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CORPORATE GOVERNANCE, BANKRUPTCY WAIVERS, AND CONSOLIDATION IN BANKRUPTCY

Daniel J. Bussel

ABSTRACT

Corporate law formalities that impede effective bankruptcy relief are properly overridden in bankruptcy. Those formalities generally count for little outside bankruptcy and should not hamstring a bankruptcy court’s ability to afford effective relief consistent with the underlying policies of the Code. Nevertheless, recent scholarship and caselaw in bankruptcy, reflecting a contract uber alles zeitgeist, has given too much credence to both entity partitions that are blind to the reality of how firms actually operate and contractual barriers to voluntary bankruptcy relief baked into corporate charters. Bankruptcy law should refocus on honoring substance over form. In doing so, corporate formalities will properly yield to underlying substantive bankruptcy policy. The limited role of corporate formalities in the event of insolvency should be factored into market expectations surrounding asset securitization, including the frailty of both entity partitions within corporate groups, and bargained-for restrictions on entities’ access to bankruptcy relief.

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INTRODUCTION

Strangely, bankruptcy law—once the vanguard of enterprise liability—increasingly kowtows to the formalities of corporate law that stand in the way of effective reorganization. Despite longstanding express exemptions under state corporate law, itself, and even as bankruptcy lawyers and judges reach for workarounds and settlements that permit enterprise-wide reorganizations and liquidations, bankruptcy courts and scholars assume that bankruptcy law regularly defers to corporate law formalism at significant cost to the underlying policies animating the Bankruptcy Code.

In two particular areas, corporate law is seen as imposing rigid and substantive limitations on bankruptcy rights. These perceived limitations sometimes preclude bankruptcy courts from crafting enterprise-wide insolvency relief consistent with the terms and objectives of the Bankruptcy Code:

First, although bankruptcy courts have long held that access to bankruptcy relief may not be waived in a contract, those same courts have generally deferred to corporate law’s decision to defer to contractual governance arrangements baked into corporate charters that hinder or preclude an entity from filing for bankruptcy relief.

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2 See, e.g., DEL. CODE ANN. tit. 8, § 303 (2011) [hereinafter DEL. GEN. CORP. LAW].


5 See, e.g., In re Franchise Servs. of N. Am., 891 F.3d 198, 207–09 (5th Cir. 2018).
Second, bankruptcy courts generally respect the legal boundaries between affiliated entities within a corporate group for substantive insolvency law purposes, even as those boundaries are routinely ignored for operational, financial, tax, and regulatory purposes.6

The explosion in “securitization” over the last twenty-five years is a primary driver of both phenomena.7 “Securitization” is based upon segregation and transfer of certain assets of an “originator” into a “bankruptcy-remote” trust or corporate subsidiary that is intended to remove the securitized assets from a future bankruptcy estate of the originator. The technique was developed to permit financial institutions to tap into the public debt markets to fund home loans and later commercial real estate mortgages. Until the early 1990s, the market for securitized debt outside of mortgage-backed securities was of de minimis proportions.8 But beginning in the 1990s, the technique was increasingly employed as a form of corporate finance with non-financial originators purporting to segregate assets in securitization vehicles as an alternative to traditional secured working capital lending.9 The bankruptcy implications of this use of securitization—which may involve segregating assets, sometimes crucial operating assets, in corporate subsidiaries that are disabled by their charters from commencing bankruptcy proceedings without the consent of their secured lender—are quite distinct from securitizations sponsored by financial institutions to fund their lending operations. Financial institutions are regulated entities, raise highly specialized issues regarding

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6 See In re Owens-Corning, 419 F.3d 195, 202 (3d Cir. 2005). On the other hand, courts routinely grant procedural consolidation or “joint administration” for purposes of docketing, filing, serving of notices, and general case administration, at the “first-day” hearing. Fed. R. Bankr. P. 1015. See, e.g., Gill v. Sierra Pac. Constr., Inc. (In re Parkway Calabasas Ltd.), 89 B.R. 832, 836 (Bankr. C.D. Cal. 1988), aff’d 949 F.2d 1058 (9th Cir. 1991). More substantively, in multi-debtor cases it is also common for all the affiliated debtors to employ the same bankruptcy counsel and for the United States Trustee to appoint a single official creditors committee. One way to manage resulting conflicts of interest when they become acute is to appoint separate committees or subcommittees or “conflicts counsel” to handle those matters that raise conflicts of interest between affiliated debtors. See, e.g., In re Wash. Mut., Inc., 442 B.R. 314, 327 (Bankr. D. Del. 2011).

7 See infra notes 164–72, and accompanying text.


9 Securitization markets collapsed following the financial crisis of 2008, but more recently, securitization activity in most sectors has rebounded to meet or exceed pre-financial crisis levels. The details are discussed in the Appendix infra at notes 221–31, and accompanying text.
systemic risk and public policy, and are ineligible for bankruptcy relief. Applying securitization techniques to a non-financial originator, however, particularly when core working capital assets are used as collateral, directly implicates the problem of bankruptcy opt-out by the originator’s secured lenders. This upsets the nuanced statutory balance drawn in the Bankruptcy Code between the rights of secured lenders and other constituents in bankruptcy cases, and potentially undermines the rehabilitative and reorganization policies of the Bankruptcy Code. Securitizing core assets of non-financial companies raises the concern of bankruptcy opt-out and is the subject of this Article.

More than twenty years ago, my UCLA colleague Lynn LoPucki suggested “the death of liability,” by which he meant a systemic inability of the holders of tort claims and statutory claims to collect judgments. For large corporations, the coming death of liability would result from continued growth in the then nascent practice of hiving off assets and pledging them exclusively to particular investors or contractual counterparties. LoPucki hypothesized at length that through a combination of complex parent-subsidiary structures, security interests, and modern asset securitization techniques, large wealthy corporate groups would render themselves judgment-proof. At a time when Exxon was the most valuable enterprise in the world, LoPucki imagined a “Zero-Asset Exxon.” By aggressively employing these strategies, Exxon could render itself judgment-proof without adversely affecting or reducing the massive scale of its operations. When LoPucki forecast the death of liability, a judgment-proof “Zero-Asset Exxon” seemed far-fetched given the vast wealth of the actual Exxon Corporation and the massive liability it was dealing with arising out of the catastrophic Exxon Valdez shipwreck and oil spill in Prince William Sound.

It seems less fanciful now.

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11 LoPucki, supra note 3, at 20–25.
12 Id. at 15–28.
13 Id.
14 Id. at 25–28.
15 Id. In LoPucki’s hypothetical, Zero-Asset Exxon’s working capital would be supplied through revolving secured credit rather than retained earnings and all other assets would be hived off to support secured debt the proceeds of which would be distributed to shareholders—not unlike a typical aggressively structured leveraged buy-out transaction.
16 See James J. White, Corporate Judgment Proofing: A Response to Lynn LoPucki’s the Death of Liability, 107 YALE L.J. 1363, 1364 (1998). Responding two years after LoPucki’s article, Professor White expressed deep skepticism about LoPucki’s prediction of companies becoming increasingly judgment-proof through securitization.
Indeed, in 2013, prominent bankruptcy scholars Douglas Baird and Anthony Casey addressed the same phenomenon of “entity partitioning” that LoPucki had described seventeen years before in the context of what they described as “withdrawal rights” from insolvency proceedings. Their fundamental premise was that bankruptcy law operated on entities, not enterprises. They suggested that sophisticated parties had finally fully absorbed this lesson and created an opt-out regime whereby they could and did effectively exclude the operation of bankruptcy law on their interests by hiving off critical assets into separate legal entities. Bankruptcy restructuring had become optional, not mandatory, for these parties.

Baird and Casey chose the Los Angeles Dodgers as their headline example, noting that the enterprise relied on three interdependent highly specialized assets: the Dodgers baseball team, Dodger Stadium which stands isolated from downtown Los Angeles in Elysian Park, and its adjacent parking lots. Dodger Stadium, the third oldest ballpark in the country, is perfectly suited for major league baseball and just about nothing else. In true Angelino fashion, most fans drive to Dodger games in their own cars. The sprawling parking lots adjacent to Dodger Stadium provide parking for them during the baseball season.

Notwithstanding the obvious economic integration of the parking lots, stadium, and team, all of which were held under common ownership and continuously operated together as part of a unified enterprise for fifty years pre-bankruptcy, by the time of the Dodgers’ bankruptcy, each asset was held in a separate limited liability company. The LLCs owning the team and the stadium filed for bankruptcy relief, but the parking lot LLC did not. Moreover, there were serious questions regarding the nonconsensual retention of the team’s franchise agreement with Major League Baseball. Baird and Casey note: “the

proofing assets); see also Yeon-Koo Che & Kathryn E. Spier, Strategic Judgment Proofing, 39 RAND J. ECON. 926, 27–28 (2008) (observing the substantial increase in the use of securitization and other judgment proofing strategies in recent years).

18 Baird, supra note 3, at 5.
19 Id. at 4–5.
20 Id. at 5. But see infra note 97, and accompanying text.
21 Baird, supra note 3, at 2–3.
22 Id. at 3–4.
23 Id.
24 Id.
25 The uncertainty regarding the ability of the team to assume its major league franchise agreement is a result of a widely recognized drafting error in section 365 that Congress has struggled to correct. From a bankruptcy policy perspective there is no sound reason to prohibit a reorganizing chapter 11 debtor from assuming its own executory contract. Daniel J. Bussel & Edward A. Friedler, The Limits on Assuming and Assigning Executory Contracts, 74 AM. BANKR. L.J. 321, 337–38 (2000).
Dodgers’ bankruptcy was emphatically not a world in which all stakeholders had to work together and no one had the right to leave the scene.26

Playing Pollyanna to LoPucki’s Cassandra, Baird and Casey conclude by suggesting:

By allowing a limited number of investors to opt out of bankruptcy in a particular, discrete, and visible way, investors as a group may be able to both limit the risk of bargaining failure and at the same time enjoy the disciplining effect that a withdrawal right brings with it. Whether this preliminary assessment is correct, however, is not nearly as important as understanding the role that withdrawal rights play under existing law and their part in the much larger challenge of integrating a theory of the firm with the law of corporate reorganizations.27

This Article suggests that some courts28 and leading bankruptcy scholars such as LoPucki, Baird, and Casey, reflecting a broader zeitgeist29 celebrating contract über alles, give too much credence to entity partitions that are blind to the reality of how firms actually operate. Bankruptcy law should refocus on honoring substance over form. Experience teaches that there is a place for mandatory ex-post-bankruptcy renegotiations displacing prepetition contractual arrangements based on current realities and traditional bankruptcy policies.30

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26 Baird, supra note 3, at 4.
27 Id. at 48. For a theory of integrating the firm with the law of corporate reorganization, see Lynn M. LoPucki, A Team Production Theory of Bankruptcy Reorganization, 57 VAND. L. REV. 741, 749–55 (2004).
28 The Dodgers’ bankruptcy court, however, was not one of them. The Dodgers’ consensual plan of reorganization largely respected entity partitions but left the Major League Baseball franchise agreement purportedly subject to withdrawal rights in place. It is unclear what the outcome would have been had substantial parties in interest litigated the extent of the withdrawal rights asserted by the equity owners of the parking lot LLC and Major League Baseball rather than compromise. Findings of Fact, Conclusions of Law, and Order Confirming Second Amended Joint Plan of Reorganization Under Chapter 11 of the Bankruptcy Code for Los Angeles Dodgers LLC and Its Debtor Affiliates, In re Dodgers LLC, No. 11-12010 (KG) (Bankr. D. Del. June 27, 2011), ECF No. 1700.
29 Of course, freedom of contract has deep roots in commercial law. For centuries, much common law has consisted of “default rules” that can be varied by contract, custom, or trade usage to the contrary, and modern commercial law has adopted this approach quite explicitly. Alan Schwartz & Robert E. Scott, The Common Law of Contract and the Default Rule Project, 102 V.A.L. REV. 1523, 1535–36 (2016). The balance between freedom of contract and other social policies, however, has fluctuated over time. HENRY S. MAINE, ANCIENT LAW, ch. V at 100 (1861) (“the movement of the progressive societies has hitherto been a movement from Status to Contract”) (emphasis in original). Mandatory rules and regulations limiting the scope of freedom of contract were more in favor mid-20th century than they seem to be now. A notable indicator of the shift in the insolvency realm has been the increasingly broad scope Congress and the courts have given statutory “safe harbors” created for derivatives and other sophisticated financial transactions. Transactions falling within the safe harbors are effectively exempt from being restructured, stayed, or avoided in bankruptcy. 11 U.S.C. §§ 546, 555, 556, 559–62 (2019). Merit Mgmt. Grp., LP v. FTI Consulting, Inc., 138 S. Ct. 883 (2018), may represent some long overdue retrenchment on this front.
30 See Iman Anabtawi & Steven Schwarcz, Regulating Ex-Post: How Law Can Address the Inevitability
Bankruptcy solves the central collective action problem posed by corporate insolvency by creating a collective proceeding. Alternatively (and inconsistently) allowing individual creditors “withdrawal rights” would also solve the collective action problem—but only by sacrificing aggregate wealth maximization, the interests of non-withdrawing non-consenting creditors and other third parties, and the social interest in debtor rehabilitation and reorganization—all to the private interest of the withdrawing creditor. Accordingly, the Bankruptcy Code properly limits any given parties’ freedom to contract around its essential provisions. Withdrawal rights are inconsistent with bankruptcy policy.

