Bankruptcy as an Essentially Contested Concept: The Case of the One-Asset Case

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BANKRUPTCY AS AN ESSENTIALLY CONTESTED CONCEPT: THE CASE OF THE ONE-ASSET CASE

JOHN D. AYER

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Bedenk: Man liebt den käse wohI, indessen man deckt ihn zu.'
(Consider: We like cheese well enough, but we still cover it up.)

—WILHELM BUSCH**

There has been an explosion of good academic work recently about bankruptcy.¹ Some of it has attempted to identify a sort of essence or

* Professor of Law, University of California at Davis. I have presented portions of this material at seminars for lawyers over the last couple of years and have profited from the comments of co-panelists and participants. In particular, much of my thinking crystallized while I was participating in a presentation organized by Randolph J. Haines at the Northeast Bankruptcy Law Institute in Quebec City in August 1992. Thanks also to participants in a faculty workshop at the University of Miami Law School.

** Quoted in BRIAN VICKERS, IN DEFENSE OF RHETORIC vii (1988).

¹ I will focus here on conventional “law” work. Still, it is hard to distinguish some of the “straight law” from some of what is done in the purlieus of economics and corporate finance. See, e.g., Michelle J. White, The Corporate Bankruptcy Decision, 3 J. ECON. PERSP. 124 (1989) [hereinafter White, Bankruptcy Decision]; Michelle J. White, Personal Bankruptcy Under the 1978 Bankruptcy Code: An Economic Analysis, 63 IND. L.J. 1 (1987).
unifying core of bankruptcy.\(^2\) I call this "mainline scholarship," for lack of a better name. Alongside it stands a genre of scholarship that seems to sidestep the austere parsimony of the "unifying core" material, seeking instead to take account of the refractory complexity of bankruptcy practice.\(^3\)

As much as I admire some of the mainline work, I have perhaps a greater temperamental affinity for this "revisionist" material because it seems to do a better job of keeping touch with the irreducible indeterminacy of bankruptcy as a theater for human greed and betrayal, with all the attendant hopes and disappointments.\(^4\)

Yet much of this revisionist scholarship, admirable though it may be, seems in an important sense, less radical than it may appear at first glance. For the revisionist scholarship shares with its more elegant predecessor the fundamental assumption that there is a core of some sort in bankruptcy law. Thus, mainline scholarship seeks to articulate the core of bankruptcy law in ideas such as asset allocation, efficiency, and so forth—the standard jargon of economics. Revisionist scholarship, to its great credit, tries to show how bankruptcy, for all its dynamism and fluidity, serves recognizable social goals (even if dynamism and fluidity are the goals that it serves). Both mainline and revisionist scholarship are thus seen as ironic, in the theological sense of the term.

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2. The conventional citation today is, of course, Thomas H. Jackson, The Logic and Limits of Bankruptcy Law (1986). In this Article, I mean to associate a lot of general work done in the genre of economics and corporate finance, as well. See, e.g., Lucian A. Bebchuk, A New Approach to Corporate Reorganizations, 101 Harv. L. Rev. 775 (1988); Barry E. Adler, Bankruptcy and Risk Allocation, 77 Cornell L. Rev. 439 (1992).


In this Article, I take a somewhat different spin on the problem by suggesting that bankruptcy may harbor no purpose at all, except in the most attenuated sense. Specifically, I suggest that the “purpose,” if you can call it that, of bankruptcy law may be to serve no purpose at all, other than to take highly divisive conflicts over public policy and dispose of them under the pretense that they have been resolved, while in fact not resolving them at all. In effect, I attempt to exhibit bankruptcy as an “essentially contested concept”—a mechanism that, by its nature and not by accident or inadequacy, harbors irreconcilable conflicts. The idea, then, would be to use the rhetoric of the law as a rallying-point for some kind of social solidarity, while leaving important conflicts intentionally (and perhaps mercifully?) unresolved.

It is obvious how this idea differs from standard “unifying core” scholarship. Perhaps less obvious is how the idea differs from what I have called revisionist work, but I think the difference is important and should be emphasized. The standard revisionist texts seem to suggest that the arena of conflict in bankruptcy law is structured as it is to serve as a kind of therapeutic exercise in which “justice” will emerge from “combat,” on the metaphor, perhaps, of a trial.

My view is somewhat more skeptical (I do not say cynical). I tend to view the matter as one of not so much solving a problem as getting rid of it—putting it out of harm’s way while keeping the books straight and general principles intact. This idea, of course, is a kind of “purpose,” just as the number “one” is a kind of “prime number,” in the sense that a prime is any number that cannot be divided except by itself or one. But this is a somewhat attenuated view of the term, and I will not let it me detain me here.

As the reader may surmise, I believe that this view of things is a helpful way of approaching a great many areas of the law. The principle

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7. There is certainly no end to scholarship professing the law’s indeterminacy. Although I certainly do not wed myself to all of it, I am often persuaded by assertions of indeterminacy in particular fields. On the other hand, many partisans on both sides of
could be demonstrated in any of a number of facets of bankruptcy law. For present purposes, I undertake to explore just one—the so-called "one-asset case," which, I suspect, bulks so large in bankruptcy practice, but has largely escaped the notice of bankruptcy commentators. My argument is that the one-asset case does not fit neatly into the framework of bankruptcy law; and that has been precisely its job: to fit, but not neatly.

To make this point, I will proceed as follows: First, I will sketch out what I mean by the one-asset case. Then, I will summarize the arguments—which are, in my view, both plausible and largely compelling—both for and against the one-asset case. Finally, I will explore in more detail a couple of problems that emerge in effecting one-asset plans.

the case seem to assume that indeterminacy is some kind of scandal. I see no necessity for this linkage. In principle, such indeterminacy may serve the ends of society even if no one had the remotest intention of achieving that result. On the impossibility of theory in constitutional law and what to do about it, with a useful survey of earlier literature, see Paul Campos, Against Constitutional Theory, 4 YALE J.L. & HUMAN. 279 (1992).

8. "Honorable mention" for contenders to pride of place in this Article might go to, e.g., the matter of exemption planning. Compare Norwest Bank Neb., N.A. v. Tveten, 848 F.2d 871 (8th Cir. 1988) with Smiley v. First Nat'l Bank (In re Smiley), 864 F.2d 562 (7th Cir. 1989).


10. I will develop my arguments for "systematic ambiguity" at greater length below. For the moment, I note that it is at least conceivable that either Congress or the Supreme Court could put an end to the ambivalence by an authoritative pronouncement of some sort (though even here, it is perhaps questionable how effective the "sovereign" might be in getting obedience at the trench level). While I was drafting this Article, I had momentary pangs of concern that one or the other of these bodies might undermine me with a spasm of clarity and simplicity. Remarkably, both of them have now rejected efforts to do so.

As to Congress, a provision in the proposed S. 1985 would have limited, and thus implicitly legitimated, the powers of the stay in one-asset cases. See S. 1985, 102d Cong., 2d Sess. § 211 (1992). But the provision was not included in the companion House bill and was dropped from the proposed compromise measure in conference committee. See ABI LEGIS. BULL., vol. III, no. 7, Oct. 8, 1992.

