirt. When the business is in the early stages of financial distress, sponsors may well be prepared to inject new capital to retain their stake. They are well-informed about the prospects of the business and may be confident that if a specific issue can be resolved high on the curve, the decline will be halted, and the business will return to profitability. And non-target creditors may view the private equity sponsor's contribution as vital in other ways—for example, through labor, management, or expertise. The private equity sponsor, and the bulk of the company's creditors, may be unwilling to accept that the existing shareholders should have no continuing stake in the business where a selective corporate restructuring is undertaken high on the demise curve. And yet, if the APR is engaged, this may very well be the result.[189]

Thus, private equity sponsors who consider their portfolio company debtor to be facing specific challenges high on the demise curve may prefer to avoid Chapter 11 altogether and to raise further debt to deal with cash flow difficulties. This has the potential to be even more pathological than the workarounds already discussed. If the debtor raises further debt without addressing the cause of its financial difficulties it may simply stave off the inevitable, with the result that it enters Chapter 11 too late, with more liabilities, and having suffered a further decline.[190] We have pushed back in Part II against the argument that selective corporate restructuring necessarily involves kicking the proverbial can down the proverbial road. Indeed, we consider that this kind of "can kicking" is more likely if the lack of selective corporate restructuring tools causes debtors high on the demise curve to favor the raising of new debt over a restructuring transaction.

IV. SELECTIVE CORPORATE RESTRUCTURING IN THE UNITED KINGDOM AND EUROPE

In Part III we saw how debtors have accomplished selective strategies in various ways. With the exception of the Texas Two-Step, they all involve an

---

189. We have not undertaken a detailed examination of "gifting" or the so-called "new value exception" for the purposes of this Article because both are inherently uncertain and only entertained at all by certain courts. A sponsor may certainly wish to avoid relying on these rather precarious exceptions as a way of retaining equity. For a good discussion, see Alexandra Wilde, *Considerations for Private Equity Firms When Utilizing Chapter 11 New Value Deals*, 1 MICH. J. PRIV. EQUITY & VENTURE CAP. L. 197 (2012).

190. Adler, *supra* note 17, at 1183.

enterprise-wide filing and implicate some of the costs associated with Chapter 11's inclusivity. And all—including the Two-Step—take the main distributional safeguards for a dissenting class of impaired creditors in section 1129(b) totally off the table and do not replace them with any adequate form of holistic fairness review. To be sure, some Code protections may remain depending on the strategy, but these operate in something of a piecemeal fashion and do not home in directly on the balance that needs to be struck between the benefits of selectivity and the risks of debtor opportunism. We also identified that the lack of properly adapted selective corporate restructuring tools may cause some large corporate debtors to avoid Chapter 11 altogether, preferring to raise new debt rather than address their specific financial difficulties.

This brings us to our comparative turn. In this part we will show how the UK, and increasingly continental Europe, have developed and are developing tools specifically designed to facilitate a selective corporate restructuring strategy. This will lay the foundations for our suggestions in Part V as to how the Bankruptcy Code could usefully be reformed.

A. UK Schemes of Arrangement

UK schemes of arrangement are a nineteenth century creation, now found in the Companies Act 2006.[191] Schemes can be used for a wide variety of purposes,[192] including the proposal of a restructuring to a debtor's creditors and/or members. Ordinarily, the debtor negotiates the restructuring with its creditors and/or members and then applies to court for leave to convene meetings to vote on the restructuring plan. Creditors and members are divided into classes for the purposes of voting at these meetings, and this first court hearing is held to determine only that the classes are properly constituted and that there is no blot on the scheme which would prevent it being sanctioned,[193] but "emphatically not . . . to consider the merits and fairness of the schemes."[194] Assuming the court grants leave to convene, the meetings are held and the legislation prescribes that the vote of a majority in number representing seventy-five percent by value of creditors or members present

191. Companies Act 2006, c. 46, §§ 895–901 (UK).

192. For a comprehensive account, see JENNIFER PAYNE, SCHEMES OF ARRANGEMENT: THEORY, STRUCTURE AND OPERATION (2d ed. 2021).

193. Court "sanction" of a UK scheme or restructuring plan is equivalent to court confirmation of a plan under 11 U.S.C. § 1129. *See*, *e.g.*, Companies Act 2006, c.46, § 899.

194. *In re* Telewest Communications plc (No. 1) [2004] EWHC (Ch) 924, [2004] B.C.C. 342 [14].

and voting must be achieved in each class for the scheme to proceed.[195] If the statutory majority is achieved in each class, the debtor returns to court to ask the court to sanction the scheme of arrangement. If the court does sanction it, the scheme takes effect once the court's order has been delivered to the Registrar for Companies.[196]

A UK scheme of arrangement shares many similarities with a prepackaged Chapter 11 bankruptcy case. Both procedures are frequently used to target financial liabilities.[197] Creditors and members are divided into classes in both procedures and the statutory majority must be achieved in each class for the restructuring plan to be capable of implementation. However, schemes of arrangement are better adapted as a selective corporate restructuring tool because they address, head on, our criticisms of the prepackaged adaptation of Chapter 11 for financial restructuring purposes.

While the debtor has to work hard to engineer around Chapter 11 to develop a prepackaged strategy which facilitates selectivity, schemes of arrangement are explicitly selective. A debtor is free to decide which creditors and members it proposes its scheme to.[198] However, as Gibson L.J. said in the *Sea Assets* case:

> If the creditors within the Scheme think the proposal unfair to them and unduly favourable to those left outside the Scheme, they can vote against the Scheme. If the majority vote in favour of the Scheme, then a minority creditor has the opportunity to seek to persuade the court that the Scheme is unfair and should not be sanctioned.[199]

This illuminates a second important difference between schemes of arrangement and prepackaged Chapter 11 plans as selective corporate restructuring tools. As we saw in Part III, Chapter 11 treats a plan in which the majority is achieved in every class as consensual and offers no holistic, overall review of fairness other than the rather high bar of a failure to meet the "good faith" standard: there is broad deference to the majority vote in this eventuality. We also saw, in Part III, that the prepackaged plans are engineered in this way to avoid the rigid distributional rules which apply to non-consensual plans, and which are so problematic for selective

195. Companies Act 2006, c.46, § 899(1).

196. § 899(4).

197. For the UK context, see Sarah Paterson, *Reflections on English Law Schemes of Arrangement in Distress and Proposals for Reform*, 15 EUR. CO. & FIN. L. REV. 471 (2018).

