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Corporate Governance, Bankruptcy Waivers, and Consolidation in Bankruptcy

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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 liability¹—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,² 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.³

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,⁴ 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.⁵

¹ The Landers-Posner debate over enterprise liability in insolvency cases was a watershed in the development of enterprise theories of liability. See generally Jonathan M. Landers, *A Unified Approach to Parent, Subsidiary, and Affiliate Questions in Bankruptcy*, 43 U. CHI. L. REV. 589 (1975) [hereinafter Landers, *A Unified Approach*]; Jonathan M. Landers, *Another Word on Parents, Subsidiaries and Affiliates in Bankruptcy*, 43 U. CHI. L. REV. 527 (1976) [hereinafter Landers, *Another Word*]; Richard A. Posner, *The Rights of Creditors of Affiliated Corporations*, 43 U. CHI. L. REV. 499 (1976).

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

³ See Douglas G. Baird & Anthony J. Casey, *No Exit? Withdrawal Rights and the Law of Corporate Reorganizations*, 113 COLUM. L. REV. 1, 4–6 (2013); Lynn M. LoPucki, *The Death of Liability*, 106 YALE L.J. 1 (1996); see generally Mary Elisabeth Kors, *Altered Egos: Deciphering Substantive Consolidation*, 59 U. PITT. L. REV. 381 (1998). But see William H. Widen, *Corporate Form and Substantive Consolidation*, 75 GEO. WASH. L. REV. 237, 259–62 (2007) [hereinafter Widen, *Corporate Form*]; William H. Widen, *Report to the American Bankruptcy Institute: Prevalence of Substantive Consolidation in Large Public Company Bankruptcies from 2000 to 2005*, 16 AM. BANKR. INST. L. REV. 1 (2008) [hereinafter Widen, *Report*]. Unless otherwise noted, section references herein are to the United States Bankruptcy Code, tit. 11 U.S.C.

⁴ See *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) (“Thorpe could not contract away its right to avail itself of the protections of § 524(g).”); *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 Weitzen*, 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*, 148 N.E. 379, 380 (Mass. 1925)).

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

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.

⁸ Joseph Shenker & Anthony Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV. 1369, 1380–81 & n.49 (1991). The Sperry-Univac transaction in 1985 is usually said to be the first private-label corporate asset-based securitization, private-label to denote that the issuer was a private bank rather than a government sponsored enterprise (GSE) and corporate asset to denote that the securitized assets were corporate assets rather than real estate mortgages. *Structured Financing Techniques*, 50 BUS. LAW. 527, 538 (1995); see also Miguel Segovia et. al., *Securitization: Lessons Learned and the Road Ahead* 8 (Int’l Monetary Fund Working Paper No. 13-255, 2013), <https://www.imf.org/en/Publications/WP/Issues/2016/12/31/Securitization-Lessons-Learned-and-the-Road-Ahead-41153>.

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.¹⁰ 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.¹¹ 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.¹² 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.¹³ At a time when Exxon was the most valuable enterprise in the world, LoPucki imagined a “Zero-Asset Exxon.”¹⁴ By aggressively employing these strategies, Exxon could render itself judgment-proof without adversely affecting or reducing the massive scale of its operations.¹⁵ 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.¹⁶

It seems less fanciful now.¹⁷

¹⁰ 11 U.S.C. § 109(b)(2), (3) & (d) (2019).

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.

¹⁷ See Dov Solomon, *The Rise of a Giant: Securitization and the Global Financial Crisis*, 49 AM. BUS. L.J. 859, 868–71 (2012) (discussing the explosion of securitization in the 2000s as a method of judgment

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.¹⁸ Their fundamental premise was that bankruptcy law operated on entities, not enterprises.¹⁹ 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.²⁰ Bankruptcy restructuring had become optional, not mandatory, for these parties.

Baird and Casey chose the Los Angeles Dodgers as their headline example,²¹ 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.²² 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.²³ The LLCs owning the team and the stadium filed for bankruptcy relief, but the parking lot LLC did not.²⁴ Moreover, there were serious questions regarding the nonconsensual retention of the team’s franchise agreement with Major League Baseball.²⁵ 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 *zeitgeist*²⁹ celebrating contract *uber 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

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 VA. 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 insolvency³¹ by creating a collective proceeding.³² 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.³³ 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.³⁴ 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,³⁵ team production theory,³⁶ artificial legal personhood,³⁷ aggregation of natural persons,³⁸ nexus of contracts,³⁹ the firm as stand-in for stakeholder constituencies constrained by

of Financial Failure, 92 TEX. L. REV. 75, 113–16 (2013); Daniel J. Bussel & Kenneth N. Klee, *Recalibrating Consent in Bankruptcy*, 83 AM. BANKR. L. J. 663 at 689–90, 707 (2009) (discussing role of creditors’ committees in case dispositive sales, settlements, and financings).

³¹ 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.

³² See THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 7–19 (1986); MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION* 1–4 (1965).

³³ See *In re Pease*, 195 B.R. 431, 433 (Bankr. D. Neb. 1996) (“The Bankruptcy Code extinguishes the private right of freedom to contract around its essential provisions.”).

³⁴ Baird, *supra* note 3, at 48.

³⁵ See generally Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937); Thomas S. Ulen, *The Coasean Firm in Law and Economics*, 18 J. CORP. L. 301, 312–13 (1993).

³⁶ See generally Margaret M. Blair & Lynn A. Stout, *A Team Production Theory of Corporate Law*, 85 VA. L. REV. 247 (1999).