Meanwhile, the Supreme Court's certiorari docket included at least two cases that provided opportunities for the Justices to address the issue. Nevertheless, the Supreme Court denied certiorari in both cases. See Greystone III Joint Venture v. Phoenix Mut. Life Ins. Co., 113 S. Ct. 72 (1992), denying cert. to 995 F.2d 1274 (5th Cir. 1991); Bryson Properties XVIII v. Travelers Ins. Co., 113 S. Ct. 191 (1992), denying cert. to 961 F.2d 496 (4th Cir.).
I. THE ONE-ASSET CASE: A SKETCH

The following scenario is a paradigm one-asset Chapter 11 case:

The debtor is a limited partnership, with a corporate general partner and investor/limited partners who signed on in large part to reap the bounty of partnership tax deductions. The partnership owns a medical office building with a present market value of perhaps $4 million. The partnership owes $10 million to Insco, an institutional lender who financed the acquisition and retained a mortgage that is "nonrecourse," in the sense that the mortgagee may look only to the asset for satisfaction of his claim. The partnership also has contracts with a supplier of management services for the office building and with a supplier of bookkeeping services for the partnership; but in each case, the partnership is current on its obligations to the contracting parties. The property yields enough to cover current operating expenses, but not nearly enough to service the debt or, by definition, to return any income to limited partners.  

Insco has begun foreclosure proceedings and is about to go to sale. If the project is terminated, then the individual limited partners will sustain substantial "rollup liabilities"—i.e., they will face demands to pay tax liabilities in cash with no corresponding infusion of liquidity to pay them.

One-asset cases cannot be formally categorized, because individual cases tend to blur off at the edges. In any event, not every detail of my


12. If the valuation at the beginning of the problem is accurate, then necessarily the project does not earn enough to service debt. Given a $4 million valuation, an assuming a current interest rate of 10%, the project would yield $400,000 beyond current operating expenses for debt service and would need to earn another $600,000 to break even.

13. Judge Edith Jones, who has perhaps been as unsympathetic as anyone to the one-asset case, recognized as much in Humble Place Joint Venture v. Fory (In re Humble Place Joint Venture), 936 F.2d 814 (5th Cir. 1991). Judge Jones stated:

There are several instances in which even one-asset real estate ventures would invoke Chapter 11 in good faith: the asset may be an operating business, like a ranch or a hotel; the development might be nearing the end of construction whose completion would markedly enhance the asset's value; and even a venture including undeveloped property might file to protect true owner equity when market conditions suggest the remedy of a debt restructuring, as opposed to simple liquidation, and the likelihood of prompt resale.

Id. at 818. Recognizing this statement as a careful effort at analytical precision, still the very seriousness of purpose on display here suggests just how hard the problem of distinction might be. For example, "an operating business like a ranch or a hotel" will
sketch is necessary to my model, but several features of the scenario are noteworthy, as follows. Perhaps most obvious is the single asset that gives the category its name. In the paradigm case, the debtor may own assets other than the office building, but they tend to be pretty trifling—e.g., some partnership letterhead, a half-used checkbook, or a vacuum cleaner. The office building is far and away the only asset of any importance to anyone. In the nature of things, it is perfectly proper to think of the asset as an irreducible entity, like a Liebnizian monad: it was here before the show starts, and it will be here after the show is over.\footnote{14}

A little less obvious, but perhaps more important, is the nature of the debt. Under the paradigm facts, there is only a single creditor with a single claim. This is perhaps a tad more sticky in practice because an entity such as this will usually have at least some "pocket-change" unsecured creditors. Some such debtors may have unsecured liabilities that are very large, indeed. But in many cases where the unsecured liabilities are small, the parties act almost as if the unsecured liabilities are nonexistent.\footnote{15} Typically the unsecured claims will be for operating services that must be paid to keep the project going. In fact, ironically, sometimes the trick will be to manufacture an event of nonpayment for the purpose of creating a creditor class to accept the plan.\footnote{16} But the driving point is that the secured creditor predominates—so much so that the case might well have been called a "one-creditor case," although the distinction is not essential.

II. WHY THE ONE-ASSET CASE HAS NO BUSINESS IN BANKRUPTCY COURT

One could make a perfectly respectable argument that the one-asset

likely have many creditors, and so will a building nearing completion. Moreover, it is hard to see just what Judge Jones meant by "market conditions [that suggest] the remedy of a debt restructuring, as opposed to simple liquidation and the likelihood of prompt resale." The debtor's argument virtually always rests on the predicate that there is a "true" market value that will be recognized given time.

14. Technically, of course, you could tear down the office building and sell off the components. In some of the more dismal recesses of the inventory of the Resolution Trust Corporation, this is perhaps a likely scenario. But for a far more common category of cases it simply isn't a factor, and that is how I treat it here.

15. For example, in \textit{In re} Greystone III Joint Venture, 102 B.R. 560 (Bankr. W.D. Tex. 1989), \textit{aff'd}, 127 B.R. 138 (W.D. Tex. 1990), \textit{rev'd}, 995 F.2d 1274 (5th Cir. 1991), \textit{cert. denied}, 113 S. Ct. 72 (1992), the proponents proposed to pay three percent on trade claims and on an unsecured deficiency, but made no attempt to bar trade creditors from pursuing the partnership or the general partner after bankruptcy.

16. \textit{See infra} note 102 (discussing requirement for confirmation in 11 U.S.C. \textsection{} 1129(a)(10) that at least one impaired class accept plan).
case, as described above, has no business in bankruptcy court. The argument would go as follows.

We can identify a number of substantive concerns that may be regarded collectively as the essence or purpose of bankruptcy law. The earliest, and historically the most important, is the “orchestration of claims.” This is the process of taking the debtor’s property and dividing it among his creditors as their interests may appear. This ordered distribution of assets is in contrast to the regime of “grab law” that exists outside of bankruptcy, under state law. A second and more familiar purpose is to give the debtor a discharge—the traditional “fresh start” for the “honest but unfortunate debtor” to permit him to go forward free of the burden of his past obligations. A third purpose, perhaps somewhat more difficult to grasp, but nonetheless essential to modern bankruptcy law, is the preservation of going-concern values. Strictly speaking, one might say that this purpose is a subset of item #1 above: one reason for orchestrating claims is to preserve going-concern values. But the idea of orchestration became popular long before anyone focused on the idea of preserving going-concern values. Moreover, the idea of preserving going-concern values seems particularly linked to the developing notion of bankruptcy as a device for reorganizing, as distinct from merely liquidating, a debtor.