198. Sea Assets Ltd. v. Perusahaan Perseroan (Persero) PT Perusahaan v. Penerbangan Garuda Indonesia [2001] EWCA (Civ) 1696 [51] (appeal taken from Ch.).

199. *Id.* at [45].

restructuring given that Chapter 11 requires all claims to receive some plan treatment. In contrast, and notwithstanding that the voting threshold for class acceptance is higher in a scheme of arrangement than in Chapter 11, UK courts retain the capacity to subject schemes of arrangement to holistic fairness review before sanction.

No fairness grounds are specified in the statute which instead leaves the court an apparently broad discretion as to whether to sanction the scheme of arrangement or not.[200] However, nineteenth century judges laid down a decision-making framework for the exercise of this discretion which is broadly followed to this day.[201] This decision-making framework has recently been paraphrased in modern language by Snowden J. in the following terms:

> (i) At the first stage, the Court must consider whether the provisions of the statute have been complied with . . . .
>
> (ii) At the second stage, the Court must consider whether the class was fairly represented by the meeting, and whether the majority were coercing the minority in order to promote interests adverse to the class whom they purport to represent.
>
> (iii) At the third stage, the Court must consider whether the scheme is a fair scheme which a creditor could reasonably approve. Importantly it must be appreciated that the Court is not concerned to decide whether the scheme is the only fair scheme or even the "best" scheme.
>
> (iv) At the fourth stage, the Court must consider whether there is any "blot" or defect in the scheme that would, for example, make it unlawful or in any other way inoperable.[202]

Two things are particularly striking about this framework. First, there is a general fairness review at (iii). Secondly, the conduct of the fairness review is heavily informed by the inquiry at (ii). Given that the statutory majority must be achieved in each class, the court is really pausing to consider whether there is any concern for majority oppression of the minority: for example, because majority creditors were connected with the company in some way or had some other collateral interest which motivated them to vote for a scheme which was fundamentally unfair to those without the collateral interest. Thus,

---

200. The statute is drafted in permissive terms, providing that if the statutory majority agrees to the scheme of arrangement the court "may" sanction it. Companies Act 2006, c.46, § 899(1).

201. Sarah Paterson, Judicial Discretion in Part 26A Restructuring Plan Procedures (Jan. 24, 2022) (unpublished manuscript), https://ssrn.com/abstract=4016519 [https://perma.cc/7U7K-53AE].

202. *In re* Noble Grp. Ltd. [2018] EWHC (Ch) 3092, [2019] B.C.C. 349 [17].

the fairness test in schemes of arrangement serves as an "important cross-check."[203] The court starts from the premise that creditors are better judges of what is in their interests than the court.[204] Unless the court has reason to suspect majority oppression of the minority it will be minded to sanction the plan. Nonetheless, the fairness cross-check will always be part of the court's inquiry and it does not serve solely to protect class minorities from capricious insiders. It may also prompt an inquiry into whether, in Gibson L.J.'s words, the scheme is "unduly favourable to those left outside the Scheme."[205] Dissenting minority creditors can therefore straightforwardly object to the sanctioning of the scheme on this ground.

While we regard holistic fairness review as essential in all selective corporate restructuring cases in which the plan has not been unanimously approved, it does not necessarily follow that fairness review should be undertaken with the same intensity in a case supported by a super-majority of creditors and/or members as it would be in a cross-class cram down case. In our view, the fairness review in schemes of arrangement strikes an appropriate balance. It pays due regard to the wishes of the majority and is likely to be relatively light touch in most cases. But it is not a rubber stamp. Thus, where dissenting creditors raise non-trivial concerns about their treatment relative to other creditors, or there is reason to suspect the majority's motivations, the court can refuse to sanction.

Both the role of holistic fairness review and the scope for adjusting the intensity of review are well-illustrated by England's own experience of a Two-Step. In 2006, Cape Plc and twenty-four subsidiaries filed what was called a "composite scheme of arrangement" between the companies and actual and potential claimants for damages for asbestos.[206] Although Cape was solvent, the court found that, "the uncertainty as to future asbestos-related concerns raises a real but unquantifiable risk that at some point in the future Cape or other companies in the group could become insolvent."[207] Under the scheme a new subsidiary was incorporated to which the asbestos claims were transferred and against which the asbestos liabilities would be solely enforceable in the future.[208] The new subsidiary received an initial

---

203. *In re* Amicus Fin. plc [2021] EWHC (Ch) 3036, [2022] Bus. L.R. 86 [40].

204. *Id.* at [43]; *In re* Telewest Communications plc (No. 2) [2004] EWHC 1466 (Ch), [2005] B.C.C. 36 [22].

205. Sea Assets Ltd. v. Perusahaan Perseroan (Persero) PT Perusahaan v. Penerbangan Garuda Indonesia [2001] EWCA (Civ) 1696 at [45].

206. *In re* Cape Plc [2006] EWHC (Ch) 1316, [2006] 3 All E.R. 1222 [1].

207. *Id.* at [5].

208. *Id.* at [20].

payment of £40 million and was to receive continued funding from its parent going forward.[209]

Consistent with the UK's selective restructuring approach, the Cape scheme was only put to those who, at that time, had or, in the future, may have had asbestos-related claims or derivative claims.[210] Yet, the Two-Step was still employed to try to insulate the trading business from the asbestos-related claims as they arose.[211] In weighing the tort claimants' interest in Cape's continued solvency,[212] and for its discussion of novel provisions enabling the scheme to be amended in the future,[213] the judgment provides much food for thought. But what is of immediate interest to us is the composite nature of the scheme and the holistic review of its fairness. All the group companies were parties to the scheme and all aspects of it were before the court: the transfer of the liabilities;[214] the funding arrangements;[215] and the proposals for paying tort claims.[216] The scheme was challenged by a former employee of a Cape subsidiary and a current Cape group employee.[217] These legal challenges were funded by Cape so that the court had arguments opposing the scheme clearly put it to at the sanction stage.[218] This comprehensive approach to evaluating the fairness of the scheme contrasts with the highly fragmented way in which Texas Two-Steps come before bankruptcy courts in the U.S.

A third way we consider schemes of arrangement to be better adapted as a selective corporate restructuring tool than prepackaged Chapter 11s is that they do not trigger the formation of an estate and impose a mandatory stay. Thus, it is straightforward for a debtor high on the demise curve to avoid the signaling and information-processing disadvantages associated with a stay, and it is straightforward for the company to continue to pay ride-through creditors while the scheme of arrangement is in progress.