³⁷ See generally *Trs. of Dartmouth Coll. v. Woodward*, 17 U.S. 518 (1819); Henry Hansmann, Reinier H. Kraakman & Richard Squire, *Law and the Rise of the Firm*, 119 HARV. L. REV. 1335 (2006).

³⁸ See *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. 682, 708 (2014).

³⁹ Compare G. Mitu Gulati, William A. Klein & Eric M. Zolt, *Connected Contracts*, 47 UCLA L. REV. 887 (2000) (critiquing nexus theory but adopting a contract-based view of the nature of the firm), with Frank H. Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89 (1985), and

public policy,⁴⁰ or the outcome of a creditors' bargain.⁴¹ Other models are certainly possible.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.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).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.

Melvin A. Eisenberg, *The Concept that the Corporation is a Nexus of Contracts, and the Dual Nature of the Firm*, 24 J. CORP. L. 819 (1999).

⁴⁰ See generally David Ciepley, *Beyond Public and Private: Toward a Political Theory of the Corporation*, 107 AM. POL. SCI. REV. 139 (2013).

⁴¹ See generally JACKSON, *supra* note 32.

⁴² 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).

⁴³ See, e.g., DEL. GEN. CORP. LAW § 303 (2011) (bankruptcy exception). *Compare* Prod. Res. Group, L.L.C. v. NCT Group, Inc., 863 A.2d 772, 792, 794 n. 67 (Del. Ch. 2004) (holding that a corporation's insolvency "makes the creditors the principal constituency injured by any fiduciary breaches that diminish the firm's value"), with N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 103 (Del. 2007) (holding that creditors of an insolvent corporation may not assert direct claims for breach of fiduciary duty against corporate directors.)

⁴⁴ Baird, *supra* note 3, at 6–7; LoPucki, *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;⁴⁵ even many firms that are functionally sole proprietorships are so organized.⁴⁶ Larger enterprises, whether privately or publicly held, are almost always organized as affiliated limited liability entities in a “corporate group.”⁴⁷ Corporate law⁴⁸ 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.⁴⁹

Given the vast amount of wealth held in corporate form, and the vast amount of economic activity engaged in by such entities,⁵⁰ corporate law would seem to

⁴⁵ See Rodney D. Chrisman, *LLCs Are the New King of the Hill: An Empirical Study of the Number of New LLCs, Corporations, and LPs Formed in the United States Between 2004–2007 and How LLCs Were Taxed for Tax Years 2002–2006*, 15 *FORDHAM J. CORP. & FIN. L.* 459, 461–63 (2009).

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).

⁴⁷ See generally John H. Matheson, *The Modern Law of Corporate Groups: An Empirical Study of Piercing the Corporate Veil in the Parent-Subsidiary Context*, 87 *N.C. L. REV.* 1091 (2008).

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

<https://fortune.com/2018/05/21/fortune-500-china-trade-facebook-breakup-call-ceo-daily-for-may-21-2018/>.

⁵¹ For a thoughtful discussion of the diminishing role of corporate law outside of bankruptcy, see Zohar Goshen & Sharon Hannes, *The Death of Corporate Law*, 94 N.Y.U. L. REV. 263, 277–89 (2019).

⁵² DEL. GEN. CORP. LAW § 216(3) (2011).

⁵³ *Id.* at § 216(2).

⁵⁴ Majority shareholder consent is required to amend the certificate of incorporation, DEL. GEN. CORP. LAW § 242, merge, DEL. GEN. CORP. LAW §§ 251–58, dissolve, DEL. GEN. CORP. LAW § 275, or sell 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).

⁵⁵ See, e.g., DEL. GEN. CORP. LAW § 291 (2011) (providing for appointment of state law receiver 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).

⁵⁷ See, e.g., DEL. GEN. CORP. LAW § 303 (2011) (bankruptcy exception).

⁵⁸ See, e.g., DEL. GEN. CORP. LAW §§ 278–79 (2011) (post-dissolution operation and management).

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 corporations to exculpate directors from the duty of care entirely. DEL. GEN. CORP. LAW § 102(b)(7) (2011); cf. *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.⁶⁰ New institutions—the bankruptcy court, perhaps a bankruptcy trustee,⁶¹ or, if not a trustee, then sometimes a court-approved chief restructuring officer,⁶² one or more creditors’ committees,⁶³ maybe an equity committee⁶⁴ or an examiner too⁶⁵—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.⁶⁶ 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).

⁶⁰ 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).

⁶¹ 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).

⁶² 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).

⁶³ 11 U.S.C. §§ 1102, 1103 (2019). *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.

⁶⁴ 11 U.S.C. § 1102(a), (b)(2) (2019).

⁶⁵ 11 U.S.C. §§ 1104(c), 1106(b) (2019). *See* Daniel J. Bussel, *A Third Way: Examiners as Inquisitors*, 90 AM. BANKR. L. J. 59, 81–84 (2016); Jonathan Lipson, *Understanding Failure: Examiners and the Bankruptcy Reorganization of Large Public Companies*, 84 AM. BANKR. L. J. 1 (2010).

⁶⁶ 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,⁶⁷ new interim supervisory powers over the debtor.⁶⁸ 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.⁶⁹ 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.⁷⁰ 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;⁷¹ neither board nor shareholder consent is *sufficient* to exit chapter 11 or confirm the debtor’s own plan of reorganization.⁷²

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).