Baird and Casey correctly note that a central overall intellectual project should be to integrate a theory of the firm with the law of corporate reorganization. That is a large project and it makes sense to approach it in steps. I have not developed a fully integrated theory of the firm, much less fully integrated that nonexistent theory with corporate reorganization law. But no such theory animates state corporation codes in any comprehensive or rigorous way either. Scholars have formulated various partial and contingent models, based on transaction and agency cost theories, team production theory, artificial legal personhood, aggregation of natural persons, nexus of contracts, the firm as stand-in for stakeholder constituencies constrained by


For the avoidance of doubt, this Article is expressly limited to problems associated with corporate governance and corporate insolvency. Although securitization of revenue streams is common in municipal finance, the discussion here is not intended to deal with the special problems associated with municipal finance, including proper treatment of segregated special revenues pledged to support debt issuances, and the complex interplay between the financial restructuring of distressed municipalities, and local governmental powers and administration.

34 Baird, supra note 3, at 48.
public policy,\textsuperscript{40} or the outcome of a creditors’ bargain.\textsuperscript{41} Other models are certainly possible.\textsuperscript{42} Any plausible theory of the firm robust enough to function in and out of bankruptcy, however, must focus on the substantive role of the corporation in commercial and social life, not corporate law formalities. To the extent that corporate law formalities become impediments to effective bankruptcy reorganizations in particular, but also to efficient liquidations, those formalities are quite properly overridden by bankruptcy law.\textsuperscript{43} Bankruptcy law is not fully integrated on a theoretical level with the corporations codes; it preempts them, thereby limiting the efficacy of the entity partition techniques observed by LoPucki, Baird, and Casey (among others).\textsuperscript{44} Those limits should be factored into market expectations surrounding asset securitization and other structuring techniques designed to avoid the ordinary operation of bankruptcy law upon a particular creditor’s claim. If they are properly factored in, it is difficult to believe that securitization of core assets of operating companies will remain a cost-effective alternative to more traditional financing arrangements. The market should place little value on a bankruptcy withdrawal right that is likely to prove illusory when it matters most.

Part I of this Article surveys the general lay of the land regarding corporate governance and enterprise liability in and out of bankruptcy. Part II addresses the problem of the waiver of bankruptcy rights through contract-based corporate governance mechanisms. Part III discusses the problem of entity partition and the substantive consolidation doctrine. Part IV builds on the waiver and substantive consolidation discussions to critique securitization as a technique for skirting the basic bankruptcy policy decision to permit the restructuring of secured debt in bankruptcy. A short conclusion follows.

\textsuperscript{40} See generally David Ciepley, Beyond Public and Private: Toward a Political Theory of the Corporation, 107 AM. POLI. SCI. REV. 139 (2013).

\textsuperscript{41} For excellent survey and critique of the extant models, metaphors and heuristics regarding corporations, see STEPHEN BAINBRIDGE, THE NEW CORPORATE GOVERNANCE IN THEORY AND PRACTICE (Oxford 2008); see also Lynn Stout, Corporate Entities: Their Ownership, Control, and Purpose in OXFORD HANDBOOK OF LAW AND ECONOMICS (2018).

\textsuperscript{42} Baird, \textit{supra} note 3, at 6–7; LoPucki, \textit{supra} note 3, at 15–32.
I. CORPORATE GOVERNANCE IN AND OUT OF BANKRUPTCY

Almost all firms employing more than a single individual are conducted through some form of limited liability entity, even many firms that are functionally sole proprietorships are so organized. Larger enterprises, whether privately or publicly held, are almost always organized as affiliated limited liability entities in a “corporate group.” Corporate law treats each limited liability entity as a separate legal person with its own assets and liabilities, and subject to certain exceptions (guarantees and contractual assumption of liability, corporate veil-piercing, and alter-ego actions, independent co-debtor liability), thereby insulates each entity’s equity interest holders and affiliates from liability for the entity’s debts. The decision to institute voluntary bankruptcy proceedings is generally a decision for the board of directors, but corporate charters sometimes seek to fetter the discretion of the board to authorize the filing of a bankruptcy petition.

Given the vast amount of wealth held in corporate form, and the vast amount of economic activity engaged in by such entities, corporate law would seem to

46 See John A. Pearce II & Ilya A. Lipin, The Uncertain Viability of a Single Member Limited Liability Company as a Choice of Entity, 9 HASTINGS BUS. L.J. 423, 424 (2013) (“Many entrepreneurs looking to formalize their businesses often turn to SMLLC [Single Member Limited Liability Company] structure as their entity of choice. In the last decade, the popularity of SMLLCs has ‘skyrocketed’ and their use has steadily risen.”) (internal citation omitted).
48 For convenience, I use “corporation” generically to refer to any form of limited liability business association, including corporations, joint-stock companies, unincorporated companies or associations, limited liability companies, limited liability partnerships, and business trusts. See 11 U.S.C. § 101(9) (2019) (defining “corporation” broadly for bankruptcy law purposes). Similarly, I use “corporate law” and “corporate governance” generically to refer to the law governing any form of limited liability business association. Although limited liability companies and partnerships, like “close corporations,” DEL. GEN. CORP. LAW § 351 (2011), may be managed directly by their equity interest holders rather than by an elected board, management tends to be centralized along the lines of the corporate model as such firms become larger. Nevertheless, the titles, appointment, duties and powers of the centralized managers in these entities may vary significantly from the typical corporate model.
49 Price v. Gurney, 324 U.S. 100 (1945) applies the general rule vesting the power to authorize bankruptcy filings in the board but appears to rely solely on otherwise applicable state corporate law as the source of this rule. See infra text accompanying note 113.
50 I have not found reliable current statistics on aggregate assets held in corporate form in the United States. It is fair to assume, however, that virtually all business assets, and, leaving to the side owner-occupied residences, the vast proportion of real estate investments, are held in corporate form. In 2017, the Fortune 500 alone had aggregate revenues of $12.8 trillion—equal to two-thirds of the Nation’s GDP. Alan Murray & David Meyer, New Fortune 500, Trade War Pause, Facebook Breakup Call: CEO Daily for May 21, 2018, FORTUNE,
be a matter of great import. In fact, I suggest below, that notwithstanding all the
ink expended on corporate law and corporate governance, corporate law should
hardly matter at all, either in or out of bankruptcy. Corporate constituents’ rights
and liabilities *inter se* and *vis-à-vis* the corporation are determined by market
forces, contract, federal securities law, and other positive law, including federal
bankruptcy law, not state corporation codes.51

Although they may be varied by contract in most instances, nonbankruptcy
corporate governance rules vest control of the corporation in a board of directors
elected by shareholder plurality vote.52 The board’s governance prerogative is
subject to limited exceptions requiring shareholder majority vote53 over certain
major actions,54 at least so long as the corporation remains solvent,55
functional,56 outside bankruptcy,57 and not in dissolution.58 Outside of these
exceptions, the scope of board discretion is very great indeed, at least when
outright self-dealing is not at issue.59


51 For a thoughtful discussion of the diminishing role of corporate law outside of bankruptcy, see Zohar
53 *Id.* at § 216(2).
54 Majority shareholder consent is required to amend the certificate of incorporation, *Del. Gen. Corp.
substantially all assets of the corporation (including assets held in wholly owned subsidiaries). *Del. Gen. Corp.
Law* §§ 242–75 (2011). For an excellent theoretical overview of the current state of play in corporate law over
the respective roles of shareholders and the board in corporate governance, see Stephen Bainbridge,
*Corporate Governance After the Financial Crisis* (Oxford Univ. Press 2012).
for insolvent corporation).
56 See, e.g., *Del. Gen. Corp. Law* § 226 (2011) (providing for appointment of a custodian to manage a
corporation in the event of deadlock or for other cause).
59 Traditionally the “business judgment rule” affords directors immunity from liability so long as they act
in good faith and satisfy their duties of care and loyalty. See Cede & Co. v. Technicolor, Inc., 634 A.2d 345,
360–61 (Del. 1993). Although the business judgment rule in theory remains bounded by the duty of care, breach
of the directors’ duty of care is measured by a gross negligence standard. Moreover, key jurisdictions now permit
*In re Cornerstone Therapeutics, Inc. S’holder Litig.*, 115 A.3d 1173, 1177–78 (Del. 2015) (noting that a charter
provision may exculpate directors from duty of care but not duty of loyalty or bad faith claims). One important
exception to the business judgment standard is directors’ approval of self-interested transactions. Those are
evaluated on a fundamental fairness standard. See Cede & Co., 634 A.2d at 368 (“[A] trial court will not find a
board to have breached its duty of care unless the directors individually and the board collectively have failed to
inform themselves fully and in a deliberate manner before voting as a board upon a transaction as significant as
a proposed merger or sale . . . . Only on such a judicial finding will a board lose the protection of the business
judgment rule under the duty of care element and will a trial court be required to scrutinize the challenged
transaction under an entire fairness standard of review.”).

Even the duties of good faith and loyalty may be circumscribed in material ways under many modern
In bankruptcy, however, corporate governance radically changes. New institutions—the bankruptcy court, perhaps a bankruptcy trustee, or, if not a trustee, then sometimes a court-approved chief restructuring officer, one or more creditors’ committees, maybe an equity committee or an examiner too—assume governance responsibilities. Neither corporate law nor any pre-bankruptcy contractual arrangements define the roles of these new actors while the company is in bankruptcy. The bankruptcy court may grant individual creditors, especially secured creditors precluded from exercising their state law limited liability company statutes. Delaware, along with twenty-five other states, permits waiver of the members’ and managers’ duty of loyalty in an LLC operating agreement. Del. Code Ann. tit. 6 § 18-1101(c), (e) (2013); 1 Larry E. Ribstein & Robert R. Keatinge, Ribstein & Keatinge on Limited Liability Companies app. 9-6 at 684–85 (2d ed. 2018). The Uniform Limited Liability Company Act, which is law in most of the rest of the United States, however, does not permit such a waiver. Unif. Ltd. Liab. Co. Act § 103(b) (Nat’l Conference of Comm’rs on Unif. State Laws 1994). Nevertheless, members may consent to specific potential conflicts of interest disclosed in their agreement. To the extent they do so, the duty of loyalty may be meaningfully circumscribed even in jurisdictions that do not permit the elimination of the duty of loyalty. See, e.g., Unif. Ltd. Liab. Co. Act § 103(b) 5–6 (Nat’l Conference of Comm’rs on Unif. State Laws 1994) (parties may designate activities that do not violate the duty of loyalty if the designation is not manifestly unreasonable); Cal. Corp. Code §§ 16103(b)-3 (4), 16404 (2019). Even Delaware, however, makes its implied covenant of good faith and fair dealing non-waivable. Del. Code Ann. Tit. 6 § 18-1101(c), (e) (2013). See generally H. Justin Pace, Contracting Out of Fiduciary Duties in LLCs: Delaware Will Lead, but Will Anyone Follow? 16 Nev. L.J. 1085 (2016).

The modern disconnect between nonbankruptcy and bankruptcy governance regimes has been persuasively attributed to the federalization of insolvency law and its administration by specialized federal courts while corporate law remained a matter of state law administered by state courts. David A. Skeel, Jr., Rethinking the Line Between Corporate Law and Corporate Bankruptcy, 72 Tex. L. Rev. 471, 487–91 (1994).