Moreover, even if the debtor does decide it needs the protection of a stay, it is still more straightforward to continue paying ride-through creditors than it is in a prepackaged Chapter 11 case. There are two ways by which a debtor

---

209. For an excellent discussion of the case, see John Townsend, *Schemes of Arrangement and Asbestos Litigation:* In re *Cape Plc*, 70 MOD. L. REV. 837, 837–47 (2007).

210. *See In re* Cape Plc [2006] EWHC (Ch) 1316, [2006] 3 All E.R. 1222, [8], [21]–[52].

211. *Id.* at [6].

212. *Id*. at [6], [37].

213. *Id*. at [56]–[73].

214. *Id.* at [3], [5], [46], [85].

215. *Id.* at [20].

216. *Id.* at [80].

217. *Id.* at [12]–[13].

218. *Id*. at [14]–[15].

can obtain a stay (known in the UK as a moratorium). The first is the Part A1 moratorium introduced into the Insolvency Act 1986[219] by the Corporate Insolvency and Governance Act 2020 ("CIGA").[220] The Part A1 moratorium permits a debtor to continue paying pre-filing debts in one of three ways: up to a threshold without consent; above the threshold, with the consent of the insolvency practitioner who oversees the moratorium (known as the monitor); or with the consent of the court.[221] Thus, even if the Part A1 moratorium is obtained to support the debtor's efforts to implement a scheme of arrangement, ride-through creditors can be paid without the approvals required to get around the automatic stay to achieve the same objective in a Chapter 11 case.

The same is true if the debtor files for administration, the second means by which a debtor can obtain a stay in UK law. Administration is the principal corporate insolvency tool in the UK and, while it does not contain any mechanisms to impose a restructuring plan on dissenting creditors, the administration moratorium can be used to shelter and support efforts to achieve a scheme of arrangement.[222] In an administration, the insolvency practitioner who takes office as the administrator can make payments to creditors where they consider it "likely to assist the achievement of the purpose of the administration."[223] The Court of Appeal in England and Wales has recently confirmed the breadth of this power,[224] and it provides the administrator, and the debtor in administration, with broad authority to pay ride through creditors' pre-administration liabilities.[225]

Finally, it is permissible to release guarantees and securities granted by group operating companies in a finance holding company's scheme of arrangement without the operating companies having to propose their own schemes of arrangement.[226] Thus, it is commonplace for a group holding company to propose a scheme of arrangement that restructures the claims of its financial creditors and releases guarantees and securities granted by the

---

219. Insolvency Act 1986, c. 45, §§ A1–A55 (UK).

220. Corporate Insolvency and Governance Act 2020, c. 12, § 1 (UK).

221. Insolvency Act 1986, §§ A28, A31(3), A32(3).

222. *See generally* THE INSOLVENCY SERV., SUMMARY OF RESPONSES: A REVIEW OF THE CORPORATE INSOLVENCY FRAMEWORK 48 (2016).

223. Insolvency Act 1986, c.45, sch. B1, ¶ 66.

224. *In re* Debenhams Retail Ltd. [2020] EWCA (Civ) 600, [2020] 3 All E.R. 319 [59], [66]–[68] (appeal taken from Ch).

225. *Id.* at [3].

226. *In re* Noble Grp. Ltd. [2018] EWHC (Ch) 3092, [2019] B.C.C. 349 [24]; *see also* Kokorin, *supra* note 114, at 121–24 (explaining how schemes of arrangement can be used to release claims against third parties that are closely connected to claims against the scheme debtor).

operating companies.[227] This facilitates selective restructuring because the principal target claims against the finance holding company can be compromised while keeping the operating companies and their operating liabilities wholly outside the restructuring. "Ricochet" claims by the operating companies against the holding company that would otherwise result from calls on the operating company guarantees do not arise and adverse signaling costs are avoided. The position with regard to non-consensual third-party releases is thus more certain than it is under Chapter 11.[228]

Nonetheless, a limitation of the scheme of arrangement is that the statutory majority must be achieved in every voting class.[229] A scheme cannot be crammed down on a dissenting class. The UK's restructuring plan procedure, to which we turn next, does not have this limitation.

B. UK Restructuring Plans

In addition to introducing the Part A1 moratorium, CIGA also introduced the new Part 26A restructuring plan procedure into the UK Companies Act 2006.[230] The Part 26A restructuring plan procedure is closely modelled on the scheme of arrangement but with certain significant differences including the power for the court to impose the plan over the objections of an entire dissenting class or classes—the so-called cross-class cram down power.[231] Part 26A once again explicitly supports selective corporate restructuring.[232] And Part 26A restructuring plans are a more powerful tool than the scheme of arrangement and can be used in a wider range of selective corporate restructuring settings.

Just as with a scheme of arrangement, the debtor is free to select creditors and/or equity holders to be compromised by the plan. The procedure is therefore explicitly designed to facilitate a selective, rather than inclusive, enterprise-wide, corporate restructuring strategy. The statutory test for evaluating the fairness of a restructuring plan where one or more classes

---

227. *See In re* Van Gansewinkel Groep BV [2015] EWHC (Ch) 2151, [2015] Bus. L.R. 1046 [63]; *In re* Noble Grp. Ltd. [2018] EWHC (Ch) 3092, [2019] B.C.C. 349 [24].

228. *See supra* Section II.D.

229. Companies Act 2006, c.46, § 899(1); WEIL, SCHEMES OF ARRANGEMENT AS RESTRUCTURING TOOLS 1 (2015), https://eurorestructuring.weil.com/wp-content/uploads/2015/01/140553_LO_BFR_Schemes_Arrangement_Brochure_v12.pdf [https://perma.cc/RV5Q-TBRJ].

230. Companies Act 2006, c. 46, Part 26A, §§ 901A–901L (UK).

231. § 901G.

232. *See id.*

dissent is more specific than the judicially developed fairness requirement for a scheme. The court must be satisfied that "none of the members of the dissenting class would be any worse off than they would be in the event of the relevant alternative."[233] The relevant alternative is "whatever the court considers would be most likely to occur in relation to the company if the compromise or arrangement were not sanctioned."[234]

The "relevant alternative" test provides dissenting creditors with more open, contextualized grounds of objection than are available in Chapter 11. This is a meaningful difference. Douglas Baird, Anthony Casey, and Randal Picker have shown how additional amounts which a purchaser may be willing to pay prepetition suppliers to preserve the relationship, over and above the purchase price which they offer for the debtor's business and assets are irrelevant for the purposes of assessing the fairness of competing bids in a Chapter 11 case.[235] However, this is precisely the sort of payment that a creditor could argue it would receive where the relevant alternative to the Part 26A restructuring plan is a sale of the business and assets as a going concern, and which can therefore be taken into account in determining whether or not what the plan offers the creditor would make them worse off.