Why itemize these purposes of bankruptcy law? The point, of course, is that when these traditional purposes are measured against the one-asset case, one must concede that none of these purposes is at stake in the one-asset case. Orchestration? In the pure case there is no need for orchestration, because there is only one creditor. Even if more creditors exist, generally one creditor will have a secured position that comes first under either state or federal law. And if unsecured creditors are involved, frequently they are trivial in the aggregate amount of their claims. In any event, typically both the secured creditor and the debtor want to make sure that any unsecured creditors are paid so that the building will continue to operate unimpeded. Discharge? The core idea of the discharge is the protection of individual debtors. However, in the example, the debt is nonrecourse, which means that creditors cannot pursue any individual debtor. Indeed, absent bankruptcy, liability would simply die with the liquidation of the asset.

17. I take the phrase “grab law” from Maclachlan. For classic accounts of bankruptcy as a matter of claims orchestration, see, e.g., JAMES A. MACLACHLAN, HANDBOOK ON THE LAW OF BANKRUPTCY 3 (1956); see also HARVEY M. LEBOWITZ, BANKRUPTCY DESKBOOK 29-31 (2d ed. 1990). For a vivid discussion of creditor collection strategies against a faltering pre-petition debtor, see generally LYNN M. LOPUCKI, STRATEGIES FOR CREDITORS IN BANKRUPTCY PROCEEDINGS, chs. 2-4 (2d ed. 1991).


19. The general partner has a kind of “unlimited” liability, of course; however, the
with preserving going-concern values—the traditional “core principle” of reorganization law. There are no going-concern values to preserve in a one-asset case: the office building almost certainly will be retained as an office building; the only question is who will own it.  

If all of this is true, then very little is left. If the debtor can keep the Chapter 11 case in court, he may succeed in deferring foreclosure and, ultimately, in effecting a plan with creditors (i.e., scaling down the debt while retaining the property). Nevertheless, every state has a foreclosure procedure of its own, and virtually every state-law procedure includes a mechanism that permits the debtor to protect itself against precipitous creditor action. Even under state law, the effect of these limitations on foreclosure is to permit the debtor to continue to gamble with the creditors’ money.

If all of this is true, then the only purpose of the one-asset bankruptcy case is to permit the bankruptcy court to serve as a “court of equitable appeals” from state mortgage foreclosure law. It is dubious, to put it mildly, that Congress ever intended bankruptcy to be used in this way.

As an additional approach to the issue, it may be useful to sketch a “classic” Chapter 11 case, and then to note how much it differs from the one-asset case outlined above. In the classic case, the debtor is a closely held corporation where at least some of the creditors are also involved in the management of the corporation. The debtor corporation may owe debt to creditors who hold a security interest in the real estate or inventory and receivables, as well as to an array of unsecured creditors lumped together generally as “the suppliers,” or more generally as “the trade.” The individual principals of the debtor corporation may have given their personal guarantee to the secured creditors, and some “insiders” may be personally liable for, e.g., trust fund tax claims.

general partner is typically a corporation with limited liability and with no significant assets of its own, aside from its interest in the disputed property. Of course the limited partners may go broke paying their tax liability, but they can file their own bankruptcy petitions. Although tax liability is not desirable, its nondischargeability represents one of the more carefully thought-out policies in bankruptcy law.

20. This is a common point of confusion. Bankruptcy advocates seeking to justify retaining prebankruptcy management in an operating business case frequently appeal to the need to preserve going-concern values. But this argument loses sight of the fact that the going-concern values may survive in a great many cases whether or not the old equity owners retain a stake.

21. Some cases under old Chapter X suggested that it was improper to use bankruptcy laws to supplant state mortgage foreclosures. See Marine Harbor Properties, Inc. v. Manufacturer’s Trust Co., 317 U.S. 78 (1942); Biltmore Grande Apartment Bldg. Trust v. Muskat (In re Biltmore Grande Apartment Bldg. Trust), 146 F.2d 81 (7th Cir. 1944); In re Champ Brewing Co., 72 F. Supp. 764 (M.D. Pa. 1947).

22. See 26 U.S.C. §§ 3102(a)-(b), 3402(a) (1988) (requiring employers to withhold
Several facts about this classic case deserve to be noted. First, it likely involves going-concern values, which can be preserved through the bankruptcy process and which might be lost otherwise. Second, a lot of people have interests in preserving the firm as a going concern. For example, the principals presumably depend on the firm for their livelihood, and, in any event, if the firm goes under they will likely never see such a good a job again. Moreover, they have a powerful stake in maximizing the value of firm assets to minimize their personal exposure on guarantees and statutory tax liabilities. Not quite so obvious, the trade creditors/suppliers have an interest in the survival of the firm sufficient to make them virtual allies of the residual owners. If the firm liquidates, all of the proceeds will likely go to the secured creditors, and the trade creditors will receive nothing. Moreover, for some of the suppliers, the debtor might be an irreplaceable customer.

All of these considerations impel the debtor and the unsecured creditors to collaborate on protecting the going-concern values by preserving the firm. In this scenario, the important parts of the bankruptcy process—e.g., the automatic stay and the presumption in favor of a debtor-in-possession—serve the interests of the allied adversaries alike. The auguries are good for a consensual plan. Indeed, the very likelihood of a consensual plan suggests that such cases are likely to create the least friction and excite the least attention.

This classic Chapter 11 scenario is derived, perhaps, from the kind of case that was common under old Chapter XI of the pre-1978 Bankruptcy Act. Clearly, this scenario differs significantly from the one-asset scenario. The "traditional" Chapter XI was designed to oust, if possible, old creditors/suppliers, to preserve the "going concern" value of the old firm, and to distribute the proceeds to the new suppliers of the new company. The bankruptcy process may well be viewed as an essentially contested concept. The prepackaged plan is simply a device to avoid having the Chapter XI court make an essentially contested decision. It may, however, result in some simplification of the legal proceedings and may be an efficient way of preserving the firm's value. As the bankruptcy court not only has to determine the value of the firm assets, but must also determine the relative priorities of the many different classes of creditors, the possibility of a consensual plan in such a scenario is quite interesting. In addition, a consensual plan may be more likely to be approved by a judge, who would otherwise determine the value of the firm assets and the relative priority of the creditors.

23. Bankruptcy Act of 1978, 11 U.S.C. § 362 (1978). The stay not only prevents creditors from taking action against the debtor, but also bars action against property of the estate—a provision which has the effect of protecting the assets against dismemberment, whether or not the old residuary owners are interested in doing so.

24. Id. §§ 1104, 1106 (1978).

25. See id. §§ 1123, 1129 (setting forth the plan requirements).

26. Which is to say, these cases result in the fewest reported decisions. Several years ago, there was a spate of publicity about so-called "prepackaged plans," as if they were something new. In fact, it is fairly clear that the Code was designed for the administration of prepackaged plans on the very scenario as described here. See In re TS Indus., 117 B.R. 682, 688-89 (Bankr. D. Utah 1990); In re Colonial Ford, Inc., 24 B.R. 1014 (Bankr. D. Utah 1982).

27. The scenario under old Chapter X was, of course, different; but for the purposes of the present discussion, I do not think the distinctions are material. Old Chapter X was designed to oust alleged malefactors and to simplify complex capital structures. 6

payroll income and social security taxes from employee paychecks); Id. § 7501(a) (1988) (declaring that the employer holds such funds "in trust for the United States"). If the employer fails to pay over trust fund taxes, the government may collect them directly from the responsible officer or employee. Id. § 6672(a) (Supp. IV 1992).