⁶⁸ See Robin Phelan & Ocean Tama, *The Use of DIP Financing As A Mechanism To Control the Corporate Restructuring Process*, 44 TEX. J. BUS. L. 15 (2011); Harvey Miller & Shai Waisman, *Creditor in Possession*, 21 BANKR. STRATEGIST 1 (2003); Douglas G. Baird, *Bankruptcy’s Quiet Revolution* 77–78, nn. 41–46 (Coase-Sandor Wkg Paper Series in Law & Econ. No. 755); AM. BANKR. INST., *ABI Report of the Commission to Study Reform of Chapter 11*, 26–28 (2014); Douglas G. Baird, *The New Face of Chapter 11*, 12 AM. BANKR. INST. L. REV. 69 (2004).

⁶⁹ See *Commodity Futures Trading Commission v. Weintraub*, 471 U.S. 343 (1985); *Wolf v. Weinstein*, 372 U.S. 633, 649–50 (1963); 7 COLLIER 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).

⁷⁰ 11 U.S.C. § 1102(a), (b)(2) (2019).

⁷¹ 11 U.S.C. §§ 1121(c), 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), (c), (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.⁷³

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.⁷⁴ Other corporate constituents—creditors, employees, customers, the public—are neither empowered by nor regulated by corporate law.⁷⁵ 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.⁷⁶

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.⁷⁷ From an operating perspective, businesses function along geographic and product lines to maximize value of the whole enterprise rather than any particular subsidiary.⁷⁸ Key corporate functions

⁷³ Bankruptcy's substance over form ethos has a long pedigree in the United States Supreme Court caselaw. *See, e.g.*, *Pepper v. Litton*, 308 U.S. 295 (1939); *Sawyer v. Hoag*, 84 U.S. 610 (1873); *see also* *Consumer News and Bus. Channel Partnership v. Financial News Network Inc.* (*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"). *See generally* Daniel J. Bussel, *Doing Equity in Bankruptcy*, 34 EMORY BANKR. DEV. J. 13 (2018).

⁷⁴ *See* David Min, *Corporate Political Activity and Non-Shareholder Agency Costs*, 33 YALE J. REG. 423, 438 (2016).

⁷⁵ *Id.* at 444–46.

⁷⁶ *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).

⁷⁷ *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); *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).

⁷⁸ Corporate management's focus on aggregate corporate profits and parent share price has long been known or assumed to be the case. *See also* Richard Squire, *Strategic Liability in the Corporate Group*, 78 U. CHI. L. REV. 605, 615 (2011). *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, *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.⁷⁹ 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.⁸⁰ 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.⁸¹ A corporate enterprise operated through a series of affiliated companies under common management and ownership is one economic unit.⁸²

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.⁸³ 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.⁸⁴ The extralegal machinations of activist

Indicators of Benefit and Burden, 22 DUKE J. COMP. & INT'L L. 425, 425–26 (2012).

⁷⁹ See Robert Charles Clark, *The Regulation of Financial Holding Companies*, 92 HARV. L. REV. 787, 816–22 (1979).

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

rise of activist investors and its implications for nonbankruptcy corporate governance).

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.*

⁹¹ 26 U.S.C. § 1501 (2019); 26 C.F.R. § 1.1502-75 (2018). *See* Martin J. McMahon, *Understanding*

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.").

⁹² Historically, an important caveat to this principle is taxation of foreign subsidiaries. TCJA, enacted in 2017, whatever its other merits or demerits, has belatedly begun to address the problem of the accumulation of untaxed profits in foreign subsidiaries of United States based corporate groups. See J. Clifton Fleming, Robert J. Peroni & Stephen E. Shay, *Expanded Worldwide Versus Territorial Taxation after the TCJA*, 161 TAX NOTES 1173 (Dec. 3, 2018); Reuven S. Avi-Yonah, *The International Provisions of the TCJA: Six Results after Six Months* (U. of Mich. L. & Econ., Working Paper No. 18-021, 2018; U. of Mich. Pub. L., Working Paper No. 621, 2018).

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

⁹⁴ See Gregory C. Keating, *The Theory of Enterprise Liability and Common Law Strict Liability*, 54 VAND. L. REV. 1285, 1329–33 (2001) ("At the turn of the twenty-first century, enterprise liability conceptions compete with fault conceptions for control over various domains of the common law of torts.").

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.”⁹⁸ The public policy supporting application of the doctrine may be based upon either legislation or “the need to protect some aspect of the public welfare.”⁹⁹

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.¹⁰⁰ Corbin discusses in particular how prospective waivers of certain fundamental rights and privileges violate the public policy doctrine,¹⁰¹ and further notes that fundamental debtor protections such as the mortgagor’s equity of redemption,¹⁰² statutory exemptions from collection of judgment,¹⁰³ usury¹⁰⁴

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 Knepp*, 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 Weitzen*, 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)).

⁹⁸ REST. (2D) OF CONTRACTS § 178(1).

⁹⁹ *Id.* at § 179.

¹⁰⁰ *Id.* at § 184.

¹⁰¹ 15 CORBIN ON CONTRACTS § 88.7 (Rev. Ed. 2019). *See also* WILLISTON ON CONTRACTS § 12.1 *et seq.* (4th ed. 2019).

¹⁰² *See, e.g., Harlee v. Federal Fin. Corp.*, 34 Del. 345, 353–54 (Del. Super. Ct. 1930); *Desseau v. Holmes*, 187 Mass. 486, 487 (Mass. 1905); *Mitchell v. Automobile Sales Co.*, 161 Tenn. 1, 6–7 (Tenn. 1930).

¹⁰³ *See, e.g., Indus. Loan & Inv. Co. v. Super. Ct.*, 189 Cal. 546, 547–48 (Cal. 1922); *Weaver v. Lynch*, 79 Colo. 537, 538–39 (Colo. 1926); *New York v. Avco Fin. Serv. of N.Y., Inc.*, 50 N.Y.2d 383, 387–88 (N.Y. 1980).

