Enhancing Rescue in Chapter 11:
Lessons from Reform Efforts in the United Kingdom

by

Robert J. Landry, III[*]

[*] Professor of Finance, School of Business and Industry, Jacksonville State University, Jacksonville, AL. Email: rlandry@jsu.edu.

Enhancing Rescue in Chapter 11:
Lessons from Reform Efforts in the United Kingdom

Abstract: This is a dynamic time for insolvency law. Many jurisdictions have or are considering reforms to their insolvency regimes. The U.K. has proposed a new standalone restructuring mechanism that incorporates aspects of Chapter 11 including the cross-class cram down and absolute priority rule, with courts having discretion to deviate from the absolute priority rule. This addresses a key problem with the absolute priority rule in the U.S. – it serves as an impediment to reorganization. This problem is exacerbated by the recent U.S. Supreme Court decision, *Czyzewski v. Jevic Holding Corp.*, which impacts the use of Chapter 11 rescue tools. This article explores the absolute priority rule, the problems associated with it and the effect of *Jevic*. The case is made that strict application of the absolute priority rule is antiquated and drawing on the U.K. reform proposal the author argues that the U.S. should reform the absolute priority rule. Doing so will facilitate the policy goal of rescue – rescue of the company, as well as the rescue of the business.

I. Introduction

We are in a dynamic time for insolvency law and proposed reforms thereto.[1] Many jurisdictions, such a Spain and the Netherlands, as well as the European Commission,[2] are considering reforms to their restructuring regimes that are influenced at least in part by the U.K.'s scheme of arrangement and Chapter 11[3] in the U.S.[4] Other jurisdictions, such as Singapore, have already implemented significant reforms to its restructuring regime.[5] The U.K.[6] and the U.S.[7] have both engaged in a review of their restructuring regimes.[8] The U.S. review has not gained

[1] *See* Sarah Paterson, *Market Organisations and Institutions in America and England: Valuation in Corporate Bankruptcy*, 93 CHI.-KENT L. REV. 801, 802 (2018) (noting the reform activity in the U.K., European Commission and the U.S.) [hereafter Paterson, *Market*]. *See also* Bob Wessels & Stephan Madaus, *Business Rescue in Insolvency Law in Europe: Introducing the ELI Business Rescue Report*, 27 INT. INSOLV. REV. 255, 255 (2018) ("Since the global financial crisis, insolvency and restricting law have been at the forefront of law reform initiatives in Europe and elsewhere.").

[2] *See* Council of the European Union, *Proposal for a Directive of the European Parliament and of the Council on preventive restructuring frameworks, second chance and measures designed to increase the efficiency of restructuring, insolvency and discharge procedures and amending Directive 2012/30/EU- General Approach*, 12536/18, October 1, 2018, available at http://data.consilium.europa.eu/doc/document/ST-12536-2018-INIT/en/pdf (last accessed February 26, 2019).

[3] Chapter 11 as used throughout this article refers to 11 U.S.C. § 1101 – 1174.

[4] Jennifer Payne, *The Continuing Importance of the Scheme of Arrangement as a Debt Restructuring Tool*, 15 EUR. CO. FIN. L. REV. 445, 445-46 (2018) [hereafter Payne, *Continuing*].

[5] *See* Meng Seng Wee, *The Singapore Story of Injecting US Chapter 11 into the Commonwealth Scheme*, 15 EUR. CO. FIN. L. REV. 553-584 (2018) (providing overview of the reforms in Singapore).

[6] *See infra* notes 155-183 and accompany text.

[7] The U.S. review by the American Bankruptcy Institute (ABI) was completed in 2014 with the issuance of a very detailed report. *See* AM. BANKR. INST. COMM'N TO STUDY THE REFORM OF CHAPTER 11, 2012-2014 FINAL REPORT AND RECOMMENDATIONS (2014) [hereafter ABI REPORT].

[8] Payne, *Continuing*, *supra* note 4, at 446.

much legislative traction;[9] however, the U.K. review has resulted in a reform proposal that will add a new standalone restructuring mechanism to the restructuring options currently available.[10]

The proposed standalone restructuring mechanism includes a cross-class cram down,[11] as well as a statutory moratorium, both of which are not available in a single restructuring option in English law.[12] These features are generally viewed as positive attributes of a restructuring regime.[13] The Chapter 11 statutory framework includes both features[14] and has influenced the U.K. proposed reform.[15] However, the U.K. has not blindly replicated Chapter 11. Notably, the proposed cross-class cram down includes the absolute priority rule (APR), the primary focus of this paper, but adds flexibility, not available in Chapter 11, for courts in the U.K. to deviate from the APR in very limited circumstances.[16] Such flexibility addresses a key criticism of a rigid application of the APR in Chapter 11 - it can act as an impediment to reorganization of a company,[17] the traditional policy objective of Chapter 11.[18] Moreover, a rigid application of the APR also impedes the rescue of a business, a broader conceptualization of the fundamental goal of insolvency law beyond the reorganization or rescue of a company.[19]

Just as the U.K. has drawn upon positive attributes of Chapter 11 in formulating their reform proposal, the U.S. should look to the U.K. reform proposal for guidance on how to improve applying the APR in Chapter 11. The need to reform the APR in the U.S. is not new as problems associated with the APR are well documented.[20] However, in light of the recent U.S. Supreme Court decision, *Czyzewski v. Jevic Holding Corp.*,[21] the necessity for reform is more acute now than at any time since the enactment of the Bankruptcy Code[22] in 1978.[23] Although, the APR is well entrenched in U.S. bankruptcy law in the context of confirming of a Chapter 11 plan,[24] *Jevic*

---

[9] *See, e.g.*, Peter C. Blain, *Chapter 11 of the Bankruptcy Code: As It Was, As It Is, and As It May Be*, ASPATORE, 2016 WL 676460, *16 (January 2016) (prospect of the ABI proposals becoming law is unclear).

[10] Jennifer Payne, *Debt Restructuring in the UK*, 15 EUR. CO. FIN. L. REV. 449, 459 (2018) [hereafter Payne, *Restructuring*].

[11] "Cram down" is a phase used in bankruptcy parlance referring to a court's authority to "cram" an "opposed plan down upon a creditor in a nonconsenting class." *In re* Lett, 632 R.3d 1216, 1228 (11th Cir. 2011).

[12] *Id*. (both aspects are available with the twinning a scheme with administration).

[13] *See, e.g.*, Sarah Paterson, *Reflections of English Law Schemes of Arrangement in Distress and Proposals for Reform*, 15 EUR. CO. FIN. L. REV. 472, 473, 478-88 (2018) (analyzing why a moratorium and cross-class cram down may be beneficial to the UK restructuring regime) [hereafter Paterson, *Reflections*].

[14] *See* 11 U.S.C. § 362(a) (automatic stay) and § 1129(b) (cram down).

[15] Howard Morris, *Not Chapter 11 but Chapter 11sh*, RECOVERY 32, 33 (Spring 2017) (acknowledging the influence of Chapter 11 on the U.K. proposal). *See also* Tim Verdoes & Anthon Verweij, *The (Implicit) Dogmas of Business Rescue Culture*, 27 INT. INSOLV. REV. 398,400 (2018) (noting the influence of Chapter 11 on recent reform proposals throughout Europe).

[16] *See infra* notes 174-175 and accompanying text.

[17] *See infra* notes 72-77, 171-173 and accompanying text.

[18] *See* ABI REPORT, *supra* note 7, at 10 (discussing purpose of Chapter 11). *See also* Sarah Paterson, *Rethinking Corporate Bankruptcy Theory in the Twenty-First Century*, 36 OXFORD J. LEGAL STUD. 697, 699-700 (2016) (summarizing policy orientation of Chapter 11) [hereafter Paterson, *Rethinking*]; Jennifer Payne, *Debt Restructuring in English Law: Lessons from the United States and the Need for Reform*, 130 LAW Q. REV. 282, 299 (2014) (noting the reorganization policy of Chapter 11) [hereafter, Payne, *Lessons*].

[19] Unless otherwise indicated, "rescue" as used in this article encompasses both rescue of a company and rescue of a business. This broader conceptualization of rescue policy is explored in Part II.

[20] *See infra* notes 72-75.

[21] Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973 (2017).

[22] All references to Bankruptcy Code or Code are to Title 11 of the U.S. Code.

[23] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2539 (1978).

[24] *See* Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 983-84 (recognizing the importance of the priority structure and inability to violate the priority structure without consent in the context of a Chapter 11 plan). *See also* Douglas

crystalized the application of the APR in a non-Chapter 11 confirmation of plan context – a structured dismissal.[25]

Such a ruling by the Supreme Court appears positive. It arguably enhances protection the APR provides for minority interests in Chapter 11,[26] which may serve to diminish the surge of secured creditor power in recent years[27] and return power to the debtor, which is consistent with the traditional policy of Chapter 11.[28] However, *Jevic* may impede the effective use of Chapter 11 rescue tools including settlements, § 363[29] sales and first-day orders.[30] This cascading effect of *Jevic* may frustrate Chapter 11s ability to foster rescue. To counter this effect U.S. policymakers should consider the U.K. proposed reform that adds discretion for courts to deviate from the APR.