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scenario outlined above. It is not possible to get good data suggesting just how many current cases look like the paradigm one-asset case and how many look like the classic cases. I suspect that the one-asset cases far outnumber the classic cases; but you would never guess so from listening to bankruptcy lawyers or professors, nor from listening to bankruptcy lore.

III. WHY THE ONE-ASSET CASE IS A GOOD USE OF THE BANKRUPTCY PROCESS

The foregoing, in summary, is the case against the one-asset case. I suppose that many readers would be happy to leave it there—to endorse my suggestion that the bankruptcy process has no role to play in one-asset cases and that such cases are just as well left to state foreclosure law. But I do not want to leave it there. Rather, to the contrary, one can make a pretty good case for leaving the one-asset case just about where it is.

Although the “principles and purposes” of bankruptcy law outlined above—orchestrating claims, giving a discharge, and protecting going-concern values—are familiar basic principles, none of them is a formal requirement for a bankruptcy filing. As to orchestrating claims, in most bankruptcy cases there is nothing to distribute and, thus, nothing to orchestrate.\(^a\) Also, the Code recognizes that in many cases there is no need for, or possibility of, a discharge.\(^b\) And the idea of preserving going-concern values, although it may be functionally important to Chapter 11, is no more than hinted at in the text of the statute.\(^c\)

Indeed, if the statute is relevant at all, one can make a respectable, if not conclusive, case that the drafters intended the bankruptcy process to accommodate the one-asset case. Present Chapter 11 was drafted against the

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COLLIER ON BANKRUPTCY ¶ 0.08 (14th ed. 1978). However, the major premise of all of this was that there were going-concern values to be preserved, in the interest of debtors and creditors alike.

28. See generally SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS, supra note 4, at 203 (estimating that over 87% of personal Chapter 7 bankruptcies can pay nothing to creditors beyond administrative expenses).

29. 11 U.S.C. § 727 (1988) (providing grounds for denying discharge in Chapter 7, including the familiar “wrongdoing” grounds, as well as the general principle that there will be no discharge in a liquidating case for a corporation); cf. id. § 1141 (1988) (providing for discharge in Chapter 11).

30. The notion of going-concern value seems to be implicit in 11 U.S.C. § 1129(a)(7) (1988), which provides that a dissenting impaired creditor must receive not less than he would receive in Chapter 7. As a practical matter, this requirement seems to presuppose that the typical Chapter 11 creditor will receive a payout keyed to the higher going-concern value, rather than the lower Chapter 7 liquidation value. Ironically, while this may be true enough in practice, it is by no means a necessity in principle: some businesses will be worth more in liquidation than as going concerns.
template of prior law and must be understood as assimilating the presuppositions of prior law, except as expressly overruled.31 That template included not only old Chapters X and XI, but also old Chapter XII.32 At the time of the Bankruptcy Code’s enactment, courts regularly administered cases under old Chapter XII that bore a strong resemblance to the one-asset case described above.33

Just as there is apparent statutory support for the one-asset case, so also is there judicial support. Numerous courts have upheld the propriety of one-asset cases. On the other hand, a number of courts have found them improper on particular facts.34 However, perhaps most interesting is not

31. This legislative policy is not express, but rather inevitable, in the sense that a legislature cannot possibly have operated any other way. To see my point, consider two of the first principles of bankruptcy law: (1) that creditors of an equivalent class share pro rata in assets available to that class; and (2) that secured creditors go to the head of the line. I have no doubt that both of these principles are true; but no where in the bankruptcy statute are they spelled out. They exist because everyone knows they exist—so obvious that they do not need to be stated. On the same principle, I know of no domestic relations statute that makes marriage a necessary condition of divorce.


Part of the folklore of bankruptcy law is that Judge Norton’s opinion in Pine Gate had more to do with the shape of the 1978 Bankruptcy Code than any other decision. Mortgagees, so it is said, were so eager to do away with the holding of Pine Gate that they would accept virtually any compromise to achieve its overruling. That may be true, but I do not care. My purpose here is not to close the inquiry, but only to muddy the water a bit.

34. See, e.g., Carolin Corp. v. Miller, 886 F.2d 693, 705 (4th Cir. 1989) (recognizing that one-asset debtors are “proper subjects for Chapter 11 relief,” but affirming dismissal for lack of good faith); Phoenix Piccadilly, Ltd. v. Life Ins. Co. (In re Phoenix Piccadilly, Ltd.), 849 F.2d 1393 (11th Cir. 1988) (concluding that a one-asset debtor’s threat to forestall pending state court foreclosure by filing a Chapter 11 petition in a distant forum supports dismissal of petition as bad-faith filing); Albany Partners,
what the courts have said, but what they have refused to say. Specifically, they have resisted virtually all entreaties to find the one-asset case improper per se. Instead, they have embraced either of two stratagems popular with judges who do not want to see their decisions corrupted by principle. One approach is the notion of "good faith": rather than seeking to articulate a governing rule for one-asset cases, judges go to great lengths to keep them under the more amorphous and flexible rubric of good faith.\(^{35}\)

The second evasive tactic is the use of "factors": long lists of items that a subsequent court may, or might, or must consider in deciding how to apply a supposed principle. The "one-asset" feature of a case typically appears on such a list, but only as one among many. The listing of "factors" for decision certainly represents an admirable instinct for precision. But as anyone who has ever owned a Jaguar must know, the more complicated the machine, the more likely it is to break down. I know a judge/teacher who says that he tells his students: "Whenever the Court of Appeals names more than three factors, you can ignore them all."\(^{36}\)

Nevertheless, it is abundantly clear that court approval of one-asset cases continues apace.\(^{37}\) And aside from Chapter 11, courts have used the

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35. I must make a confession of interest here. As a judge, I once opined against what then seemed to me the excesses of "good faith" as a decisional framework in this area. See In re Victory Constr. Co., 42 B.R. 145, 148-49 (Bankr. C.D. Cal. 1984). Fat lot of good it did me. On the other hand, my views on this issue have evolved somewhat over time. I used to assume that the deployment of good faith represented nothing more than a deplorable failure of intellectual energy on the judge's part. I can see now that what is going on here is a studied resistance against formulation, even where it could be done. For a somewhat different view of the good-faith issue, see Ponoroff & Knippenberg, supra note 3. Their footnote 11 includes a useful bibliography of earlier work. See id. at 923 n.11.

36. I assume the source of this remark would just as well remain anonymous in this context, but it is not me.


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bankruptcy process in a number of instances to correct perceived deficiencies in state mortgage foreclosure law.\textsuperscript{38}

Although not authority in the strict sense, perhaps the ultimate endorsement of the one-asset case comes from the United States Supreme Court, in the well-known \textit{Timbers} case.\textsuperscript{39} Although the propriety of the petition was not at stake in \textit{Timbers}, the facts of the case put it well within the category of the one-asset case as defined here. And no one has suggested that \textit{Timbers} was not properly within the jurisdiction of the bankruptcy court.