¹⁰⁴ *See, e.g., Indus. Loan Co. v. Grisham*, 115 S.W.2d 214, 217 (Mo. Ct. App. 1938); *Motor Contract Co. v. van der Volgen*, 162 Wash. 449, 451 (Wash. 1931).

and bankruptcy rights have long been prominent examples of contracts void as against public policy.¹⁰⁵ 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.¹⁰⁶

Courts have long extended this principle to business entities as well as individual debtors.¹⁰⁷ Contractual waivers of the right to file for bankruptcy or other core bankruptcy rights are therefore not enforceable.¹⁰⁸ This policy of forbidding bankruptcy waivers extends to so-called “*ipso facto* clauses” that

¹⁰⁵ 15 CORBIN ON CONTRACTS § 88.7 (Rev. Ed. 2019).

¹⁰⁶ HSBC Bank USA v. Branch (*In re* Bank of New Engl. 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* Weitzen, 3 F. Supp. 698, 698–99 (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 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 WILLISTON ON CONTRACTS § 12.3 (4th ed. 2019) (internal citations omitted).

¹⁰⁸ Bankruptcy’s recognition of security interests and other competing property rights in the debtor’s assets is a crucial qualification on this principle. *See generally* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, n. 4 (1972); James E. Krier & Stewart J. Schwab, *Property Rules and Liability Rules: The Cathedral in Another Light*, 70 N.Y.U. L. REV. 440, 443, 456 (1995).

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.¹⁰⁹ Moreover, as a general proposition, orders of nonbankruptcy courts enjoining debtors from filing bankruptcy petitions are also unenforceable as void against public policy.¹¹⁰

Although corporate debtors' right to file a bankruptcy petition is nonwaivable, in *Price v. Gurney*,¹¹¹ 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.¹¹² 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.¹¹³ If there is a deadlocked board or a dispute, shareholders may call a special meeting to elect a new board of directors.¹¹⁴ The board holds the right to commence insolvency proceedings for the corporate debtor, a right that may not be waived by contract.¹¹⁵

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.¹¹⁶

¹⁰⁹ 11 U.S.C. § 365(b), (e), (f) (overriding *ipso facto* defaults that would otherwise prevent assumption of contracts); § 541(c)(1)(A) (overriding *ipso facto* provisions that would otherwise cause the bankruptcy estate to forfeit property rights upon filing or conditions or restricts transfer); § 1124(2)(A) (authorizing reinstatement of claim notwithstanding incurable ipso facto default) (2019).

¹¹⁰ See *In re Hollis*, 150 B.R. 145, 147–48 (Bankr. D. Md. 1993); *In re Surace*, 52 B.R. 868, 870 (Bankr. C.D. Cal. 1985).

¹¹¹ *Price v. Gurney*, 324 U.S. 100 (1945).

¹¹² See *id.* at 104, 106 (“[T]he initiation of the proceedings, like the run of corporate activities, is left to the corporation itself, i.e. to those who have the power of management If the District Court finds that those who purport to act on behalf of the corporation have not been granted authority by local law to institute the proceedings, it has no alternative but to dismiss the petition.”).

¹¹³ See *Winter v. Bel-Aire Invs. (In re Bel-Aire Invs.)* 97 B.R. 88, 90 (Bankr. M.D. Fla. 1989); *In re Am. Int'l Indus., Inc.*, 10 B.R. 695, 696–97 (Bankr. S.D. Fla. 1981).

¹¹⁴ See *In re Acoustic Fibre Sound Sys., Inc.*, 20 B.R. 769, 777–78 (Bankr. S.D. Ind. 1982).

¹¹⁵ See *Gurney*, 324 U.S. at 104; *In re Pease*, 195 B.R. 431, 435 (Bankr. D. Neb. 1996) (“[A]ny attempt by a creditor in a private pre-bankruptcy agreement to opt out of the collective consequences of a debtor's future bankruptcy filing is generally unenforceable. The Bankruptcy Code [extinguishes] the private right [of freedom] to contract around its essential provisions”).

¹¹⁶ A creditor holding a pledge of the corporation's shares of voting stock and voting the shares to elect a new board of directors runs some of these risks. *B Keenihan v. Heritage Press, Inc.*, 19 F.3d 1255, 1259 (8th Cir. 1994) (bankruptcy court lacks jurisdiction to question validity of state court temporary restraining order

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.¹¹⁷ 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.¹¹⁸ 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 can 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*

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

Examine the Nonrecourse Carveouts of Loan Agreements, L.A. LAW., Jan. 2016, at 18, 21.

¹¹⁹ See *DeBold v. Case (In re Tri-River Trading, LLC)*, 329 B.R. 252, 266–67 (B.A.P. 8th Cir. 2005); *In re Kingston Square Assocs.*, 214 B.R. 713, 729–31 (Bankr. S.D.N.Y. 1997) (refusing to find bad faith filing even though debtor orchestrated the filing of the involuntary petition to evade corporate charter bankruptcy remote provisions).

¹²⁰ *In re Intervention Energy Holdings, LLC*, 553 B.R. 258, 265–66 (Bankr. D. Del. 2016).

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).

¹²² *Franchise Servs. of N. Am. v. United States Trs. (In re Franchise Servs. of N. Am.)*, 891 F.3d 198, 203 n.1 (5th Cir. 2018); see also *In re Blue Chip Capital DC, LLC*, 600 B.R. 735, 737 (Bankr. D.D.C. 2019) (dismissing chapter 11 case for cause without regard to contractual veto of filing exercised by creditor).

