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Bankruptcy's Identity Crisis

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Thanks to Ken Ayotte, Jared Ellias, Victoria Ivashina, Dominique Mielle, Elizabeth Pollman and Kate Waldock for helpful comments and conversations; to Julia Raphael and Anna Statz for excellent research assistance; and to the University of Pennsylvania Carey Law School for generous summer funding.

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Abstract

The large companies that currently file for Chapter 11 look very different than the typical Chapter 11 cases of the past. The liability side of debtors' balance sheets is much more complex and now consists primarily of secured rather than unsecured obligations. Many firms that might once have borrowed on a secured basis from a bank and on an unsecured basis from bondholders now have first and second liens instead. Leveraged loans have further contributed to the prevalence of secured debt. While these developments are beneficial in many respects, they have exacerbated two serious problems in Chapter 11. The first is the unusually high variability in outcomes in large cases as lenders enter and exit the lending syndicates, and as debtors and creditors exploit loopholes in the credit documents through "uptiering" and "dropdown" or "trapdoor" transactions. Second is a growing perception that insiders benefit from Chapter 11 and outsiders often do not. An unfortunate irony is that efforts (such as restructuring support agreements) to reduce the first problem, uncertainty, often exacerbate the second, insider control. Part I of the Article recounts the shift in debtors' capital structure due to the new financing techniques, highlighting a surprising feature of the emergence of the leveraged loan and CLO markets: women played an unusually prominent role. Part II explores the close, though partial, relationship between private equity funds and these recent developments. The final part considers a series of potential solutions and interventions for addressing the downsides of the new financing techniques. The Part advocates an incrementalist approach while warning that, unless the perception that Chapter 11 is rigged in favor of insiders is addressed, pressure may build for more radical reform.

Keywords: bankruptcy law, Chapter 11, secured obligations, corporate bankruptcy, corporations, unsecured creditors, leveraged loans, private equity, CLO, collateralized loan obligation, capital structures, RSA fees

JEL Classifications: G23, G24, G32, G33, K22

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Bankruptcy's Identity Crisis

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Introduction

Chapter 11 is experiencing an identity crisis. Current bankruptcy law assumes that troubled corporations have substantial amounts of unsecured debt held by widely scattered unsecured creditors, as does the standard normative account of corporate bankruptcy.[1] This assumption, which once mirrored

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[1] The standard account is the "creditors' bargain theory" formulated by Thomas Jackson and Douglas Baird. See, e.g., **Thomas H. Jackson, The Logic and Limits of Bankruptcy Law** 7-17 (Harvard Univ. Press 1986) (describing the theory of creditors bargaining outside the bankruptcy process); Douglas G. Baird & Thomas H. Jackson, Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy, 51 **U. Chi. L. Rev.** 97, 112-14 (1984) (explaining that interest holders strike bargains in acquiring rights to assets). Jackson recounts the origins of the creditors' bargain theory in a recent essay. See Thomas H. Jackson, A Retrospective Look at Bankruptcy's New Frontiers, 166 **U. Pa. L. Rev.** 1867, 1867–68 (2018).

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reality, is reflected in, among other things, the creation of an estate-funded creditors' committee in every substantial bankruptcy case to counteract collective action problems that might impede coordination by unsecured creditors.[2]

The large companies that currently file for Chapter 11 look very different than the typical Chapter 11 cases of the past. Although the operating businesses that file for Chapter 11 are not necessarily different, their capital structure is. The liability side of debtors' balance sheets is much more complex and now consists primarily of secured rather than unsecured obligations.[3]

These changes are part of the larger revolution in financial engineering in the past several decades. Many firms that might once have borrowed on a secured basis from a bank or syndicate of banks and on an unsecured basis from bondholders or other unsecured creditors now have first and second liens instead.[4] The emergence of the leveraged loan market has further

[2] 11 U.S.C. § 1102(a)(1). For a defense of creditors' committees, in response to contentions that they should no longer be mandatory in large cases, see Christopher S. Sontchi & Bruce Grohsgal, Should the Appointment of a Committee of Unsecured Creditors Be Made Optional in Chapter 11?, **Am. Bankr. Inst. J.**, Nov. 2019, at 12, 73-75.

[3] These developments are chronicled in greater detail in Part I(A)(2) (ubiquity of secured debt) and Part I(A)(3) (increasing complexity) infra.

[4] See, e.g., Kenneth Ayotte, Anthony J. Casey, & David A. Skeel, Jr., Bankruptcy on the Side, 112 **Nw. U. L. Rev.** 255, 269-72 (2017) (describing RadioShack's two groups of secured lenders).

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contributed to the prevalence of secured debt.[5] Leveraged loans are secured loans to troubled corporate debtors that are often packaged together in securitized entities called collateralized loan obligations, or CLOs.[6] The expansion of secured financing has shifted the center of gravity in current Chapter 11 cases. Secured creditors, not unsecured creditors, are now the principal players.[7]

These developments are in some respects quite beneficial. By providing access to credit for struggling companies, leveraged loans may sometimes make bankruptcy unnecessary for a firm whose distress would have landed it in Chapter 11 in an earlier era.[8] The novel financing techniques (and parallel developments) also have improved Chapter 11 in two important respects. Cases proceed much more quickly than they once did, due to factors such as milestones imposed by a debtor's secured lenders.[9] In addition, the new lending techniques may help break

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[5] The rise of the leveraged loan market is described in Elisabeth de Fontenay, Do the Securities Laws Matter? The Rise of the Leveraged Loan Market, 39 **J. Corp. L.** 725 739-41 (2014).

[6] For discussion of leveraged loans and CLOs, see Part I(A)(1), infra.

[7] David A. Skeel, Jr. & George Triantis, Bankruptcy's Uneasy Shift to a Contract Paradigm, 166 **U. Pa. L. Rev.** 1777, 1779 (2018).

[8] See, e.g., Matt Grossman, Junk-Loan Market Shrugs Off Economic Worries, Wall St. J., Feb 13, 2023 (noting that this "loan market helps keep cash-poor businesses afloat and provides much of the funding for Wall Street's mergers-and-acquisitions machine").

[9] For evidence that cases are faster, see, e.g., Foteini Teloni, Chapter 11 Duration, Pre-Planned Cases, and Refiling Rates: An Empirical Analysis in the Post-BAPCPA Era, 23 **Am. Bankr. Inst. L. Rev.** 571, 592-93 (2015) (finding that the mean duration for traditional Chapter 11 cases dropped from 634 to 430 days after 2005, and the mean for all cases (including prepackaged bankruptcies) fell from 480 to 261 days after 2005).

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the monopoly a debtor's pre-bankruptcy lenders have over new financing in bankruptcy, as an unintended consequence of the increased multiplicity and diversity of lenders.[10] Two or more of a debtor's current lenders may offer competing financing bids, as in the recent Neiman Marcus bankruptcy.[11]

While the developments have been beneficial overall, the financing revolution has exacerbated several of the biggest problems in current Chapter 11 practice. The first is the unusually high variability in outcomes in large cases as lenders enter and exit the lending syndicates, and as debtors and creditors exploit loopholes in the credit documents through strategies such as "uptiering" (arranging with a subset of lenders for a loan that has priority over existing senior lenders) and "dropdown" or "trapdoor" (transferring assets to subsidiaries that are not restricted under the debtor's loan documents and using the assets as collateral for new loans).[12] The new financing techniques exacerbate this tendency by creating new coordination issues. The coordination issues that bedevil current cases do not arise naturally, due to an

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[10] This is a central theme of David A. Skeel, Jr., Pandemic Hope for Debtor-in-Possession Financing, 131 **Yale L.J. Forum** 315, 318 (2021) ("Although the new capital structure complexity has potential downsides, it also has a significant upside: it can provide a solution, or at least the beginning of a solution, to the lack of competition for DIP financing.").

[11] See id. at 315 ("After Neiman Marcus, the luxury department store, filed for Chapter 11 in May 2020, two different groups of lenders vied to provide bankruptcy financing.").

[12] These maneuvers, often associated with Serta and J. Crew, respectively, are described in more detail in Part II(A), infra.

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inability or failure to coordinate, as did the collective action problems of the past. They arise from the terms of contracts the parties negotiate with one another. For this reason, I sometimes will call them "synthetic collective action problems."

Uncertainty—even uncertainty arising from coordination issues—is not always pernicious. If creditors sometimes find themselves on the losing side of an uptiering or dropdown transaction, and sometimes find themselves on winning, the variability of outcomes may not seem problematic. But even if the results were a wash overall, the uncertainty invites unnecessary costs as creditors jockey for inside position.[13] And some creditors may be systematically disadvantaged as a result of the maneuvers, rarely finding being included in the winning coalition.[14]

Although companies owned by private equity funds are not the only companies that reflect the new capital structure, private equity funds have been especially aggressive in exploiting credit documents.[15] And private equity sponsors are

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[13] For a similar argument, see Kenneth Ayotte & Alex Zhicheng Huang, Standardizing and Unbundling the Sub Rosa DIP Loan, unpublished manuscript, at 21 (Dec 27, 2022), available on SSRN.Com (discussing "deadweight costs").

[14] See, e.g., id. ("Anecdotally, CLOs are often the victims of priority-shifting tactics.")

[15] Private equity funds are pools of investment capital their managers use to, among other things, acquire companies, usually borrowing a substantial portion of the purchase price. The private equity managers ordinarily run the company for a few years, with the intention of later selling it or taking it public again. For an analysis of the private equity industry by an unabashed booster, see **Sachin Khajuria, Two and Twenty: How the Masters of Private Equity Always Win** (2022).