11 U.S.C. §§ 701, 702, 1104(a)-(b) & 1106 (2019). Under these statutes, trustees are routinely appointed in chapter 7 cases but only appointed for cause in a chapter 11 case. If a trustee’s appointment is ordered and there is sufficient creditor interest to hold an election, unsecured creditors may choose a qualified “disinterested person” to serve as trustee. 11 U.S.C. §§ 101(14), 321–22, 702, 1104(b) (2019). Once a trustee is appointed, the governance prerogatives previously held by the board of directors (or other governing board) are vested in the trustee. See Commodity Futures Trading Commission v. Weintraub, 471 U.S. 343 (1985); see also 11 U.S.C. § 323 (2019).

Douglas G. Baird, Chapter 11’s Expanding Universe, 87 Temple L. Rev. 975, 983 n.34 (2015) (noting that in the forty then most recent large chapter 11 cases, thirty-five percent of debtors engaged professional turnaround firms and fifteen percent installed CROs).

See generally Daniel J. Bussel, Coalition Building Through Bankruptcy Creditors’ Committees, 43 UCLA L. Rev. 1547, 1549–51 (1996); Bussel & Klee, supra note 30, at 688–91, 736.

Chief restructuring officers also exist outside of bankruptcy. As a formal matter, their authority in such cases is delegated authority from the board of directors. To the extent that the board appoints a chief restructuring officer under pressure from creditors (the usual case), revocation of the delegated authority or other board interference with the chief restructuring officer may breach forbearance or other agreements with creditors.
remedies but furnishing continuing financing, new interim supervisory powers over the debtor. Moreover, when not displaced by a trustee or chief restructuring officer, corporate managers and directors become fiduciaries owing first duties to the creditors, rather than shareholders. Primary responsibility for representing shareholder interests shifts to large shareholders themselves either individually or in some cases through the appointment of large holders to an “equity security holders committee” appointed by the U.S. Trustee or on order of the bankruptcy court. Neither board nor shareholder consent may be necessary to exit chapter 11 or to determine the shape and governance of the reorganized firm under a creditor’s plan of reorganization, neither board nor shareholder consent is sufficient to exit chapter 11 or confirm the debtor’s own plan of reorganization.

Corporate law is a great redoubt of formalism, but insolvency law, rooted in equity, celebrates substance over form and gives primacy to bankruptcy policies focusing on the protection of creditor interests, maximization of aggregate value.

67 11 U.S.C. §§ 362(a) (automatic stay); 363(a), (c), & (e) (use of cash collateral); 364 (post-petition extensions of credit) (2019).
69 See Commodity Futures Trading Commission v. Weintraub, 471 U.S. 343 (1985); Wolf v. Weinstein, 372 U.S. 633, 649–50 (1963); 7 COLIER ON BANKRUPTCY ¶¶ 1108.09[2], 1108.10; see also North American Catholic Educ. Programming Found. v. Gheewalla, 930 A.2d 92, 103 (Del. 2007). These authorities, of course, make the debtor-in-possession’s management fiduciaries with duties to all parties-in-interest, but if the estate is clearly insolvent, creditor interests are paramount. Note that in proposing a plan, however, the debtor’s management acts in its capacity as fiduciaries for the debtor, not the debtor-in-possession. 11 U.S.C. § 1121 (2019). The statute in this way subtly recognizes that in connection with the plan process the debtor may be in an adversary position with respect to some or all creditor interests. See DANIEL J. BUSSEL & DAVID A. SKEEL, JR., BANKRUPTCY 532 (10th ed. 2016).
71 11 U.S.C. §§ 1121(e), 1129(b) (2019). Debtors’ exclusive right to file a plan ends no more than eighteen months after the bankruptcy filing and may lapse or terminate earlier by court order or the appointment of a trustee. Id. at § 1121(b), (e), (d)(2) (2019); see also Matter of Gaslight Club, Inc. 782 F.2d 767, 770–72 (7th Cir. 1986) (court appointing responsible person to represent the debtor-in-possession); Manville Corp. v. Equity Security Holders’ Committee (In re Johns-Manville Corp.), 66 B.R. 517, 520 (Bankr. S.D.N.Y. 1986) (enjoining a shareholders’ meeting called to replace the board of directors as potentially disruptive of pending chapter 11 proceedings).
72 Reorganization plans are usually confirmed with the informed consent of all impaired classes of claims and interests. 11 U.S.C. §§ 1124–1126, 1129(a)(8) (2019). A plan, however, may be confirmed without the consent of a particular impaired class if the court finds that the “cramdown” standard of § 1129(b) is met as to that class. In a successful cramdown, the confirmed plan binds the nonconsenting class as well as everyone else. Both consensual and cramdown plans must comply with the legal standards of § 1129(a) which may be raised by the court itself, dissenting members of consenting classes, or other objecting constituents in the case.
fair distribution of the value so maximized consistent with legal priorities, and rehabilitation and reorganization.\footnote{Bankruptcy’s substance over form ethos has a long pedigree in the United States Supreme Court caselaw. \textit{See}, e.g., \textit{Pepper v. Litton}, 308 U.S. 295 (1939); \textit{Sawyer v. Hoag}, 84 U.S. 610 (1873); \textit{see also Consumer News and Bus. Channel Partnership v. Financial News Network Inc.} (\textit{In re Financial News Network Inc.}), 980 F.2d 165, 169 (2d Cir. 1992) (noting that “in bankruptcy proceedings substance should not give way to form”). \textit{See generally Daniel J. Bussel, Doing Equity in Bankruptcy, 34 EMORY BANKR. DEV. J. 13 (2018).}}

Even outside of bankruptcy, corporate law formalism fits poorly for corporate groups consisting of affiliated corporate entities under common ownership. Corporate law regulates the internal affairs among shareholders and those who manage the company.\footnote{\textit{See} \textit{David Min, Corporate Political Activity and Non-Shareholder Agency Costs}, 33 YALE J. REG. 423, 438 (2016).} Other corporate constituents—creditors, employees, customers, the public—are neither empowered by nor regulated by corporate law.\footnote{\textit{Id.} at 444–46.} For corporations that are subsidiaries of other corporations, however, assuming (as is the common case) that there are no minority shareholders to empower or protect, compliance with corporate law is merely form for form’s sake.\footnote{\textit{See PHILLIP I. BLUMBERG ET AL., BLUMBERG ON CORPORATE GROUPS} § 1.03, at 1-6–1-9 (2d ed. Supp. 2005) (noting that in 2002, the 100 largest American corporations owned, on average, 187 subsidiaries, with the high being a company owning 1,876; ninety-five percent of those subsidiaries were at least ninety-five percent owned by the parent corporation).}

Accordingly, corporate managers, quite rationally and routinely, ignore the separate legal personhood of subsidiaries within the corporate group save as they grudgingly render tribute at the altar of legal compliance to gain some tax, licensing, accounting or regulatory benefit, or protect the broader corporate group from failures of performance or legal liabilities incurred by their own wholly-owned and controlled affiliates.\footnote{\textit{See Cassandra Jones Havard, Back to the Parent: Holding Company Liability for Subsidiary Banks—A Discussion of the Net Worth Maintenance Agreement, the Source of Strength Doctrine, and the Prompt Corrective Action Provision}, 16 CARDOZO L. REV. 2353, 2355 (1995); \textit{see also Corrigan v. U.S. Steel Corp.}, 478 F.3d 718, 724 (6th Cir. 2007) (holding that corporate veil piercing was not allowed where general partnership was formed by wholly owned subsidiaries of the parent corporations, even though formed only a month a part and involved in the same transactions).} From an operating perspective, businesses function along geographic and product lines to maximize value of the whole enterprise rather than any particular subsidiary.\footnote{\textit{Corporate management’s focus on aggregate corporate profits and parent share price has long been known or assumed to be the case. \textit{See also Richard Squire, Strategic Liability in the Corporate Group}, 78 U. CHI. L. REV. 605, 615 (2011). \textit{See generally Landers, Another Word, supra note 1, at 527. The phenomenon has been most extensively documented in connection with multinationals that manipulate transfer pricing and financing decisions to minimize the consolidated group’s overall tax liabilities, particularly the liability for United States federal income taxes. See Glen Rectenwald, Note, \textit{A Proposed Framework for Resolving the Transfer Pricing Problem: Allocating the Tax Base of Multi-National Entities Based on Real Economic}}
such as strategic management, tax, legal and accounting functions, cash management, and capital allocation, are routinely centralized at the parent level. The board and management of the parent, consistent with customary compensation arrangements and their fiduciary duty to parent shareholders, rationally adopt an enterprise-wide perspective. Corporate formalities within domestic United States corporate groups at subsidiary levels should mean nothing to the extent that it is the law’s policy to reflect and support underlying business realities. A corporate enterprise operated through a series of affiliated companies under common management and ownership is one economic unit.

If the corporation is not dominated by a single controlling shareholder, minority shareholders’ formal corporate law rights usually do not matter at the parent level for publicly-held corporations either. Dissatisfied shareholders routinely sell their shares, or if they continue to hold them, remain passively dissatisfied, rather than organize themselves to assert their governance prerogatives under corporate law. The extralegal machinations of activist


80 Senior management is generally incentivized by grants of parent equity or options to purchase the parent’s equity, and the amount of such grants is typically tied to the achievement of financial metrics tied to the overall enterprise’s performance. See id. at 832–33.

81 The special problems posed by the foreign subsidiaries of multinational groups based in the United States are outside the scope of this Article. See infra notes 91, 127.

82 Courts have generally articulated fact-specific requirements in determining whether the corporate group is really one economic unit for corporate veil-piercing and bankruptcy purposes. See Fish v. East, 114 F.2d 177, 191 (10th Cir. 1940). But they generally avoided recognizing the overarching reality that corporate groups operate on an enterprise-wide basis. See Landers, supra note 1.

83 See Carol Goforth, Proxy Reform as a Means of Increasing Shareholder Participation in Corporate Governance: Too Little, But Not Too Late, 43 AM. U. L. REV. 379, 383–94, 464 (1994) (“It is difficult to contend seriously that shareholders have a meaningful role in corporate governance under existing regulations.”). Goforth discusses in depth the ways in which shareholder control over corporate governance has been diluted and eroded over time and the resulting low rates of participation. Indeed, in the context of mergers and acquisitions, minority shareholders may be afforded some protections such as appraisal rights, and when the transaction involves insiders, the right to contest the fairness of the entire transaction. See DEL. GEN. CORP. LAW § 262 (2011); In re Nine Systems Corp. Shareholders Litigation, C.A. No. 3940-VCN, (Del. Ch. Sept. 4, 2014).

84 Stephen Bainbridge, Director Primacy & Shareholder Disempowerment, 119 HARV. L. REV. 1735, 1735 (2005) (“[T]he housekeeping rules of corporation law effectively preclude shareholders from initiating corporate decisions . . . . [T]he extent to which corporate law is stacked against shareholder ‘intervention power’ goes beyond just the housekeeping rules; much of business law acts to limit shareholder involvement in corporate governance’”); Lucian Bebchuk, The Myth of the Shareholder Franchise, 93 VA. L. REV. 675, 676 (2007) (arguing that corporate shareholders lack any “‘powers of corporate democracy’”). But see Marcel Kahan & Edward Rock, Embattled CEOs, 88 TEX. L. REV. 987, 987 (2010) (“[C]hief executive officers of publicly held corporations in the United States are losing power to their boards and to their shareholders . . . . [T]his decline in CEO power represents a long-term trend, rather than a temporary response to economic and political conditions.”) Kahan and Rock credit shareholder activism and regulatory changes to shareholder voting as the source of CEO-disempowerment. See also Goshen, supra note 51, at 283–84, 308–10 (describing 21st century
investors and the possibility of hostile acquisition—a market mechanism rather than a legal mechanism—is the most salient constraint on the management of most solvent public companies, and the most meaningful protection for public shareholder interests from weak or faithless boards and managements.\(^85\)

Of course, corporate law does matter for shareholders of privately-held corporations (other than de facto sole proprietorships) that do not reside within corporate groups.\(^86\) But where governance really matters, it is highly unusual for shareholders to rely on off-the-rack governance arrangements set out in state statutes.\(^87\) Shareholders will generally negotiate specialized governance rules and embody their rights and responsibilities in a shareholder agreement, operating agreement, or otherwise in the firm’s organizational documents.\(^88\) Governance becomes a matter of contract among equity holders rather than positive law.