Moreover, even if the "no worse off" test is satisfied, it is still in the court's discretion whether to sanction the plan.[236] The statute offers no guidance on the exercise of this discretion and the courts are in the foothills of working out a structured decision-making framework that they can use to assess not only that the dissenting creditors are not worse off as a result of the plan than they would be in the event of the relevant alternative, but also to ensure that no creditor or member gets too good a deal (too much unfair value) as a result of the plan.[237]

Overall, however, the judicial exercise is the same in the case of a Part 26A restructuring plan as it is in the case of a scheme of arrangement. In order to sanction the plan or scheme, the court determines whether the plan is a fair plan, which a creditor in the dissenting class could reasonably be expected to consent to, notwithstanding that they withheld their consent.[238] Thus, the relevant alternative concept and the residual judicial discretion operationalize the requirement that the plan is one that a rational creditor in the dissenting

---

233. § 901G(3).
234. § 901G(4).
235. Baird et al., *supra* note 2, at 1682–83.
236. *See* Paterson, *supra* note 201.
237. *Id.*
238. LATHAM & WATKINS LLP, INSOLVENCY LITIGATION 41 (Suzzanne Uhland et al. eds., 2021).

class could reasonably consent to, notwithstanding that they did not do so. A sanctionable plan is *Pareto superior*: everyone is at least as well off as they would be if the plan were not sanctioned and most (if not all) stakeholders are better off under the plan. But the justification for imposing the plan on the dissenting creditors is not anchored solely in efficiency or utilitarian arguments. The plan is also one which the dissenting creditors could be expected to consent to if rational bargaining had been possible. In other words, just as in a Part 26A scheme of arrangement, the plan must be a fair plan which a creditor could reasonably approve.[239]

Part 26A is, of course, relatively new, and so there have been relatively few cases. But cases have arisen in which the court has been asked to exercise its cross-class cramdown power and there has already been considerable judicial focus on excluded creditors. The courts have begun to develop guidelines for dealing with excluded creditors and, strikingly, are developing a flexible, rather than a rigid, approach. In other words, the court does not test the relative treatment of the excluded creditors and the included creditors by reference to the "no worse off" test. Instead, depending on the circumstances, the court will seek to ascertain whether the excluded creditors are critical to the restructuring; whether the costs of including them outweigh the benefits; and generally, whether including them within the plan would make a material difference to target creditors.[240] This would seem to be precisely the sort of exercise which Markell argues should have happened in the *Nuverra* case: "[t]he real argument seems to be that trade debt is necessary for the reorganization's success, and thus may be treated more favorably. This may be true. As an empirical observation, however, it should be subject to proof."[241]

Notably, UK courts have also begun to put debtors' feet to the fire on this point, even where the cross-class cramdown power is not engaged.[242] For example, in the convening hearing in the *Virgin Atlantic* case, Trower J. carefully reviewed the exclusion from the plan of more than 1,000 creditors with claims of under £50,000 for reasons of "logistical difficulties"; public bodies with claims for liabilities such as air traffic control charges required for the continuation of the company's business; creditors such as sales agents

---

239. *In re* Virgin Active Holdings Ltd. [2021] EWHC (Ch) 1246, [2022] 2 B.C.L.C. 62 [221].

240. *See* Paterson & Walters, *supra* note 34, at 446–47; *In re* DeepOcean 1 UK Ltd. [2020] EWHC (Ch) 3549, [2021] Bus. L.R. 632 [11]–[12]; *In re* Virgin Active Holdings Ltd. [2021] EWHC (Ch) 814 [11]; *In re* Virgin Active Holdings Ltd. [2021] EWHC (Ch) 1246 at [264]; *In re* Virgin Atl. Airways Ltd. [2020] EWHC (Ch) 2191, [2021] 1 B.C.L.C. 87 [11]; *In re* Virgin Atl. Airways Ltd. [2020] EWHC (Ch) 2376, [2021] 1 B.C.L.C. 105 [65]–[67].

241. Markell, *supra* note 51, at 4.

242. Paterson & Walters, *supra* note 34, at 446–47.

whose goodwill was similarly essential for business continuity; and suppliers who had agreed with the debtor to accept payment at or below the level proposed in the plan.[243] At the sanction stage, Snowden J. agreed that all of these creditors had been excluded for "respectable commercial reasons."[244] He focused, particularly, on the logistical burden of bringing numerous creditors with small claims into the plan and, specifically, the company's explanation in its explanatory statement that "the cost savings to be borne by including those below £50,000 are outweighed by the practical time and cost of including them."[245] Overall, the task is to ensure that excluded creditors are not getting too good a deal—too much unfair value which should be shared with the target creditors. The court may arrive at the conclusion that this is not the case because if it were to insist on a sharing of the excluded creditors' returns, the restructuring would simply fail and everyone, including the target creditors, would be worse off; or because the costs of selecting between critical creditors and non-critical creditors would exceed the gains so that the only winners would be the advisers; or because even if the excluded creditors were brought within the compromise, the losses to target creditors would not be materially reduced so that the game is not worth the candle.[246] In all of these cases, if the excluded creditors were to be brought within the renegotiation, target creditors would be no better off, and in some cases, worse off. Crucially, the fact that creditors are excluded from the renegotiation should not lead rational target creditors to withhold consent to their own renegotiation.

As it becomes more common to review ride through creditors in Part 26A restructuring plans even where no party has objected, we would expect this practice to be adopted in the scheme of arrangement context, without undermining our point on the varying intensity of review. The schemes of arrangement and restructuring plan procedures therefore do a better job of facilitating selectivity while at the same time protecting dissenting creditors than does Chapter 11.

Part 26A also has nothing equivalent to the APR. Indeed, the court has jurisdiction to sanction a plan in which existing shareholders retain equity even if creditors are not paid in full.[247] Even so, as we have seen, the statutory test for evaluating the fairness of a cross-class cram down restructuring plan

---

243. *In re* Virgin Atl. Airways Ltd. [2020] EWHC (Ch) 2191 at [11].
244. *In re* Virgin Atl. Airways Ltd. [2020] EWHC (Ch) 2376, [2021] 1 B.C.L.C. 105 [67].
245. *Id.* at [65]–[66].
246. For a more detailed discussion, see Paterson & Walters, *supra* note 34.
247. This follows from the legislative decision not to incorporate the APR in Part 26A. *See* Paterson, *supra* note 201.

involves comparing the creditor's treatment in the plan with what they would receive in the event of the relevant alternative. In exercising its residual discretion, the court will likely focus on the justification for the decision to allocate shareholders equity in the plan if they would have received nothing in the event of the relevant alternative. Nonetheless, the courts can sanction a plan which allocates equity to existing shareholders over the objections of a dissenting class if they consider it fair to do so, an outcome which is much more difficult to engineer in Chapter 11.