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over-represented in large corporate bankruptcy cases more generally. Roughly 70% of the companies that qualify as distressed are owned by private equity funds.[16]

In addition to enhanced uncertainty, the second problem in Chapter 11 is a growing perception that insiders benefit from Chapter 11 and outsiders often do not. This perception stems in part from controversial cases largely unrelated to the new financing techniques, such as the Purdue Pharma opioid case.[17] But insider control is especially prevalent in cases involving the new financing techniques.

An unfortunate irony of the current landscape is that efforts to solve the first problem--uncertainty--frequently exacerbate both the perception and the reality of insider control. The most obvious illustration here is the now-ubiquitous use of restructuring support agreements, or RSAs.[18] By committing the parties to the terms of a potential reorganization plan, RSAs help counteract an important source of

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[16] See Mayra Rodriguez Valladares, Over Half of Rated Company Defaulters Are Owned by Private Equity Firms, **Forbes.com**(July 16, 2020), https://www.forbes.com/sites/mayrarodriguezvalladares/2020/07/16/over-half-of-rated-company-defaulters-are-owned-by-private-equity-firms/?sh=33bd33d37b1c [https://perma.cc/KLC6-C75B].

[17] See, e.g., Anthony J. Casey & Joshua C. Macey, In Defense of Bankruptcy for Mass Torts, U. Chi. L. Rev., manuscript at 916-18 (forthcoming, 2023)(describing controversy over Purdue Pharma case), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4349533&dgcid=ejournal_htmlemail_bankruptcy%2C%3Areorganization%3Acreditors%3Aejournal_abstractlink.

[18] Casey, Tung and Waldock document the rapid rise in use of RSAs. See generally Anthony J. Casey, Frederick Tung & Katherine Waldock, Restructuring Support Agreements: An Empirical Analysis (unpublished manuscript, 2021).

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uncertainty:the risk that a deal a debtor reaches with some of its creditors will fall apart if creditors sell their claims and the new holders do not share their predecessors' perspective.[19] But RSAs are negotiated by insiders and usually benefit the insiders by, among other things, paying them to "backstop" the sale of new stock when a company emerges from Chapter 11.[20] The solution can be as dissatisfying as the problem, raising concerns that Chapter 11 no longer works as intended and may need to be rethought.

Part I of the Article recounts the shift in debtors' capital structure due to the new financing techniques, highlighting a surprising feature of the emergence of the leveraged loan and CLO markets: women played an unusually prominent role. This Part chronicles the coordination problems that have recently arisen, as reflected in a handful of much-discussed recent cases such as Serta, J. Crew, and Radio Shack. These developments have exacerbated two key problems in current bankruptcy practice: the uncertainty of outcomes and the perception that insiders dominate Chapter 11.

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[19] See, e.g., David A. Skeel, Jr., Distorted Choice in Corporate Bankruptcy, 130 **Yale L.J.** 366, 370 (2020) ("The RSA commits its signatories to support a future reorganization plan that conforms to the terms of the RSA, including the proposed payout to each creditor class.").

[20] A "backstop" is a promise, for which the insiders are given a fee, to purchase any stock that remains unsold after the offering. For description, in a controversial case that upheld very lucrative backstopping fees, see In re Peabody Energy Corp., 933 F.3d 918 (8th Cir. 2019).

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Part II explores the close, though partial, relationship between private equity funds and these recent developments. The frequent presence of private equity funds in the most notorious cases raises two questions: whether the problems have more to do with private equity than with the new financing techniques, and whether overrepresentation of private equity is likely to endure. This Part concludes that the problems are not simply private equity problems and that private equity sponsored companies may not be quite as ubiquitous in the future in Chapter 11 as they are now.

Part III considers a series of potential solutions and interventions that have been or might be proposed for addressing the downsides of the new financing techniques. The analysis begins by considering the possibility that the problems will be addressed by better contract drafting. This Part then explores four potential correctives, ranging loosely from the least to the most intrusive: using priming liens more frequently; barring signing fees for those who commit to an RSA; imposing of a good faith duty for debt; and restricting or banning the use of third-party releases. This Part advocates an incrementalist approach while warning that, unless the perception that Chapter 11 is rigged in favor of insiders is addressed, pressure may build for more radical reform.

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I. The New Coordination Problems

The classic theory of bankruptcy is premised on a debtor with widely scattered, unsecured creditors whose inability to coordinate could jeopardize the continued existence of an otherwise viable firm, destroying its going concern value.[21] Large corporate debtors in Chapter 11 now often look very different than those envisioned by the classical theory. Their debt is nearly all secured rather than unsecured, and the debtor and creditors seem to be in a position to anticipate and plan for the possibility of bankruptcy.[22] Yet serious coordination problems remain.[23] Because these problems emerge in an environment where coordination is possible, and traditional collective action problems do not exist, they are "synthetic" collective action problems.

The discussion of the new coordination problems in this part proceeds in three steps. The part begins by exploring key features of the capital structure of current large corporate debtors. Next, it briefly describes the conflicts that have arisen in three much-discussed recent cases. In each case, the

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21 See supra note 1.

22 See Skeel, supra note 5, at 1779.

23 See, e.g., Kenneth Ayotte & Christina Scully, J. Crew, Nine West, and the Complexities of Financial Distress, **Yale L.J. Forum** 363, 363-366 (2021)(describing the complexity of current capital structures).

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conflicts were made possible by gaps in the governing loan documents. The part then focuses on two key problems that have been exacerbated by these developments—the uncertainty of recent cases and the perception that insiders control the Chapter 11 process—and considers the relationship between them.

A. Key Features of Lending and Capital Structure

1. Leveraged Loans, CLOs and Pioneering Women

The first key feature of current capital structure is the widespread use of leveraged loan borrowing. The term "leveraged loan" refers broadly (and loosely) to any "type of loan made to borrowers who already have high levels of debt and/or a low credit rating."[24] Two decades ago, loans that fit this description comprised only a pittance of the debt markets--$100 billion in volume. Since then, the use of leveraged loans has grown exponentially. The current volume of $1.5 trillion is comparable to, and soon likely to exceed, the volume of the traditional high yield debt market.[25]

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[24] U.S. Securities and Exchange Commission, "Leveraged Loan Funds," https://www.investor.gov/introduction-investing/investing-basics/investment-products/mutual-funds-and-exchange-traded-0 [https://perma.cc/LA9G-CJXC].

[25] Matt Wirz, Junk-Loan Defaults Worry Wall Street Investors, **Wall St. J.** (Sept. 7, 2022), https://www.wsj.com/articles/junk-loan-defaults-worry-wall-street-investors-11662429632 [https://perma.cc/Y85C-9MHE] (showing that the leveraged loan market is $1.5 trillion).

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Securitization in the form of collateralized loan obligation structures, or CLOs, has been a key engine for the growth of the leveraged market. Before the advent of CLOs, a leveraged loan was little more than a very risky loan to a struggling company. To create a CLO, the organizer purchases numerous leveraged loans, and packages them into a CLO, selling interests in the CLO to various tranches of investors. Much as securitization did with mortgages, CLOs vastly expanded the market for leveraged loans.

A striking feature of the emergence of the leveraged loan and CLO markets is the greater role women seem to have played here than in other precincts of Wall Street, such as the mortgage bond markets.[26] A recent story speculated on the reason for this phenomenon:

> The strong female cadre in CLOs traces back to gender discrimination at banks in the late 1980s, when Wall Street still outshone Silicon Valley as the destination of choice for the U.S.'s top university graduates . . . Banks had just started hiring more women with finance and technical degrees but rarely placed them in high-profile--and high-paying--roles like trading bonds or chasing merger deals.
>
> . . . .
>
> Instead, women trainees were often assigned to commercial lending, the less-glamorous business of making loans to corporations. While bond traders like Michael Milken and corporate raiders like Carl Icahn monopolized the limelight, women were often

[26] The prevalence of men of Italian descent in Morgan Stanley's pioneering mortgage bond department is a recurring theme of **Michael Lewis, Liar's Poker: Rising Through the Wreckage on Wall Street** (1989).

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> crunching the numbers behind their big leveraged buyouts.[27]

Dominique Mielle, who rose to partnership at the hedge fund Canyon Capital Advisors, offers a different perspective. To the extent a disproportionate percentage of CLO pioneers were indeed women--a question that awaits empirical verification, Mielle emphasizes--women may have benefitted from an inherent gender neutrality:

> The CLO structure is . . . pretty transparent and pretty measurable. You have vintages of CLOs, and they play in the same sandbox, right? You have the same set of loans that you have to choose from and optimize your portfolio and issue your debt at the optimal cost as well. Then, you look at the return on equity, and it's all tracked by either analysts or rating agencies. And so, it's much more transparent who is good and who is not good.[28]

This gender neutrality in CLOs is notable when compared to hedge funds, which "started at different times; they have different strategies, different growth paths, et cetera."[29]

The same qualities Mielle identifies as creating opportunities for women suggest that leveraged loans and CLOs are not inherently problematic. Their transparency makes them easier

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[27] Matt Wirz, Women Claim New Turf on Wall Street, **Wall St. J.** (Feb. 2, 2019), https://www.wsj.com/articles/women-claim-new-turf-on-wall-street-11549108800. [perma.cc/6DDV-QM3P] According to some evidence, CLOs structured by women also perform somewhat better than CLOs assembled by men. Matt Wirz, Female CLO Managers Tend to Outperform Men, **Wall St. J.** (Feb. 8, 2019), https://www.wsj.com/articles/female-clo-managers-tend-to-outperform-men-11549630802 [perma.cc/RT5T-4Z7F].

[28] Interview with Dominique Mielle (Oct. 12, 2022) (transcript on file with author).