Following this Introduction, an overview of the broad conceptualization of rescue in Chapter 11 as used in this article is explored. Part III details the cross-class cram down and the role of the APR in Chapter 11. Part IV summarizes *Jevic* and its cascading effect on rescue tools. The need for reform and shortcomings of prior U.S. reform proposals pertaining to the APR are addressed in Part V. This is followed by Part VI which highlights key aspects of the proposed U.K. reform that can guide U.S. reform, along with a specific reform proposal. Part VII provides the conclusion.

II. Conceptualization of Rescue in Chapter 11

Any consideration of a reform in a particular policy domain must begin with a clear articulation of the goal of that particular policy domain. Only with a clear goal in mind, can we

---

G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930, 1932 (2006) (APR "has been the foundation of our corporate reorganization laws for decades").

[25] Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 983. The structured dismissal is not provided for in the Code, but is a construct of various aspects of bankruptcy law resulting in an order that combines aspects of a typical confirmation order with a dismissal order in Chapter 11. *See id*. at 979. The ABI characterizes the structured dismissal as a "hybrid dismissal and confirmation order . . . that . . . typically dismisses the case while, among other things, approving certain distributions to creditors, granting certain third-party releases, enjoining certain conduct by creditors, and not necessarily vacating orders or unwinding transactions undertaken during the case." ABI REPORT, supra note7, at 270. For an overview of the structured dismissal, *see generally* Kaylyn Webb, Comment, *Utilizing the Fourth Option: Examining the Permissibility of Structured Dismissals that do not Deviate from the Bankruptcy Code's Priority Scheme*, 33 EMORY BANKR. DEV. J. 355, 372-379 (2018) (detaining the legal authority for the structured dismissal and appropriate use thereof); Norman L. Pernick & G. David Dean, *Structured Chapter 11 Dismissals: A Viable and Growing Alternative after Sales*, 29 AM. BANKR. INST. J. 1 (2010) (overview of structured dismissals).

[26] *See infra* notes 70-71 and accompanying text (discussing minority protection the APR affords generally).

[27] *See* David A. Skeel, Jr., *Creditor's Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PENN. L. REV. 917, 918-928 (discussing shift from manager orientation to the "creditor-oriented cast"). For an analysis that suggests secured creditor control theory is overstated, see generally Jay Lawrence Westbrook, *Secured Creditor Control and Bankruptcy Sales: An Empirical View*, 2015 U. ILL. L. REV. 831-848.

[28] Concentrated secured creditor power diminishes Chapter 11's ability to achieve the goals of "reorganization of businesses and the maximization of asset values for all creditors." Juliet M. Moringiello, *When Does Some Federal Interest Require a Different Result?: An Essay on the Use and Misuse of Butner v. United States*, 2015 U. ILL. L. REV. 657, 658-59. Tilting the power back to the debtor away from secured creditors enhances the underlying reorganization goal of Chapter 11.

[29] 11 U.S.C. § 363(b).

[30] *See, e.g.*, Hollace T. Cohen, *Pre-Plan Settlements Post-Jevic – Jevic's Impact on the Absolute Priority Rule and Other Core Bankruptcy Principles*, 27 NORT. J. BANKR. L & PRACT.1, 16-23 (2018) (analyzing the impact of *Jevic* on settlements and first day orders that violate the APR). *See also* Ralph Brubaker, *Taking Bankruptcy's Distribution Rules Seriously: How the Supreme Court Saved Bankruptcy from Self-Destruction*, 37 BANKR. L. LETTER 1, 1 (2017) (questioning validity of priority-skipping devices post-*Jevic*).

determine the existence of a problem,[31] or perhaps a potential problem, that policymakers need to address.[32] In this section the traditional primary goal of Chapter 11, reorganization of the company and the parameters it entails, is explored. Reorganization of the company, it is argued, is too restrictive of a goal. The goal should encompass a broad conceptualization of rescue.[33] This sets the stage to consider if the APR and *Jevic* present problems for Chapter 11 in achieving the broad conception of rescue, and, if so, a consideration of the reform proposed herein.

A. Traditional Policy Goal of Chapter 11 and Rescue Options

When a company is economically viable but experiencing cash-flow insolvency, i.e. financial distress,[34] there are two options to deal with the financial distress in Chapter 11: rescue the company in its present form or rescue the business in a new entity.[35] First, rescue of the company entails a rehabilitation through a reorganization or restructuring of the company's debt.[36] Chapter 11's policy goal is firmed rooted in a rescue of the company through reorganization or restructuring the company.[37] The Bankruptcy Code gives a Chapter 11 debtor powers that give the debtor leverage to facilitate a rescue of the company.[38] Such powers include debtor-in-possession control,[39] exclusivity to propose a reorganization plan,[40] an *ipso facto* ban[41] and the

[31] Professor Jackson recognized this basic and fundamental step in bankruptcy policymaking. *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 2-3 (1986). There must be an understanding of what bankruptcy can and should do, i.e. the goal of bankruptcy law. *Id.* With that underpinning "problems" in the bankruptcy system can be resolved. *Id.*

[32] For a discussion of the importance of problem definition in a policy analysis and reform consideration, see Nan. S. Ellis & Cheryl M. Miller, *Welfare Waiting Periods: A Public Policy Analysis of Saenza v. Roe*, 11 STAN. FL. & POL'Y REV. 343, n. 122 (2000).

[33] For a thoughtful analysis of the trend for a broad conceptualization of rescue, a "rescue culture," see generally Verdoes & Verweij, *supra* note 15, at 399-401.

[34] Alan Schwartz, *A Normative Theory of Business Bankruptcy*, 91 VA. L. REV. 1199, 1200 (2005) ("A firm is only in financial distress if it would have positive earnings were it not required to service its debt.").

[35] *See* Payne, *Lessons*, *supra* note 18, at 282 (detailing the options).

[36] *Id*. at 282.

[37] Courts have recognized that Chapter 11's paramount goal is to rehabilitate the debtor. Lynn M. LoPucki, *Changes in Chapter 11 Success Levels Since 1980*, 87 TEMP. L. REV. 989, 998 (2015) (citations omitted). This rehabilitation or reorganization is designed to save or rescue, the company – the goal of Chapter 11. *See id*.

[38] *See* Comment, Elizabeth B. Rose, *Chocolate, Flowers, and § 363(b): The Opportunity for Sweetheart Deals without Chapter 11 Protections*, 23 EMORY BANKR. DEV. J. 249, 254 (2006) (recognizing the powers provided to a debtor in Chapter 11 that provide "the debtor leveraging power in a reorganization"). Congress recognized this need to give the debtor power in Chapter 11 to facilitate a rescue. *See* H.R. Rep. No. 595, 95th Cong., 1st Sess., at 231-232 ("Proposed Chapter 11 recognizes the need for the debtor to remain in control to some degree, or else debtors will avoid the reorganization provisions in the bill until it would be too late for them to be an effective remedy.).

[39] Rose, *supra* note 38, at 254. *See also* Foteini Teloni, *The Bankruptcy Abuse Prevention and Consumer Protection Act: An Empirical Examination of the Act's Business Bankruptcy Effects*, 88 AM. BANKR. L.J. 237, 240 (2014) (observing that debtor-in-possession feature gives the debtor-in-possession control in the Chapter 11 process).

[40] 11 U.S.C. § 1121(b) (providing exclusivity for debtor to file a plan of reorganization). *See also* Rose, *supra* note 38, at 255 (noting the control exclusivity gives a debtor-in-possession); Teloni, *supra* note 39, at 240 (discussing role exclusivity plays in giving debtor-in-possession control in Chapter 11).

[41] For example, in the context of utilities § 366 of the Code limits the ability of a utility to modify services post-petition for twenty-one days so as to provide the debtor-in-possession the opportunity to provide adequate assurance of payment. Teloni, *supra* note 39, at 247-48.

ability to assume, reject and assign contracts.[42] The premise of this emphasis on debtor power or control is that the debtor will promote a rescue the company through reorganization[43] which is the value maximizing option in Chapter 11.[44]

The second option, a rescue of the business in a new entity, typically involves a sale of the company to a new company,[45] preserving the going concern value of the business.[46] Although, such a sale does not fit squarely within the traditional reorganization goal of the company, the Bankruptcy Code does provide statutory authority for the sale of the business as a going concern.[47] With the law on the books permitting such sales, practitioners have adapted their Chapter 11 practice in recent years away from the traditional goal of rescuing the company through a reorganization plan to rescuing the business through a sale of the business. Such sales of the businesses as a going concern in Chapter 11 have increased in recent years, accounting for at least 30 percent of all Chapter 11s.[48] Thus, facilitating a rescue through a sale of the business as a going concern, is a viable option in Chapter 11.