Those governance contracts, however, do not limit the government’s regulatory powers in many areas.\(^89\) The tension between the substantive objectives of many regulatory regimes and corporate law formalism has been directly resolved in favor of substantive regulatory compliance in these fields. The federal tax code, tort law, labor and employment law, and various other bodies of regulatory law are prominent examples of regulatory regimes that may impose enterprise-wide liability when members of the corporate group fall within the jurisdiction of tax authorities, courts, or regulators.\(^90\)

Thus, virtually all U.S.-based corporate groups file consolidated tax returns under the control of the parent of the corporate group.\(^91\) Firms are taxed on an

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\(^{85}\) Goshen, supra note 51, at 283–84; Henry G. Manne, Mergers and the Market for Corporate Control, 73 J. Pol. Econ. 110. 113–15 (1965). The existence of a controlling shareholder may undermine the market for corporate control and focus more attention on minority shareholders’ rights under the applicable corporation law. See also Ronald J. Gilson & Jeffrey N. Gordon, Controlling Controlling Shareholders, 152 U. Pa. L. Rev. 785, 785–87 (2003) (“[T]he presence of a large shareholder may better police management than the standard panoply of market-oriented techniques . . . . The presence of a controlling shareholder reduces the managerial agency problem . . . .”).

\(^{86}\) 1 O’NEAL & THOMPSON, CLOSE CORPORATIONS AND LLCs: LAW AND PRACTICE § 4:2 (Rev. 3d ed. 2015). See also Book Review: Close Corporations, Law and Practice (Callaghan 2d ed. 1971), 72 Colum. L. Rev. 604, 605 (1972) (“Given the statutory norm of transferable share interests and management by an elected board of directors, assurance of detailed control by shareholders [of a closely held corporation] requires either an agreement or special provisions in the articles of incorporation or bylaws.”).

\(^{87}\) O’NEAL & THOMPSON, supra note 86, at § 4:2.

\(^{88}\) Id.

\(^{89}\) See generally BLUMBERG, supra note 76, at pt. IV.

\(^{90}\) Id.

enterprise-wide basis without regard to corporate law. 92 Other regulatory obligations likewise extend to all members of a corporate group under a wide variety of labor, environmental, and regulatory regimes. 93 Increasingly, common law tort liability has expanded to impose enterprise liability directly on affiliated corporate group members, or indirectly, by expanding the scope of duty to injured persons to encompass supervisory and other activities conducted or directed by the tort-feasing entities’ affiliates 94

Similarly, finance, like government and commerce, typically deals with a corporate group as a unified enterprise rather than as separate legal entities. Financial reporting is done, and credit is extended on an enterprise-wide basis supported by suretyship and co-obligor relationships among corporate group affiliates that effectively contract around the limited liability rules created by corporate law. 95

II. WAIVING ACCESS TO BANKRUPTCY THROUGH A CORPORATE CHARTER

Bankruptcy law is premised upon a collective execution principle that requires protection against individual creditors’ ability to opt out. 96 Thus, federal bankruptcy policy precludes contractual waiver of the debtor’s right to file a bankruptcy petition or (within limits) to discharge and restructure claims through bankruptcy. 97

Consolidated Returns, 12 Fla. Tax Rev. 125, 127 (2012) (“Virtually all publicly owned United States corporations, as well as the handful of large privately owned corporations that cannot (or chose not to) make an election under subchapter S, as well as the domestic subsidiaries of foreign corporations, elect to report their income for federal tax purposes as part of a consolidated group rather than as separate entities.”).


93 See generally Adolf A. Berle, Jr., The Theory of Enterprise Entity, 47 Colum. L. Rev. 343 (1947).


95 See Widen, Corporate Form, supra note 3, at 244–47 (critiquing Owens-Corning).

96 See Jackson, supra note 32, at 123–38 (1986).

97 See, e.g., Cont’l Ins. Co. v. Thorpe Insulation Co. (In re Thorpe Insulation Co.), 671 F.3d 1011, 1027 (9th Cir.), cert. denied 568 U.S. 815 (2012) (“To confirm the § 524(g) plan, Thorpe also needed the affirmative vote of 75 percent of asbestos claimants voting on the plan. 11 U.S.C. § 524(g)(2)(B)(ii)(IV)(bb). If Thorpe did not negotiate with asbestos claimants and their representatives to set a plan that they would support, a successful reorganization would not have been possible. If, in negotiating the terms of the plan, Thorpe had to accommodate the asbestos claimants’ interests in preserving direct action rights and maximizing the trust’s insurance assets—interests potentially adverse to those of Continental—it is not liable to Continental for doing
The principle that prospective contractual waivers of basic debt protection rights, including access to federal bankruptcy relief, are unenforceable, is embodied in basic contract law, independent of express statutory provisions outlawing such contracts. The Restatement Second of Contracts provides that “a promise or other term of an agreement is unenforceable on grounds of public policy if legislation provides that it is unenforceable or the interest in its enforcement is clearly outweighed in the circumstances by a public policy against the enforcement of such terms.”

If a contract is found to be void as against public policy, courts may refuse to enforce the contract and leave both parties as they were before entering the agreement. But so long as the parties are acting in good faith, a court may sever the unenforceable provision and still enforce the rest of the agreement in favor of a party who did not engage in serious misconduct if the performance as to which the agreement is unenforceable is not an essential part of the agreed exchange.

Corbin discusses in particular how prospective waivers of certain fundamental rights and privileges violate the public policy doctrine, and further notes that fundamental debtor protections such as the mortgagor’s equity of redemption, statutory exemptions from collection of judgment, usury, so. Thorpe could not contract away its right to avail itself of the protections of § 524(g).”) (citing Bank of China v. Huang (In re Huang), 275 F.3d 1173, 1175 (9th Cir. 2002); see also Wank v. Gordon (In re Wank), 505 B.R. 878 (B.A.P. 9th Cir. 2014); In re Jeff Benfield Nursery, Inc., 565 B.R. 603 (Bankr. W.D. N.C. 2017) (denying enforcement of pre-bankruptcy automatic stay waiver); Nw. Bank & Trust Co. v. Edwards (In re Edwards), 439 B.R. 870, 874 (Bankr. C.D. Ill. 2010); Double v. Cole (In re Cole), 428 B.R. 747 (Bankr. N.D. Ohio 2009); In re Knapp, 229 B.R. 821, 842 (Bankr. N.D.Ala. 1999) (“Courts have long held that a pre-dispute agreement to waive benefits conferred by the bankruptcy laws is wholly void as against public policy.”); In re Madison, 184 B.R. 686 (Bankr. E.D. Pa. 1995) (agreement not to file bankruptcy for certain time period is not binding); In re Pease, 195 B.R. 431, 433 (Bankr. D. Neb. 1996) (“[T]he Bankruptcy Code extinguishes the private right of freedom to contract around its essential provisions.”); In re Westzen, 3 F.Supp. 698 (S.D.N.Y.1933) (“It would be repugnant to the purpose of the Bankruptcy Act to permit the circumvention of its object by the simple device of a clause in the agreement, out of which the provable debt springs . . . .”) (quoting Fed. Nat’l Bank v. Koppel, 253 Mass. 157 (1925)).

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and bankruptcy rights have long been prominent examples of contracts void as against public policy. Finally, uniform law concerning bankruptcy is a matter of particular federal interest under the Constitution and states are precluded from creating special exceptions to the public doctrine targeted at limiting these federally created and protected rights.

Courts have long extended this principle to business entities as well as individual debtors. Contractual waivers of the right to file for bankruptcy or other core bankruptcy rights are therefore not enforceable. This policy of forbidding bankruptcy waivers extends to so-called “ipso facto clauses” that

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105 15 CORBIN ON CONTRACTS § 88.7 (Rev. Ed. 2019).
106 HSBC Bank USA v. Branch (In re Bank of New Eng. Corp.), 364 F.3d 355, 364–66 (1st Cir. 2004) (Bankruptcy Code preempts state common law “rule of explicitness” operating to disallow creditor’s right to post-bankruptcy interest as a bankruptcy specific rule of contract law); see also AT&T Mobility v. Concepcion, 533 U.S. 333, 338–40 (2011) (Federal Arbitration Act preempts California unconscionability doctrines targeted at arbitration). Indeed, courts have found that state insolvency statutes that are in competition with the federal bankruptcy scheme are subject to implied or field preemption in light of the Constitutional decision to confer on Congress the power to make uniform laws concerning bankruptcies. Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518, 524–25 (1933); Stellwagon v. Clum, 245 U.S. 605, 613–15 (1918); Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1201 (9th Cir. 2005); see also Sturges v. Crowninshield, 17 U.S. 122, 208 (1819) (Contracts Clause limits state authority to enact bankruptcy legislation). These authorities are analyzed in KENNETH N. KLEE & WHITMAN L. HOLT, BANKRUPTCY AND THE SUPREME COURT 1801–2014, at 124–46 (West Academic 2015).
107 In re Trans World Airlines, Inc., 261 B.R. 103, 114–15 (Bankr. D. Del. 2001); In re Pease, 195 B.R. 431, 432–34 (Bankr. D. Neb. 1996); In re Weitz, 3 F. Supp. 698, 698–99 (S.D.N.Y. 1993) (“It would be repugnant to the purpose of the Bankruptcy Act to permit the circumvention of its object by the simple device of a clause in the agreement, out of which the provable debt springs . . . . It would be vain to enact a bankruptcy law with all its elaborate machinery for settlement of the estates of bankrupt debtors, which could so easily be rendered of no effect.”) (quoting Fed. Nat’l Bank v. Koppel, 253 Mass. 157 (1925)). The existence of this long line of precedent in this area is an important factor for modern courts. “Although the power of the courts to invalidate bargains of parties on grounds of public policy is unquestioned and is clearly necessary, the impropriety of a transaction should be convincingly established in order to justify the exercise of the power. How far courts should extend public policy beyond what has already been established by precedent, in the absence of a clear-cut declaration of such policy by constitution, legislation or judicial precedent has been questioned . . . .” 5 WILISTON ON CONTRACTS § 12.3 (4th ed. 2019) (internal citations omitted).

Drawing bright-line distinctions between property and contract rights in bankruptcy can be problematic. See, e.g., Bussel, Equity in Bankruptcy, supra note 73, at 14–20 (advocating a balancing test for enforcement of specific performance rights that includes as a factor weighing against enforcement the contractual source of a claim and favoring finality in the conveyancing of property). Property rights, like contract rights, are commonly created or assigned by private agreement. Nevertheless, bankruptcy law (like other bodies of law) has long distinguished between property and contract rights and afforded bankruptcy courts lesser leeway to substantively alter property rights. U.S. v. Sec. Indus. Bank, 459 U.S. 70, 83–85 (1982); Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 588–89 (1935).
contractually alter or eliminate rights upon the debtor’s filing for bankruptcy or other financial condition defaults, even though such clauses are generally considered enforceable under nonbankruptcy law. Moreover, as a general proposition, orders of nonbankruptcy courts enjoining debtors from filing bankruptcy petitions are also unenforceable as void against public policy.

Although corporate debtors’ right to file a bankruptcy petition is nonwaivable, in *Price v. Gurney*, the Supreme Court also held that a dissident shareholder could not file a bankruptcy petition for the corporation under Chapter X of the Bankruptcy Act of 1898 if state corporate law provided that only the directors had the power to authorize the filing of a petition. Consistent with *Price*, under state corporation law (and bankruptcy law), unless the corporation’s charter or bylaws provide otherwise, bankruptcy filings may be authorized by a resolution of the board of directors at a duly convened meeting. If there is a deadlock or a dispute, shareholders may call a special meeting to elect a new board of directors. The board holds the right to commence insolvency proceedings for the corporate debtor, a right that may not be waived by contract.