[29] Id. Mielle chronicles her own experience in a thoughtful and entertaining recent book. **Dominique Mielle, Damsel in Distressed: My Life in the Golden Age of Hedge Funds** (2021).

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to track than many other investments. It is perhaps coincidental, but perhaps not, that these CLOs, whose transparency stands in striking contrast to many hedge and private equity fund investments,[30] often appear to be on the losing side of the aggressive creditor tactics discussed below.[31]

The rise of the leveraged loan market has vastly increased the liquidity available to struggling mid-size and large corporations. For many firms, this may enable them to avoid a default or bankruptcy that might have been inevitable in an earlier era.[32]

Spurred by the success of leveraged loans, a new private capital industry has emerged, in which non-bank lenders make direct loans to companies with the same non-investment grade profile. Lenders such as HPS, Ares, Blackstone, Centerbridge and Oak Tree are major sources of these direct loans, and many of the largest private equity funds also now have a private capital dimension.[33]

The flipside of the benefits of these loans--that they provide additional liquidity for companies that might not

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[30] See, e.g. Ayotte & Huang, supra note 13 (arguing for standardization of DIP financing agreement terms to remove lenders' ability to include lucrative and opaque terms, such as backstopping fees).

[31] See, e.g. id. at 21 (CLOs as losers in these skirmishes). The aggressive tactics are discussed in Part I(B) infra.

[32] See, e.g., Grossman, supra note 9.

[33] See, e.g., Brian DeChesare, Private Equity Strategies: Growth, Buyouts, Credit, Turnarounds, & Toll Roads to Nowhere, **Mergers & Inquisitions** (July 29, 2020), https://mergersandinquisitions.com/private-equity-strategies/ [perma.cc/94ZZ-PNMC] (listing major players).

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otherwise have access to credit--is that the borrowers pose a high risk of default.[34] Moreover, because the originators of the loans often quickly transfer them to CLOs, whose trustees have weaker oversight incentives than a traditional bank, they may not be monitored as effectively as traditional loans, although the evidence on this point is mixed.[35] If they do file for bankruptcy, they may be in worse condition than a company that filed for bankruptcy earlier in its cycle of decline.

2. Predominance of Secured Claims

The second key feature of the typical large corporate debtor's financial distress is a predominance of secured debt. Struggling businesses have always taken on considerable secured debt prior to a default or bankruptcy,[36] but the current environment has magnified this trend in several respects. The first is access to sources of secured debt that did not exist in

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[34] See, e.g., Grossman, supra note 9 ("Some investors have worried that the added pressure on already shaky balance sheets could spark a wave of missed payments or bankruptcies.")

[35] McClane finds less intervention to police covenant violations with loans included in CLOs. Jeremy McClane, Reconsidering Creditor Governance in a Time of Financial Alchemy, 2020 **Colum. Bus. L. Rev.** 192, 259-61. Mitchell Berlin, Greg Nini and Edison Yu conclude, by contrast, that monitoring does not appreciably decline because many borrowers have traditional loans as well as leveraged loans. Mitchell Berlin, Greg Nini & Edison G. Yu, Concentration of Control Rights in Leveraged Loans, at 2-3 (unpublished manuscript, Nov. 27, 2019), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3494154 [perma.cc/2D46-P9AE

[36] See, e.g., Steven L. Schwarcz, The Easy Case for the Priority of Secured Claims in Bankruptcy, 47 **Duke L. J.** 425, 429 (1997)(describing the value of having the option to borrow on a secured basis at a time of stress).

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the past. The leveraged loans we encountered in the last subsection are a prime example.

The shift in this regard is vividly illustrated by the capital structure of companies acquired by private equity funds. In the 1980s, when they were known as leveraged buyout or LBO firms, private equity funds financed acquisitions primarily with unsecured junk bonds.[37] If the company fell into distress and filed for bankruptcy, it fit the traditional paradigm of a relatively small amount of secured senior debt, and a substantial amount of unsecured debt. Private equity funds currently use leveraged loans to finance acquisitions far more than in the past, which has tilted the capital structure balance toward secured rather than unsecured debt.[38]

The second, overlapping development is the increased use of first and second lien arrangements--overlapping in the sense that first or second lien loans may be purchased for CLOs, just as leveraged loans are. In a first and second lien arrangement,

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[37] A considerable popular literature recounts the rise of takeovers financed by junk bonds, a strategy pioneered by Michael Milken at Drexel Burnham. One of the best accounts is **Connie Bruck, The Predators' Ball: The Inside Story of the Rise of Drexel Burnham and the Junk Bond Raiders** (1988).

[38] The use of leveraged loans has declined recently due to interest rate increases, but the direct loans that have filled some of the vacuum are also secured. See, e.g., Chris Cumming, Private Equity Turns to Direct Lenders as Leveraged Loans Dry Up, **Wall St. J.** (June 8, 2022), https://www.wsj.com/articles/private-equity-turns-to-direct-lenders-as-leveraged-loans-dry-up-11654682400 [perma.cc/AB5B-FTJF] ("Buyout firms are increasingly looking to private lenders to finance their deals, as the once robust flow of junk bonds and leveraged loans has dwindled to a trickle."). But the direct loans that private equity funds have turned to are also secured.

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the first liens have senior liens on the collateral, and the second liens junior.[39] The second liens occupy a similar position to the unsecured bonds issued by companies with bonds, and often are used by companies for whom bonds would be too costly or difficult to issue. The difference is that second liens, unlike bonds, are secured.

The predominance of secured debt is reflected in the location of the residual claimant or "fulcrum security" of Chapter 11 debtors. The fulcrum security is the first class of claims of a debtor that cannot realistically be paid in full. These are the creditors that will benefit most from an effective Chapter 11 process and suffer from an inefficient one.[40] The Bankruptcy Code appears to envision that the fulcrum security will be a class of widely scattered unsecured claims.[41] It provides, for instance, for an estate-funded unsecured creditors committee in every substantial case.[42] Current cases often do not

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[39] See, e.g., Ayotte et al, supra note 3, at 269-70 (describing first and second lien arrangements for RadioShack). Unitranche loans often have a similar structure, except that the arrangement technically has a single lien, with senior and junior cashflow rights. For a good overview of Unitranche financing, see McCarthy M. Shelton, Turning the Middle Market Upside Down: Unitranche Financing in U.S. Middle-Market Leveraged Buyouts, at 17-20 (2017) (college honors thesis, Appalachian State University), https://case.edu/law/sites/case.edu.law/files/2020-02/Shelton%2C%20Mac%20Spring%202017%20Turning%20the%20Middle%20Market%20Upside%20Down%20%2843%20p.%29.pdf [perma.cc/HV6B-MLJ8].

[40] See generally, David A. Skeel, Jr., The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases, 78 **Va. L. Rev.** 461, 463 (1992)(describing bankruptcy provisions that enhance authority of the residual creditors, and assuming these are unsecured creditors).

[41] See, e.g., id. at 479-485 (explaining how the voting process concentrates authority on the residual class).

[42] 11 U.S.C. § 1102(a)(1).

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fit this paradigm. In many recent cases, the second liens are the fulcrum security, because so much of the capital structure consists of secured debt.[43]

3. Complexity

A final noteworthy feature of current capital structure is complexity, which has had ironic implications: Although the evolution of finance has magnified the parties' ability to coordinate, thus rendering traditional collective action problems obsolete for most firms, the greater ability to contract has not eliminated coordination problems. Their complexity has introduced new coordination problems.

One form of complexity arises from the use of separate entities within a corporate enterprise. In recent work, Ken Ayotte shows that debtors can exploit lenders' differing valuations of the debtor's assets by creating new subsidiaries.[44] If a debtor has two potential lenders, one of whom places an optimistic valuation on one of the debtor's assets and the other lender on another asset, the debtor can exploit their optimism

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[43] See generally Douglas G. Baird & Robert K. Rasmussen, Antibankruptcy, 119 **Yale L.J.** 648, 675 (2010) ("If the second lien position is the fulcrum security-- the security which is in the money, but not being paid in full-- then the reorganization is being run for the second lien lenders' benefit and they should pay for it.").

[44] Kenneth Ayotte, Disagreement and Capital Structure Complexity, 49 **J. Legal Stud.** 3 (2020).

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by putting the assets in separate subsidiaries and borrowing in each case from the more optimistic lender.

Additional complexity may arise from the efforts of sophisticated parties to anticipate, or to exploit, gaps in a lending agreement. "Substantive choices of contract terms are path dependent and affected by the law firm that provides the first draft," Ayotte and Christina Scully point out, "not just the economics of the transaction."[45] Rather than reducing complexity, the presence of sophisticated parties "magnifies the impact of a contract's inevitable flaws:"

> Sophisticated parties use these flaws to reallocate value from one coalition to another. Restructuring transactions add complexity to capital structures due to new layers of debt and legal entities, as well as the prospect of costly litigation exploiting ambiguous provisions in law and contract. Capital structure changes that occur in such scenarios … are workarounds of the contractual and legal constraints on the ground when the restructuring happens.[46]

Somewhat counterintuitively, several finance scholars have found that so-called "covenant-lite" loans--that is, loans with weak lender protections--may be more complex than traditional loans.[47]

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[45] Ayotte & Scully, supra note 17, at 365.
[46] Id. at 366.
[47] Victoria Ivashina & Boris Vallee, Complexity in Loan Contracts 4 (May 6, 2022) (unpublished manuscript) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3218631 [perma.cc/DDR5-L9FH].

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B. Complexity in Action

The ingredients of current capital structure have proven to be unusually combustible, giving rise to contested bankruptcies and restructurings that scholars have referred to as "bankruptcy hardball"[48] and "hostile restructurings."[49] Similarly vivid terms have crept into the practitioner literature, which warns about "lender on lender violence" and "predatory priming."[50] The fallout can be seen both in debtors' efforts to avoid bankruptcy and in the bankruptcy context.