In the *Virgin Active* case,[248] Snowden J. considered two justifications for shareholder participation somewhat akin to the "gifting" and "new value" exceptions to the APR. Gifting, which is controversial in the U.S., permits senior creditors to gift to junior classes, including shareholders, part of the distribution they would otherwise be entitled to.[249] The new value exception allows existing shareholders to retain their shares, even when a senior class has not been paid in full, if they have contributed new capital necessary for a successful restructuring.[250] In *Virgin Active* Snowden J. gave weight both to gifting[251] and the introduction of fresh shareholder money[252] as justification for the allocation of equity to existing shareholders[253] and the approach to new value in particular suggests that UK courts have the flexibility to go beyond the relatively tight boundaries on the concept in the U.S. courts, both in regards to non-cash contributions and the need for market testing.[254]

Seymour and Schwarcz are fiercely critical of corporate restructuring regimes which do not insist on absolute priority.[255] In their view, the omission of the APR removes a vital incentive to bargaining while opening the door for senior creditors and shareholders to collude to cut intermediary classes out of the plan.[256] However, as we have sought to demonstrate in Part III

---

248. *In re* Virgin Active Holdings Ltd. [2021] EWHC (Ch) 1246, [2022] 2 B.C.L.C. 62 [266]–[300].

249. Michael Carnevale, *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, 235 (2012).

250. Wilde, *supra* note 189, at 199.

251. *In re* Virgin Active Holdings Ltd. [2021] EWHC (Ch) 1246 [266]–[269].

252. *Id.* at [278]–[300].

253. One of us has suggested elsewhere that new value provides the more robust analytic foundation for continuing shareholder equity participation. *See* Paterson, *supra* note 201 (arguing that there is no adequate safeguard against the risk of collusion between secured parties and equity with gifting).

254. *Id.*

255. Jonathan M. Seymour & Steven L. Schwarcz, *Corporate Restructuring Under Relative and Absolute Priority Rules: A Comparative Assessment*, 2021 U. ILL. L. REV. 1, 19–33.

256. *Id.* at 10.

above, practitioners have worked around the APR to engineer plans which are not subject to a holistic, independent fairness review and the rule's inflexibility may encourage debtors high on the demise curve to take on more debt so that they enter Chapter 11 too late, with more liabilities. We therefore approve of the broad discretion given to UK courts to allow shareholders to retain equity even when creditors are not paid in full. Without this flexibility, shareholders have little incentive to tackle isolatable problems high on the demise curve where they risk losing their investment. Finally, we should also mention that Part 26A offers the same benefits as the scheme of arrangement in terms of the lack of an automatic stay; the availability of moratoria which facilitate payments to ride through creditors; and the ability to release third party guarantees in the plan for the principal debtor.

C. A Note of Caution About the UK

There are some caveats to our general approval of the UK approach. First, the new Part 26A restructuring plan procedure offers debtors the ability to exclude a class from the vote where they have no "genuine economic interest in the company."[257] The courts are just beginning to work out the contours of this test, but it may be that dissenting creditors have less ability to argue that the plan is unfair because of their treatment relative to ride through creditors where it is engaged. Secondly, other procedures in the UK statutory toolbox that facilitate selective restructuring are open to the criticism that they do not adequately balance and safeguard the interests of target creditors.[258] It is not the purpose of this Article to offer a detailed critique of the UK corporate insolvency and restructuring law system, but the short point is that while we consider that the general approach to selectivity in schemes of arrangement and Part 26A restructuring plans offers considerable inspiration for a well-balanced regime, we are not uncritical of selectivity as it functions in UK law as a whole. Indeed, there is undoubtedly the flexibility for ingenious lawyers to work around the UK regime to achieve selectivity in ways we would categorically not approve of.

---

257. Companies Act 2006, c. 46, § 901C(4) (UK).

258. Sarah Paterson, *Debt Restructuring and Notions of Fairness*, 80 MOD. L. REV. 600, 601–11 (2017) (critiquing pre-packaged administrations); Paterson & Walters, *supra* note 34, at 454–59 (disapproving of company voluntary arrangements).

D. Emerging European Variants

Although the UK scheme of arrangement has been on the statute books since the nineteenth century, for much of the twentieth century large corporate restructuring was predominantly an out of court affair in the UK.[259] However, when changes in the finance markets made out-of-court restructuring more challenging during the last quarter of the twentieth century, the scheme of arrangement was reinvigorated as a corporate restructuring tool.[260] Although the lack of a cross-class cram down power came to be seen as a limitation,[261] leading to CIGA's introduction of Part 26A, the scheme of arrangement performed relatively well as a corporate restructuring tool in the decade after the financial crisis.[262]

In contrast, many continental European jurisdictions did not have effective tools for restructuring large corporations. This led the European Commission to publish a non-binding recommendation on a new approach to business failure in 2014 which sought to encourage E.U. Member States to implement early restructuring procedures.[263] Impatient with the lack of any progress in response to the recommendation, the E.U. subsequently enacted a directive on preventive restructuring frameworks.[264] While the Directive does not have automatic effect in Member States in E.U. law—national legislation is required to implement it—and the Directive adopts a minimum harmonization approach, with a good deal of optionality for Member States within it,[265] it does provide foundations for a comprehensive unified European approach to selective restructuring.

The Directive is firmly anchored in the concept of "preventive" proceedings.[266] Broadly, the restructuring procedures with which it is concerned are intended to be available where there is a "likelihood" that the debtor will become insolvent falling short of actual insolvency as understood

259. *See* SARAH PATERSON, CORPORATE REORGANIZATION LAW AND FORCES OF CHANGE 38–40 (Oxford Univ. Press, 2020).

260. *Id*. at 72–74.

261. *See* Paterson, *supra* note 197, at 486–88.

262. *See* PATERSON, *supra* note 259, at 72–74.

263. *See generally* Commission Recommendation of 12 Mar. 2014, On a New Approach to Business Failure and Insolvency, 2014 O.J. (L 74/65).

264. *See generally* Council Directive 2019/1023, 2019 O.J. (L 172/18).

265. For criticism of this approach see Horst Eidenmüller, *Contracting for a European Insolvency Regime*, 18 EUR. BUS. ORG. L. REV. 273 (2017).