Creditors’ lawyers nevertheless have long attempted to evade the proscription on contractual waiver of corporate bankruptcy rights by obtaining control over the corporate decision to file bankruptcy without actually claiming outright control over the corporation, which might risk liability to third parties or equitable subordination of their clients’ claims.
The most sophisticated techniques involve attempts to fetter the board’s prerogative of filing for bankruptcy. Examples include requiring the consent of an “independent” director appointed by the creditor to any bankruptcy filing, the issuance of a “golden share” of common equity, and requiring the consent of its holder (the creditor or an affiliate) to any bankruptcy filing. Bankruptcy courts sometimes refuse to honor these provisions if they believe the nonconsenting director or shareholder is failing to honor fiduciary duties to the corporation because of explicit or implicit understandings with a creditor that he will vote against a resolution to file a bankruptcy petition. Courts have also allowed precluding old officers and board of directors from filing a bankruptcy petition for corporation); see also In re Intervention Energy Holdings, LLC, 553 B.R. 258, 264 (Bankr. D. Del. 2016) (“Even so long ago as 1912, the United States Supreme Court was forced to address parties attempting to circumvent the bankruptcy laws by ‘circuitry of arrangement.’ Today’s resourceful attorneys have continued that tradition.”); see also Citicorp Venture Capital, Ltd. v. Comm. of Creditors Holding Unsecured Claims, 160 F.3d 982 (3d Cir. 1998); Pepper v. Litton, 308 U.S. 295, 311 (1939); Citicorp Venture Capital v. Committee of Creditors Holding Unsecured Claims (In re Papercraft Corp.), 211 B.R. 813 (W. D. Pa. 1997), aff’d sub nom. Citicorp, 160 F.3d at 982.}

\[117\] In re Intervention Energy, 553 B.R. at 262. 
\[118\] See In re Insight Terminal Solutions, LLC, No. 19-32231(1)(11), 2019 Bankr. LEXIS 2949, at *10 (Bankr. W.D. Ky. Sept. 23, 2019) (finding charter amendments requiring creditor/warrant holder consent to bankruptcy filing violate public policy); Windels Marx Lane & Mittendorf, LLP v. Source Enters. (In re Source Enters.), 392 B.R. 541, 554–55 (S.D.N.Y. 2008); In re American Globus Corp., 195 B.R. 263, 265–66 (Bankr. S.D.N.Y. 1996) (finding that the bankruptcy could proceed despite the unanimity requirement and objection of the minority partner because the minority partner had violated his fiduciary duties and abrogated the unanimity requirement by himself ignoring the formalities required in the bylaws throughout the history of the LLC); cf. In re Kingston Square Assoc., 214 B.R. 713, 737–38 (Bankr. S.D.N.Y. 1997). But see In re Orchard at Hansen Park, LLC, 347 B.R. 822, 826–27 (Bankr. N.D. Tex. 2006). Interestingly, no court seems to have avoided “springing guarantees” of corporate debts that are conditioned on control persons not authorizing a bankruptcy filing of the corporation. Like the golden share, the springing guarantee could be analyzed as a contractual workaround against the proscription of advance waiver of bankruptcy. Moreover, it directly incentivizes breach of fiduciary duty in cases where the corporation may benefit from the protection of bankruptcy. Courts, nevertheless, have generally enforced bad boy guarantees triggered by bankruptcy filings or other equivalent events, such as an assignment for the benefit of creditors or generally not paying debts as they mature. See, e.g., In re Extended Stay Inc., 418 B.R. 49, 59 (Bankr. S.D.N.Y. 2009) (asserting that “public policy arguments relating to the guaranty claims [were] of minimal relevance” where principal liable under bad boy guarantee due to bankruptcy filing by borrower actually authorized the filing), aff’ d, 435 B.R. 139 (S.D.N.Y. 2010); G3-Purves St., LLC v. Thomson Purves, LLC, 101 A.D.3d 37, 41 (N.Y. App. Div. 2012) (“contrary to the guarantors’ contention, the carve-out language in the loan agreement was unambiguous and provided for personal liability for a violation of certain enumerated exceptions, including defined ‘springing recourse events’”). First Nat’l Bank v. Brookhaven Realty Assoc., 637 N.Y.S.2d 418, 421 (N.Y. App. Div. 1996) (“[t]he appellants are bound by the terms of the contract[,] and enforcement of the bankruptcy default clause is neither inequitable, oppressive, [nor] unconscionable”), appeal dismissed, 88 N.Y.2d 963 (1996); Wells Fargo Bank, N.A. v. Daniels, Wells Fargo Bank, N.A. v. Daniels, 2011-Ohio-6555, at *11 (Ohio Ct. App. 2011) (“[T]he plain language of the guaranty agreements and the related agreements provided that Daniels and Baird would become liable for the entire indebtedness upon the occurrence of certain events, including the borrower filing a petition for bankruptcy” and that “[t]he agreements did not require the guarantors’ consent to, authorization of, or even knowledge about the filing of the bankruptcy petition in order to trigger their liability.”); see Marshall E. Tracht, Insider Guaranties in Bankruptcy: A Framework for Analysis, 54 U. MIAMI L. REV. 497, 545–50 (2000); Nader Pakfar, Kelsey, et al. Securities Breach with the Return of CMBS, Attorneys for Borrowers Must Carefully

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circumvention of contractual consent requirements limiting access to bankruptcy by validating the filing of a friendly involuntary petition instigated by some of the debtor’s insiders.119

The Delaware bankruptcy court was the first court to confront the golden share technique in a published opinion. In Intervention Energy, it found the technique to be a thinly disguised contractual waiver of access to bankruptcy and refused to enforce it on public policy grounds.120 As a result of the creditor’s overreaching in the charter to impose special limitations on bankruptcy filing authority, the standard corporate governance rules embodied in the Delaware corporation code applied by default, a moderate and sensible result consistent with Price v. Gurney.121 In Franchise Services,122 however, the Fifth Circuit subsequently enforced a golden share provision also governed by Delaware law, distinguishing Intervention Energy on the ground that the holder in Franchise Services was a bona fide shareholder123 and not “a creditor [that] has somehow contracted for the right to prevent a bankruptcy where the equity interest is just a ruse.”124 The implication of Franchise Services, however, remains that if a creditor bargains for a golden share simply as a means of avoiding the prohibition on contractual bankruptcy waivers and is not otherwise a “bona fide shareholder,” the court will not enforce the golden shareholder consent requirement.125


121 Id.; see also In re Insight Terminal Solutions, 2019 Bankr. LEXIS 2949, at *10 (finding charter amendments requiring creditor/warrant holder consent to bankruptcy filing violate public policy).


123 The golden shares in Franchise Services were preferred shares issued to an investor in exchange for $15 million. The preferred share investor also held debt with a face amount of $3 million. The Fifth Circuit viewed the preferred shares as an equity investment, hence its characterization of the investor as a bona fide shareholder. Of course, the line between debt and equity is a notoriously thin one and preferred stock straddles the line. Preferred stock of well-capitalized firms functions as a debt-equivalent, particularly when it carries mandatory redemption or conversion to debt features. See generally Kenneth A. Carow & John J. McConnell, A Survey of U.S. Corporate Financing Innovations 1970–1997, 12.1 J. APPLIED CORP. FIN. 55 (1999). Viewed in this light, it is at best unclear whether the Fifth Circuit was correct in honoring the golden share feature of the preferred shareholder’s contract as embodied in the corporate charter.

124 In re Franchise Servs. of N. Am., Inc., 891 F.3d at 203 n.1.

125 In addition to the golden share, there are a plethora of other devices and strategies lenders use that are designed to encumber a debtor’s right to bankruptcy relief. To name a few examples, lenders may require that the borrower be structured as a bankruptcy-remote vehicle apart from the main business; the lender may require
The bankruptcy policy supporting the longstanding prohibition of pre-petition bankruptcy waivers directly applies to attempts to contractually vary corporate governance rules to prohibit voluntary bankruptcy filings without creditor consent. Indeed, any set of contractual arrangements with the substantive effect of requiring the consent of a creditor or its designated representative to a voluntary corporate bankruptcy filing, whether in the creditor’s debt contract or baked into the corporate charter, should run afoul of the public policy prohibiting advance waiver of access to bankruptcy. Bankruptcy at its core is a procedure for dealing with business failure on an ex-post collective basis that binds dissenters. It is fundamentally inconsistent with the basic decision to make such a procedure available on a debtor’s petition to allow a dissenting creditor to unilaterally veto the collective process. Rather, the dissenter should assert its substantive objections to its treatment and other substantive rights within the framework of the statutory procedure.126 The golden share (and its ilk) is too clever by half.

III. SUBSTANTIVE CONSOLIDATION OF AFFILIATED CORPORATE ENTITIES

Substantive consolidation is a bankruptcy doctrine of corporate disregard commonly applied within insolvent corporate groups.127 In a substantive consolidation, the assets and liabilities of the consolidated entities are pooled while intercompany and duplicate claims (including guarantees of consolidated affiliates’ debts) are extinguished.128 Importantly, however, security interests that “independent” (read: creditor-interested) directors serve on the board and ensure that bankruptcy can only proceed with that director’s permission; the lender may require insertion of “Bad Boy Guaranty” provisions, see supra note 116; the lender may try to restrict the bankruptcy venue or limit it to only certain chapters of the Code, making a successful bankruptcy an unlikely prospect; and the lender may require any variety of pre-petition waivers in order to make bankruptcy more difficult. See generally Harold Novikoff, et al., Bankruptcy Remote Vehicles and Bankruptcy Waivers, SG001 ALI-ABA 97 (2001); see also Tracht, supra note 116.


127 The root of the doctrine in United States insolvency law is usually identified as Sampell v. Imperial Paper & Color Corp., 313 U.S. 215 (1941). The Second Circuit played an important role in the development of the doctrine under the Bankruptcy Act of 1898. Flora Mir Candy Corp. v. R.S. Dickson & Co. (In re Flora Mir Candy Corp.), 432 F.2d 1060, 1062–63 (2d Cir. 1970); Chem. Bank N.Y. Tr. Co. v. Kheel, 369 F.2d 845, 846–47 (2d Cir. 1966); see also Charles Seligson & Charles F. Mandel, Multi-Debtor Petition—Consolidation of Debtors and Due Process of Law, 73 COMMERCIAL L.J. 341, 341–42 (1968). I leave to one side the increasingly pressing problem of the multinational corporate group subject to concurrent insolvency proceedings in different nations governed by substantively different national insolvency laws. The solution to the perplexing insolvent multinational group puzzle may well be an international regime favoring substantive consolidation governed by the law of the parent corporation’s center of main interests. But the nations of the world are a very long way from agreeing to such a regime ex-ante, although ex-post negotiated protocols or settlements in individual cases may approximate such a solution.

128 Woburn Assocs. v. Kahn (In re Hemingway Transp., Inc.), 954 F.2d 1, 11 (1st Cir. 1992)
and other rights in property are not avoided in a consolidation, except, of course to the extent that the collateral for a secured claim or other interest in property is an intercompany debt, lease, or equity interest that is extinguished in the consolidation.129 Most courts traditionally held that both filed and non-filed affiliates may be consolidated in bankruptcy, 130 as indeed occurred in some of the earliest and best-known cases.131 Post-consolidation, secured claims remain protected in bankruptcy to the extent of the collateral's value; they are not, however, immune from restructuring or alteration.

Substantive consolidation is a judicially created equitable doctrine that antedates the enactment of the Bankruptcy Code.132 To the extent there is express recognition of substantive consolidation in the current Bankruptcy Code, it resides either in bankruptcy’s “all writs” statute,133 or, in the chapter 11

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129 Sampsell, 313 U.S. at 220–21 (distinguishing rights of bona fide lien creditor).
131 See Sampsell, 313 U.S. at 218 (consolidating non-filed corporate transferee of individual bankrupt debtor’s assets with individual bankrupt debtor’s estate because “[m]ere legal paraphernalia will not suffice to transform into a substantial adverse claimant a corporation whose affairs are so closely assimilated to the affairs of the dominant stockholder that in substance it is little more than his corporate pocket.”). Notwithstanding the older authorities supporting the consolidation of non-debtor entities, some recent decisions find that non-debtor consolidation is beyond the authority of the bankruptcy court. Official Comm. of Unsecured Creditors v. Archdiocese of Saint Paul & Minneapolis (In re Archdiocese of Saint Paul & Minneapolis), 888 F.3d 944, 954 (8th Cir. 2018) (finding that statutory limitation on involuntary filing of non-profit entities precludes non-debtor consolidation); Audette v. Kasemir (In re Concepts Am., Inc.), Nos. 14 B 34232, 2018 Bankr. LEXIS 1324, at *15 (Bankr. N.D. Ill. May 3, 2018). Some courts recognizing non-debtor consolidation in theory practically limit the availability of non-debtor consolidation by imposing onerous notice requirements. Leslie v. Mihranian (In re Mihranian), No. CC-17-1048-KuSA, 2017 Bankr. LEXIS 4124, at *4 (9th Cir. B.A.P. Dec. 4, 2017); SE Property Holdings LLC v. Stewart (In re Stewart), No. 15-12215-JDL, 2017 Bankr. LEXIS 2539, at *4, 5 (Bankr. W.D. Ok. Aug. 17, 2017); see also Thomas J. McElhinney, A Bankruptcy Litigation Framework for Series LLC Eligibility, Property of the Estate, and Substantive Consolidation, 35 EMORY BANKR. DEV. J. 151 (2019) (applying substantive consolidation doctrine to Series LLC).
132 See Douglas Baird, Substantive Consolidation Today, 47 BOSTON COLL. L. REV. 5, 15–16 (2005); J. Maxwell Tucker, Grupo Mexicano and the Death of Substantive Consolidation, 8 AM. BANKR. INST. L. REV. 427, 426, 428 (2000). There are historical and conceptual ties among substantive consolidation, veil-piercing, fraudulent transfer and recharacterization doctrines and these related bodies of law often work together, or separately, to limit withdrawal rights and entity partitions, and impose enterprise liability within corporate groups, corporate parent shareholders, or, in some cases particularly with respect to fraudulent transfer cases, third parties. The discussion here, however, focuses particularly on the application of substantive consolidation doctrine.
133 11 U.S.C. § 105(a) (2019) (“The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title.”).
context, as a means of implementing a plan of reorganization. The leading academic work on substantive consolidation is that of Mary Beth Kors and William Widen. Kors and Widen come at the subject from competing perspectives.