A third option is available to address financial distress of a company that has progressed to an economically unviable state, i.e. economic distress:[49] a liquidation of assets.[50] Here the value of the assets sold separately is greater than the going concern value of the net worth of the company.[51] The Bankruptcy Code expressly provides for this option. Chapter 11 provides for a liquidating plan.[52] Additionally a company may file for Chapter 7[53] and liquidate[54] or a Chapter 11 debtor can convert to Chapter 7 for a liquidation.[55] These options seek to provide a greater return to creditors than the return available in a rescue of the company or rescue the business as a going concern when the company is in economic distress.

---

[42] For example, in the context of commercial leases a debtor-in-possession is given certain limited rights early on in a case under § 365. *See* Teloni, *supra* note 39, at 250-54 (discussing the rights of the debtor-in-possession and balancing of those with that of the landlord).

[43] *See* Rose, *supra* note 38, at 254-55 (observing that debtor-in-possession control enhances opportunity for successful reorganization).

[44] It is generally viewed that a Chapter 11 plan of reorganization process with bargaining among the players will foster value maximization. *See, e.g.*, J. Bradley Johnston, *The Bankruptcy Bargain*, 65 AM. BANKR. L.J. 213, 257 (1991). The power or control the debtor has facilitates that bargaining process in proposing a reorganization plan.

[45] *Id*. at 282.

[46] *See* Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 688, 691-692 (2003) (noting that sales are a way to preserve going concern value). This benefit of a sale of a business has been recognized for decades in U.S. bankruptcy law. *See* Recent Case, *Bankruptcy – In General – Sale of Entire Assets not Permitted in Chapter XI Arrangement*, 65 HARV. L. REV. 686, 687 (1952) ("A sale of an entire business may be necessary to preserve going-concern value from the potentially dismembering effect of the secured creditors' liens or to resolve an otherwise irreconcilable conflict between secured and unsecured creditors over the reorganization plan.").

[47] 11 U.S.C. § 363(b).

[48] In an empirical study of the disposition of Chapter 11 cases from 1997 to 2011, § 363 sales accounted for 20% of the dispositions from 1997 to 2005. This increased to 32% from 2005 to 2011. Teloni, *supra* note 39, at Fig. 4.

[49] Schwartz, *supra* note34, at 1200 ("Economic distress occurs when the firm cannot earn revenues sufficient to cover its costs, exclusive of financing costs. Such a firm has negative economic value.").

[50] Payne, *Lessons*, *supra* note 18, at 282.

[51] *Id*.

[52] 11 U.S.C. § 1123(a)(5)(D) (providing for sale of all or part of assets in a plan).

[53] *Id*. at § 109(a), (b) (detailing who may be a debtor under Chapter 7).

[54] *Id*. at § 704(a)(1) (trustee liquidates assets).

[55] *Id*. at § 1112(b) (provides for conversion of Chapter 11 case to Chapter 7).

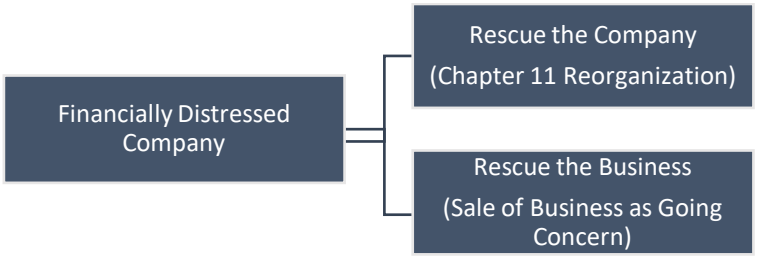
B. Broader Conceptualization of the Policy Goal of Rescue in Chapter 11

Rescue in Chapter 11 should not be limited to merely the reorganization or restructuring a company.[56] Rescue is a broad construct that certainly includes the reorganization and restructuring of a company, but it also includes preserving the going concern of a viable business – the rescue of the business.[57] Chapter 11's policy goal should be broader and encompass rescue as used in modern Chapter 11 practice – rescuing the business.[58]

Over twenty-five years ago Professor Westbrook recognized a broad view of rescue in noting that the options available in a rescue regime include an administration with a quick sale, a reorganization through a financial restructuring and a third approach, without articulating what that approach may be.[59] Reorganization through financial restructuring fits neatly within the traditional policy orientation of Chapter 11: reorganization of the company. However, administration through a quick sale, particularly the sale of substantially all of the assets as a whole, embraces a broad concept of rescue: rescuing a business. And Westbrook's third, yet undefined option, offers an even broader orientation of rescue that certainly encompasses rescue of the business.

Modern Chapter 11 practice reflects Westbrook's broad conceptualization of rescue – the traditional policy goal of rescuing the company through reorganization as well as modern Chapter 11 practice of a rescuing a business through a sale. This broader conceptualization of rescue in Chapter 11 was recently recognized by the Eleventh Circuit when the court noted that the sale of substantially all of a debtor's assets in Chapter 11 can advance the goals of Chapter 11.[60] Rescue as used throughout this article encompasses this broad conceptualization of rescue. It is the benchmark to gauge whether reforms are needed. Figure 1 depicts this conceptualization of rescue in Chapter 11.

Figure 1: Chapter 11 Rescue Options for Financially Distressed Company



[56] *See* VANESSA FINCH & DAVID MILMAN, CORPORATE INSOLVENCY LAW: PERSPECTIVES AND PRINCIPLES, THIRD EDITION 198 (2017) (Recognizing the distinction between rescue of the company, rescue of the business and the various outcomes of a successful rescue.)

[57] *See, e.g.*, Ignacio Tirado, *Scheming against the Schemes: A New Framework to Deal with Business Financial Distress in Spain*, 15 EUR. CO. FIN. L. REV. 516, n.6 (2018) (articulating a broad view of "rescue" in Spain encompassing both the rescue of the company and the rescue of the business). Such a broad view of rescue is evident in the U.K. in which a turnaround of a company (company rescue) and sale preserving the core assets of a business (business rescue) fall under the umbrella of rescue. *See* BO XIE, COMPARATIVE INSOLVENCY LAW: THE PRE-PACK APPROACH IN CORPORATE RESCUE 4 (2016).

[58] *See supra* note 60 and accompanying text.

[59] Jay Westbrook, *Chapter 11 Reorganization in the United States* in INSOLVENCY LAW: THEORY AND PRACTICE 367 (1993)

[60] *See In re* Walter Energy, Inc. et al., 911 F.3d 1121, 1152-54 (11th Cir. 2018).

III. Cross-Class Cram Down and the Role of the Absolute Priority Rule in Chapter 11

The Bankruptcy Code permits two types of cram down in the confirmation of a Chapter 11 plan. Confirmation of a plan of reorganization is permitted over dissenting impaired creditors within a class if that class votes to accept the plan treatment[61] and cross-class cram down over an entire class of dissenting impaired creditors is permitted if the APR is satisfied.[62] Although cram down within a class raises some concerns over the protection of minority interests, the cross-class cram down raises a greater level of concern over the protection of minority interests,[63] which brings into play the APR.[64]

In order to confirm a Chapter 11 plan over a dissenting impaired creditor class, the APR requires "that a dissenting class of unsecured creditors must be provided for in full before any junior class can receive or retain any property [under a reorganization] plan.'"[65] The APR is a product of judicial construction with its origins in the equity receivership reorganization cases,[66] but it is now codified in the "fair and equitable"[67] requirement of the Code.[68]

The APR is rooted in the "common law maxim that creditors would be paid ahead of equity."[69] It requires that a creditor, absent consent, receive the same value of the debtor's assets in a bankruptcy that the creditor would receive outside of bankruptcy.[70] It is a type of minority creditor protection designed to avoid the problems associated with information asymmetry and disparities in control of a debtor that possibly could result with owners, insiders or a controlling secured creditor reaping value from a failing business for their own benefit.[71]

---

[61] 11 U.S.C. § 1126(c), (d). *See also*, Jeffrey M. Sharp, *Bankruptcy Reorganizations, Section 1129, and the New Capital Quagmire: A Call for Congressional Response*, 28 AM. BUS. L.J. 525, 531-32 (1991) (summarizing this in class cram down confirmation standard).

[62] *Id*. at § 1129(b)(1), (2). *See also* RODRIGO OLIVARES-CAMINAL, ET AL., DEBT RESTRUCTURING, SECOND EDITION 172-3 (2016); Sharp *supra* note 61, at 533-34 (summarizing this cross-class cram down confirmation standard).

[63] *See* Payne, *Restructuring*, *supra* note 10, at 469 (noting need for minority interest protection with cram down); Wessel and Madaus, *supra* note 1, at 274 (cross-class cram down power requires protections). *See also*, *In re* Lett, 632 F.3d at 1128 (recognizing the need to protect minority impaired interests in a cross-class cram down).