Two recent cases are emblematic of the principal strategies debtors have employed in an effort to postpone a potential default or bankruptcy. In Serta, the first case, the sponsor employed an aggressive though plausible interpretation of its loan documents to justify a new loan from a subgroup of its existing lenders that effectively enjoyed seniority over its existing secured creditors.[51] The Serta strategy, which was also

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[48] Jared A. Ellias & Robert J. Stark, Bankruptcy Hardball, 108 **Calif. L. Rev.** 745 (2020).

[49] Diane Lourdes Dick, Hostile Restructurings, 96 **Wash. L. Rev.** 1333 (2021).

[50] See, e.g., Jennifer Selendy, Max Siegel, and Samuel Kwak, Improved T&C May Avoid Lender-on-Lender Violence, available at https://www.selendygay.com/news/publications/2022-08-26-improved-tc-may-avoid-lender-on-lender-violence; Jeff Norton et al., Predatory Priming: How Can Investors Protect Their Priority?, O'MELVENY (Sept. 9, 2020), https://www.omm.com/resources/alerts-and-publications/publications/predatory-priming-how-can-investors-protect-their-priority/.

[51] The bankruptcy judge in the Serta case drew a stronger conclusion, stating from the bench that "there simply is no ambiguity in my mind" that it was permitted by the loan documents. But he has not yet ruled on the question whether the transaction violated the implied covenant of good faith and fair dealing. See Serta Debtors Win Summary Judgment that 2020 Uptier Exchage Was

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employed in Boardriders and TriMark,[52] is often referred to as "uptiering" or an "uptier exchange."[53] In each case, the exploitation of apparent gaps in existing lending agreements facilitated additional secured borrowing and prompted a battle in bankruptcy.

The second strategy is exemplified by J. Crew. Taking advantage of a gap in its principal credit agreement, J. Crew transferred assets (in this case, intellectual property) to a subsidiary that was not restricted from borrowing by the credit agreement, then used the assets as collateral for a new loan.[54] This maneuver has become known as a "dropdown" or "trapdoor" transaction.[55]

In other cases, problems do not emerge until after a debtor files for bankruptcy. RadioShack is a particularly baroque illustration.[56] Radio Shack had two major groups of secured lenders, the ABL group and SCP, which had overlapping interests in the same collateral. The ABL group was divided into "first out" lenders and "second out" lenders, with the first out group entitled to be paid first. The various entanglements threatened

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Permitted as Open-Market Purchase Under 2016 Credit Agreement, Reorg-Research.Com, March 28, 2023.

[52] See Ayotte & Scully, supra note 17, at 372.

[53] See, e.g., Jackson Skeen, Uptier Exchange Transactions: Lawful Innovation or Lender-on-Lender Violence?, 40 **Yale J. Regul.** 408 (2023).

[54] Ayotte & Scully, supra note 17,at 368-69.

[55] Id.

[56] The developments summarized below are discussed in detail in Ayotte et al, supra note 3, at 269-70.

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to derail the case after Standard General, one of the second out ABL lenders, offered to buy many of RadioShack's stores.

The Standard General proposal precipitated a shifting set of allegiances both between and within the two loan facilities. ABL first out lenders attempted to use the ABL agreement to block the bid, and an SCP creditor invoked the intercreditor agreement to the same effect. Cerberus, another SCP creditor, initially consented to the objection but then threw its support behind the Standard General bid. The court finally cut through the confusion by hinting that it would not let the first out ABL lenders block the bid and ruling that the intercreditor agreement did not preclude Standard General's bid. But it could easily have held that the bid was preempted by one or both contracts.[57]

Traditional collective action problems--the inability of widely scattered unsecured creditors to coordinate--are nowhere to be found in these cases. The disputes involve secured creditors and the new coordination problems—problems that arise from gaps and uncertainties in the parties' contracts.

C. The Darkside of the New Regime

[57] Id. at 270-71.

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Navigating financial distress has always been uncertain, of course, but outcomes are unusually unpredictable in the current environment. In Radio Shack, a broad reading of the contracts would have precluded a potentially attractive offer for Radio Shack stores, sharply diminishing the value of this asset. In the Caesar's bankruptcy, which involved asset sales loosely analogous to J. Crew's dropdown transaction, the two private equity sponsors seemed likely to retain nearly all of the equity under a proposed reorganization plan pursued by Caesars' financial advisor.[58] The plan was derailed by an examiner's report finding a high likelihood that the transfers could be successfully challenged as fraudulent conveyances and on related grounds.[59] The court eventually confirmed a plan that gave Apollo and TPG, the private equity funds, only a small fraction of the equity they initially expected. In the bankruptcy of Nine West, skirmishing over contract terms generated fees that consumed "23% of the $600 million enterprise-value estimate."[60]

The Nine West battle highlights a key cost of the current uncertainty. Even if any given creditor will sometimes be on the

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[58] The asset sales are chronicled in **Max Frumes & Sujeet Indap, The Caesars Palace Coup: How A Billionaire Brawl Over The Famous Casino Exposed The Power And Greed Of Wall Street** 63-90 (2021). [ILL pending]

[59] The report concluded that the potential damages claims challenging the transactions that the examiner deemed either "reasonable" or "strong" were $3.6 to $5.1 billion. Id. at 228.

[60] Ayotte & Scully, supra note 17, at 380.

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winning side of the jockeying for advantage, and sometimes lose, thus ending up even overall, the skirmishes generate considerable deadweight costs.[61] And it is likely that some groups of creditors, such as CLOs, are systematically disadvantaged.[62]

A second key feature of Chapter 11 is the dominance of insiders. As with unpredictability, insider dominance is not a new phenomenon, but it has escalated. The complexity of companies' capital structure and of the bankruptcy process has magnified the advantage enjoyed by repeat players--a small group of bankruptcy lawyers and financial advisors cycle through the big Chapter 11 cases. The insiders are the only ones with the sophistication and familiarity needed to navigate the system.

The prevalence of insiders is not invariably problematic. Indeed, in a new book Douglas Baird identifies the "unwritten rules" developed, transmitted, and honored by insiders as the chief reason for the success of American bankruptcy law.[63] "The law of corporate reorganizations works as well as it does," Baird writes, "because its practitioners, like its judges, enjoy a shared understanding of its past."[64] They know the unwritten rules—that modest "tips" to pacify objecting parties are

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61 See supra note 13 and accompanying text.
62 Id.
63 **Douglas G. Baird, The Unwritten Law Of Corporate Reorganizations** (2022).
64 Id. at 183.

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permissible, for instance, but "side-deals" are not. "When well-represented, well-informed parties compete on a level field, the judge allows them to play on. Interventions should come only when the dynamics of the negotiations fail to account for the interests of the various constituencies and the stakes are large enough to make the game worth the candle."[65]

But insider dominance also carries considerable costs. Some of the costs are optical. A system that is perceived to be dominated by insiders may lose credibility among those outside the insider circle.[66] In the 1930s, the perception that the Wall Street bankers who dominated corporate reorganization sought "business patronage" and that their Wall Street lawyers were "charging all the traffic will bear." [67] as William Douglas put it in a famously scathing speech spurred Congress to gut the existing reorganization framework. Congress ushered out the Wall Street bankers and lawyers who had served as gatekeepers to the big corporate reorganizations of the era.[68] Even if the

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[65] Id. at 182. Although this Article highlights concerns about insider dominance, I have provided a generally sympathetic account of the role insiders played in the emergence of modern corporate reorganization in other work. See generally **David A. Skeel, Jr., Debt's Dominion: A History Of Bankruptcy Law In America** (2001).

[66] Melissa Jacoby has written about the costs of perceived unfairness in the related context of representation of ordinary citizens and small creditors in the bankruptcy process. See, e.g., Melissa Jacoby, Federalism Form and Function in the Detroit Bankruptcy, 33 **Yale J. Reg.** 55, 70-71 (2016) (discussing the underrepresentation of city residents and small creditors in the city of Detroit's bankruptcy filing).

[67] Quoted in Debt's Dominion, supra note 55, at 121.

[68] Id.

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complaints are exaggerated, as they sometimes were in the 1930s, these perceptions can corrode the functioning of the system.

Underlying the perceptions of insider dominance are more tangible costs. While insiders and their clients benefit, other constituencies may not. As Vincent Buccola has pointed out, legacy creditors who will not have a role with the reorganized company ("the odd ones out," in his account), often will be the losers.[69] Although some can perhaps anticipate this status and adjust the terms of contracts or loans to the debtor accordingly, others cannot.[70] And the maneuvering by insiders to put their favored resolution strategy in place will generate deadweight costs.[71] It is of course possible that an insider-oriented system is desirable even with these costs, but the costs are real.

The parties have devised contractual strategies for reducing the uncertainty of the Chapter 11 process. When a debtor's existing lenders provide new financing for bankruptcies, they often include "milestones" that dictate the direction of the case rather than leaving it to negotiations after the bankruptcy filing.[72] In a restructuring support

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[69] Vincent S.J. Buccola, Unwritten Law and the Odd Ones Out, 131 **Yale L.J.** 1559, 1563 (2022) (stating this argument about the "odd ones out.").

[70] Id. at 1579-80.

[71] Id. at 1580.

[72] See, e.g., Frederick Tung, Financing Failure: Bankruptcy Lending, Credit Market Conditions, and the Financial Crisis, 37 **Yale J. On Regul.** 651, 672 (2020) (defining milestones).