Although courts have shown a generalized lack of sympathy for one-asset cases, they have been notably unwilling to exclude such cases from the bankruptcy arena. Indeed, the courts' general handling of the issue offers strong support for the general principle set forth here—the idea that the ambivalence is deep-seated and persistent, and that there are strong impulses to leave the issue unsettled. Such is my general case. I turn now to two particular points that merit more extensive treatment.

\textbf{A. "Other Peoples' Money"}

One of the best ways to see the tension between the various groups of interest holders in a Chapter 11 case is to consider the role of the manager of a bankruptcy estate.\textsuperscript{40} The following scenario illustrates the competing

\textsuperscript{38} See, e.g., DiPierro v. Taddeo (\textit{In re Taddeo}), 685 F.2d 24, 25 (2d Cir. 1982) ("We do not believe that Congress labored for five years over this controversial question only to remit consumer debtors—intended to be the primary beneficiaries of the new Code—to the harsher mercies of state law."); \textit{In re Tucker}, 131 B.R. 245, 246 (Bankr. D. Me. 1991) (recognizing "the policy objective of encouraging home ownership through a strong home mortgage market"); \textit{overruled by In re Simcock}, 152 B.R. 7 (Bankr. D. Me. 1993).

\textsuperscript{39} See United Sav. Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 365 (1988) (holding that undersecured creditor had no right to "lost opportunity cost" in the pendency of the Chapter 11 case).

\textsuperscript{40} I choose this distinctive phrase—"manager of a bankruptcy estate"—advisedly. The manager of the Chapter 11 estate may be either the trustee, or the debtor-in-possession ("DIP") with the powers of a trustee. \textit{See} 11 U.S.C. § 1107 (1988).
concerns in a typical case:

You represent DebtorCo, the debtor in a Chapter 11 proceeding. Claims outstanding against DebtorCo total $1 million, and DebtorCo has $1 million cash in the Bank. Your client has an investment opportunity with an expected gross return of $1 million (i.e., a net return of zero), subject to the following probabilities: there is a fifty-percent chance that the project will yield $2 million gross and a fifty-percent chance that it will yield zero.

The managers of DebtorCo—the people who hired you, and whom you talk to every day—all were elected by the prepetition shareholders; indeed, several of them are shareholders themselves. The managers all want to press forward with a plan built around this investment opportunity ("Plan I"). The creditors' committee wants to press for immediate liquidation and distribution of the cash on hand ("Plan II").

The motivations on each side are clear enough. The shareholders get nothing under Plan II. They may also get nothing under Plan I, but they stand a fifty-percent chance of getting $1 million (i.e., the $2 million return less $1 million for creditors' claims). On the other hand, the creditors get paid in full under Plan II. They might get paid in full under Plan I, but they stand a fifty-percent chance of losing everything.

What are your responsibilities as counsel? Must you favor Plan I over Plan II? Plan II over Plan I? Would it be permissible for you to refuse to take a stand? This is a highly stylized problem designed to expose a difficulty that underlies, to some degree or other, virtually any operating bankruptcy case. The question is: What is the responsibility of management when faced with two "equal" claims?41

Typically, the equity holders of the debtor want to exercise DIP powers for tactical reasons, if not otherwise. Although the retention of the DIP is generally viewed as "tilting towards equity," this perception is not necessarily true. If the trustee standard is applied with rigor, the DIP may find that he gets no special advantage from remaining in possession. On the other hand, some pro-equity arguments subsist independent of whether there is a DIP. See infra notes 96-97 and accompanying text (discussing Central Ice Cream).

41. These claims are “equal” in that each one has the same net return. Strictly speaking, of course, basic finance theory would hold that these two choices are not equal at all, because the hypothetical rational investor has not only an enthusiasm for return, but also an aversion to risk. Other things being equal, a rational investor favors less risk to more. Suppose this particular enterprise were financed with all equity (i.e., no debt) by a single investor. Given the two choices, the investor would favor Plan II to Plan I (even though returns are equal) because the risk of Plan II is smaller. Under these constraints, it is easy enough to imagine a project where the total return, discounted for risk, of two different projects is indeed “equal.” See generally Richard A. Brealey & Stewart C. Myers, Principles of Corporate Finance 161-65 (4th ed. 1992)
There is a substantial literature on this and related questions in connection with solvent or near-solvent companies. Although the claim seems central to bankruptcy law, it has received surprisingly less attention than one might expect. Conventional presentations can sidestep the issue because, in practice, the obligation of the manager of the estate is typically masked behind the vaporous pieties of the "business judgment" rule. To be sure, there is a considerable literature that addresses the issue more or less clearly from the standpoint of "economics." Thus, a number of critics have sought to show that, under the conventions of economic argument, Chapter 11 makes no sense. Some more recent work offers ad hoc adjustments of the primitive economic model, to try to save appearances in the face of awkward brute fact. Others, while not insisting so on any such stylized model of the possible world, have treated Chapter 11 as a more general instance of systems failure, but offer corresponding proposals for reform. A small (but interesting) body of literature seeks to locate a more

(discussing the capital-asset pricing model). For more on hypothetical all-equity financing, see infra notes 96-97 and accompanying text (discussing Central Ice Cream).


46. See Lynn M. LoPucki & William C. Whitford, Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies, 139 U. Pa. L. Rev. 125 (1990) (hereinafter LoPucki & Whitford, Bargaining over Equity's Share]; LoPucki & Whitford, supra note 4; Lynn M. LoPucki & William C. Whitford, Preemptive Cram Down, 65 Am. Bankr. L.J. 625 (1991); Michael Bradley & Michael Rosenzweig, The Untenable Case for Chapter 11, 101 Yale L.J. 1043 (1992). All of these studies focus on large public companies in which management is typically disassociated from ownership. In such cases, it may appear that management is mainly interested in feathering its own nest, and, therefore, any benefits to residuary owners occur, if at all, only fortuitously. But cf. Douglas G. Baird, A World Without Bankruptcy, 50 Law & Contemp. Probs., 173 (1987) (analyzing how society would deal with bankruptcy problems and issues in the absence of bankruptcy law). Whatever the merits of these studies, they have little to do with the typical one-asset case.
general kind of method in all the Chapter 11 madness. 47 None of these analyses seems to have considered the proposition that by leaving things in a muddle, the statute may be doing exactly what Congress intended to do.

The point of departure is that the motivations of shareholders of a debt-laden corporation are different from the motivations of creditors. 48 This is not a principle of law, but rather a simple matter of arithmetic. The legal question is how to reconcile these competing interests when the debtor is wavering between profit and loss.