[64] The APR is just one of several safeguards for minority interests in Chapter 11. Other safeguards, beyond the scope of this paper, include classification of creditors that are "substantially similar" under 11 U.S.C. § 1122(a), compliance with the best interests test under 11 U.S.C. § 1129(a)(7)(B) (liquidation analysis) and requiring that the plan "not discriminate unfairly" among class members under 11 U.S.C. § 1129(b)(1). *See* Payne, *Lessons*, *supra* note 18, at 300-01 (recognizing the safeguards in place in Chapter 11) [hereafter, Payne, *Lessons*]. *See also* RODRIGO OLIVARES-CAMINAL, ET AL., *supra* note 62, at 169-76 (analyzing the best interest test, the requirement to not unfairly discriminate and the APR).

[65] Norwest Bank Worthington v. Ahlers, 108 S. Ct. 963, 966 (1998) (citation omitted). *See* Sharp, *supra* note 61, at 526 ("The absolute priority rule requires that claims to nonexempt assets of the debtor be assigned strict priority of payment and that each class of claims be paid in full before any junior class receives value."); JACKSON, *supra* note 31, at 214 (succinctly summarizing application of the APR under the Code).

[66] OLIVARES-CAMINAL ET AL., *supra* note 62, at 172; JACKSON, *supra* note 31, at 213, n. 11.

[67] 11 U.S.C. § 1129(b)(1).

[68] Norwest Bank Worthington v. Ahlers, 108 S. Ct. at 966. *See also* OLIVARES-CAMINAL, ET AL., *supra* note 62, at n. 192.

[69] Elizabeth Warren, *A Theory of Absolute Priority*, 1991 ANN. SURV. AM. L. 9, 37.

[70] JACKSON, *supra* note 31, at 213.

[71] *See, e.g.*, Warren, *supra* note 69, at 37. Professor Warren focuses on the power of owners/insiders to the detriment of creditors, but the APR plays a role in protecting minority creditors from dominant secured creditors. *See, e.g.*, Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 986-7 (recognizing the risk of collusion between senior secured creditors and other creditors to squeeze out intermediate creditors).

Although the APR can offer protection to minority interests, its application has been criticized.[72] It is viewed as an impediment to reorganizations in that it increases costs, limits compromise and may eliminate junior interests unnecessarily.[73] For example, as Professor Warren explained, if old equity is barred from participating in a reorganized debtor (i.e. retain their equity interest) under a strict application of the APR because a senior class of creditors object to the reorganization plan, then the APR may actually impede a reorganization.[74] If holdout creditors overvalue their position, the APR will ensure their participation but this may lead to a break down in bargaining resulting in a failed reorganization or in a diversion of value of the company to holdout creditors.[75] Moreover, a *carte blanche* application of the APR to prohibit participation by equity in the reorganized debtor may reduce the going-concern value of the debtor because the equity holder's knowledge, attributes of continued management and willingness to fund the debtor may be lost.[76]

These criticisms illustrate how a strict application of the APR ignores the dynamic nature of rescue and how it is impractical.[77] This supports the argument for adding flexibility to the application of the APR. The case for reform is strengthened when we consider how *Jevic*, as outlined in the next section, exacerbates the problems associated with the APR.

IV. *Jevic* and its Cascading Effect

A. *Jevic* in a Nutshell

The basic facts of *Jevic* are straightforward.[78] Two creditors (Sun and CIT), Jevic (the debtor) and the unsecured creditors committee[79] reached a settlement resolving litigation among the parties that would result in the following: (1) CIT paying $2 million dollars to cover unsecured creditors' committee's fees; (2) Sun assigning a lien in Jevic's remaining cash ($1.7 million dollars) so that administrative expenses and taxes could be paid, with the balance of funds going

[72] *See* Note, *The Proposed Bankruptcy Act: Changes in the Absolute Priority Rule for Corporate Reorganization*, 87 HARV. L. REV. 1786, 1786-87 (1974) (collecting authorities criticizing the APR) [hereafter *Proposed Bankruptcy Act*]; Gregory K. Jones, *The Classification and Cram Down Controversy in Single Asset Bankruptcy Cases: A Need for the Repeal of Bankruptcy Code Section 1129(a)(10)*, 42 UCLA L. REV. 623, n. 115 (1994) (collecting authorities detailing criticisms).

[73] *Proposed Bankruptcy Act*, *supra* note 72, at 1786-87. *See also*, Yesha Yadav, *Too-Big-To-Fail Shareholders*, 103 MINN. L. REV. 587, n. 12 (2018) (collecting authorities criticizing the APR).

[74] Warren, *supra* note 69, at 32.

[75] *Id*.

[76] *Id*. at 32-3. *See also* JACKSON, *supra* note 31, at 221 (noting the argument that existing owners or shareholders have expertise and knowledge in the debtor that can enhance the value of the debtor).

[77] *See* Stephen J. Lubben, *The Overstated Absolute Priority Rule*, 21 FORDHAM J. CORP. & FIN. L. 581, 602 (2016).

[78] For a detailed factual analysis of *Jevic*, see Jonathan C. Lipson, *The Secret Life of Priority: Corporate Reorganization after Jevic*, 93 WASH. L. REV., 631, 640-46 (2018); Nicholas L. Georgakopoulos, *Through Jevic's Mirror: Orders, Fees, and Settlements*, 72 BUS. LAW. 917, 924-33 (2017).

[79] The Code provides for the appointment of a committee of unsecured creditors, as well as other potential committees of creditors or equity holders. 11 U.S.C. § 1102(a)(1). Such committees are conferred powers and duties. 11 U.S.C. § 1103. Effectively committees have a seat at the table in a Chapter 11 proceedings as the committee is a "party in interest" with a right to be heard. 11. U.S.C. § 1109(b).

to general unsecured creditors; and (3) dismissal of the Chapter 11 case.[80] The settlement required that the funds assigned by Sun not be distributed to priority wage claims.[81]

This distribution violated the Code's priority rules because the priority wage claims were skipped in favor of lower general unsecured claims.[82] This provided the Supreme Court the opportunity to determine the applicability of the APR in a non-confirmation of a Chapter 11 plan context. The Supreme Court provided an answer to this narrow question: whether, in the absent of consent, can a bankruptcy court "approve a structured dismissal that provides for distributions that do not follow ordinary priority rules[?]"[83] The Supreme Court said no[84] and held that the priority rules, such as the APR, are applicable in the context of a Chapter 11 structured dismissal.[85]

B. Cascading Effect of *Jevic*

Although the *Jevic* holding is limited to structured dismissals that violate the APR,[86] it has important implications beyond the structured dismissal. Dissenting Justices Alito and Thomas noted the "novel and important question" the case presented[87] and scholars are recognizing the significance of the opinion.[88] The importance of *Jevic* is also seen as courts begin to grapple with applying the decision.[89] It is in the application of *Jevic* to other rescue tools - settlements, § 363 sales and first-day orders[90] - that may violate the APR in which *Jevic's* importance materializes.[91] If the effective use of these tools is curtailed post-*Jevic*, the capacity of Chapter 11 to promote rescue may be undercut, making the need to reform the APR more pressing. The impact of *Jevic* on these three tools is detailed below.

1. Settlements

Bankruptcy judges have authority to approve a settlement between a debtor and other parties, such as creditors and committees, if the court finds the settlement fair and equitable.[92] The ability for the debtor and the parties in a Chapter 11 case to compromise and settle disputes is an important rescue tool. The more that contested issues are resolved consensually prior to a confirmation hearing of a plan of reorganization, the more likely a plan will be confirmed provided

[80] Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 981.
[81] *Id.* Sun required this provision because priority wage claimants had a lawsuit against Sun and Sun did not want the funds to finance the litigation. *Id.*
[82] *Id*. at 978, 981.
[83] *Id*. at 983. *See also* Georgakopoulos, *supra* note 78, at 932 (noting the narrow scope of the question answered).
[84] Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 978, 983.
[85] *See* Lipson, *supra* note 78, at 646 (citing Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 984-86).
[86] Brubaker, *supra* note 30, at 2, 4.
[87] Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 987.
[88] Lipson, *supra* note 78, at 633 (citing Brubaker, *supra* note 30, at 1).
[89] *See infra* notes 97-104, 120-122, 133-136 and accompanying text.
[90] Other rescue tools beyond the scope of this paper, such as gifting, may be impacted by *Jevic*. Cohen, *supra* note 30, at 3, 15-19. Interestingly, the structured dismissal itself as a rescue tool may be subject to future litigation. The Supreme Court did not opine on the legality of the structured dismissal. Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 985.
[91] *See, e.g.*, Brubaker, *supra* note 30, at 1 (recognizing the importance of *Jevic* and noting that "*Jevic* should prompt a serious re-examination of the entire gamut of priority-violation distributions devices.").
[92] *See* FED. R. BANKR. P. 9019(a); *In re* Fryar, 570 B.R. at 607 (citation omitted). *See also* Bethany K. Smith, Note, *Up the chute, Down the Ladder: Shifting Priorities Through Structured Dismissals in Bankruptcy*, 84 FORDHAM L. REV. 2989, 2296-2998 (2016) (summarizing the caselaw requirements for approval of a settlement in bankruptcy).

it does not violate the Code's requirements for confirmation.[93] Confirmation of the plan will not guarantee that a Chapter 11 will successfully achieve Chapter 11s rescue goal, but confirmation of a plan certainly enhances the prospects of rescue. Thus, the ability to reach settlements and compromises along the way toward confirmation is a vital rescue tool.