Kors’ view is that nonconsensual substantive consolidation is a limited doctrine that should be rarely invoked and only in exceptional circumstances: (1) where there is no prejudice to any objecting party, or (2) where consolidation is a practical necessity because assets and liabilities are so scrambled amongst the entities within the corporate group that separate assignment to individual members of the group is impossible.

The Widen view is that substantive consolidation is and should be a relatively common response when it reflects the actual operations of an insolvent corporate group. The doctrine is particularly useful in avoiding battles over an arbitrary multiplication of claims based on principles of co-liability and suretyship law, and the treatment of intercompany accounts and claims based on the transfer of assets that regularly occurs in corporate group cases.
Both views are reflected in modern case law. The Widen view finds expression in such cases as Auto-Train\textsuperscript{140} and Eastgroup\textsuperscript{141} and the large number of bankruptcy court decisions confirming consolidated reorganization plans.\textsuperscript{142} These courts express the test for substantive consolidation as essentially a generalized balancing test weighing the advantages and harms of consolidation. Kors is embraced in Owens-Corning\textsuperscript{143} which in turn is critiqued by Widen. In the Courts of Appeals,\textsuperscript{144} the law reviews,\textsuperscript{145} and in the rarefied world of the writers and consumers of non-consolidation opinions,\textsuperscript{146} Kors seems to be winning the debate. Courts in her camp generally express the legal test for substantive consolidation as a two-prong analysis developed by the Second Circuit in Augie-Restivo.\textsuperscript{147} This legal test requires that the proponent demonstrate either a hopeless commingling of assets of liabilities that leaves the court with no practical alternative to consolidation or a lack of reliance on entity separateness by any objecting party.

As William Widen has pointed out,\textsuperscript{148} it is somewhat ironic that Owens-Corning has become the leading modern case authority in the two-prong line. In Owens-Corning, the banks successfully opposing substantive consolidation plainly did not rely on the financial condition of any individual entity, but rather viewed Owens-Corning as a consolidated enterprise in making their credit decision. They made their credit decision on the basis of consolidated financials only,\textsuperscript{149} and moreover demanded a web of guarantees from the members of the consolidated group to ensure that all the assets of the group members were available to satisfy their obligations regardless of which entity was the owner.\textsuperscript{150} The Third Circuit, somewhat perversely, viewed the subsidiary guarantees as evidence of bank reliance on structural seniority at the subsidiary level rather

\textsuperscript{140} Drabkin v. Midland-Ross Corp. (\textit{In re} Auto-Train Corp.), 810 F.2d 270, 276 (D.C. Cir. 1987).
\textsuperscript{141} Eastgroup Properties v. Southern MotelAssoc., Ltd., 935 F.2d 245 (11th Cir. 1991).
\textsuperscript{142} See generally Widen, Report, supra note 3, at 1.
\textsuperscript{143} \textit{In re} Owens-Corning, 419 F.3d 195 (3d Cir. 2005).
\textsuperscript{145} See Graulich, Post-Modern Trend, supra note 135; Baird, Substantive Consolidation, supra note 132.
\textsuperscript{146} See Richard D. Jones & Richard A. Bendit, Practical Advice on the Preparation of the Substantive Non-Consolidation Opinion in Real Estate Transactions, SF88 Am. Law Inst.-Am. Bar Ass’n 375, 387 (2001); see also Steven L. Schwarz, The Limits of Lawyering: Legal Opinions in Structured Finance, 84 TEX. L. REV. 1, 14 (2006); E. Kristen Moyer, Non-Consolidation and True Sale/Transfer Opinions in Securitized Real Estate Loan Transactions, 21(3) PRAC. REAL EST. LAW 7 (2005).
\textsuperscript{147} \textit{In re} Augie/Restivo Baking Co., 860 F.2d 515 (2d Cir. 1988).
\textsuperscript{148} See Widen, Corporate Form, supra note 3, at 264–65.
\textsuperscript{149} \textit{In re} Owens-Corning, 419 F.3d 195, 213 (3d Cir. 2005).
\textsuperscript{150} \textit{Id.} at 212–13.
than evidence that the banks were making an enterprise-based loan to the group as a whole supported by the entire pool of assets, regardless of which pocket within the group held title to the assets.\footnote{Id. at 212.}

A primary objection to Widen’s more liberal view of substantive consolidation is a perception that substantive consolidation creates an undesirable discontinuity between bankruptcy and nonbankruptcy rules of decision. The proceduralist view of bankruptcy first advanced by Professor Jackson\footnote{See JACKSON, supra note 32, at 7–19; Thomas H. Jackson, Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors’ Bargain, 91 YALE L.J. 857, 857–60 (1982).} insists that substantive entitlements should not be affected by bankruptcy except to the extent necessary to translate those entitlements into the form of a collective proceeding. Jackson and his many academic disciples argue that altering substantive entitlements leads to “forum shopping”—that is, bankruptcy filings that are motivated by a given constituent’s desire to obtain the benefit of the more favorable bankruptcy rule rather than to solve collective action problems.\footnote{See Thomas H. Jackson, On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors’ Bargain, 75 VA. L. REV. 155, 162 (1989).}

How ironic that substantive consolidation motivated to redress and preclude assertion of “withdrawal rights” and duplicative claims by those who have caused or exploited the debtor’s hiving off assets into separate subsidiaries draws this proceduralist objection\footnote{See generally Widen, Corporate Form, supra note 3; J. Maxwell Tucker, Substantive Consolidation: The Cacophony Continues, 18 AM. BANKR. INST. L. REV. 89 (2010); In re Owens-Corning, 419 F.3d at 212.} Substantive consolidation in these circumstances solves a collective action problem caused by those who want to avoid collective process by opting out of the bankruptcy proceeding or by manipulating its collective execution rules to their advantage.

Passing over this irony, bankruptcy consolidation involving insolvent entities, even if it is substantive, does not actually represent a discontinuity between bankruptcy and nonbankruptcy law rules of decision. Nonbankruptcy corporate governance rules expressly contemplate that the standard arrangements will shift as the corporation becomes insolvent.\footnote{See DEL. CODE ANN. tit. 8, § 291 (2019) (providing for appointment of state law receiver for insolvent corporation); see also Official Comm. of Unsecured Creditors v. Fleet Retail Fin. Grp. (In re Hechinger Inv. Co. of Del.), 274 B.R. 71, 89 (D. Del. 2002); Credit Lyonnais Bank Nederland, N.V. v. Pathe Comm’ns’ns Corp., No. 12150, 1991 Del. Ch. LEXIS 215, at *108 (“At least where a corporation is operating in the vicinity of insolvency, a board of directors is not merely the agent of the residue risk bearers, but owes its duty to the corporate enterprise.”).} Indeed, nonbankruptcy law acknowledges that when formal insolvency proceedings...
commence the nonbankruptcy regime is displaced by insolvency law rules that bring the protection of nonshareholder interests to the fore.\textsuperscript{156}

In defending his proceduralist vision of bankruptcy law, Professor Jackson specifically approved of the law of preferences to the extent that it operated to control preferred creditors’ opt-out behavior by reaching back into the prebankruptcy period and avoiding transfers, lawful and valid at the time they were made, that undermined the bankruptcy pro rata distribution scheme.\textsuperscript{157} The exigency of protecting the collective proceeding from individual creditor opt-out justified the recharacterization of lawful transactions effected on the eve of bankruptcy as unlawful preferences.\textsuperscript{158}

More recently, Professor Westbrook has on a similar basis argued that asset partitioning functions as a secret lien and that entity disregard may be an appropriate response to undisclosed, nontransparent asset partition.\textsuperscript{159} Although Westbrook and I identify a similar problem, Westbrook’s limited recommendation is to require disclosure of an enterprise’s entire corporate structure so creditors can more fully appreciate risk.\textsuperscript{160} Certainly, disclosure is independently desirable. A concealed or secret withdrawal right is potentially subject to greater abuse than an open and notorious one. Disclosure, however, does not address the fundamental conflict between a collective proceeding and the existence of contract-based “withdrawal rights.” Secrecy or transparency is not the appropriate touchstone of the enforceability of a contractual “withdrawal right;” the touchstone should be whether the right is fundamentally destructive of the collective wealth maximization and rehabilitative purposes of the collective proceeding.\textsuperscript{161}

No one suggests that bankruptcy courts should order substantive consolidation as a matter of course without advancing some collective interest recognized in the insolvency proceeding and weighing the equities of those

\textsuperscript{156} See Davis v. Woolf, 147 F.2d 629, 633 (4th Cir. 1945) (“The law by the great weight of authority seems to be settled that when a corporation becomes insolvent . . . the officers and directors no longer represent the stockholders, but by the fact of insolvency, become trustees for the creditors . . . .”); see also Pepper v. Litton, 308 U.S. 295, 307–08 (1939).


\textsuperscript{158} Jackson, Avoiding Powers, supra note 157, at 757–60.


\textsuperscript{160} Id. at 52.

\textsuperscript{161} For the avoidance of doubt, Professor Westbrook clearly acknowledges that disclosure is a starting point and not a complete solution to the problem of asset partitioning. Id. at 36.
prejudiced by consolidation. But neither should there be any bias against protecting the collective interest over the objection of a creditor who simply prefers to retain the advantage conferred by manipulating corporate governance or entity structures to avoid playing by insolvency rules. Bankruptcy law, while generally respecting the value of non-debtor property rights, may override individual creditors’ procedural and contractual nonbankruptcy rights to opt out of the proceeding in the service of bankruptcy’s collective execution process.

IV. SECURITIZING CORPORATE ASSETS

A. Securitization Today

Two landmark Reports of the Association of the Bar of the City of New York, identify the “one central, core principle” of asset securitization: “a defined group of assets can be structurally isolated, and thus serve as the basis of a financing that is independent . . . from the bankruptcy risks of the [originator] of the assets.” The proponents of asset securitization argue that by transferring assets to a trust or limited liability company that engages in no business activity other than the ownership and management of segregated assets, the transferred assets are removed from the transferor’s estate. If a court concludes that the transaction is a “true sale,” it will honor this characterization and treat the assets as bankruptcy remote—that is, as beyond the reach of a bankruptcy of the transferor. Credit rating agencies such as Moody’s and Standard and Poor’s have agreed to rate securities issued by these trusts or limited liability companies based on the quality and value of the assets transferred rather than the general credit of the transferor. This enables a transferor with, say, a single A credit rating to obtain financing at AA rates by segregating assets into “bankruptcy remote vehicles.”

162 See In re Abeinsa Holding, Inc. 562 B.R. 265, 281 (Bankr. D. Del. 2016) (“The partial substantive consolidation in the Plans is not an imprecise lumping of assets and creditors together, but the result of careful analysis of ownership, operational entanglements, and creditor expectations . . . .”).

163 See, e.g., In re ADPT DFW Holdings, LLC, 574 B.R. 87, 107 (Bankr. N.D. Tex. 2017) (holding that 140 separate legal entities should be substantively consolidated over the objection of a disputed unsecured creditor).