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agreement, the parties commit to the terms of a potential reorganization plan.[73] Like DIP financing agreements, RSAs usually have milestones, and RSAs also require that any creditor who purchases the claim of a signatory to the RSA must itself commit to the terms of the RSA.[74] This removes the risk that a tentative agreement will unravel after some of the signatories sell their claims to other investors.[75]

Although DIP financing agreements and RSAs can be problematic when they are linked, each can beneficially reduce the uncertainty of Chapter 11. They streamline the restructuring process, and once they are in place can reduce jockeying among the parties to participate in the favored transaction.[76] But they also increase insider dominance. Insiders invariably arrange the RSA, for instance, and they often receive a fee for participating, either directly or in connection with transactions such as the debtor's exit financing.[77] Those outside the inner circle do not receive the fees.

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[73] See, e.g., Skeel, Distorted Choice, supra note 14 at 370 (defining an RSA).

[74] Id. at 385.

[75] Id.

[76] Edward Morrison defended RSAs in similar terms in the Inaugural Harvey R. Miller Lecture at Columbia Law School in April 2022, available at https://vimeo.com/708639990 [perma.cc/D8X8-B4ZV]. .

[77] The most widely discussed recent example is chronicled in In re Peabody Energy Corp., 933 F.3d 918 (8th Cir. 2019), which approved extremely generous fees for the insiders in the case.

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II. Is This a Private Equity Phenomenon?

One of the most remarkable features of the distressed debt market is captured in a simple statistic: roughly seventy percent of the companies on Moody's list of potentially distressed businesses are owned by private equity fund sponsors.[78] Not surprisingly, given that distressed businesses are the logical candidates for Chapter 11, private equity sponsors are a familiar presence in Chapter 11.[79] It is possible that the concerns discussed thus far are primarily a function of the prevalence of private equity-sponsored debtors in bankruptcy. This part asks why private equity funds have become so prominent in Chapter 11, what implications this has, and whether the trend will continue.

One obvious reason for the rise of private equity is the liquidity generated by leveraged loans and CLOs, which are central to private equity acquisitions. The growing market for leveraged loans provides the funding private equity funds need for new transactions. In addition, private equity funds have themselves been highly attractive investments for investors in

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[78] Valladares, supra note 12 (identifying this statistic).

[79] See generally Luisa Beltran, The year in bankruptcy isn't just an FTX story. What's next could be even bigger, **Fortune** (Dec. 29, 2022), https://fortune.com/2022/12/29/the-year-in-bankruptcy-isnt-just-an-ftx-story-whats-next-could-be-even-bigger/ [perma.cc/B22Q-XTSW] (finding that there were forty-nine private equity sponsored company bankruptcies in 2022).

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an environment where returns to other investments are relatively low.[80] As of 2020, roughly 35% of the investment in private equity funds came from public pensions for precisely this reason.[81] With considerable funding for their own stake in acquisitions, and access to leveraged loans for the additional funds they need, private equity funds have been unusually active.

The diminished attractiveness of publicly held companies may be an additional, though perhaps less central, factor. After the corporate scandals involving Enron, WorldCom and other companies, Congress passed the Sarbanes-Oxley Act in 2002. Sarbanes-Oxley requires publicly held companies to establish internal control systems and gives the company's chief executive officer and accounting firm responsibility for certifying the efficacy of the internal controls.[82] Some have attributed the decline in the number of publicly held firms to the added regulatory costs created by the Act, while others have attributed this phenomenon to other factors.[83] Either way, the

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[80] See, e.g., Heather Gillers, Calpers Portfolio Chief Laments Returns, Wall St. J., Sept. 21, 2022 (noting the California pension fund attributed its lagging returns to a failure to put substantial investment in provide equity, which other funds "have relied on in recent years to amp up returns").

[81] **Preqin, 2020 Preqin Global Private Equity And Venture Capital Report** 42 (2020) (stating that public pensions hold 35% of investment in private equity).

[82] For a brief overview of the Sarbanes-Oxley Act, see George S. Georgiev, The Breakdown of the Public-Private Divide in Securities Law: Causes, Consequences, and Reforms, 18 **N.Y.U. J.L. & Bus.** 221, 258-60 (2021).

[83] For a critique of the overregulation thesis and an argument that this thesis prompted deregulatory measures that increased the ease of capital

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shift appears to have affected private equity acquisitions as well. Rather than taking most of the companies they acquire public after a few years, as in the past, private equity funds hold them longer or sell them privately, including to other private equity funds.[84] Private equity fund ownership is thus less temporary than in the past.

It is possible that the ubiquity of private equity sponsored Chapter 11 debtors is more a temporary aberration than a permanent change. Before and during the COVID-19 pandemic, an extremely low interest rate environment put pressure on pension funds and other institutional investors to search for higher returns, since even the more fiscally responsible pension funds assume at least a 6% return.[85] This made private equity, with its robust returns, especially attractive. Rising interest rates could reduce the comparative advantage private equity had enjoyed over other investments.[86] In addition, the growth of the market for private capital—direct loans to struggling

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raising by private companies, see id. at 260-63, citing to Elisabeth de Fontenay, The Deregulation of Private Capital and the Decline of the Public Company, 68 **Hast. L.J.** 446, 466-70 (2017).

[84] See generally id. at 471 (noting that "the decline of IPOs has left private company investors such as founders, venture capital and private equity funds, and employees with only mergers and acquisitions as a ready means of exit").

[85] See, e.g. Oliver Giesecke & Joshua Rauh, Trends in State and Local Pension Fund, unpublished manuscript, Oct. 19, 2022, at 2, available at file:///C:/Users/dskee/Downloads/SSRN-id4258469.pdf (finding liability weighted average discount rate of 6.76%).

[86] See, e.g., Heather Gillers & Dion Rabouin, Pensions Brace for Private-Equity Losses, **Wall St. J.** (Sept. 24, 2022), https://www.wsj.com/articles/pensions-brace-for-private-equity-losses-11663985240.

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businesses—could provide an alternative to private equity acquisitions.[87]

Even if the high market share private equity sponsored companies have in Chapter 11 proves to be the apex of the trend, the lure of private equity as an investment and the funds' access to financing are likely to endure. A non-trivial number of the companies the funds acquire will default, which means that private equity sponsors will remain a major presence in Chapter 11. Given that "sponsor-owned companies are responsible for almost every hardball priming transaction," as one scholar notes, the brinkmanship—and attendant uncertainty—of current Chapter 11 practice will likely continue.[88]

The predominance of sponsor-owned Chapter 11 debtors exacerbates both the appearance and the reality of insider dominance in Chapter 11. When a traditional publicly held company files for bankruptcy, the grip of its old managers and shareholders may be loosened considerably. If a majority of its directors are independent, they are likely to focus more on

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[87] The largest private equity funds now have their own private capital branches, so they may be the ones making some of these loans. See, e.g., Lisa Lee & Olivia Raimonde, Private Equity Firms Are Cutting Out Banks and Funding LBOs themselves, **Bloomberg** (Aug. 11, 2021), https://www.bloomberg.com/news/articles/2021-08-11/blackstone-ares-are-turning-into-banks-for-lbo-financing#xj4y7vzkg?leadSource=uverify%20wall [perma.cc/EKV7-KAUE] ("More and more, private equity firms looking to finance big leveraged buyouts are cutting out the Wall Street banks, and borrowing money from each other or from direct lenders.").

[88] Vincent S.J. Buccola, Sponsor Control: A New Paradigm for Corporate Reorganization, 90 **U. Chi. L. Rev.** 1, 6 (2023).

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resolving its financial distress than on protecting the incumbent decision makers. By the time the company nears default, it may have looked to new or existing lenders for liquidity who may force the replacement of existing managers.

Sponsor-owned companies are different. They typically have a small board of directors that is tightly controlled by the sponsor-owner.[89] Sponsors often negotiate for releases absolving themselves of potential liability for pre-bankruptcy misbehavior in connection with RSAs that shape the reorganization process.[90] The sponsor's continued influence raises concerns that the debtor, among other things, will not vigorously challenge problematic transactions that the company may have engaged in prior to bankruptcy. This feeds the perception that Chapter 11 is rigged in favor of insiders and their professionals.

To counter this perception, private equity funds often appoint a new board of directors shortly before the company files for bankruptcy. Whether the ostensibly independent directors are genuinely independent is debatable. Many are repeat players, having served for the same law firms in multiple cases.[91] The private equity sponsors are represented by insider

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[89] See id. at 22-23 (explaining the close relationship a sponsor will have with a company's board).

[90] Id. at 40-41.

[91] See Jared A. Ellias, Ehud Kumar, & Kobi Kastier, Bankruptcy Directors, **S. Calif. L. Rev.** at 6 (forthcoming 2022) ("Private-equity sponsors are repeat players that can appoint individuals to many boards.").

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lawyers and financial analysts, and the boards of sponsor-owned Chapter 11 companies often had insider directors.

III. Solutions and Interventions

The shift in the capital structure of Chapter 11 debtors and the dominant role played by private equity funds has contributed to an identity crisis in Chapter 11. The traditional collective action problems of bankruptcy theory are much less salient, having been replaced by coordination problems arising from gaps and uncertainties in the parties' contracts.

The problems this Article has focused on--highly uncertain outcomes and insider control--are a perennial feature of corporate reorganization in America. The irony that efforts to reduce uncertainty tend to exacerbate the influence of insiders could easily be traced back through bankruptcy history, for instance.[92] But they have taken a distinctive form in the current era.

This Part considers a series of potential solutions and interventions that have been or might be proposed. It starts

[92] Earlier corporate reorganization stars such as Paul Cravath touted their inside knowledge as essential to the smooth functioning of reorganization practice. The "provisions of the modern reorganization agreement," Cravath wrote, "are the result of the experience and prophetic vision of a great many able lawyers." Paul Cravath, Reorganization of Corporations: Certain Developments of the Last Decade, in **Some Legal Phases Of Corporate Financing, Reorganization, And Regulation** 153, 178 (1917).