In *Jevic* the Supreme Court discussed settlements that include interim distributions that violate the Code's priority rules contrasting them with structured dismissals with final distributions.[94] This discussion was dicta, but implicit in the Court's discussion is that interim distributions may be permissible if there are "significant offsetting bankruptcy–related justification[s]",[95] whereas final distributions in a structured dismissal with no justification for violating the priorities of the Code is impermissible.[96] Bankruptcy courts are beginning to tackle approval of settlements post-*Jevic*.

For example, in the case of *In re Fryar*[97] a bankruptcy court, relying on *Jevic*, denied approving of a settlement, over objection, that included distributions that violated the Code's priority rules because there was no "significant code-related objective."[98] Similarly, a bankruptcy court in the case of *In re Constellation*,[99] relying on *Jevic*, did not approve a settlement, over objection, that violated the APR.[100] Just as in *Fryar*, there was no evidence that the settlement promoted saving the business or plan,[101] i.e., no "significant code-related objective" for violating APR.

In a third bankruptcy decision, *In re Short Bark Industries, Inc.*,[102] the bankruptcy court approved a settlement, over objection, as part of a proposed debtor-in-possession financing which provided for escrowing $110,000 for payment of general unsecured creditors, thus skipping priority and administrative claims.[103] The bankruptcy court distinguished *Jevic* because the settlement was early in the case, its approval provided for the continued employment of over 500 people and it permitted the business to continue.[104] Thus, in contrast to *Fryar* and *Constellation*, there was a "significant code-related objective" to deviate from the Code's priority scheme.

Post-*Jevic*, beyond showing a settlement is "fair and equitable",[105] parties seeking approval of a settlement with interim distributions that violate the APR will likely need to make an additional showing of a "significant offsetting bankruptcy-related justification."[106] This may be able to be shown as in the *Short Bark* case, but in cases where there is no rescue on the horizon, obtaining approval of a settlement that violates the APR will likely be a difficult task post-*Jevic*. This impact on settlements may infringe upon Chapter 11s ability to foster rescue.

---

[93] If a plan complies with § 1129(a) or complies with § 1129(b) bankruptcy courts do not have discretion to deny confirmation. *In re* Trenton Ridge Investors, LLC, 461 B.R. 440, 455-58 (Bankr. S.D. Ohio 2011).
[94] *See* Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 985-86.
[95] *Id*. at 986.
[96] *See* Georgakopoulos, *supra* note 78, at 940.
[97] *In re* Fryar, 570 B.R. 602 (Bankr. E.D. Tenn. 2017).
[98] *Id*. at 610.
[99] *In re* Constellation Enterprises LLC, Case No. 16-11213, Order Denying Joint Motion Approving Settlement, Doc. No. 963 (Bankr. D. Del., May 16, 2017).
[100] Robert J. Keach & Andrew C. Helman, *Life After Jevic, An End to Priority-Skipping Distributions*, 36 AM. BANKR. INST. J. 12, 73 (2017).
[101] Cohen, *supra* note 30, at 30; Keach & Helman, *supra* note 100, at 73.
[102] *In re* Short Bark Industries, Inc., Case No. 17-11502, Final Order, Doc. No. 200 (Bankr. D. Del., Sept. 11, 2017).
[103] Cohen, *supra* note 30, at 20. *See also* Shane G. Ramsey, *Despite Jevic, Priority Skipping Found to be Permitted as Part of Final Approval of DIP Financing*, THE BANKRUPTCY PROTECTOR (Sept. 19, 2017).
[104] Cohen, *supra* note 30, at 22; Ramsey, *supra* note 103.
[105] *In re* Fryar, 570 B.R. at 610 (detailing the "fair and equitable" requirement).
[106] *See* Georgakopoulos, *supra* note 78, at 940; Cohen, *supra* note 30, at 19.

2. § 363(b) Sales

In *Jevic* the Supreme Court recognized that there are three conclusions to a Chapter 11 case: confirmation of a plan which may include a distribution of assets and possibly the continuation of the business; conversion to Chapter 7 for liquidation; or dismissal.[107] The Eleventh Circuit recently noted the options to bring a Chapter 11 to conclusion are a little broader, to include a sale of substantially all of a debtor's assets under § 363.[108] In fact, the sale of substantially all of a Chapter 11 debtor's assets under § 363(b), rather than through a plan, to a successor corporation[109] is the rescue tool of choice in an increasingly number of Chapter 11s.[110] Such a sale may or may not be followed by a liquidation plan,[111] conversion to Chapter 7[112] or a dismissal.[113]

The § 363(b) sale of substantially of a debtor's assets is a vital rescue tool.[114] Just as with a successful classic Chapter 11 with a plan of reorganization in which the business continues to operate, a § 363(b) sale of substantially of assets as a going concern the underlying business is not shut down as in a Chapter 7 liquidation.[115] The outcome of this type of sale "bears a close resemblance to the end result of a classic reorganization."[116] This outcome through a § 363(b) is quicker than a Chapter 11 plan and can be accomplished without meeting the requirements of the Chapter 11 plan process.[117] The quicker process saves not only time and monetary costs associated with the plan process,[118] but helps preserve the going concern value of the business.[119]

Post-*Jevic* if a proposed § 363(b) sale includes distributions that violate the APR the approval of the sale may be subject to attack because the logic of *Jevic* in prohibiting priority violating final distributions in a structured dismissal are applicable to such a sale.[120] For example, the First Circuit was presented with the argument that the bankruptcy court's approval of a § 363(b)

---

[107] Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 975.
[108] *See In re* Walter Energy, Inc. et al., 911 F.3d 1121, 1152-54 (11th Cir. 2018).
[109] *In re* Daily Gazette Company, 584 B.R. 540, 546 (Bankr. S.D. Va. 2018).
[110] *See, e.g.*, Jodie A. Kirshner, *Design Flaws in the Bankruptcy Regime: Lessons from the U.K. for Preventing a Resurgent Creditors' Race in the U.S.*, 17 U. PENN. J. BUS. L. 527, 529 (2015) (highlighting the increased use of sales rather than plans).
[111] *In re* Daily Gazette Company, 584 B.R at 546-7.
[112] *In re* Walter Energy, Inc. et al., 911 F.3d at 1135 (§ 363 sale of substantially all assets followed by a conversion to Chapter 7).
[113] 11 U.S.C. § 1112(b) (provides for dismissal for cause). *See also* Webb, *supra* note 25, at 355-358 (analyzing the exit options available in the context of a § 363(b) sale in Chapter 11)
[114] A sale of a business is a rescue tool in that the distressed business is sold to a stronger owner without all or some of the business debts, resulting a business "rescue" with a new owner. Wessel & Madaus, *supra* note 1, at 261-2, 271-72.
[115] *In re* Walter Energy, Inc. et al., 911 F.3d at 1153.
[116] *Id*. *See also* William T. Bodoh & Michelle M. Morgan, *Inequality Among Creditors: The Unconstitutional use of Successor Liability to Create a New Class of Priority Claimants*, 4 AM. BANKR. INST. L. REV. 325, 335 (1996) (noting the result of a § 363 sale can be substantially the same as a sale through a plan of reorganization).
[117] *In re* Walter Energy, Inc. et al., 911 F.3d at 1153.
[118] Bodoh & Morgan, *supra* note 116, at 335 ("One advantage that a section 363 sale has over a sale pursuant to a plan of reorganization is efficiency, in terms of both time and money.").
[119] Georgakopoulos, *supra* note 78, at 921 ("Sales realize value, preserve going-concern value, resolve uncertainties, and restore productivity in ways that fundamentally promote the goals of reorganization . . .").
[120] *See* Brubaker, *supra* note 30, at 4, 8 (noting the applicability of the logic of *Jevic* to other priority-skipping mechanisms, including sales).

sale violated *Jevic* because the sale provided for payment of some unsecured claims without paying higher priority administrative claims.[121] The distributions violated the APR.[122] The First Circuit did not address the merits of the argument because the sale order was final and not stayed under § 363(m),[123] but the case shows how the argument can be presented and but for the procedural quandary of the appellant, the court would have had to address the applicability of *Jevic* to § 363(b) sales.

The ability to facilitate rescues through § 363(b) sales may be curtailed in light of the uncertainty of *Jevic*'s applicability to such sales. It is likely that bankruptcy courts will reach divergent viewpoints on this issue. As the parties litigate, the advantages of § 363(b) sales such as the savings in monetary costs, quick outcomes, and preservation of the going concern value of a business may be diminished. Post-*Jevic,* the importance of this rescue tool may be lessened, at least in the short term, and perhaps longer term depending on how courts apply *Jevic*.