A superficial review of the facts will cause many readers tofavor the creditors because any other result will permit the debtor to “gamble with other peoples’ money.” 49 This is true in that under Plan I the equity owners have everything to gain and nothing to lose. But this is too simple. Where there is a choice between sure compensation for creditors and nothing for equity on the one hand, versus a credit risk and an equity opportunity on the other, the creditors will value at naught all of the debtor’s opportunities and pass up risks that ought, in some global sense, to be taken. 50

Hasty observers might respond that, because the problem is unanswer-

47. See Korobkin, supra note 3, at 780-82.

48. Early formulations of this principle include Joseph E. Stiglitz, Some Aspects of
the Pure Theory of Corporate Finance: Bankruptcies and Takeovers, 3 BELL J. ECON.
& MGMT. SCI. 458 (1972); Michael C. Jensen & William H. Meckling, Theory of the
Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. FIN. ECON.
305, 340 (1976); Jeremy I. Bulow & John B. Shoven, The Bankruptcy Decision, 9 BELL
J. ECON. 437 (1978). In this Article, I treat the interests of managers and residuary
owners as if they are alike. Thus I sidestep the analysis developed in Susan Rose-
Ackerman, Risk Taking and Ruin: Bankruptcy and Investment Choice, 20 J. LEGAL

49. For a common-sense exposition of the point, see in Lynn M. LoPucki, The
Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code? (pts.
1 & 2), 57 AM. BANKR. L.J. 99, 247 (1983). LoPucki’s study is virtually the only
comprehensive review of small Chapter 11s, marred only by his settled antipathy to
the process as he finds it. Cf. Lynn M. LoPucki, A General Theory of the Dynamics of the
State Remedies/Bankruptcy System, 1982 Wis. L. REV. 311. The ultimate example is In
re Tri-State Paving, 32 B.R. 2 (Bankr. W.D. Pa. 1982), where the principals took the
cash out of the debtor’s bank account and went gambling in Las Vegas. The trustee
prevailed in an action against the principals. However, Elizabeth Warren and Jay
Westbrook, in their bankruptcy text, suggest that the principals should have argued
that the “company’s prospects were so bleak that a run at the tables was the best investment
alternative remaining.” ELIZABETH WARREN & JAY L. WESTBROOK, THE LAW OF
DEBTORS AND CREDITORS 591 (2d ed. 1982).

50. See, e.g., White, Bankruptcy Decision, supra note 1, at 129 (noting the risk of
too-hasty filing). Concern over too-quick liquidation figures prominently in discussions
of British insolvency law. See, e.g., Creditors Worry About a Quick Sell, FIN. TIMES,
able in principle, this matter is best left to private contract, beyond the interference of the law. Although the proponent might be able to make her case on this point, as a matter of practice, the issue has long since been decided otherwise. For centuries debtor-creditor law has been considered one of those areas outside the scope of private contract, where the state sets the rules and the parties cannot vary the terms. The best the parties can do is to take those terms into account in their planning and plan around them. Although the normative question may remain open, the analytical question is not whether the Bankruptcy Code can restrict the parties on the facts of this hypothetical, but whether it has. In my view, this question currently stands unresolved and is not likely to get an early realization. The interests on each side are so appealing and the arguments (and authorities) so well entrenched that the best that one can expect is to recognize and apply them as appropriate.

B. Why the Creditor Should Win

From the creditor’s perspective, the whole purpose of bankruptcy is to liquidate the debtor’s estate and distribute it to creditors according to their interests. Yet, Chapter 11 is often considered a debtor-protection measure. And certainly, some provisions of the Bankruptcy Code must be justified, if at all, in terms of their benefit to debtors. But debtor

51. See U.C.C. § 9-501(3) (1992). The Bankruptcy Code also supplies unavoidable contract terms. For example, the debtor cannot contract away his power to get a discharge, no matter how much he wants to. Even accepting state regulation of secured transactions, still Professor Baird would apparently argue that this is an area where bankruptcy should not vary state-law rules because doing so would lead to unwholesome forum shopping. See Baird, supra note 44. Not to dwell on the point at length, but Baird apparently fails to grasp how many counter-inducements there are to discourage an enterprise from filing.

52. I accept that there are “costs” incident to this kind of contract regulation and that someone will bear these costs—perhaps the debtor whom we are trying to protect. But the incidence of the costs is an empirical question that cannot be answered in the abstract. Those costs they may go “forward” to the debtor in the form of higher prices, etc., or “backward” to the producer in the form of lower profits. It all depends on the shape of the relevant supply and demand curves.


54. Most obvious is the bankruptcy discharge in Chapter 7, where the debtor is typically an individual dependant on wages who seeks to free up her earning capacity and wipe out prior debts. 11 U.S.C. § 727. Even here, of course, the argument may be cast in social terms. For example, one may argue that the discharge has some residual benefit to society in that society gains from the debtor’s renewed motivation. On the other hand, one may argue that the protection is illusory insofar as debtors as a class bear the burden of the individual discharge in the form of higher finance charges. This is no place to
protection is at best a latecomer to the bankruptcy agenda. As a matter of history, liquidation and distribution long precede debtor protection and remain the core of any "asset case" under Chapter 7. Furthermore, Chapter 11 certainly can, and often does, serve this function as well. Chapter 11 may have the additional function of preserving going-concern values. 55

This function raises an important point of confusion. Some commentators (and probably many practitioners and judges) believe that there is an equivalence between preserving going-concern values and preserving the old equity ownership interest. This is clearly wrong because the business may continue even after the old equity is cut off. 56 In fact, nothing in Chapter 11 indicates that its ultimate purpose is any different from that of Chapter 7. 57

Next, there is the matter of the so-called debtor-in-possessio n ("DIP"). In the typical Chapter 11 case, the debtor remains in possession of the estate assets and has the powers and obligations of a trustee. The presumption for a DIP is commonly thought of as a debtor-protective device, and its presence argues against, rather than in favor of, creditor control. However, this interpretation misconceives the role and responsibility of the DIP. From the standpoint of legislative purpose, one can identify a rather different purpose for the DIP: creditor economy. For example, suppose the case of the truly "honest but unfortunate debtor." 58 He may have fallen on hard times, and he may never see daylight in the business again, but he still may be the person best suited to manage the business efficiently. 59 Thus, it may

pursue all the infinite byways that can be sighted down this road.

55. This is certainly implicit in the notion that the debtor's business may continue to operate unless the court orders otherwise. 11 U.S.C. § 1108. But the debtor's business may continue to operate in Chapter 7, as well. See id. § 721. See generally John D. Ayer, Dialectic in the Corner Pocket, NORTON BANKR. L. ADVISER, Feb. 1991, at 11-12.

56. Some readers will concede this may be true for a public company, but argue that it is not so clear for a private company, where equity and management are one. Even conceding that there are important functional differences between public and private companies, still the point in the text stands. If the old equity owner has management skills that are essential to the continuation of the business, she will certainly have the opportunity to be retained as an employee. Absent a better offer, she will likely accept employment by the debtor, however inferior it may be to the opportunity to participate as equity.

57. See 11 U.S.C. §§ 1106, 1107. Indeed, Chapter 11 specifically provides for conversion or dismissal for "unreasonable delay by the debtor that is prejudicial to creditors." Id. § 1112(b)(2).