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with measures the parties themselves might take, moves to potential duties imposed by bankruptcy judges, and concludes with possible legislative correctives.

A. Addressing Gaps by Contract

Since the most aggressive stratagems have exploited gaps in the debtor's loan documents, the first line of defense is contract drafting. If lenders altered lending contracts to remove the possibility of uptier or dropdown transactions, some of the maneuvers that have characterized recent cases might prove transitory.

In one respect, the early evidence about improved contracting in this context is encouraging. A rich contracts literature shows that problematic terms in contracts tend to be inefficiently sticky. After a surprising interpretation of the "pari passu" clause in sovereign debt contracts, for instance, many sovereign debt contracts continued to include the troublesome clause without clarifying its meaning.[93] A new study of the provisions that were construed to permit Serta-style uptiering, by contrast, finds that the loophole has been closed

[93] See **Mitu Gulati & Robert E. Scott, The Three And A Half Minute Transaction** 2 (2013) (describing how contracts continued to use a clause without clarification after a "heretical interpretation" of it).

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in many of the new contracts.[94] Far fewer, however, have been amended to remove the risk of J. Crew-style dropdown or trapdoor transactions. This could suggest either that stickiness is sometimes but not always an issue, or that the provisions that leave a crack open for dropdowns may be beneficial overall, despite their opportunistic use in some cases.

Even if provisions that egregiously misfire are likely to be corrected, improved drafting is unlikely to be more than a partial remedy for the uncertainty engendered by current capital structure. Given that contract drafting is often path dependent rather than vigilant and objective, and sophisticated parties have an incentive to find gaps when a company faces financial distress,[95] coordination issues will not be removed by ex post fixes to the problems that have emerged thus far.

B. Imposing a Duty of Good Faith

The standard response to a worrisome residual of opportunism is to invite courts to impose a duty of good faith.[96]

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[94] Vincent S.J. Buccola & Greg Nini, The Loan Market Response to Dropdown and Uptier Transactions at 42-43(unpublished manuscript, 2022), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4143928 [perma.cc/8JDM-KHNS] (explaining how lenders have since updated their views on the subject).

[95] Ayotte & Scully, supra note 17, at 365-66 ("The prospect of interaction between contracts when there is not enough money to go around creates a search for loopholes and other creative strategies.").

[96] This is the principal proposed solution to the related problem of coercive bond restructuring transactions, for instance. See, e.g., William W. Bratton & Adam J. Levitin, The New Bond Workouts, 166 **U. Pa. L. Rev.** 1597, 1604 (2018) ("We suggest that the intercreditor duty of good faith . . .

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While corporate directors owe duties of care and loyalty to shareholders, Delaware, the leading source of corporate law, has been hesitant to extend similar protection to bondholders and other creditors, especially while the company is solvent.[97] If the debtor falls into financial distress, creditors may be permitted to sue the directors for alleged misbehavior, but the suit must be brought derivatively on behalf of all, rather than directly.[98]

In response to the aggressive tactics of sponsor-owned companies, several scholars have advocated that courts police this behavior with a good faith duty. "Importantly," one scholar and a prominent practitioner write, "we believe that management would be restrained if they knew they would be forced to justify their conduct under a judicial inquiry with more bite. While a more aggressive application of the business judgment rule would not eliminate opportunism, it would likely deter the most egregious cases."[99] Sounding a similar theme, another scholar

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would provide an effective solution to any resulting problems."). Mitu Gulati has advocated use of a similar approach with sovereign debt. See, e.g., Mitu Gulati & William W. Bratton, Sovereign Debt Reform and the Best Interest of Creditors, 57 **Vand. L. Rev.** 1, 8 (2004) ("Resolution of [sovereign debt] disputes, therefore, requires a robust good faith principle.").

97 See, e.g., Katz v. Oak Indus. Inc., 508 A.2d 873, 880 (Del. Ch. 1986) (stating that bondholders protected only if a transaction is "wrongfully coercive.").

98 See, e.g., North American Catholic Educational Programming Foundation, Inc. v. Gheewalla, 930 A.2d 92, 103 (Del. 2007) ("[I]ndividual creditors of an insolvent corporation have no right to assert direct claims for breach of fiduciary duty against corporate directors. Creditors may nonetheless . . . bring[] derivative claims.").

99 Ellias & Stark, supra note 39, at 785.

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urges "all courts to approach disputes arising out of loan restructurings with a renewed emphasis on existing legal and equitable principles, such as the implied covenant of good faith and fair dealing," pointing out that "under basic principles of state contract law, the implied covenant is generally understood to mean that parties to contracts should behave honestly and work to uphold the spirit of the agreement."[100]

Although the prospect of a judicial eye over the parties' shoulders is attractive, it is important to register several cautions (each consistent with points made by the scholars just quoted). First, adding a robust new good faith duty would step in precisely the opposite direction than Delaware courts have tended, even with their traditional (shareholder-oriented) fiduciary duties. In the past several decades, Delaware has increasingly proceduralized its fiduciary duties in the corporate law context, diminishing the focus on subjective factors.[101] The proceduralization is most pronounced with

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[100] Dick, Hostile Restructurings, supra note 38, at 1384. Eric Talley and Sneha Pandya offer an intriguing, though somewhat speculative, historical account of Delaware courts' reluctance to look beyond the terms of bonds and other lending contracts and to police the parties' good faith. They too advocate for enhanced good faith scrutiny. See Eric Talley and Sneha Pandya, Debt Textualism and Creditor-on-Creditor Violence: A Modest Plea to Keep the Faith at 3-4 (unpublished manuscript, Jan. 2023), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4317353 [perma.cc/4R35-PXAM].

[101] This is reflected in the deference given to approval by disinterested directors and shareholders in contexts such as self-dealing transactions and corporate freezeouts that previously would have been subject to entire fairness review. See, e.g., Kahn v. M&F Worldwide Corp., 88 A.3d 635, 645-46 (Del. 2018) (detailing the new business judgment standard of review in a case about freezeouts).

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publicly held corporations, and it does not preclude careful review,[102] but it is a noticeable shift in Delaware law. To the extent this reflects difficulties in applying subjective factors, advocates for a robust good faith duty may be expecting too much from the bankruptcy judges who would be applying the duty.[103] Second, the traditional view that fiduciary duty-like protections are more essential for shareholders than creditors, given the open-ended nature of their commitment to the firm,[104] is still compelling, in my view, and cautions against giving courts a roving commission to intervene on good faith grounds. Finally aggressive intervention might chill legitimate behavior or serve as an attractive nuisance to creditors' committees or other parties after the fact, inviting them to challenge even defensible transactions.

This does not mean that imposing a good faith duty is a bad idea. But it should only be wielded in egregious cases. Caesars would have been a close call in that regard, perhaps justifying

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[102] In Marchand v. Barnhill, 212 A.3d 805 (Del. 2019), for instance, the Delaware Supreme Court held that simply complying with federal Food and Drug Administration regulation was not sufficient to satisfy a board's oversight obligations, given the importance of food safety to a ice cream manufacturer.

[103] Jared Ellias and Elisabeth de Fontenay draw a somewhat different conclusion, contending that Delaware courts are attentive to substantive considerations. But they too are skeptical of "a revival and extension" of good faith doctrine, worrying that judges may not be well-positioned to "mak[e] such determinations in the extraordinarily complex and fast-moving world of debt transactions.". Jared Ellias & Elisabeth de Fontenay, Law and Courts in an Age of Debt, **U. Pa. L. Rev.** (forthcoming 2023), manuscript at 34.

[104] The classic exposition came from Nobel-prize winning economist Oliver Williamson. Oliver Williamson, Corporate Governance, 93 **Yale L.J.** 1197 (1984).

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intervention due to the magnitude of, and questionable consideration for, the transfers made by the private equity sponsors prior to the bankruptcy.[105] But this is the domain of fraudulent conveyance;[106] it's not clear that a good faith duty would be needed.[107]

Serta is perhaps the most compelling of the recent cases for good faith intervention. Uptier transactions are designed to exploit the minority of the current lenders that are not offered an opportunity to participate in the new loan transaction. Unless the minority were invited to participate and declined, the transactions are hard to justify. But even here, the case for intervening in the future is weaker, given that that contracting parties are aware of the issue and many have addressed it in their contracts.[108]

C. Banning Signing Fees in RSAs

[105] The transfers of key real estate assets by the operating company prior to bankruptcy are chronicled in **Frumes & Indap**, supra note 61, at 77-90.

[106] As noted earlier, the examiner valued the claims at $3.6 to $5.1 billion. The parties ultimately settled. See supra note 47.

[107] This point echoes the findings of Laura Lin's classic empirical study of a cases around the time Delaware's famous Credit Lyonnais dicta suggesting the directors owed a duty to creditors when a firm is in the vicinity of insolvency. Laura Lin, Shift of Fiduciary Duty Upon Corporate Insolvency: Proper Scope of Directors' Duty to Creditors, 46 **Vand. L. Rev.** 1485, 1487 n. 7 (1993).

[108] See Buccola & Nini, supra note 81, at 42-43.

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As we discussed earlier,[109] an increasingly standard technique for reducing the uncertainty of current cases is for the debtor and some of its creditors to negotiate a restructuring support agreement prior to filing for bankruptcy. This commits both the parties and subsequent purchasers of the claims of signatories to the terms of a future reorganization plan consistent with the RSA. While they curb uncertainty, RSAs frequently benefit the insiders who negotiate them by providing a signing bonus or other fees.