3. First-Day Orders

Often at the outset of a Chapter 11 filing a debtor will file certain motions, collectively called "first-day motions."[124] In such motions a Chapter 11 debtor may seek authority to pay certain creditors for pre-petition services or goods that the debtor views as vital to continued operations of the business, i.e., the creditor is a "critical" vendor.[125] In some instances requests to pay prepetition wages of employees are included in such motions.[126] Sometimes debtor-in-possession financing is included in such motions that provides for paying a lender on their prepetition claim first when the lender continues financing the debtor post-petition - a "roll-up."[127] Such payments violate the priority structure of the Code and are not expressly authorized by the Code, but some courts approve such payments out of necessity to promote the reorganization of the debtor.[128]

The idea behind permitting these priority violating distributions is that they are needed to make a reorganization successful.[129] For example, employees may leave if pre-petition wages are not paid or vendors of important supplies that are not paid for prepetition supplies may not trade with the debtor post-petition. If valuable employees leave or important vendors do not trade, it may be a significant constraint on the debtor's ability to rescue the business. Thus, the use of first-day motions to obtain this type of relief in first-day orders are an important tool in rescuing a business.

---

[121] *In re* Old Cold LLC, 879 F.3d 376, 388 (1st Cir. 2018).
[122] *Id*.
[123] *Id.*
[124] *In re* The Colad Group, Inc., 324 B.R. 208, 212 (Bankr. W.D. N.Y. 2005).
[125] *See In re* Pioneer Health Services, Inc., 570 B.R. 228, 232 (Bankr. S.D. Miss. 2017).
[126] Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 985.
[127] *Id.* Such provisions effectively cross-collateralize a lender's pre-petition loan with both the pre-petition collateral and new post-petition collateral. This type of forward looking cross-collateralization of a pre-petition debt with post-petition collateral is not authorized in the Code and some courts do not permit such terms in a post-petition financing agreement. *See In r*e Saybrook Mfg. Co., 963 F.2d 1490, 1494–95 (11th Cir. 1992) ("cross-collateralization is not authorized as a method of postpetition financing under section 364 .... it is beyond the scope of the bankruptcy court's inherent equitable power because it is directly contrary to the fundamental priority scheme of the Bankruptcy Code").
[128] *See In re* Pioneer Health Services, Inc., 570 B.R. at 233.
[129] Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 985.

In *Jevic* the Supreme Court discussed, in dicta, first-day orders and arguably[130] approved such orders if they had a "significant offsetting bankruptcy-related justification."[131] Whether *Jevic* sanctions approval of such orders across the board is doubtful because the logic behind striking down the structured dismissal is applicable to first-day orders that violate the APR.[132] At least one bankruptcy court post-*Jevic* has not interpreted the dicta so broadly.

In the case of *In re Pioneer Health Services, Inc.*,[133] the bankruptcy court considered *Jevic* and viewed it as providing a "restrictive view of critical vendor payments" and that such payments should be limited to those that have "significant offsetting bankruptcy-related justification."[134] In so doing the bankruptcy court did not approve payments to physicians for prepetition claims as critical vendors of the debtor which operated hospitals and other health care facilities because there was no showing of a "significant offsetting bankruptcy-related justification."[135]

This interpretation of *Jevic* indicates that post-*Jevic* first-day orders that violate the Code's priority structure may well be subject to higher scrutiny.[136] If the ability to pay employee pre-petition wages, pay critical vendors or obtain post-petition financing is limited in light *Jevic*, the ability of Chapter 11 to facilitate a rescue may be compromised. For example, in the context of post-petition financing, the only game in town for a debtor to obtain post-petition financing may be the pre-petition lender and the inability to provide that lender a roll-up may be a deal breaker. If that is the case, and if there is not another vehicle to obtain post-petition capital, the ability of Chapter 11 to enable a rescue may well be short-lived.

V. Need for Reform and Prior U.S. Reform Proposals

The traditional criticism of a strict application of the APR, i.e. that it is an impediment to reorganization, applies today just as it has in the past. However, with the cascading effect of *Jevic* on important rescue tools in modern Chapter 11 practice the traditional criticism has more teeth. Reform to the Code is necessary to lessen the bite of a rigid application of the APR. In crafting a reform, consideration of prior U.S. reform proposals can be a starting point. Even though prior reform proposals, as discussed below, do not adequately address the problems associated with the APR, they illustrate some options available for reform.

In the 1970s the Commission on the Bankruptcy Laws of the United States (Commission) effectively proposed abolishment of the APR because it was viewed as largely impractical in application, but the proposed Bankruptcy Act of 1973 never became law.[137] This proposed reform was extreme in that it would seriously impede the minority protection the APR can provide. Although Congress did not follow the recommendation of the Commission, the Commission's concerns were reflected in the Bankruptcy Reform Act of 1978[138] as the codified APR was more

---

[130] Georgakopoulos, *supra* note 78, at 924, 934.
[131] *See* Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 985-6.
[132] *See* Brubaker, *supra* note 30, at 5.
[133] 570 B.R. (Bankr. S.D. Miss. 2017).
[134] *Id.* at 235.
[135] *Id.* at 236.
[136] Cohen, *supra* note 30, at 20.
[137] Lubben, *supra* note 77, at 593-4. *See also*, Sharp, *supra* note 61, at 530-31 (discussing the Commission proposal and noting the proposed reform to permit retention of property by owners without complying the APR was not adopted by Congress).
[138] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).

limited in scope than the common law rule.[139] Since 1978 the statutory language of the APR in Chapter 11 is largely unchanged.[140]

In the 1990s the National Bankruptcy Review Commission (NBRC) recommended amending the Code to provide for the purchase of a reorganized debtor by "members of a junior class of claims or interests" without violating the APR.[141] This proposal facilitates the sale of a business to equity holders or to creditors that would otherwise violate the APR. However, this proposal does not go far enough. It did not address the application of the APR to settlements or financing associated with first-day orders and roll-ups – other rescue tools.

More recently the ABI proposed a modification of the APR in Chapter 11.[142] The proposal provided that a plan can be confirmed over the objection of an immediately junior class provided that class received "not less than the redemption option value."[143] Moreover, a plan may be confirmed over the objection of a senior class that is not paid in full provided the "deviation from the absolute priority rule treatment of the senior class is solely for the distribution to an immediately junior class of the redemption option value."[144] The heart of the proposal is the redemption option value that attempts "to capture the total enterprise value of the firm," which the ABI recognized was complex.[145] In light of the complexity the proposal has not garnered much interest.[146] Beyond the problem of complexity, the proposal would not resolve the issues arising under the cascading effect of *Jevic* on other rescue tools. It would just interject a different valuation method in the process.

In late 2018 the Small Business Reorganization Act (SBRA)[147] was introduced into Congress[148] which would add a new subchapter to Chapter 11 applicable to small business debtors.[149] The SBRA makes the APR generally inapplicable to small business debtors[150] and replaces it with a new framework to effectuate a cross-class cram down. Under the SBRA a small business debtor can obtain confirmation over an objecting class of secured creditors as long as the

---

[139] *See id.*, at 594. For example, the APR as codified in the Bankruptcy Code was relaxed in that it applied only to classes of creditors, as opposed to each creditor individually. Pamela Foohey, *Chapter 11 Reorganization and the Fair and Equitable Standard: How the Absolute Priority Rule Applies to All Nonprofit Entities*, 86 S. JOHN'S L. REV. 31, 46-47 (2012).

[140] One notable exception is The Bankruptcy Abuse and Consumer Protection Act of 2005 (BAPCPA) which did modify the application of the APR in individual Chapter 11 cases only. *See In re* Maharaj, 681 F.3d 558, 569-73 (4th Cir. 2012) (analyzing change made by BAPCPA to the APR in individual Chapter 11s). *See generally*, Stanley E. Golich, *Plain-Meaning Rules: Did BAPCPA Abolish the Absolute-Priority Rule?*, 31 AM. BANKR. INST. J. 34-35, 82-84 (2012) (analyzing the changes to the APR and caselaw interpreting such after BAPCPA in individual Chapter 11 cases).

[141] NATIONAL BANKRUPTCY REVIEW COMMISSION, BANKRUPTCY: THE NEXT TWENTY YEARS, 545 (1997).

[142] *See* ABI REPORT, *supra* note 7, at 207-224.

[143] *Id*. at 208, 218.

[144] *Id*. at 208-9, 218-19.

[145] *Id*. at 219. *See also* Paterson, *Reflections*, *supra* note 13, at 490 (noting the complexity of the options approach proposed).

[146] *See* Paterson, *Reflections*, *supra* note 13, at 490.

[147] Small Business Reorganization Act of 2018, H.R. 7190, 115th Congress (2017-2018); Small Business Reorganization Act of 2018, S. 3689, 115th Congress (2017-2018).