164 See New Developments in Structured Finance, 56 BUS. LAW. 95 (2000); Structured Financing Techniques, supra note 8, at 527.

165 New Developments in Structured Finance, supra note 164, at 101; Structured Financing Techniques, supra note 8, at 529.

166 See Moye, supra note 146, at 8.

167 See MOODY’S INV’R SERV., BANKR. REMOTENESS CRITERIA FOR SPECIAL PURPOSE ENTITIES IN GLOBAL STRUCTURED FIN. TRANSACTIONS (2014); S&P GLOBAL RATINGS, STRUCTURED FIN.: ASSET ISOLATION AND SPECIAL-PURPOSE ENTITY METHODOLOGY (2017).
The originator’s bankruptcy-disabled subsidiary or trust is described as a “bankruptcy remote vehicle” or a “special purpose entity.” Securitized debt carries a lower interest rate than non-securitized secured borrowings supported by the same collateral. Although rating agencies, bankers, and lawyers promoting securitization make vague claims of efficiency arising from the segregation of collateral into bankruptcy remote vehicles to support debt issues, the lower borrowing costs associated with this financing appear to be solely a function of the bankruptcy opt-out feature of the transaction. Rating agency and financial market acceptance of a securitization require legal opinions that conclude bankruptcy remoteness of the securitization vehicle will be respected. In particular, marketable securitizations require legal opinions that (1) the collateral has been transferred to the entity in a “true-sale” and is no longer property of the originator, and (2) bankruptcy courts will not consolidate the “bankruptcy-remote” securitization vehicle with the originator’s bankruptcy estate, should the originator commence bankruptcy proceedings.

The overall global market for securitized debt is of staggering dimensions. Total outstanding securitized debt exceeds $6 trillion. In the United States alone, annual new issuances in recent years were $436 billion (2015), $373 billion (2016), $510 billion (2017), and $531 billion (2018). Preliminary indications suggest the 2019 pace may equal or exceed that of 2018.

The vast majority of this debt, however, does not involve non-financial corporate originators securitizing core operating assets.
The securitization markets undercutting the proper functioning of chapter 11 and most directly implicating the “withdrawal rights” identified by LoPucki, Baird, and Casey are still, fortunately, a much smaller universe. That universe principally consists of the markets for single-borrower, single-asset commercial mortgage backed securities (CMBS), and the market for securitization of equipment, transportation fleets, and floorplan financing. However, we are also observing increasing securitization of operating receivables in a variety of industries. The following figures illustrate the magnitude of the potential problem and its growth over time. Figure 1 collects the data on new securitization issuances over the last thirty years broken down into eight categories of financing used by non-financial operating companies. The categories are: general equipment financings, transportation equipment (with trucks, railcars, auto fleets, and aircraft separately broken out), floorplan arrangements for dealers, receivables financings (separately broken by sector including franchisors, utilities, and energy), and a small but growing miscellaneous category.

broader securitization market for interested readers.
As Figure 1 makes clear, these categories of securitizations remain small relative to the overall securitization market, and their growth from de minimis levels prior to 1993 has been cyclical. New issuances in these categories first peaked in 2001 at over $40 billion, shrank to $20 billion in the 2002 recession, returned to the $30–40 billion level before the 2008 financial crisis, collapsed completely in the financial crisis, and then grew steadily to a new peak in 2017 of over $50 billion.

The ABS Database, Asset-Backed Alert, Harrison Scott Publications, https://www.abalert.com/db/absdb.pl (last visited Aug. 6, 2019). The entire database is available to subscribers for download at the above link. The categories represented in Figure 1 are aggregations of issuances coded with the following collateral codes: (1) Auto-Fleet Leases (AF); (2) Energy (NR, RE); (3) Equipment (EQ, EL), (4) Floorplan Loans (FP); (5) Franchises and Trade Receivables (FF, FL, WB, TR, RO); (6) Ground & Sea Transport (TU, RC, SH, TP); (7) Air Transport (AC, AK); (8) Utilities (UT, CT); and (9) Miscellaneous (WS, PF, RE, TO, EZ). A full list of collateral codes and more information about the ABS Database is available at About the ABS Database, Asset-Backed Alert, Harrison Scott Publications, https://www.abalert.com/market/about_db.pl (last visited Aug. 6, 2019). The author thanks Asset-Backed Alert for generously providing complimentary limited-term access to the database.
Single-asset single-borrower commercial real estate securitizations, shown below in Figure 2, while also fluctuating with the business cycle, demonstrate a stronger secular growth trend peaking at over $35 billion in 2017.

![Figure 2: SASB CMBS Issuances 1996–2018](https://www.sifma.org/resources/research/us-mortgage-related-issuance-and-outstanding)

Inevitably, the growth of these markets means that bankruptcy judges and lawyers in operating chapter 11 cases will increasingly encounter reorganizing firms that have funded their operations through special purpose affiliates. Application of substantive consolidation and recharacterization doctrines to this growing form of financing will become increasingly salient in the next round of financial distress, particularly if that round of financial distress heavily involves the transportation sector or a sector that relies on securitization in lieu of traditional receivables financing.

**B. LTV and General Growth**

In the context of the securitization of pools of consumer obligations by financial intermediaries, the characterization of the structured finance transaction as a true sale makes a good bit of sense. This sort of structured finance transaction effectively amounts to the transfer of a pool of mortgage

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177 U.S. Mortgage-Related Issuance and Outstanding, SIFMA (Feb. 5, 2019), https://www.sifma.org/resources/research/us-mortgage-related-issuance-and-outstanding. The entire database is freely available for download at the above URL address in Excel format. The data appearing in Figure 2 can be found in the Tab titled “Non-Agency Issuance,” and the Column titled “Single-Asset/Single-Borrower.”
loans or other consumer debt obligations from the financial originator to a set of investors who then bear the risks of ownership of those assets. But the true sale character of a transaction involving the segregation of core operating assets of a functioning business into an affiliated financing subsidiary on its face involves a far different set of considerations. Here, the originator is not merely selling off self-liquidating assets to investors but effectively obtaining its working capital from secured lenders who seek to insulate themselves from the business risks associated with these core operating assets. Arrangements of this sort famously failed their first courtroom encounter with the realities of bankruptcy in In re LTV Steel Company.178

In LTV, the bankruptcy debtor, LTV Steel Co. (LTV), was one of the largest legacy manufacturers of integrated steel products in the United States, employing 17,500 people and providing medical coverage and other benefits to approximately 100,000 retirees and their dependents. LTV successfully emerged from a prior chapter 11 in 1993.179

Abbey National was a financial institution located in the United Kingdom.180 Following its previous reorganization, LTV and Abbey National entered into its first securitization transaction in October 1994 as a substitute for a traditional secured working capital credit facility collateralized by its accounts receivable from the sale of steel products.181 To effectuate this agreement, LTV created a wholly-owned subsidiary known as LTV Sales Finance Co. (Sales Finance).182 LTV then entered into an agreement with Sales Finance which purported to sell all of LTV’s rights and interests in its accounts receivables to Sales Finance on a continuing basis.183 Abbey National then agreed to loan $270,000,000.00 to Sales Finance in exchange for Sales Finance granting Abbey National a security interest in the receivables.184 On the date LTV filed its petition, Chase Manhattan Bank was Abbey National’s agent for this credit facility.185

In 1998, LTV entered into another securitization financing arrangement.186 To that end, LTV created LTV Steel Products, LLC (Steel Products), another

179 Id. at 279–80.
181 See In re LTV Steel Co., 274 B.R. at 280.
182 Id.
183 Id.
184 Id.
185 Id.
186 Id.
wholly-owned subsidiary. LTV entered into an agreement with Steel Products which purported to sell all of LTV’s right, title, and interest in its inventory to Steel Products on a continuing basis. Chase Manhattan and several other banking institutions then agreed to loan $30,000,000.00 to Steel Products in exchange for a security interest in Steel Products’ inventory. Abbey National was not involved in this asset-backed securitization facility, and it had no interest in pre-petition inventory allegedly owned by Steel Products.

Neither Sales Finance nor Steel Products filed for chapter 11 relief when LTV encountered a need for further chapter 11 relief in 2000. Nevertheless, when LTV filed its petition for relief it moved the court for an interim order permitting it to use cash collateral. This cash collateral consisted of the receivables and inventory that are ostensibly owned by Sales Finance and Steel Products. LTV stated to the court that it would be forced to shut its doors and cease operations if it did not receive authorization to use this cash collateral. A hearing was held on LTV’s cash collateral motion on December 29, 2000 as part of the first day hearings. Abbey National was not present at the cash collateral hearing but LTV and Chase Manhattan reached an agreement regarding an interim order permitting LTV to use the cash collateral. Chase Manhattan did not formally consent to the entry of this order, as it could not secure Abbey National’s consent to the form of the order, but Chase Manhattan did negotiate some of the terms of the order and did not raise an objection to its entry by the court. The court determined that entry of the interim order was necessary to permit LTV to continue business operations, that the interests of Abbey National and all other creditors who had an interest in the cash collateral were adequately protected by the order, and that entry of the order was in the best interests of the estate and creditors of the estate. Accordingly, the court entered a use of cash collateral order affording Abbey National and the other holders of securitized obligations the protections typically afforded a senior

187 Id.
188 Id.
189 Id.
190 Id.
191 Id.
192 Id.
193 Id.
194 Id.
195 Id.
196 Id. at 280–81.
197 Id. at 281.
198 Id.
secured lender holding first liens in the debtor’s inventory and accounts receivable.\textsuperscript{199}

Abbey National sought to modify this order, arguing there was no basis for the court to determine that the receivables, which were Abbey National’s collateral, were property of LTV’s bankruptcy estate.\textsuperscript{200} It contended that the transaction between LTV and Sales Finance was properly characterized as a true sale.\textsuperscript{201}

The bankruptcy court rejected this request for modification writing:

Furthermore, there seems to be an element of sophistry to suggest that [LTV] does not retain at least an equitable interest in the property that is subject to the interim order. [LTV]’s business requires it to purchase, melt, mold and cast various metal products. To suggest that [LTV] lacks some ownership interest in products that it creates with its own labor, as well as the proceeds to be derived from that labor, is difficult to accept. Accordingly, the Court concludes that [LTV] has at least some equitable interest in the inventory and receivables, and that this interest is property of [LTV]’s estate. This equitable interest is sufficient to support the entry of the interim cash collateral order.

Finally, it is readily apparent that granting Abbey National relief from the interim cash collateral order would be highly inequitable. The Court is satisfied that the entry of the interim order was necessary to enable [LTV] to keep its doors open and continue to meet its obligations to its employees, retirees, customers and creditors. Allowing Abbey National to modify the order would allow Abbey National to enforce its state law rights as a secured lender to look to the collateral in satisfaction of this debt. This circumstance would put an immediate end to [LTV]’s business, would put thousands of people out of work, would deprive 100,000 retirees of needed medical benefits, and would have more far reaching economic effects on the geographic areas where [LTV] does business. However, maintaining the current status quo permits [LTV] to remain in business while it searches for substitute financing, and adequately protects and preserves Abbey National’s rights. The equities of this situation highly favor [LTV]. As a result, the Court declines to exercise its discretion to modify the interim order . . . .\textsuperscript{202}

\textsuperscript{199} Id. at 281–82.
\textsuperscript{200} Id. at 282.
\textsuperscript{201} Id. at 284.
\textsuperscript{202} Id. at 285–86.

https://scholarlycommons.law.emory.edu/ebdj/vol36/iss1/6
After the bankruptcy court decision in *LTV*, the cash collateral litigation settled before a final order was entered on the question of the “true sale” nature of the securitization. *LTV* prompted great angst in the securitization industry, which worried that the court’s nonruling drew into question the “true sale” status of securitizations of all kinds.\(^{203}\) Subsequent attempts to override *LTV* by statute failed in the wake of the public outcry surrounding Enron Corporation’s abuse of off-balance sheet financing through its own special purpose entities.\(^{204}\)

The robustness of the structural isolation of assets in bankruptcy remote vehicles was again tested in *General Growth Properties*.\(^{205}\) The lead debtor—General Growth Properties (GGP)—was one of the Nation’s largest real estate investment trusts (REITs), owning and operating more than two hundred commercial shopping centers across forty-four states.\(^{206}\) GGP controlled numerous “bankruptcy-remote” subsidiaries structured as special purpose entities that held commercial real estate financed by securitized mortgages.\(^{207}\) Following the financial crisis of 2008, GGP failed to secure refinancing of its substantial and maturing debts.\(^{208}\) Many of GGP’s subsidiaries, however, were in good financial health with excess cash flow.\(^{209}\) On the eve of bankruptcy, the debtor replaced the “independent directors” of numerous subsidiaries; the newly constituted boards then joined in the chapter 11 filing.\(^{210}\) The subsidiaries’ creditors objected, arguing that the legal separateness of the special purpose entities ensured their exclusion from bankruptcy proceedings of the parent corporation.\(^{211}\) The bankruptcy court denied motions to dismiss the subsidiary cases as either unauthorized (because of the failure to obtain the required independent director’s consent) or in bad faith.\(^{212}\) After rejecting those challenges, the bankruptcy court subsequently authorized cash management, use of cash collateral, and debtor-in-possession financing on a consolidated basis.\(^{213}\) While hardly a complete substantive consolidation, these actions collectively constituted a significant inroad on the concept of structural isolation and


\(^{206}\) Id. at 47.