While acknowledging that RSAs can serve a valuable coordination function, several scholars have advocated that courts ban signing fees. RSAs with signing fees should be prohibited altogether,[110] they suggest, "even if this puts ultimate confirmation at risk."[111] They worry that RSAs interfere with the Chapter 11 disclosure and voting process, and that signing fees effectively give signatories compensation that other creditors in their class do not receive. Absent a formal

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[109] See supra notes 64-67 and accompanying text.

[110] Edward J. Janger & Adam J. Levitin, The Proceduralist Intervention—A Response to Skeel, 130 **Yale L.J.** 335, 346-49 (2020) [hereinafter Proceduralist Inversion] (noting that "[i]n an earlier article we took the position that entitlement-distorting RSAs ought to be proscribed," and subsequently stating that this response is intended "not only to defend our position, but to flesh it out"); Edward J. Janger & Adam J. Levitin, Badges of Opportunism: Principles for Policing Restructuring Support Agreements, 13 **Brook. J. Corp. Fin. & Com. L.** 169, 186 (2018) [hereinafter, Badges of Opportunism](calling payments to signatories a "badge of opportunism.").

[111] Proceduralist Inversion, supra note 94, at 344.

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court ruling that the signatories provided a benefit to the estate, they conclude, signing fees should never be permitted.[112]

RSAs undeniably do sidestep Chapter 11 disclosure and voting rules, which preclude the debtor and creditors from soliciting votes on a reorganization plan before the court has approved a disclosure statement.[113] An RSA is invariably negotiated long before the debtor files the disclosure statement. The parties that negotiate RSAs are bankruptcy insiders, and the signing fees may give an extra recovery to those insiders. A ban would vindicate the formal voting rules and curb the favoritism of insiders. A ban also is hard to beat for ease of enforcement.

But the cost of a ban would be considerable. As even their critics acknowledge, RSAs enable the parties to coordinate, thus reducing the uncertainty of the Chapter 11 process. The prospect of an RSA may also induce some companies--especially those owned by private equity sponsors--to file a Chapter 11 case they would otherwise delay.[114] Although creditors sometimes might be willing to commit to an RSA without receiving a signing fee, often they would not. The creditors who negotiate the RSA incur significant

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[112] See id. at 347 ("Just as the coercive aspects of the plan process all come with procedural protections associated with the vote, administrative expense priority should only be granted to a creditor upon a finding of benefit to the estate.").

[113] See, e.g., Skeel, Distorted Choice, supra note 14, at 373.

[114] See Buccola, Sponsor Control, supra note 75, at 39-42.

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expenses--both direct expenses and the cost of forgoing the opportunity to buy or sell claims during the negotiation process.[115] In negotiating a deal that benefits all creditors, the participants provide a public good, for which payment is appropriate.

As with the good faith duty, this does not mean that bankruptcy courts should approve every RSA that comes before them. Courts should assess whether the fees associated with an RSA are appropriate, much as they do with lockup provisions in merger transactions in corporate law.[116] If the fees are egregious, they should not be permitted. The recent Peabody Energy case was a missed opportunity to signal that courts will not approve an RSA that gives insiders far more than reasonable compensation for their involvement in the negotiations.[117] In that case, RSA participants were promised fees for backstopping Peabody's exit financing that objectors claimed to be as high as $1.4 billion.[118] By refusing to approve the RSA, the court could have discouraged insider abuse of RSAs.

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115 See Skeel, Distorted Choice, supra note 14, at 401-404 ("The creditors who negotiate the terms of an RSA- and thus the terms of a potential reorganization plan -provide a public good, since reorganization may be valuable for everyone, and they also forgo the opportunity to trade during the negotiations.").

116 See id. at 416-21 ("Absent a presumption against rights offerings as part of a PSA, a court needs to determine whether the entitlement coercion is excessive, as well as the related question of whether plan proponents are receiving excessive compensation for the public good they have supplied.").

117 In re Peabody Energy Corp., 933 F.3d 918 (8th Cir. 2019).

118 See Skeel, Distorted Choice, supra note 14, at 420.

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D. Loosening the Sclerotic Market for Bankruptcy Financing

One of Chapter 11's great innovations was its inclusion of a provision giving bankruptcy courts broad discretion to authorize so called "debtor in possession" or "DIP" financing—financing for its operations in bankruptcy.[119] The court can authorize financing on an unsecured basis, as an administrative claim, on a secured basis, or even on a secured basis with priority over existing security creditors.[120] This last option is known as a "priming lien." The DIP financing provision makes it far more likely that a potentially viable debtor can obtain financing than might otherwise be the case.

Although DIP financing is essential, and DIP financing agreements have long been used to curb some the problems that emerged in the early years of the bankruptcy code,[121] several serious problems have emerged, each magnifying the influence of insiders. The first and most longstanding is the difficulty of obtaining financing from anyone other than the debtor's existing

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119 See 11 U.S.C. § 364.

120 Id.

121 See, e.g., Douglas G. Baird & Robert K. Rasmussen, The End of Bankruptcy, 55 **Stan. L. Rev.** 751, 785 (2002) ("These revolving credit facilities and the practical control they give lenders over a firm are some of the most striking changes in Chapter 11 practice over the last twenty years."); David A. Skeel, Jr., Creditors' Ball: The "New" New Corporate Governance in Chapter 11, 152 **U. Pa. L. Rev.** 917, 919 (2003) (explaining that there has been an increasing use of DIP financing agreements).

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lenders. Because the inside lenders invariably have liens on most or all of a debtor's assets, they would be the principal beneficiary of the proceeds of a new lender's loan. As a result, new lenders are reluctant to provide financing; the market is costly and uncompetitive.[122] The obstacle to outside financing could be surmounted by giving new lenders priority: a priming lien. But courts have been very reluctant to give serious consideration to outside loans, which would require a valuation hearing and a finding that the existing lenders are "adequately protected."[123]

Second, and related, the debtor and inside creditors often link their DIP financing agreement to an RSA. In the Neiman Marcus bankruptcy, for instance, signatories to the RSA would receive generous fees for participating in the DIP financing and backstopping $75 million of exit financing.[124] But the RSA precluded signatories from offering alternative financing, which

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[122] For empirical evidence confirming this, see B. Espen Eckbo, Kai Li & Wei Wang, Rent Extraction by Super-Priority Lenders 4 (Tuck Sch. of Bus., Working Paper No. 3384389, 2020) https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3384389 [perma.cc/QG2U-UXBB] (citing evidence that eighty percent of bankruptcy financing comes from the debtor's current lenders); Frederick Tung, Financing Failure: Bankruptcy Lending, Credit Market Conditions, and the Financial Crisis, 37 **Yale J. On Reg.** 651, 655 n.13 (2020) (noting that in a sample data set of debtor-in-possession loans, seventy-five percent of bankruptcy financing came from debtors' current lenders.).

[123] See, e.g., Skeel, supra note 7, at 327-28.

[124] Id. at 332.

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meant that they would sacrifice the fees if they made a competing offer for financing.[125]

Bankruptcy courts could loosen the sclerosis, and insider dominance, of the bankruptcy financing market with several simple interventions. The most obvious is simply to adopt a more hospitable stance toward priming liens.[126] Inside lenders invariably fend off a potential priming lien by warning that considering financing from outside lenders, or from non-favored current lenders, would require a costly valuation hearing, and that the outsiders could not demonstrate that the insiders are adequately protected. The market might thaw if a few bankruptcy judges called the insiders' bluff and held the hearing. Courts should also decline to enforce provisions that cut off access to potential funding from outside lenders. First and second lien agreements sometimes preclude second lien holders from offering new financing.[127] As discussed above, RSAs may similarly constrain their signatories.[128] The leading bankruptcy courts have sometimes adopted local rules indicating that they will not

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125 See id. at 333.

126 See id. at 328 ("A thawing of this reluctance [towards priming liens] is essential to the emergence of a competitive lending market, given the debt-overhang issues that discourage new lenders from making loans without an assurance of priority.").

127 See id. at 328-30 ("One standard term gives first lienholders the exclusive right to enforce the parties' rights in their collateral.").

128 See id. at 332-33 (describing the ways in which an RSA may constrain its signatories using the example of Neiman Marcus).

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allow, or will rarely allow, problematic provisions.[129] They could do the same with provisions that discourage outside lenders from providing financing.

E. Regulatory Restraints on Private Equity Funds

Since the uncertainty and insider dominance of current Chapter 11 practice are intertwined with private equity funds, another possible strategy is regulatory reform of private equity. Senator Elizabeth Warren and other progressives are the principal advocates of this approach.[130] "For far too long," she has complained, "Washington has looked the other way while private equity firms take over companies, load them with debt, strip them of their wealth, and walk away scot-free -leaving workers, consumers, and whole communities to pick up the pieces."[131]

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[129] Provisions that the Southern District of New York and Delaware have warned against, and require prominent disclosure of, include cross collateral provisions (provisions that secure a pre-bankruptcy obligation with the lien given for new bankruptcy financing) and DIP financing agreements that give the lender a security interest in avoidance actions. See Rule 4001-2: Requests For Use Of Cash Collateral Or To Obtain Credit – Amended December 1, 2017, available at https://www.nysb.uscourts.gov/rule-4001-2 [perma.cc/R78C-HE33]; Rule 4001-2 Cash Collateral and Financing Orders, available at http://www.deb.uscourts.gov/content/rule-4001-2-cash-collateral-and-financing-orders [perma.cc/M35X-EHWB].

[130] See https://www.warren.senate.gov/newsroom/press-releases/warren-baldwin-brown-pocan-jayapal-colleagues-unveil-bold-legislation-to-fundamentally-reform-the-private-equity-industry [perma.cc/L7CU-275M].