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.

¹²⁶ *But see* Steven Schwarcz, *Rethinking Freedom of Contract: A Bankruptcy Paradigm*, 77 TEX. L. REV. 515, 584–85 (1999).

¹²⁷ The root of the doctrine in United States insolvency law is usually identified as *Sampson 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

(distinguishing substantive consolidation from joint administration and noting that "substantive consolidation merges the assets and liabilities of the debtor entities into a unitary debtor estate"); *Kheel*, 369 F.2d at 847.

¹²⁹ *Sampsell*, 313 U.S. at 220–21 (distinguishing rights of bona fide lien creditor).

¹³⁰ *See id.* at 219; Patrick C. Sargent, *Bankruptcy Remote Finance Subsidiaries: The Substantive Consolidation Issue*, 44 BUS. LAWYER 1223, 1233–36 (1989) (discussing case law supporting consolidation of non-debtor affiliates). A recent example is *Clark's Crystal Springs Ranch LLC v. Gugino* (*In re Clark*), 692 Fed. Appx. 946, 947–48 (9th Cir. 2017) (consolidating debtor limited liability company with its sole member a non-debtor family trust).

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 the theory practically limit the availability of non-debtor consolidation by imposing onerous notice requirements. *Leslie v. Mihanian* (*In re Mihanian*), 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 2339, 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.¹³⁴ The leading academic work on substantive consolidation is that of Mary Beth Kors¹³⁵ and William Widen.¹³⁶ 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.¹³⁷

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.¹³⁸ 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.¹³⁹

¹³⁴ 11 U.S.C. § 1123(a)(5)(C) (2019) (“Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—(5) provide adequate means for the plan’s implementation, such as—(C) merger or consolidation of the debtor with one or more persons”); *see also* 11 U.S.C. § 101(41) (2019) (“‘person’ includes individual, partnership, and corporation, but does not include governmental unit”). Interestingly, the exclusion of governmental unit from the Bankruptcy Code’s definition of “person” may suggest that substantive consolidation may not occur except in compliance with otherwise applicable nonbankruptcy law in a chapter 9 case. There does not appear to be any precedents for nonconsensual substantive consolidation that is not authorized by law in the municipal bankruptcy cases. Some commentators have suggested that some of the Supreme Court’s recent case law demanding express statutory predicates for the exercise of traditional equitable powers may undermine the legal basis for substantive consolidation. *See, e.g.,* Tucker, *supra* note 132, at 434; Rachel A. Greenleaf, *Is Substantive Consolidation a Viable Cause of Action Post-Law?*, 37 AM. BANKR. INST. J., Dec. 2018 at 54; Hon. Christopher D. Jaime, *Objections to Exemptions Under State Law After Law v. Siegel*, 36 AM. BANKR. INST. J., Mar. 2017 at 14. But the Supreme Court has never rejected the substantive consolidation doctrine directly or suggested that its own prior caselaw embracing the doctrine has been overruled *sub silentio*, and the doctrine continues to be regularly employed in the lower courts, subject to the varying standards discussed in the text.

¹³⁵ *See* Kors, *supra* note 3; *see also* Timothy E. Graulich, *Substantive Consolidation—A Post-Modern Trend*, 14 AM. BANKR. INST. L. REV. 527 (2006); Baird, *Substantive Consolidation*, *supra* note 132.

¹³⁶ *See* Widen, *Corporate Form*, *supra* note 3; *see also* Widen, *Report*, *supra* note 3.

¹³⁷ Kors, *supra* note 3, at 451.

¹³⁸ *See* Widen, *Corporate Form*, *supra* note 3, at 251–53, 323–24.

¹³⁹ *See* Daniel J. Bussel, *Multiple Claims, Ivanhoe and Substantive Consolidation*, 17 AM. BANKR. INST. L. REV. 217, 226–30 (2010); Widen, *Corporate Form*, *supra* note 3, at 281–84, 343–44; *see also In re Falls Event Ctr. LLC*, 600 B.R. 857, 868, 870 (Bankr. D. Utah 2019) (“[T]he Falls Parties are controlled by common management and they have no economic existence separate and apart from each other The Falls Parties’ affairs are so entangled with those of TFEC that it would be most efficient to consolidate them”).

Both views are reflected in modern case law. The Widen view finds expression in such cases as *Auto-Train*¹⁴⁰ and *Eastgroup*¹⁴¹ and the large number of bankruptcy court decisions confirming consolidated reorganization plans.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*¹⁴³ which in turn is critiqued by Widen. In the Courts of Appeals,¹⁴⁴ the law reviews,¹⁴⁵ and in the rarefied world of the writers and consumers of non-consolidation opinions,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*.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,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,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.¹⁵⁰ The Third Circuit, somewhat perversely, viewed the subsidiary guarantees as evidence of bank reliance on structural seniority at the subsidiary level rather

¹⁴⁰ *Drabkin v. Midland-Ross Corp. (In re Auto-Train Corp.)*, 810 F.2d 270, 276 (D.C. Cir. 1987).

¹⁴¹ *Eastgroup Properties v. Southern Motel Assoc., Ltd.*, 935 F.2d 245 (11th Cir. 1991).

¹⁴² See generally Widen, *Report*, *supra* note 3, at 1.

¹⁴³ *In re Owens-Corning*, 419 F.3d 195 (3d Cir. 2005).

¹⁴⁴ See *Spradlin v. Beads & Steeds Inns, LLC (In re Howland)*, 674 Fed. Appx. 482, 488–89 (6th Cir. 2017); *In re Lisanti Foods, Inc.*, 241 Fed. Appx. 1 (3d Cir. 2007); *FDIC v. Colonial Realty Co.*, 966 F.2d 57, 59 (2d Cir. 1992).