58. This phrase is from Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).

59. This seems to be the burden of 11 U.S.C. § 1104, especially § 1104(a)(1) (providing that a trustee may be appointed "for cause including fraud, dishonesty, incompetence, or gross mismanagement"). In the absence of fraud, etc., the appointment
be better for everyone, not least the creditors, that the debtor remain in control throughout the liquidation or transition.

Under this analysis, the DIP is nothing more than a species of trustee. There is plenty of authority for the proposition that management of an insolvent entity owes to creditors a fiduciary obligation in bankruptcy, and even out of bankruptcy. In addition, there is some authority that the principle holds even when the entity is not, strictly speaking, insolvent. Familiar commentary also supports this view.

of a trustee would not be appropriate. But even this section is amenable to multiple readings. Thus, the negative inference from § 1104(a)(1) might be that it is better for creditors to leave the debtor in possession in the absence of fraud, etc; or the inference might be that the debtor is being offered the opportunity to remain in possession as an inducement to encourage her to avoid fraud, etc.


63. Davis v. Woolf, 147 F.2d 629, 633 (4th Cir. 1945):

“The law by the great weight of authority seems to be settled that when a corporation becomes insolvent, or in a failing condition, the officers and directors no longer represent the stockholders, but by the fact of insolvency, become trustees for the creditors, and that they cannot by transfer of its property or payment of cash, prefer themselves or other creditors . . . .” (emphasis added) (quoting Arnold v. Knap, 84 S.E. 895, 899 (W. Va. 1915)).

64. See, e.g., Michael Cook & Carolyn Schwartz, At a Troubled Company, Officers
These arguments have a ring of familiarity about them; however, perhaps none of these arguments is conclusive, as shall be seen in reviewing the case against creditor control.

C. Why the Debtor Should Win

As plausible as these arguments for favoring creditors may be, there are a number of other arguments that seem to meet and virtually offset them. And these counter-arguments are not merely matters of judicial gloss; they are built into the structure of the statute itself. Thus, “Chapter 11 is not the flip of the coin, in football; it is the serve, in tennis.” Or, less poetically, there are provisions in the statute itself that count as a “tilt to the debtor.”

Perhaps the most obvious “tilt to the debtor” in Chapter 11 is the so-called “exclusivity period,” which provides in the typical case that the prebankruptcy managers get the first shot at formulating a plan. The importance of the exclusivity period is apparent upon analysis of the motivations and the possibilities of the parties in a simple case. If the creditor had its way, the creditor would simply propose a plan calling for some sort of transfer of the old entity to new ownership. If there were insufficient funds to satisfy all claims, as would almost always be the case, then the old residuary owners would be wiped out. A transfer might be by some sort of auction sale, by more extensive marketing, or by credit bid at a foreclosure, depending on what served the creditor’s interest; or, the transfer might be a piecemeal liquidation. In principle, it might just as well be a sale in place as a going concern. The point is that none of this helps the old equity owners, and no such plan will be proposed as long as the old equity is in charge.

65. I heard this metaphor several years ago from George Treister in one of his bankruptcy update programs.
66. Unless the court orders otherwise, the debtor has 120 days in which to formulate a plan. 11 U.S.C. § 1121(b) (1988). For a useful review of early exclusivity cases, see Nimmer & Feinberg, supra note 43.
67. See, e.g., Teachers Ins. & Annuity Ass’n of Am. v. Lake in the Woods (In re Lake in the Woods), 10 B.R. 338 (E.D. Mich. 1981) (holding that a request for extension should not be used as leverage in any dispute with creditors). Such a holding is not inconsistent with the idea that the basic exclusivity period is itself leverage in the dispute with creditors.
68. See Bruce A. Markell, The Case Against Breakup Fees in Bankruptcy, 66 AM. BANKR. L.J. 349 (1992) (arguing that the superior title awarded a buyer in a bankruptcy purchase is one of the signal advantages of taking the debtor through the bankruptcy court). Professor Jackson treats the sale to creditors as the essence of a Chapter 11 case; however, this position is qualified his later work, where he questions whether Chapter 11 has any distinctive purpose at all. See Jackson, supra note 2.
Then there is the matter of the DIP. In the previous section, I sketched the proposition that the DIP was only a species of trustee. But this is at best a half-truth. Conceding that retention of the DIP may sometimes serve the interests of creditors, still it is unlikely in the extreme that Congress intended this to be the only reason for favoring the DIP. Indeed, there is another quite different, and perhaps more visible, justification for the retention of the DIP. The most obvious, and for present purposes the most important, is that the DIP scheme gives the old equity practical control and a chance to structure the case for its own advantage.69

Another statutory basis for positing a “tilt to equity” is the provision in the Code for an equity committee. Although equity committees are rare, and there is no fully articulated rationale for their place in the Code,70 the only conceivable purpose for equity committees seems to be to enhance the chances of residuary owner participation in the reorganization.

There is a final statutory point, perhaps not so momentous, but still worth attention. This is the matter of the exercise of the avoiding powers. A number of courts have found an operational difference between the trustee and the DIP, holding that the statute of limitations binding trustees in such cases does not run during the incumbency of a DIP.71

Moreover, there may be less than meets the eye in the notion that a DIP

69. This can be inferred at least from the rule on the exclusivity period: The period may be terminated at any time on a proper showing; but it terminates in any event when the court appoints a trustee. 11 U.S.C. § 1122 (1988). There is a third, perhaps subsidiary, reason for the DIP that serves both debtors and creditors. If the manager of a troubled business knows that she will not be ousted from possession merely by filing a petition under Chapter 11, she will be more willing to do so when it is needed than she would be otherwise. Martin Bienenstock pointed this out to me in conversation.


has the obligations of a fiduciary. Concededly, the statement appears in many cases; but at best, "fiduciary" is one of those terms that subsist at a high level of abstraction where they can float free and unimpeded of any binding content.\textsuperscript{72} And on close scrutiny, the cases cited by the creditors on that issue seem to stand for less than the creditors want. Almost universally, those cases involve situations of direct self-dealing between the debtor and residuary owners or between the debtor and his close allies—cases, in other words, of fraudulent transfer that have little or nothing to do with management's power to put estate assets at risk.

The following hypothetical suggests just how slippery the fiduciary issue may be:

Alice, an attorney, was counsel to David, the debtor-in-possession, in a Chapter 11 case where a principal asset was David's farm. The farm was subject to a security interest held by Newbank securing a loan of $1 million. David's parents offered to buy the farm for $700,000. Following Alice's instructions, David retained a real estate agent to see if the property would yield a better price. After diligent efforts (national advertising, etc.), the agent reported that he could find no one willing to pay more than $700,000 for the property. Alice thereupon petitioned the court for permission to sell the property out of the ordinary course of business (see 11 U.S.C. § 363 (1988)) to David's parents for $700,000. She gave notice of all these facts to all creditors, including Newbank. No one requested a hearing, and the property was sold to David's parents, who paid $700,000 cash to David as DIP. The proceeds were distributed to Newbank.