[131] I

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In 2019, Warren and several other progressives introduced the Stop Wall Street Looting Act, which would impose new restrictions on private equity.[132] The legislation was reintroduced in 2021.[133] The Stop Wall Street Looting Act would hold the funds personally responsible for debt and other obligations incurred by companies they acquire, thus removing the shield of limited liability.[134] Acquired companies would not be permitted to make dividends or other distributions for two years after the acquisition,[135] and private equity would lose the favorable tax treatment currently given to "carried interest."[136] The proposed legislation would also amend bankruptcy law to enhance the treatment of employees and take away the authority of "sham" private equity directors to determine whether or not to see managers and other insiders of the company.[137]

The most spectacular provisions, which would hold private equity funds personally liable for the obligations of the companies they acquire, might be defended as discouraging the funds from gambling with a company's future. The funds would be

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132 Id.

133 Id. For a detailed section-by-section summary of the legislation, see https://www.warren.senate.gov/imo/media/doc/The%20Stop%20Wall%20Street%20Looting%20Act%20of%202021%20Section%20by%20Section%20Final.pdf [perma.cc/LU6P-CGHS].

134 See id. at 1.

135 See id.

136 Id. at 4.

137 Id. at 2.

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more careful if the managers shared in the risk of failure.[138] In practice, however, the provisions would do far more. By imposing liability for any default, regardless of the reason, they would destroy the private equity model, much as the bankruptcy reforms of the New Deal destroyed large-scale corporate reorganization practice.[139] Effectively banning private equity is unwarranted, given the benefits that private equity-style acquisitions can bring.

At least one of the minor reforms--the sham director provision--warrants closer consideration, however.[140] Whereas the directors of a Chapter 11 debtor, serving as "debtor in possession," are ordinarily the ones who bring causes of action for pre-bankruptcy misbehavior, this provision would vest the authority in a representative of the creditors committee.[141] Creditors' committee control is an imperfect solution. In many current cases, the unsecured creditors who are represented by the creditors' committee are out of the money. This creates a

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[138] See, e.g., Press Release, supra note 138 ("Firms will share responsibility for the liabilities of companies under their control including debt, legal judgments and pension-related obligations to better align the incentives of private equity firms and the companies they own.")

[139] For a description of how the Chandler Act of 1938 destroyed the corporate reorganization practice in the New Deal, see Skeel, supra note 55, at 123-27.

[140] Ellias, Kumar & Kastier reach a similar conclusion, although they advocate a somewhat different approach. See Ellias, Kumar & Kastier, supra note 78, at 4 (proposing that bankruptcy judges consider whether creditors overwhelmingly support the private equity directors).

[141] A Bill to subject certain private funds to joint and several liability with respect to the liabilities of firms acquired and controlled by those funds, and for other purposes, H.R. 5648, 117th Cong. 1st Sess., Oct. 20, 2021 § 202(e).

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risk that the committee would be motivated more by the holdup power control of the litigation gave it than a cost-benefit analysis of whether litigation would be beneficial to the estate. But private equity sponsors' installment of new "independent" directors has rightly generated considerable skepticism.[142] Shifting control over this litigation to more disinterested party would reduce the perception, and possibly the reality, of insider control in bankruptcy.

F. Reforming Non-Debtor Releases

Controversial mass tort cases such as the Purdue Pharma bankruptcy are starkly different in most respects than cases with the sponsor-owned debtors that are a focus of this Article. But they do have a key feature in common: third party releases. Although the Sacklers, the family that owned Purdue Pharma, did not themselves file for bankruptcy, their liability would be released in return for a contribution to the bankruptcy case. Similarly, most or all Chapter 11 cases with sponsor-owned debtors release the private equity fund and its partners.[143]

The ability to discharge the obligations of non-debtor insiders further contributes to the perception of insider

[142] See, e.g, Ellias, Kumar & Kastier, supra note 78.

[143] Buccola argues that the non-debtor release is a key feature of these cases for the funds. Buccola, Sponsor Control, supra note 75, at 6.

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control in bankruptcy. Because courts are more willing to permit non-debtor releases in some circuits than others, debtors and inside creditors forum shop to bankruptcy courts that are willing grant non-debtor releases.[144] Purdue Pharma established a mailing address and filed for Chapter 11 in White Plains, New York, knowing it would get a particular bankruptcy judge.[145] The private equity funds that owned Caesars filed its case in Chicago, because Seventh Circuit caselaw is congenial to third party releases.[146]

The existential question with non-debtor releases is whether they should be banned altogether. A prohibition (other than in asbestos cases, where non-debtor releases are authorized by statute)[147] could be justified on both legal and policy grounds. Legally, bankruptcy courts do not have obvious statutory authority to grant a discharge to non-debtors, and these releases have been challenged constitutionally on due process and separation of powers grounds.[148] The infirmity of

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144 For highly critical discussions these and related issues, see Adam Levitin, Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances, 100 **Tex. L. Rev.** 1079, 1082 (2022); Lynn M. LoPucki, Chapter 11's Descent into Lawlessness, 96 **Am. Bankr. L.J.** 247 (2022).

145 Id.

146 See, e.g., Frumes & Indap, supra note 47 (describing creditors' attorney's accusation that Caesars filed in Chicago because of the caselaw on third party releases).

147 11 U.S.C. § 524(g).

148 The classic challenge to the legality of third party releases is Ralph Brubaker, Bankruptcy Injunctions and Complex Litigation: A Critical Reappraisal of NonDebtor Releases in Chapter 11 Reorganizations, 1997 **U. Ill. L. Rev.** 959.

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non-debtor releases on policy grounds, from the perspective of critics, is that they give the benefits of bankruptcy to parties who have not subjected themselves to the requirements of bankruptcy law by filing for bankruptcy.

Defenders of non-debtor releases point out that it may be impossible to achieve a truly global resolution of a company's financial distress if the related claims against major shareholders or insurance companies are not addressed in the bankruptcy.[149] The litigation would simply continue after bankruptcy. Defenders also emphasize that victims may receive larger and more equitable recoveries when non-debtors make contributions in return for non-debtor releases than they would outside of bankruptcy.[150] In the private equity context, the funds might be more reluctant to file for Chapter 11, and might wait too long, if Chapter 11 did not offer the prospect of a non-debtor release.[151] From this perspective, the non-debtor release is an inducement for private equity sponsors, much as deviations from absolute priority are sometimes thought to

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[149] Tony Casey has stressed this point. See Anthony J. Casey, Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy, 120 **Colum. L. Rev.** 1709, 1749-50 (2020).

[150] With Purdue Pharma, the Sacklers threatened to interpose serious defenses to actions to recover, among other things, distributions they received, and it would be difficult to reach assets the Sacklers hold in offshore trusts. See, e.g., Geoff Mulvihill, Legal shield for Purdue Pharma is at the heart of appeals, **Seattle Times**, Sept. 4, 2021, available at https://www.seattletimes.com/business/legal-shield-for-purdue-pharma-owners-is-at-heart-of-appeals/ [perma.cc/89YQ-RT9Q].

[151] This is a central theme of Buccola, Sponsor Control, supra note 75.

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entice managers to file for Chapter 11,[152] and lockups in corporate law may encourage the directors of a target company to agree to a change in control transactions.[153]

Whether these benefits justify allowing non-debtor releases is quite debatable. The risk to non-debtors of post-bankruptcy exposure could have a beneficial disciplining effect. And the benefits of a global resolution of financial distress are much less obvious with private equity sponsored Chapter 11 cases than with mass torts, which may involve thousands of victims. Perhaps the best approach would be to permit non-debtor releases in mass tort cases--that is, expand current bankruptcy law to encompass all mass torts, not just asbestos--and prohibit releases in other contexts with respect to any creditor that has not consented.[154]

Conclusion

[152] See, e.g., Douglas G. Baird, The Initiation Problem in Bankruptcy, 11 **Int'l Rev. L. & Econ.** 223 (1991).

[153] David A. Skeel, Jr., Lockups and Delaware Venue in Corporate Law and Bankruptcy, 68 **U. Cinn. L. Rev.** 1243, 1256-57 (2000).

[154] To the extent third party releases continue to be permitted, at least in some contexts, courts should impose some of the disclosure and transparency obligations that would apply if the third party had itself filed for bankruptcy. Courts should assess the third party's capacity and responsibility to pay and consider whether creditors would likely recover more outside of bankruptcy if the release were not allowed. Lindsey Simon makes this case at length in Lindsey D. Simon, Bankruptcy Grifters, 131 **Yale L.J.** 1154 (2022).

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This Article has offered an initial assessment of the implications for bankruptcy of the shift in large corporate debtors' capital structures and the dramatic increase in private equity owned debtors in Chapter 11. The Article described key features of the shift and considered the extent to which it is a private equity phenomenon. It identified uncertainty and the enhanced dominance of insiders, which create a perception of unfairness and increase the deadweight costs of bankruptcy, as the dark side of these developments. The Article then considered a variety of correctives that scholars have proposed or that might be proposed.

The response that emerged is incrementalist. The most dramatic possible correctives, such as banning RSA signing fees or imposing an aggressive good faith duty, do not seem warranted. Modest adjustments such as bankruptcy courts' willingness to strike down egregious RSA fees and to grant priming liens to outside lenders would diminish the perception that Chapter 11 is rigged in favor of insiders and fails to adequately protect the interests of victims and other outsiders.

It is possible that a true overhaul of Chapter 11 is needed, given the dramatic shifts in debtors' capital structure, and that it is simply not yet apparent what that alternative framework might look like. But it seems more likely that limited

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adjustments to existing Chapter 11 are preferable and sufficient.

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