¹⁴⁵ See Graulich, *Post-Modern Trend*, *supra* note 135; Baird, *Substantive Consolidation*, *supra* note 132.

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. Schwarcz, *The Limits of Lawyering: Legal Opinions in Structured Finance*, 84 TEX. L. REV. 1, 14 (2006); E. Kristen Moye, *Non-Consolidation and True Sale/Transfer Opinions in Securitized Real Estate Loan Transactions*, 21(3) PRAC. REAL EST. LAW 7 (2005).

¹⁴⁷ *In re Augie/Restivo Baking Co.*, 860 F.2d 515 (2d Cir. 1988).

¹⁴⁸ See Widen, *Corporate Form*, *supra* note 3, at 264–65.

¹⁴⁹ *In re Owens-Corning*, 419 F.3d 195, 213 (3d Cir. 2005).

¹⁵⁰ *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.¹⁵¹

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 Jackson¹⁵² 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.¹⁵³

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 draw this proceduralist objection!¹⁵⁴ 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.¹⁵⁵ Indeed, nonbankruptcy law acknowledges that when formal insolvency proceedings

¹⁵¹ *Id.* at 212.

¹⁵² 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).

¹⁵³ 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).

¹⁵⁴ 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.

¹⁵⁵ 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 Commc'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.").

commence the nonbankruptcy regime is displaced by insolvency law rules that bring the protection of nonshareholder interests to the fore.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.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.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.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.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.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

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).

¹⁵⁷ See Jackson, *Nature of Bankruptcy*, *supra* note 153, at 170; see also Daniel J. Bussel, *The Problem With Preferences*, 100 IOWA L. REV. 11, 14–17 (2014) (discussing policies underlying preference law); Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725, 757 (1984).

¹⁵⁸ Jackson, *Avoiding Powers*, *supra* note 157, at 757–60.

¹⁵⁹ Jay Lawrence Westbrook, *Transparency in Corporate Groups*, 13 BROOK. J. CORP. FIN. & COM. L. 33 (2018).

¹⁶⁰ *Id.* at 52.

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.¹⁶² 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.¹⁶³ 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,¹⁶⁴ 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.”¹⁶⁵ 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.¹⁶⁶ 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.¹⁶⁷ 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,¹⁶⁸ the lower borrowing costs associated with this financing appear to be solely a function of the bankruptcy opt-out feature of the transaction.¹⁶⁹ Rating agency and financial market acceptance of a securitization require legal opinions that conclude bankruptcy remoteness of the securitization vehicle will be respected.¹⁷⁰ 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,¹⁷¹ and (2) bankruptcy courts will not consolidate the "bankruptcy-remote" securitization vehicle with the originator's bankruptcy estate, should the originator commence bankruptcy proceedings.¹⁷²

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).¹⁷³ Preliminary indications suggest the 2019 pace may equal or exceed that of 2018.¹⁷⁴

The vast majority of this debt, however, does not involve non-financial corporate originators securitizing core operating assets.¹⁷⁵

¹⁶⁸ See Stephen Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J. L. BUS. & FIN. 133, 134–35 (1994).

¹⁶⁹ See *id.* at 151; see also Kenneth C. Kettering, *Securitization and its Discontents: The Dynamics of Financial Product Development*, 29 CARDOZO L. REV. 1553, 1569 (2008) ("Substantially all of the benefits claimed for securitization are nothing more than consequences of the structure's purported avoidance of the Bankruptcy Tax . . .").

¹⁷⁰ See, e.g., The Comm. of Structured Fin. and the Comm. on Bankr. and Corp. Reorganization, Ass'n of the Bar of N.Y.C., *Special Report on the Preparation of Substantive Consolidation Opinions*, 64 BUS. LAW. 411, 416–18 (2009); MOODY'S INV'R SERV., BANKR. REMOTENESS CRITERIA FOR SPECIAL PURPOSE ENTITIES IN GLOBAL STRUCTURED FIN. TRANSACTIONS 2–4 (2014) (requesting legal opinions that indicate satisfaction of several structuring criteria); S&P GLOBAL RATINGS, STRUCTURED FIN.: ASSET ISOLATION AND SPECIAL-PURPOSE ENTITY METHODOLOGY 8 (2017) ("We may look to a non-consolidation opinion to derive comfort regarding [the risk of substantive consolidation] when assessing insolvency remoteness.")

¹⁷¹ See *Special Report on the Preparation of Substantive Consolidation Opinions*, *supra* note 170, at 412–13.