266. *See* Council Directive 2019/1023, 2019 O.J. (L 172/18) 1. For the difficulties with this concept see Nicolaes W.A. Tollenaar, *The European Commission Proposal for a Directive on Preventive Restructuring*, 30 INSOLVENCY INTEL. 65 (2017).

by national law.[267] The Directive is therefore aimed squarely at debtors who have not slid too far down the demise curve and seeks to ensure that Member States have tools that enable debtors to take steps to avoid wider enforcement. Unsurprisingly, therefore, it takes an approach that facilitates the adoption of selective restructuring procedures in Member States.

Article 8 of the Directive provides that the restructuring plan must specify "the affected parties," either individually or by category, together with their claims or interests covered by the plan.[268] Additionally, it requires a description of the parties who are not affected by the plan either individually or by category of debt "together with a description of the reasons why it is not proposed to affect them."[269] Thus, as with the UK approach, the debtor can select creditors who will ride through unaffected by the plan by reference to criteria other than the Directive's distributional tests of fairness.[270] This has already been borne out in practice in cases where debtors have used the new Dutch procedure, *Wet Homologatie Onderhands Akkoord* ("WHOA") to restructure. In one such case, the debtor proposed a restructuring of ordinary, unsecured claims, while claims incurred after a cut-off date were to be paid in full out of new unsecured financing provided by its bank. The debtor justified this unequal treatment on the ground that the claims arising after the cut-off date would have to be paid in full in order to enable the debtor to continue in business—and the Rotterdam District Court agreed.[271]

Furthermore, the Directive provides for an optional, rather than mandatory stay.[272] We have already argued that this facilitates selective corporate restructuring strategy because a debtor high on the demise curve targeting specific liabilities may wish to avoid the signaling and information-processing disadvantages of stay protection and may be able to manage its process without a stay.[273] Moreover, the stay protection provided for in the European Restructuring Directive is even better adapted to a selective corporate restructuring strategy than the English law moratoria which we

---

267. Council Directive 2019/1023, Art. 4, 2019 O.J. (L 172/18).

268. *Id.* at Art. 8.

269. *Id.* at Art. 2(1)(2) provides that "affected parties" means "creditors, including, where applicable under national law, workers or classes of creditors and, where applicable under national law, equity holders, whose claims or interests respectively, are directly affected by the restructuring plan."

270. *Id.* at Arts. 10–13; *see also* OLIVARES-CAMINAL ET AL., *supra* note 89, at 60–61.

271. Ferdinand Hengst & Reinout Vriesendorp, *The WHOA in Practice: With Greater Clarity, Come Teething Problems*, DE BRAUW BLACKSTONE WESTBROEK (Mar. 17, 2021), https://www.debrauw.com/articles/the-whoa-in-practice-with-greater-clarity-come-teething-problems [https://perma.cc/9MDV-YM82].

272. Council Directive 2019/1023, art. 6, 2019 O.J. (L 172/18).

273. *Supra* Section II.C.

discussed in Section IV.A. This is because Article 6 provides that the stay can be general (affecting all creditors) or applicable to individual creditors (though not the claims of workers unless alternative protection is in place).[274] Thus, the Directive offers the flexibility to target stay protection at particularly troublesome creditors, while leaving creditors who are excluded from the plan entirely outside of the stay's scope. The Directive also appears to permit Member States to choose to keep the stay confidential from those who are not included within it.[275]

The Directive is silent on the possibility of releasing third party guarantees in the restructuring of the principal debtor. However, recall that the Directive adopts a minimum harmonization approach: there is nothing to prevent a Member State from supplementing their national procedure with a third party release mechanism,[276] and both the Dutch WHOA and the German *Unternehmensstabilisierungs- und Restrukturierungsgesetz* ("StaRUG") include such mechanisms.[277] The Directive provides explicitly for cross-class cram down and the distributional tests of fairness in a cross-class cram down scenario are complex and difficult to interpret.[278] Notably, the Directive provides Member States with the option to select between an APR and a relative priority rule ("RPR").[279] It is interesting to note that the Dutch WHOA adopts the APR in a cross-class cram down unless there is a justification to deviate from it and the deviation is not detrimental to the interests of the relevant creditor class.[280] Similarly, the German StaRUG has the APR but with exceptions which include where the cooperation of the shareholder is required for the continuation of the business.[281] The APR is therefore an anchor rule in the WHOA and StaRUG which distinguishes these

274. Council Directive 2019/1023, art. 6(3), 2019 O.J. (L 172/18).

275. José M. Garrido et al., *Restructuring and Insolvency in Europe: Policy Options in the Implementation of the EU Directive* 5–7 (IMF., Working Paper No. 2021/152, 2021), https://www.imf.org/en/Publications/WP/Issues/2021/05/27/Restructuring-and-Insolvency-in-Europe-Policy-Options-in-the-Implementation-of-the-EU-50235 [https://perma.cc/54A9-PJZM].

276. Kokorin*, supra* note 114, at 110.

277. *Id.*

278. *See* OLIVARES-CAMINAL ET AL., *supra* note 89, at 67–70.

279. *See* Council Directive 2019/1023, art. 11, 2019 O.J. (L 172/18). For criticism of this approach see Seymour & Schwarcz, *supra* note 255 and text thereto.

280. DE BRAUW BLACKSTONE WESTBROEK, COURT CONFIRMATION OF EXTRAJUDICIAL RESTRUCTURING PLANS: WHAT YOU NEED TO KNOW ABOUT THE NEW ACT 5 (2022), https://dwbxnuhxoazve.cloudfront.net/20220321-WHOA-Booklet-March-2022.PDF [https://perma.cc/X5ZS-CLW9].

281. *See The New German Restructuring Regime ("German Scheme") Will Enter into Force on 1 January 2021*, MILBANK (Dec. 30, 2020), https://www.milbank.com/en/news/the-new-german-restructuring-regime-german-scheme-will-enter-into-force-on-1-january-2021.html [https://perma.cc/8KL7-3FDU].

procedures from the UK's Part 26A restructuring plan procedure, but the approach to cross-class cramdown is still more flexible than it is in the U.S.

In sum, the Directive is well-designed to facilitate selective corporate restructurings, and it is clear that Member States are implementing it in ways that facilitate selective restructuring. This brings us to our recommendations.