\(^{207}\) Id. at 48, 61.

\(^{208}\) Id. at 53.

\(^{209}\) Id. at 55.

\(^{210}\) Id. at 68.

\(^{211}\) Id. at 61–62.

\(^{212}\) Id. at 71–72.

\(^{213}\) Id. at 55.
underscore the legal infirmity of formal barriers to bankruptcy relief for “bankruptcy remote” entities in exigent circumstances.

C. Assessing Securitization of the Core Assets of a Non-Financial Operating Company

Notwithstanding the enormous volumes of the securitization of financial assets in order to fund the lending operations of financial institutions, we still remain thirty years in, at the threshold of widespread securitization of operating companies’ core assets. Experimentation across different industries and asset types is taking place and volume is increasing.\(^{214}\) The foundations of these securitizations and entity partitions among affiliated corporations and bankruptcy-remoteness remain vulnerable to the substance-over-form logic of bankruptcy, especially if the assets securitized are core assets of a nonfinancial operating company. The economic goal of the securitization technique is to segregate assets for the benefit of a particular investor and insulate those assets from bankruptcy risk. That objective is antithetical to effective bankruptcy relief when involving core operating assets of nonfinancial firms. In this context, the foundations of securitization are truly rotten.\(^{215}\) Lawyers, bankers, raters, courts, and scholars should not pretend otherwise.

CONCLUSION

Bankruptcy courts are destined to struggle with the problem of withdrawal rights forever. Powerful creditors have never fully accepted the concept that they can be compelled to participate in a collective proceeding in the event of the common debtor’s insolvency and have sought ways to opt out of those proceedings when it is to their advantage to do so. They show no signs of giving up (increasingly convoluted) efforts to structure bankruptcy-remote relations, through statutory exceptions and preferences,\(^{216}\) the creation of property rights in their favor,\(^{217}\) and contractual strictures. If they have the political strength to carve out express exemptions in the Bankruptcy Code, courts may have little

\(^{214}\) See supra text and figures at notes 175–77.


\(^{217}\) BUSSEL & SKEEL, supra note 69, at 39 (“Congress can effectively prefer some constituents over others by excluding property in which the preferred constituents have an interest from the estate.”).
flexibility to prevent the opt-out. Constitutionally protected property rights may similarly constrain the courts. In these cases, strict construction of statutory exemptions (and in some cases recharacterization of property rights based on substance over form analysis) may provide limited relief.

But bankruptcy courts should not countenance creditor attempts to opt out of the collective process that arise only from a private contract between debtor and creditor. Bankruptcy has always been willing to sacrifice strict compliance with contractual entitlements to the exigencies of the collective proceeding, subject to the constraints imposed by federal insolvency law itself.218 The fact that these contractual entitlements are embodied in corporate charters does not alter their essentially contractual nature. Bankruptcy courts should not reflexively defer to pre-bankruptcy entity partitions and corporate charters that are the functional equivalent of a contractual right to withdraw assets from, or limit access to, bankruptcy relief.

It is always open to the board of directors to invoke bankruptcy relief notwithstanding pre-bankruptcy contracts with creditors to the contrary. It should not matter whether those bargained-for bankruptcy waivers are found in corporate charters or creditor contracts. Once the board invokes the insolvency regime (or upon other creditors filing an involuntary bankruptcy petition), the niceties of corporate law are effectively preempted and the complex insolvency governance model (in which the board shares decision making power with competing institutions) prevails. From that point forward the bankruptcy court deals with the firm as a reorganization or liquidation problem in which all interested constituencies may have a voice, and in many cases roles, rights, and obligations that they did not have under the pre-bankruptcy regime.219 Constituents with claims against affiliated companies in bankruptcy proceedings that effectively operate as a unified enterprise should not be surprised that they may be treated as a claimant against that unified enterprise, except to the extent that the bankruptcy equities themselves demand otherwise and so long as the value of their rights in property are adequately protected.220

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218 See Jackson, supra note 32, at 7–19; see also Jackson, Avoiding Powers, supra note 157, at 725.


220 See In re Murel Holding Corp., 75 F.2d 941 (2d Cir. 1935) (L. Hand, J).
APPENDIX: SECURITIZATION DATA AND TRENDS NOT INVOLVING CORE OPERATING ASSETS OF NON-FINANCIAL ORIGINATORS

Consumer debt obligations arising out of automobile loans and leases, home mortgages, student loans, cellular phone contracts, and credit cards constitute the largest and longest established sector of the securitization market. In 2017, for example, these consumer categories constituted $267 billion of the new issuances in the United States, or 52% of the total. Although beyond the scope of this Article, securitization of consumer debt obligations raises important policy issues of its own, particularly as it relates to systemically important financial institutions and consumer debt restructuring; consumer debt securitizations are not the focus of this Article. Former SEC Commissioner Luis A. Aguilar, for example, has publicly noted the significant public policy implications of the explosive growth of securitization, and suggested further regulation may be necessary.

Although also beyond the scope of this Article, the overall market for securitized commercial loan obligations including commercial real estate, accounts receivable, equipment, commercial paper, and collateralized loan obligations arising out of commercial transactions is even larger than the consumer market.

The principal categories of commercial loan securitizations of this nature are commercial paper securitization, the creation of collateralized loan obligations, and commercial mortgage-backed securities (CMBS). CMBS sometimes mimic the residential real estate mortgage model in which smaller loans from many different borrowers are bundled together into large pools; such CMBS is outside the scope of this Article. In 2017, about one-third of the CMBS market, however, involved a large loan to a single borrower secured by a single real property asset. This sort of CMBS raises the problem of hiving off corporate assets into separate entities to secure corporate financings discussed here. The market for commercial securitization grew from nothing in the 1980s to a $6 trillion behemoth by 2006. Securitization issuance of all types collapsed in the Great Recession of 2008-09 and is only now approaching pre-recession levels.

221 S&P Global Ratings, GLOBAL STRUCTURED FINANCE OUTLOOK 2018: VOLUME COULD REACH $1 TRILLION IF STEADY ECONOMIC CONDITIONS PERSIST at 4 (Jan. 3, 2018) (This figure is achieved by adding all U.S. ABS less equipment/fleet/floorplan and adding U.S. RMBS-related).
222 Luis A. Aguilar, Correcting Some of the Flaws in the ABS Market (Aug. 27, 2014) (transcript available at SEC.gov).
224 See infra chart at note 231.
Notwithstanding the general recovery, some submarkets, such as Asset Backed Commercial Paper and private label RMBS remain at small fractions of their prerecession levels, as demonstrated in the below Figure 3.

![Figure 3: Asset-Backed Commercial Paper Outstanding 2002–2018](image)

In 2017, the aggregate size of these market segments in the United States were: Asset-based commercial paper (ABCP)—$239 billion (outstandings); collateralized loan obligations (CLO)—$118 billion (new issuances); and CMBS ex SASB—$58 billion (new issuances). This market principally serves and funds financial institutions that structure traditional commercial loan obligations with multiple borrowers, and then either sell off participations or pool the resulting assets and then securitize those pools to fund their own lending operations.227

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226 See supra Figure 1 at note 176, Figure 2 at note 177, & Figure 3 at note 225; S&P Global Ratings, *GLOBAL STRUCTURED FINANCE OUTLOOK 2018: VOLUME COULD REACH $1 TRILLION IF STEADY ECONOMIC CONDITIONS PERSIST* at 4 (Jan. 3, 2018).

227 Although the aggregate outstandings in the ABCP market remain significant in absolute terms, the market for ABCP collapsed in the wake of the Great Recession of 2008–09 and has never approached its prerecession level of $1.2 trillion. See S&P Global Ratings, *GLOBAL STRUCTURED FINANCE OUTLOOK 2018: VOLUME COULD REACH $1 TRILLION IF STEADY ECONOMIC CONDITIONS PERSIST* at 4, 18 (Jan. 3, 2018); supra Figure 3, at note 225.
Financial institutions’ decision to fund lending activities in this way may significantly complicate down-the-line restructuring negotiations with defaulting borrowers. Frequently, investors in collateralized debt obligations are organized as bankruptcy remote limited liability companies whose charters sharply limit the fund manager’s discretion in restructuring negotiations involving fund assets.

In the home mortgage context, the problems caused by lack of servicer discretion to modify were severely aggravated in the aftermath of the 2008 financial crisis by the statutory limits on nonconsensual modification of home mortgages in the Bankruptcy Code. Regrettably, home mortgages on primary residences and most consumer automobile loans are subject to special statutory provisions that greatly limit the ability of consumers to nonconsensually restructure these obligations—regardless of whether they have been pooled and securitized. Securitization further aggravated these problems caused by statutory anti-modification rules by imposing contractual arrangements on mortgage servicers that greatly limited discretion to agree to consensual restructuring as well. Mayer, Morrison & Piskorski discuss the problems facing servicers with limited modification discretion in the context of securitization of residential mortgages (RMBS).

Although there are no comparable statutory limitations on nonconsensual restructuring of commercial loan obligations, securitization of those obligations subject to contractual restrictions on consensual restructuring may unnecessarily force costly “cramdown” plans. Worse, those limitations on manager authority may obstruct transactions that require secured creditor consent and support to transfer collateral free and clear or raise new capital. Nevertheless, the sale of participations in traditional commercial loans or their pooling and securitization do not create additional barriers to a borrower’s bankruptcy filing, and do not confer any “withdrawal right” on any creditor or exempt the underlying commercial loan from bankruptcy restructuring should the borrower file for bankruptcy relief. Accordingly, although this vast commercial loan securitization market, like the consumer loan securitization market, raises significant public policy issues, those issues are also beyond the scope of this Article. I nevertheless note the recent significant revival of the CDO market in Figure 4 below:

229 11 U.S.C §§ 1322(b)(2) (principal residences); 1325(a) (consumer automobile loans) (2019).
The data in Figure 4 is drawn from *The ABS Database*, HARRISON SCOTT PUBLICATIONS, ASSET-BACKED ALERT, https://www.abalert.com/db/absdb.pl (last visited Aug. 6, 2019). The entire database is available to subscribers for download at the above link. The categories represented in Figure 4 represent issuances coded with the following collateral codes: AR, BZ, CB, EM, HF, HY, IG, PS, RA, RB, RL, RU, SD, and SP (these codes encompass both CLOs and CDOs, although I use the term CDOs here broadly to refer to both). Note that the data collected by Asset-Backed Alert on CDOs only includes new issuances, exclusive of refinancings, and repricings. SIFMA data includes refinancings and repricings and there is no ready mechanism for segregating them from new issuances in that data set. The SIFMA data shows a disproportionately large (150%) increase in CDOs in 2017. See *US ABS Issuance and Outstanding*, SIFMA.ORG (July 1, 2019), https://www.sifma.org/resources/research/us-abs-issuance-and-outstanding/, for the effect of including refinancings and repricings. The SIFMA and Asset-Backed Alert data sets are not strictly comparable even for new issuances. But SIFMA shows total CDO issuances of $119.7 billion, $294.3 billion, and $280.7 billion, for years 2016, 2017, and 2018, respectively, while Asset-Backed Alert shows $83.6 billion, $126.3 billion, and $140.2 billion for the same years, suggesting that the SIFMA data includes a surge in CDO repricing and refinancing occurring in 2017. That elevated CDO refinancing activity appears to have continued at a slightly reduced pace in 2018.