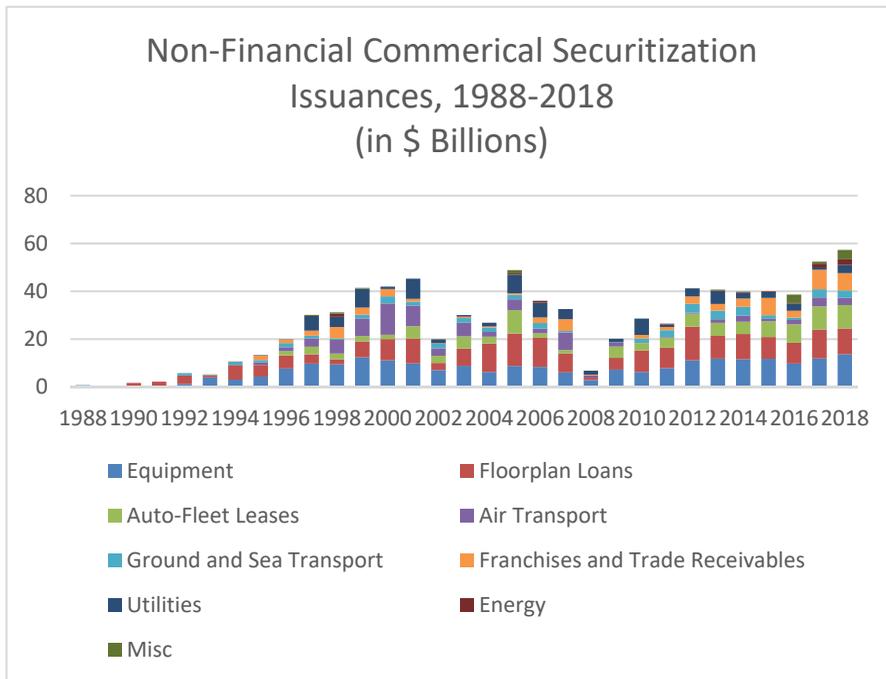
¹⁷² See *id.* at 416–18.

¹⁷³ S&P GLOBAL RATINGS, GLOBAL STRUCTURED FINANCE 2019 SECURITIZATION ENERGIZED WITH \$1 T IN VOLUME at 4, Table 1 (Jan. 7, 2019).

¹⁷⁴ See generally *id.*

¹⁷⁵ I have attached a brief Appendix to this Article sketching out data and trends in the issuance of the

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.



**Figure 1: Non-financial commercial securitization issuances
1988–2018 (\$ billions)¹⁷⁶**

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.

¹⁷⁶ *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.

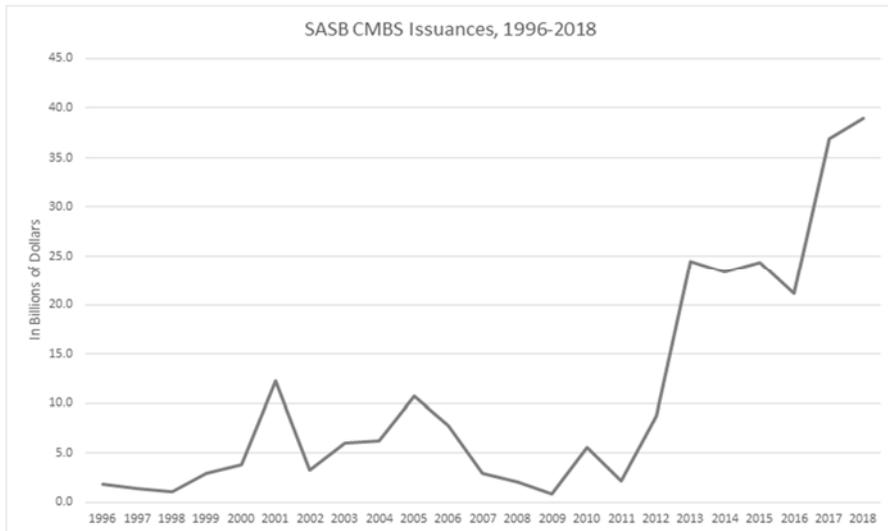


Figure 2: SASB CMBS Issuances 1996–2018¹⁷⁷

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

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

¹⁷⁸ *In re LTV Steel Co.*, 274 B.R. 278 (Bankr. N.D. Ohio 2001).

¹⁷⁹ *Id.* at 279–80.

¹⁸⁰ Spain's Santander Group acquired Abbey National in 2004. See Mark Mulligan, *Santander Profits Driven by Abbey Acquisition*, FIN. TIMES (July 25, 2005), <https://www.ft.com/content/b0eae68c-fe85-11d9-94b4-00000e2511c8>.

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.¹⁸⁷ 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.¹⁸⁸ 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.¹⁸⁹ 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.¹⁹⁰

Neither Sales Finance nor Steel Products filed for chapter 11 relief when LTV encountered a need for further chapter 11 relief in 2000.¹⁹¹ Nevertheless, when LTV filed its petition for relief it moved the court for an interim order permitting it to use cash collateral.¹⁹² This cash collateral consisted of the receivables and inventory that are ostensibly owned by Sales Finance and Steel Products.¹⁹³ 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.¹⁹⁴ A hearing was held on LTV's cash collateral motion on December 29, 2000 as part of the first day hearings.¹⁹⁵ 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.¹⁹⁶ 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.¹⁹⁷ 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.¹⁹⁸ 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.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.²⁰⁰ It contended that the transaction between LTV and Sales Finance was properly characterized as a true sale.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 order²⁰²

¹⁹⁹ *Id.* at 281–82.

²⁰⁰ *Id.* at 282.

²⁰¹ *Id.* at 284.

²⁰² *Id.* at 285–86.

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

²⁰³ See Kettering, *supra* note 169, at 1558–69 (2008); see also Heather Hughes, *Property and the True-Sale Doctrine*, 19 U. PA. J. BUS. L. 870, 900 (2017).

²⁰⁴ See Jonathan C. Lipson, *Enron, Securitization and Bankruptcy Reform: Dead or Dormant?* 11 J. BANKR. L. & PRAC. 101, 115–16 (2002).

²⁰⁵ *In re General Growth Prop. Inc.*, 409 B.R. 43 (Bankr. S.D.N.Y. 2009).

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.

²¹⁵ See David Gray Carlson, *The Rotten Foundations of Securitization*, 39 WM. & MARY L. REV. 1055 (1998).