V. TACKLING CHAPTER 11'S INCLUSIVITY PROBLEM HEAD ON

In this Part we explore the possibility of a new Chapter of the Bankruptcy Code which would tackle Chapter 11's inclusivity problem head on. But what we hope to do, above all else, is start a broader conversation joining siloed debates about financial restructuring; landlord restructuring; and restructuring of tort liabilities into a single debate about selective strategies. The detail of what follows is therefore much less important than our overall conclusion: selectivity is normatively desirable but must be subject to independent oversight; Chapter 11 provides serious obstacles to selectivity and lawyers' ingenious efforts to engineer around these obstacles either undermine efforts to review the selective plan holistically or are so complex and fraught with risk that debtors avoid Chapter 11 altogether raising more debt and entering the process too late and with more liabilities; and thus, it is time for a serious conversation about how U.S. corporate bankruptcy law could better accommodate selective restructuring while providing safeguards against abuse.

Our starting point is a proposal by the National Bankruptcy Conference ("NBC") in 2014 to introduce a new Chapter 16 of the Bankruptcy Code to "facilitate court supervision of bond restructurings."[282] The NBC was focused on the difficulties of restructuring bond debt out of court caused by limitations imposed by the Trust Indenture Act of 1939 which we have already touched on in passing.[283] They considered prepackaged Chapter 11 bankruptcy to be unnecessarily expensive for a selective restructuring of financial debt, stating that "[w]here disinterested financial creditors are the only affected creditors and a supermajority of them can agree to the terms of a restructuring of their obligations, a Chapter 11 filing, in any form, may be inefficient and unnecessarily risky."[284]

Thus, the NBC recommended the introduction of:

---

282. Letter from Richard Levin, *supra* note 62.
283. *See* Roe, *supra* note 60; *see* Bratton & Levitin, *supra* note 60.
284. Letter from Richard Levin, *supra* note 62, at 3.

> [A] new, streamlined procedure under a new chapter of the Bankruptcy Code that would permit a court to impose on all members of the affected creditor class a modification of payment terms that has been accepted by the requisite disinterested majority or super majority vote, without triggering the whole panoply of Bankruptcy Code provisions, requirements and limitations that typically accompany the filing of a petition under the Bankruptcy Code.[285]

This new procedure could only be initiated by the debtor and would only be available for the purpose of modifying the rights of one or more classes of claims for borrowed money under a bond indenture or a loan agreement. Crucially, there would be no bankruptcy estate; no automatic stay; and no restriction on the payment of prepetition debt. In arriving at its recommendations, the NBC drew inspiration from European procedures, including the UK scheme of arrangement, and what was, at the time, a proposal in the Netherlands to introduce an equivalent proceeding, which eventually became the WHOA. They described these procedures as "specialized procedures that allow debtors to restructure bank or bond debt with judicial oversight without having to initiate broader insolvency proceedings."[286]

We would categorize the UK scheme of arrangement and the Dutch WHOA more broadly as tools which facilitate selective corporate restructuring strategies. For sure, restructuring financial liabilities while all other creditors ride through the case is a classic example of a selective corporate restructuring strategy. But as we have sought to demonstrate, it is not the only one. A selective strategy makes sense whenever the debtor is high on the demise curve and its financial distress relates to a specific bundle of liabilities so that, if those liabilities are restructured, the debtor's difficulties will be resolved, and no broader operational restructuring is necessary. We have already seen that the prepackaged Chapter 11 is not ideally adapted for this purpose because the debtor is still having to engineer around multiple issues: a fundamentally inclusive process; an automatic stay which makes it difficult to pay ride through creditors; an inhospitable environment for third party releases; and a technique which depends on consent in every class. It will come as no surprise, therefore, that we support the NBC's proposal. But we would go much further.

At this point, it is worth recalling that one of our concerns about prepackaged Chapter 11 cases is that they undermine protection for

285. *Id.* at 2.
286. *Id.* at 4.

dissenting creditors. The NBC recommendation underlines the sophisticated nature of financial creditors and their ability to adjust their finance terms and we agree with both propositions. But in a world where senior creditors may increasingly line up with equity to drive through a plan,[287] we are concerned about a process in which controlling groups have little to fear by way of independent, holistic overview. We are, therefore, in some sympathy with scholars who have criticized the short circuiting of a full Chapter 11 plan by means of a prepackaged case.[288] However, where we part company with these scholars is that we do not think the answer is to force the parties back into Chapter 11's all-inclusive machinery. Instead, we suggest that what is needed is a mechanism specifically designed to facilitate selectivity but with appropriately tailored protections.

Thus, we would not limit a new Chapter 16 to cases modifying rights under an indenture or loan agreement. We would take seriously the question of whether a new type of optional stay, which could be inclusive or targeted, should be available where necessary. We would not limit the procedure to cases where the vote was achieved in every class, and we would revisit Chapter 11's rigid distributional rules to see whether they remain fit for the twenty-first century to incentivize debtors high on the demise curve to address specific difficulties proactively if doing so means that equity will inevitably lose its shirt. The problem of the incentives to file where equity will inevitably be lost are well-known in a small business context and have led to the introduction of the new subchapter V of Chapter 11 of the Bankruptcy Code with a new cram down rule.[289] Notwithstanding strident defense of the APR and furious criticism of the more flexible distributional rules in Europe,[290] we consider it less desirable if debtors high on the demise curve are disincentivized from cauterizing a developing situation before it infects the rest of the business because doing so will inevitably lead to their equity position being wiped out. In other words, the APR cure may be worse than the disease.

But most importantly of all, we would follow the UK approach of putting an independent, holistic review of the overall fairness of the plan by the judge at the very center of any new Chapter. In his work, Vincent Buccola has also considered the case for a more streamlined version of Chapter 11 and in a

287. *See generally* Kenneth Ayotte & Jared A. Ellias, *Bankruptcy Process for Sale*, 39 YALE J. ON REGUL. 1 (2022).

288. *See*, *e.g.*, LoPucki, *supra* note 53.

289. 11 U.S.C. § 1190(3).