[148] *Legislative Update: Small Business Reorganization Act*, 38 AM. BANKR. INST. J. 8, 8 (2019) [hereafter Legislative Update].

[149] *Id*. For concise overview of the bill, see Katy Stech Ferek, *U.S. Lawmakers Propose New Bankruptcy Process for Small Businesses; Bipartisan Bill could make Process Cheaper and Faster*, WSJ PRO. BANKRUPTCY (Nov 29, 2018), available at https://www.wsj.com/articles/federal-lawmakers-propose-new-bankruptcy-process-for-small-businesses-1543526806 (last accessed March 3, 2019).

[150] SBRA, § 1181(a).

plan provides that the secured creditor retain their lien, received payment equal to value of claim or indubitable equivalent.[151] Confirmation of an objecting class of unsecured claimholders is available if the plan offers all disposable income of the debtor over a 3 to 5 year period.[152] If these requirements are met, the owners of the business can retain their ownership interest without paying senor interests in full.[153]

This reform is positive in that it will overcome the impediment the APR presents to owners retaining an interest in a debtor post-confirmation in small business cases. However, the reform is too narrow. It does not expressly provide for the sale to other junior classes of claims or interests and the reform would not curtail the cascading effect of *Jevic* on other rescue tools. Importantly, the reform should apply to all business debtors, not just a small business debtor – a debtor with approximately $2.5 million in debt.[154]

VI. Proposed U.K. Reform: Lessons for U.S. Reform

Each of the U.S. proposals described above are flawed in that they do not fully address the traditional difficulties associated with the APR and the problems stemming from *Jevic*. Some reforms are too broad and others are not broad enough. However, recent reform efforts in the U.K. can provide guidance to U.S policymakers on how to amend the APR.

A. U.K. Proposed Reform

The U.K. reform proposal for a new standalone restructuring mechanism is the product of the Insolvency Service's consultation published in May 2016 which explored options for reforming the insolvency framework.[155] In September 2016 the Insolvency Service published a summary of responses[156] and then in August 2018 the Insolvency Service published the government response detailing the proposed new standalone restructuring mechanism.[157] The most germane aspects of the proposed standalone restructuring mechanism to this article are the cross-class cram down and the APR.[158]

Under the proposed standalone[159] restructuring mechanism, cross-class cram down of secured and unsecured creditors will be permitted[160] provided certain safeguards[161] for the

---

[151] SBRA, § 1191(c)(1) (incorporating requirements for cram down of secured creditor class in 11 U.S.C. § 1129(b)(2)(A)).
[152] SBRA, § 1191(c)(2).
[153] Theresa A. Driscoll, *U.S. Senators Propose Legislation That May Make Chapter 11 Reorganization a Viable Option for Small Businesses*, NEW YORK LAW JOURNAL (Dec. 5, 2018).
[154] 11 U.S.C. § 101(51D) (defining small business debtor).
[155] Insolvency Service, *A Review of the Corporate Insolvency Framework: A consultation on options for reform*, May 2016 [hereafter Insolvency Service, *Consultation*].
[156] Insolvency Service, *Summary of Responses: A Review of the Corporate Insolvency Framework*, Sept. 2016 [hereafter "Insolvency Service, *Summary of Responses"*].
[157] Department of Business, Energy & Industrial Strategy (BEIS), *Insolvency and Corporate Governance: Government response*, August 26, 2018 [hereafter "BEIS, *Government response*"].
[158] For a concise overview of the proposed reform for a standalone restructuring mechanism, see Payne, *Restructuring*, *supra* note 10, at 469-70.
[159] BEIS, *Government response*, *supra* note 157, at ¶ 5.124.
[160] *Id*. at ¶ 5.123.
[161] *Id*. at ¶ 5.148.

protection of creditors are in place.[162] A vital aspect of protection is the role envisioned for the courts throughout the process,[163] which is similar to the process for schemes of arrangement.[164] The proposal includes requirements pertaining to class formation[165] and voting threshold requirements,[166] which provide some protection. The protection these afford is manifest in the requirement that the court have a hearing to examine the classes proposed, with parties ability to object to the class formation, and the requirement that the court confirm that the proposal can be voted on.[167] Following the vote the court will hold a second hearing to consider confirmation of the proposed plan.[168] The court will have "absolute discretion" to confirm the plan or not and there will be a right to appeal if the plan is confirmed.[169]

Another important protection included in the proposed reform for a dissenting creditor class is the requirement "that a dissenting class of creditors must be satisfied in full before a more junior class may receive any distribution or keep any interest under the restructuring plan[,]"[170] i.e., the APR. In light of the criticisms of the APR such as inflexibility,[171] impediment to effective reorganization[172] and potential for abuse by some at the expense of others,[173] the Government added flexibility for a court to deviate from a strict application of the rule.[174] Under the proposal a court may confirm a plan that does not comply with the APR "where noncompliance is: [1] necessary to achieve the aims of the restructuring; and [2] just and equitable in the circumstances."[175]

This injection of flexibility into application of the APR, at first blush, appears to infringe upon the protection the rule is designed to provide to creditors. However, the test to deviate from the APR is a high threshold that is premised on the baseline standard for confirmation - compliance with the APR.[176] To deviate from that baseline standard, the deviation must be vital to "an effective and workable restructuring plan" and sanctioned by the court.[177] As with the class formation and voting requirements, it is the integral role of the court in approving such a deviation that provides protection to creditors when there is noncompliance with the APR.

Important in any discussion of the APR is the basis for valuation employed in the analysis to determine compliance with the rule.[178] A detailed analysis of valuation in this context is

---

[162] *See* Payne, *Restructuring*, *supra* note 10, at 469-70 (noting the need for protections for creditors and summarizing them).
[163] *Id.* at 469 ("careful oversight of the courts, provides a significant protection for creditors.").
[164] BEIS, *Government response*, *supra* note 157, at ¶ 5.135.
[165] *Id*. at ¶¶ 5.149-151.
[166] *Id*. at ¶¶ 5.153-155.
[167] *Id*. at ¶¶ 5.135, 5.149-151.
[168] *Id*. at ¶¶ 5.135, 5.149.
[169] *Id*. at ¶¶ 5.152, 5.166.
[170] *Id*. at ¶ 5.163.
[171] *Id*. at ¶ 5.159.
[172] *Id*. at ¶ 5.160.
[173] *Id*. at ¶ 5.162.
[174] *Id*. at ¶ 5.164.
[175] *Id*.
[176] *See id.*
[177] *Id*.
[178] *See* JACKSON, *supra* note 31, at 212-13 (valuation is important in all reorganization cases and the application of the APR in particular).

complex[179] and well beyond the ambit of this article.[180] However, the Government considered the issue and after consultation determined that the "next best alternative for creditors" rather than a "minimum liquidation value" should be the value employed in a cross-class cram down scenario.[181] This approach is flexible, but will require courts to decide valuation if there is a challenge to the value employed.[182] As with other aspects of the proposed reform, courts will be central to the process, and in the case of the proposed valuation standard there may be an increase in litigation and a burden on the courts.[183]

B. Lessons for the U.S. Reform

The new standalone restructuring mechanism has many similarities to Chapter 11 in its current form. Similar to the U.K. reform proposal, Chapter 11 provides for a cross-class cram down[184] and has certain protections for minority creditors and interests through rules pertaining to class composition of claims or interests[185] and voting.[186]

Just as in the U.K. proposal, the bankruptcy court plays an integral role in the process.[187] The bankruptcy court will hold a hearing to consider approval of a disclosure statement ensuring it has adequate information,[188] prior to the solicitation of votes from creditors or interest holders.[189] After voting, the bankruptcy court will hold a second hearing,[190] at which parties may object,[191] to consider confirmation of the plan.[192] If the plan is confirmed parties can appeal the order of confirmation.[193]

Comparable with the U.K. proposal Chapter 11 has the APR.[194] However, English courts will have discretion to deviate from a strict application of the APR in confirming a restructuring plan.[195] Under Chapter 11 there is no statutory discretion to deviate from the APR.[196] Section 1129(b)(1) provides that if there is a dissenting class the court "shall confirm the plan . . . if the plan . . . is fair and equitable[,]"[197] i.e., complies with the APR. Importantly, *Jevic* expressly expanded the statutorily mandated lack of discretion bankruptcy courts have to deviate from the

---

[179] *See id.* at ¶ 5.169 (recognizing complexity of the issue).
[180] *See generally* Paterson, *Rethinking*, *supra* note 18, at 718-723 (analyzing the complex valuation options in modern restructuring practice).
[181] *Id*. at ¶ 5.174; see also Payne, *Restructuring*, *supra* note 10, at 470.
[182] *Id*. at ¶ 5.175.
[183] Payne, *Restructuring*, *supra* note 10, at 470-1.
[184] 11 U.S.C. §§ 1129(a)(8), (b)(1).
[185] *Id*. at § 1123.
[186] *Id*. at § 1126(c), (d).
[187] *See* Rafael Efrat, *The Case for Limited Enforceability of a Pre-Petition Waiver of the Automatic Stay*, 32 SAN DIEGO L. REV. 1133, 1161 (1995) (recognizing the important role of bankruptcy judges in the bankruptcy process). This integral role of the bankruptcy judge is part of fabric of the traditionalist view of bankruptcy theory. *See, e.g.*, Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 Yale L.J. 573, 579 (1998) ("[B]ankuptcy judges should enjoy broad discretion to implement bankruptcy's substantive policies.").
[188] 11 U.S.C. § at § 1125(a)(1).
[189] *Id*. at § 1125(b).
[190] *Id*. at § 1128(a).
[191] *Id*. at § 1128(b).
[192] *See id* at §§ 1129(a) (requirements for consensual plan) and (b) (cram down requirements).
[193] FED. R. BANKR. P. 8002(a) and 8003(a).
[194] 11 U.S.C. § 1129(b)(1), (2).
[195] *See supra* notes 174-175 and accompanying text.
[196] *See* 11 U.S.C. § 1129(b)(1), (2).
[197] *Id*. at § 1129(b)(1).