²¹⁶ For example, see the highly problematic expansion of the many statutory safe harbors for sophisticated financial instruments. See Stephen J. Lubben, *The Bankruptcy Code Without Safe Harbors*, 84 AM. BANKR. L.J. 123, 124 (2010); Charles W. Mooney, Jr., *The Bankruptcy Code’s Safe Harbors for Settlement Payments and Securities Contracts: When is Safe Too Safe?* 49 TEX. INT’L L.J. 245, 253, 258 (2014); Mark J. Roe, *The Derivatives Market’s Payment Priorities as Financial Crisis Accelerator*, 63 STAN. L. REV. 539, 572–73 (2011).

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

* * *

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

²¹⁹ THURMAN ARNOLD, *THE FOLKLORE OF CAPITALISM* 230 (Yale Univ. Press 1937) (describing corporate insolvency proceedings as “the union of law and economics . . . celebrated by one of the wildest [intellectual] orgies in intellectual history”); cf. Charles J. Tabb, *What’s Wrong with Chapter 11?* 1–3 (U. Illinois C. Law Legal Studies Res. Paper No. 19-15, Mar. 14, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3352137.

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.²²¹ 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.²²²

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.²²³ 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.²²⁴

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).

²²³ S&P Global Ratings, GLOBAL STRUCTURED FINANCE OUTLOOK 2018: VOLUME COULD REACH \$1 TRILLION IF STEADY ECONOMIC CONDITIONS PERSIST at 4 (Jan. 3, 2018).

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.

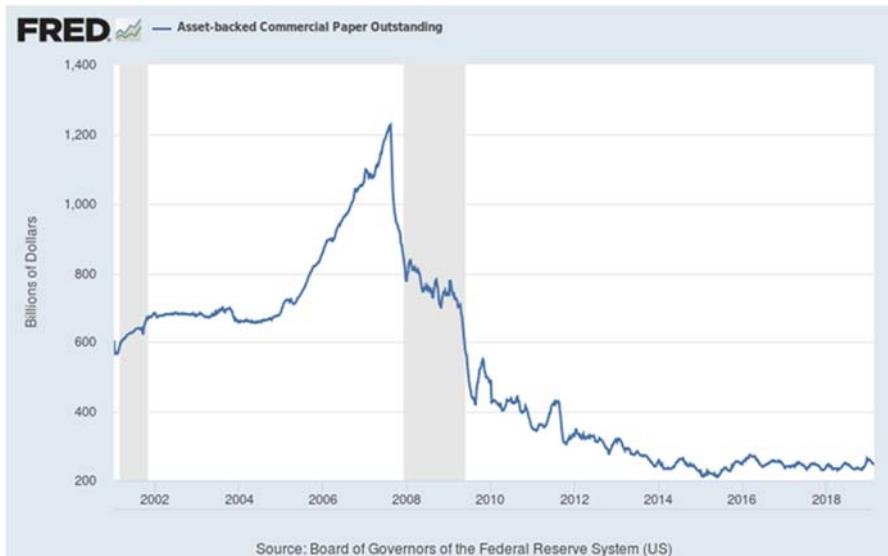


Figure 3: Asset-Backed Commercial Paper Outstanding 2002–2018²²⁵

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).²²⁶ 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

²²⁵ Board of Governors of the Federal Reserve System (US), *Asset-backed Commercial Paper Outstanding*, FRED, FEDERAL RESERVE BANK OF ST. LOUIS, <https://fred.stlouisfed.org/series/ABCOMP> (last updated Feb. 21, 2019).

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.²²⁸ 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.²²⁹ 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).²³⁰

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:

²²⁸ 11 U.S.C. §§ 1123(b)(5), 1322(b)(2) (2019); *see also* Samuel Bufford, *The Chapter 13 Alternative: A Legislative Solution to Undersecured Home Mortgages*, 45 U. RICHMOND L. REV. 1091 (2011).

²²⁹ 11 U.S.C. §§ 1322(b)(2) (principal residences); 1325(a) (consumer automobile loans) (2019).

²³⁰ Mayer, Morrison & Piskorski, *A New Proposal for Loan Modifications*, 26 YALE J. REG. 417 (2009).

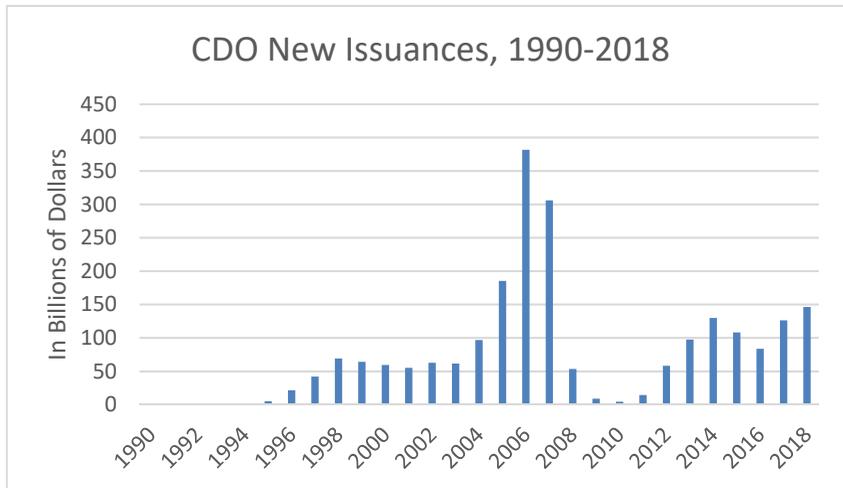


Figure 4: CDO New Issuances 1990–2018²³¹

²³¹ 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.