290. Seymour & Schwarcz, *supra* note 255.

broader context than the NBC proposal.[291] He leans towards a far more restrictive role for judges in which they would be presented with essentially binary choices: do the conditions warrant displacing the ordinarily prevailing property rules, and if so, does the proposed transaction give those whose interests are being transformed fair compensation?[292]

We would go the other way and leave the judge broad discretion to decide on the fairness of a selective plan including, crucially on the fairness of leaving excluded creditors outside the plan. Of course, as Lord Bingham has put it in a UK context, we would expect the exercise of judicial discretion in selective restructuring plans to "quickly be confined between banks of practice and authority."[293] Yet, we consider that what Buccola calls "a wise chancellor" is essential where a debtor is targeting specific creditors to absorb the loss, to guard against both debtor opportunism and majority oppression.[294]

Of course, we acknowledge very real concerns for the relationship between bankruptcy rules and judicial discretion. In Douglas Baird's words: "Guiding the decision making of judges is what legislation is all about. Rules exist in every legal system because unbridled discretion is not a good thing. Judges ordinarily do not play tennis without a net."[295]

Thus, in one view, the role of the bankruptcy judge is solely to "call balls and strikes, not to pitch or bat."[296] For us, however, judicial discretion in selective corporate restructuring is an example of what Carl Schneider has called "rule-failure discretion."[297] As Schneider puts it, discretion can be deliberately created "where it is believed that cases will arise in circumstances so varied, so complex, and so unpredictable that satisfactory rules that will accurately guide decision-makers to correct results in a sufficiently large number of cases cannot be written."[298]

We envisage that the new Chapter 16 would clearly mark the boundaries within which judicial discretion is to be exercised. We have already seen that the foundational concept of the relevant alternative provides a powerful

---

291. Buccola*,* *supra* note 113, at 750.

292. *Id.* at 748.

293. TOM BINGHAM, THE BUSINESS OF JUDGING: SELECTED ESSAYS AND SPEECHES: 1985-1999, at 36, 42–43 (2000).

294. Buccola, *supra* note 113, at 747.

295. Baird, *supra* note 19, at 832.

296. *Chief Justice Roberts Statement – Nomination Process*, U.S. CTS., https://www.uscourts.gov/educational-resources/educational-activities/chief-justice-roberts-statement-nomination-process [https://perma.cc/4WU7-SMDB].

297. CARL E. SCHNEIDER, *Discretion and Rules: A Lawyer's View*, *in* THE USES OF DISCRETION 47, 62 (Keith Hawkins ed., 1992).

298. *Id.* at 62.

orientating principle against which judicial discretion is exercised in the UK. As Schneider puts it "rules have a primacy in law because of their capacity to provide superior legitimacy, wisdom, fairness and efficiency."[299] Yet, as Schneider also convincingly demonstrates, rules regularly "fail to deliver on those promises."[300] In our view, no set of rules will ever deliver the type of holistic fairness review which we consider essential to a selective corporate restructuring regime. And so, for us, there will always be a place for judicial discretion.

We offer no further detail here because it is not our principal objective to produce a granular proposal. Specifically, we do not address here the powerful criticism that we cannot simply graft a selective regime onto a fundamentally inclusive regime and must, instead, rewrite the entire rule book.[301] One reason we do not engage with this criticism is because we do think that a new Chapter 16 can be developed without undermining all of Chapter 11's architecture. Another reason boils down to pragmatism: there is an urgent need to tackle Chapter 11's inclusivity problem, but Congress is unlikely to contemplate comprehensive reform of Chapter 11 any time soon.[302] To reiterate: our aim is not to present a detailed blueprint for a new selective restructuring regime.

Instead, we seek to start a broader conversation about selectivity in Chapter 11. To that end, we have drawn on UK and European examples to make our concerns for Chapter 11's inclusivity problem more vivid. And having regard to this wider comparative and international context, we note the concerns that some scholars have expressed about regulatory competition: that the availability of more streamlined procedures which facilitate selectivity will drive U.S. debtors to restructure overseas.[303]

VI. CONCLUSION

Market appetite for selective restructuring is understandable. As we have sought to explain, selective restructuring is normatively desirable for debtors high on the demise curve who face distinct challenges that lend themselves

---

299. *Id.* at 88.

300. *Id.*

301. We are grateful to Daniel Bussel for this excellent point.

302. Lack of Congressional engagement to date with the ABI Commission's comprehensive proposals informs our skepticism. *See* AM. BANKR. INST., *supra* note 75.

303. *See generally* Oscar Couwenberg & Stephen J. Lubben, *Good Old Chapter 11 in a Pre-Insolvency World: The Growth of Global Reorganization Options*, 46 N.C. J. INT'L. L. 353 (2021); Bruce A. Markell, *Domestic Entities as Chapter 15 Debtors: A Possibility?*, 41 BANKR. L. LETTER NL 1 (2021); Casey & Macey, *supra* note 64.

to a targeted approach. But the law needs to channel selective restructuring cases into appropriately designed procedures which provide sufficient guardrails against debtor opportunism and majority oppression. Otherwise, benefits will become unbundled from appropriate checks and balances—precisely the accusation critics level at many aspects of modern Chapter 11 practice.[304]

Chapter 11 uneasily accommodates this market appetite with two potential adverse consequences: (i) that selective restructuring plans shoehorned into Chapter 11 lack sufficient guardrails; and/or (ii) that Chapter 11's "sledgehammer to crack a nut" inclusivity becomes so unattractive that debtors simply eschew filing as an early response to financial distress, raise more debt, and enter Chapter 11 too late with a greater debt burden that makes it more difficult to stabilize the business.

We end, however, with two notes of caution. First, we share the concerns of those who worry that selective restructuring is just a cloak for collusive deals between powerful creditors and equity at the expense of target creditors. Hence, our criticism of current workarounds and our emphasis throughout on the importance of guardrails. Second, we categorically do not recommend a single standard of review, or the same intensity of review, in all types of selective restructuring case. One size does not fit all. Different considerations may apply where strongly adjusting finance creditors absorb the loss than where the challenge relates to tort liabilities associated with historic business practices. Indeed, while we understand the concern that we are asking judges to do too much, one benefit of our approach in placing the judge in the center of a selective restructuring procedure with a wide discretion, gradually bounded by precedent and practice, is that different answers can be offered for qualitatively different questions. It may well be that a tort victim has a claim to what we have elsewhere[305] called, borrowing from Calabresi and Bobbit, "absolute worthiness."[306] In other words, tort claimants may have a greater moral claim to see a wider pool of creditors share in the loss than other target creditors in other types of selective restructuring cases. This issue deserves its own treatment, and we plan to devote a further article to it. For now, we merely place a marker that the quality and intensity of review need not necessarily be identical in every type of selective restructuring case.

---

304. *See, e.g.,* Melissa B. Jacoby, *Shocking Business Bankruptcy Law*, 131 YALE L.J.F. 409, 411 (2021).

305. Paterson & Walters, *supra* note 34, at 464.

306. GUIDO CALABRESI & PHILIP BOBBITT, TRAGIC CHOICES: THE CONFLICTS SOCIETY CONFRONTS IN THE ALLOCATION OF TRAGICALLY SCARE RESOURCES 63 (1978).