APR in confirming a plan to structured dismissals.[198] This likely has a cascading impact on other rescue tools that infringe upon the APR.[199]

The U.S. should amend § 1129(b) to statutorily provide discretion to bankruptcy courts to deviate from the APR. The requirements of § 1129(b)(1) and (2) - the "fair and equitable" requirement and the definition thereof - should not be modified and would serve as the baseline for a cram down, just as in the U.K. proposal.[200] However, discretion for the bankruptcy court to deviate from this baseline standard should incorporated into the statutory framework.

In crafting a statutory solution, the standard in the U.K. proposed restructuring mechanism, as well as prior U.S. case law, can serve as guides. English courts will have discretion to deviate from the APR if it is "necessary to achieve the aims of the restructuring; and just and equitable in the circumstances."[201] Bankruptcy courts have deviated from the APR when there are "significant Code-related objectives"[202] or a "significant offsetting bankruptcy-related justification."[203] Section 1129(b)[204] should be amended to add a new subsection (3) that provides as follows:

> (3) The court may confirm a plan that is not fair and equitable, as defined in subsection (b)(2), if such is:
>
> (A) necessary to achieve a significant offsetting Chapter 11-related objective; and
>
> (B) just and equitable in the circumstances.

This suggested reform may appear radical in light of the well-entrenched position of the APR.[205] Arguably, the most serious problem of such a proposal is that the minority protection provided by the APR will be diminished. However, the reality is that many bankruptcy courts already ignore the APR.[206] This leads to litigation with disparate results from court to court and varying degrees of protection afforded to minority interests by the APR.[207] This reform proposal will set a standard to guide bankruptcy courts. Granted the litigation will not end, but the statutory standard will provide a framework within in which courts can work with in deviating from the APR.

---

[198] *See supra* notes 82-85 and accompanying text.
[199] *See supra* notes 86-91 and accompanying text.
[200] *See supra* notes 176-177 and accompanying text.
[201] BEIS, *Government response*, *supra* note 157, at ¶ 5.164.
[202] Czyzewski v. Jevic Holding Corp., 137 S. Ct. at 985.
[203] *Id*. at 986.
[204] 11 U.S.C. § 1129(b)(1) should be modified to add "except as provided herein" after the phrase "is fair and equitable."
[205] In 1939 the Supreme Court characterized the APR as a "fixed principle" in evaluating reorganizations. Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106, 116 (1939). *See also*, Sharp, *supra* note 61, at 527 (noting how early cases recognized the APR was "firmly imbedded" in bankruptcy law); JACKSON, *supra* note 31, at 213, n. 11 (recognizing the "fixed principle" in the caselaw).
[206] Baird & Bernstein, *supra* note 24, at 1932; JACKSON, *supra* note 31, at 213 (noting that the APR in practice is regularly circumvented). *See also*, *supra* notes 102-104, 124-125 and accompanying text analyzing rescue tools that run afoul of a strict application of the APR.
[207] *See supra* notes 97-106, 133-135 and accompanying text (discussing the variance in application of the APR to rescue tools by bankruptcy courts).

Importantly bankruptcy courts already play a large role in the Chapter 11 process.[208] They are not merely an umpire but have an active role along the way in a Chapter 11 case.[209] The role the bankruptcy court plays is vital to protecting minority interests, just as it is in the English law and in the proposed reform.[210] This discretion, just as with English judges in the proposed restructuring mechanism,[211] will give bankruptcy courts the ability to balance the interests of various stakeholders and provide protection for minority stakeholders.[212]

The bankruptcy court ability to balance of interests will also facilitate rescue in Chapter 11. No longer will the APR serve as a rigid barrier to confirmation of a plan. Nor will the potential cascading effect of *Jevic* serve as a rigid barrier to employing other rescue tools. The bankruptcy court will be able to exercise discretion in limited circumstances to deviate from the APR to achieve "a significant offsetting Chapter 11-related objective" if it is "just and equitable." The bankruptcy court will no longer be blindly tethered to the APR. The bankruptcy court can break away from the APR when necessary to achieve the objective of rescue if it is just and equitable.[213]

VII. Conclusion

The Chapter 11 statutory framework and underling statutory policy rationale of Chapter 11 with an emphasis on fostering reorganization of a company has not materially changed since 1978. However, Chapter 11 practice has changed and evolved to foster not only the reorganization or rescue of a company, but rescue of the business as well. This broader orientation of Chapter 11 is seen in rescue tools, such as § 363 sales, that facilitate a rescue that is broader than rescue of the company. In light of this broader conception of rescue and the role of Chapter 11, the rigid adherence to the APR as codified in 1978, as seen in *Jevic*, is antiquated. This is particularly true when the cascading effect of *Jevic* on the use of Chapter 11 rescue tools is considered.

The U.K. in drawing on Chapter 11 has proposed an APR that is flexible and compatible with a restructuring regime that embraces a broad conceptualization of rescue. U.S. policymakers should take lessons from the U.K. and reform the APR to reflect modern Chapter 11 in practice.

---

[208] *See* Jennifer Payne, *The Role of the Court in Debt Restructuring*, 77 CAMBRIDGE L. J. 124, 125 (2018) (bankruptcy courts play significant role in Chapter 11) [hereafter Payne, *Role*]. Likewise, English courts play a large role in schemes of arrangement. *Id*. at 126. *See also* Wessels & Madaus, *supra* note 1, at 258 (recognizing the important role that judges in the U.S. and England play in both restructuring regimes).

[209] Melissa B. Jacoby, *What Should Judges do in Chapter 11*?, 2015 U. ILL. L. REV. 576 - 81, 583 (bankruptcy judges are not umpires but have vital independent duties in a bankruptcy case).

[210] *See generally* Payne, *Role, supra* note 208, at 134-141 (discussing role of courts in protecting minority interests). In other common law jurisdictions the courts play a vital role in the insolvency regime. *See also* Wee, *supra* note 5, at 562-67 (discussing the proactive role of courts in Singapore's insolvency regime).

[211] *See supra* note 177 and accompanying text.

[212] *See* BEIS, *Government response*, *supra* note 157, at ¶ 5.165.

[213] Two other lessons from the U.K. proposed reform, which are beyond the ambit of this article, warrant further research and consideration by the U.S. First, the U.S. should consider adopting the "absolute discretion whether or not to confirm a plan on just and equitable grounds" that English courts will have, as they do with schemes, under the proposed restructuring reform. BEIS, *Government response*, *supra* note 157, at ¶¶ 5.152, 5.166. Bankruptcy courts do not have discretion to deny confirmation of a plan in compliance with § 1129(a) or § 1129(b). *In re* Trenton Ridge Investors, LLC, 461 B.R. at 455-58.

Secondly, the U.S. should look to the proposed valuation standard in the U.K. restructuring mechanism to see if any lessons can be derived from it to improve the valuation approach in the U.S. The U.S approach to valuation is complex and it has been suggested that it may be time for reform. *See* Paterson, *Market supra* note 1, at 802-03; Paterson, *Reflections*, *supra* note 13, at 490 (noting that some U.S. practitioners have argued reforming the valuation method).

Modern Chapter 11 practice and its rescue tools reflect an insolvency regime that is dynamic. The Code and the courts rigid adherence to the APR reflects an insolvency regime that is static.[214] Policymakers must infuse flexibility into the APR to ensure that the Chapter 11's law on the books is as dynamic as modern Chapter 11 practice and its rescue tools. This is necessary for Chapter 11 to fully foster a broad conceptualization of rescue that includes rescue of the company, as well as rescue of the business.

[214] Professor Sharp recognized this philosophical divide in the application of the confirmation of a plan requirements, including the APR. *See* Sharp, *supra* note 61, at 543-44. One viewpoint holds that the confirmation standards are static and limited by the Code. *Id.* The other viewpoint embraces a dynamic view of the confirmation standards in the Code in which the standards are the guiding principles. *Id*.