Three months later, David secured an order discharging his liability on all claims, including Newbank's $300,000 deficiency claim. The estate was then closed. Six months later, David's parents sold the property to David's next-door neighbor, Newt, for $1.2 million. The parents kept $700,000 for themselves and paid over the $500,000 balance to David.

On further inquiry, Newbank learned that Newt had first offered to buy the property for $1.2 million just three weeks before the bankruptcy case began. The deal had fallen through, apparently because David could not deliver clean title. Newt had thereupon invested his money elsewhere and lost interest in David's property. But later, his other investments having prospered, he approached David's parents about reopening negotiations, and this deal was the result.

\textsuperscript{72} Deborah A. DeMott, Beyond Metaphor: An Analysis of Fiduciary Obligation, 1988 DUKE L.J. 879, 879. For the classic formulation of the role of the director, see Harold Marsh, Jr., Are Directors Trustees? Conflict of Interest and Corporate Morality, 22 BUS. LAW. 35 (1966); see also John M. Olson, The Fiduciary Duties of Insurgent Boards, 47 BUS. LAW. 1011 (1992).
This is a slightly stylized version of *In re Schipper*, which I have been presenting over the past couple of years in panel discussions on professional responsibility for lawyers. Although I have not kept precise score, my strong impression is that my auditors generally tend to be unsympathetic to the position of the debtor in this case and conclude that the proceeds of the second sale should somehow flow to the estate. But in fact, three courts—the bankruptcy court, the district court on appeal, and a three-judge panel of the circuit court—all denied the relief.

The *Schipper* case, particularly the Seventh Circuit opinion, is remarkable not so much for its result as for its reasoning. The courts might have held for the defendants by concluding that the aggrieved creditor suffered no actual harm (though this conclusion is questionable). But the circuit court went further and sought to define a general principle governing the fiduciary duty of a DIP in a Chapter 11 case. The court recognized that two fiduciary duties were possibly relevant here: (1) the "general fiduciary duty" to creditors or the "corporate fiduciary" duty standard; and (2) the "high standard of duty applied in the common law to trustees." The court assumed, *arguendo*, that Schipper’s nondisclosure would have been culpable had he labored under the "higher standard" applied to a common-law fiduciary. However, the court found that there was no such duty, and hence, no liability. Indeed, the circuit court pointed more strongly, stating that "the Bank fails to cite to a single case in which a court has applied the trustee standard to a debtor in possession. That is because there are none."

As an understanding of the role of the DIP, the court of appeals decision in *Schipper* is atrocious. If the court found the caselaw somehow deficient on the topic, it may be because it is the statute, not the case law, that imposes on the DIP the duties of a trustee. And, as discussed earlier, the statutory rule itself is innocuous; it is merely a special case of a more general rule that managers of any entity owe a fiduciary obligation to residiary owners, no matter who the residiary owners might be.

This general managerial duty includes, in virtually any case, the duty of loyalty, including the duty to avoid self-dealing except in highly restricted circumstances based on exhaustive disclosure. Similar principles hold

74. *Schipper*, 109 B.R. at 837-38; 112 B.R. at 920; 933 F.2d at 515-16.
75. *Schipper*, 933 F.2d at 515.
76. *Id.* at 516.
77. *Id.*
79. See generally David S. Ruder, *Duty of Loyalty—A Law Professor’s Status Report*, 40 BUS. LAW. 1383 (1985) ("[T]he principles are easy to state in general terms but may be difficult to apply."); Marsh, *supra* note 72.
under the law of trusts, where there is authority that self-dealing is impermissible altogether. Other formulations are more tolerant, permitting self-dealing, for example, where there is adequate disclosure together with a show of substantive fairness.

Of course it is possible that the court of appeals in Schipper, on sober consideration of the facts in context, concluded that the self-dealing in this case was proper. But having so badly mishandled the conceptual framework, it is vain to speculate on just how it might have gone about the job.

On this score at least, Judge DeGunther's opinion for the bankruptcy court represents a vast improvement. Judge DeGunther held, at least implicitly, that if there had been a covert side deal between the debtor, the parents, and the neighbor, then some sort of action would be in order. However, finding on inquiry that there was no such option, Judge DeGunther treats his work as done.

This approach is not discreditable, but it seems to confuse two kinds of inquiry. One is the possibility of an under-the-table deal, which Judge DeGunther considered and ruled on. The other issue, which was not discussed, is the question of what, if anything, the creditor might have done had it known of the prior offer. It seems entirely likely that the creditor would have acted differently. For example, the creditor might have gone to the "once and future buyer" and sought to reopen negotiations on the spot, while the property was still property of the estate. Short of this, the creditor might at least have taken a long, critical look at his own appraisal, to determine why it did not reflect the possible third-party bid. None of these measures is possible, however, as long as the creditor languishes in ignorance.

Finally, even accepting that the debtor had no definite knowledge that the neighbor would reappear, it seems virtually certain that the debtor and the parents must have entertained the possibility, thereby giving them a motivation to get the property out of the estate and park it with the parents on a hope and a prayer, independent of any enforceable obligation. Although this "hope and a prayer" cannot really count as a balance-sheet asset, it seems precisely the sort of thing that a concerned creditor might want to know.

Taken in this light, Schipper clearly represents a godsend to counsel for DIPs. We are bound to hear more of it in the future as DIPs and their


82. See Schipper, 109 B.R. at 834.
counsel try to protect themselves and their assets against claims of creditors.

Out of the infinite possible occasions for discussion on one-asset cases, only a few can be treated in this Article. Perhaps the most interesting is In re Lionel Corp. 83 Lionel's most important asset was an eighty-two percent interest in Dale, a solvent corporation not part of Lionel's Chapter 11 case. Lionel, as DIP, proposed to sell the stock under 11 U.S.C. § 363 for $50 million. The creditors' committee recommended the sale, but the shareholders objected. The shareholders argued that sale under section 363 sidestepped the process of plan, disclosure, and confirmation and deprived the estate of an asset that might be "the cornerstone for a sound plan." 84 The bankruptcy court and the district court had allowed the sale. The court of appeals reversed and remanded, holding that the bankruptcy judge must "articulate sound business justifications for his decisions"; 85 otherwise the objecting shareholders should prevail. In a dissenting opinion, Judge Ralph K. Winter said that the equity holders' arguments were "the legal equivalent of the 'Hail Mary pass' in football." 86

Several comments about Lionel are in order. 87 Most important for our purposes, Lionel may not stand for anything at all about a "tilt toward the debtor." It may be simply an opinion about the plan process and the attempt to bypass the plan process via section 363. Such an opinion would hardly be outlandish. There is indeed a good deal of question about how far one can use section 363 to violate the plan process. 88 If that is all Lionel stands

83. Committee of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063 (2d Cir. 1983).
84. Id. at 1066.
85. Id.
86. Id. at 1072 (Winter, J., dissenting).
87. Although only marginally relevant to the main line of the argument set forth here, I cannot let the opportunity pass without noting that Lionel gives powerful evidence of what seems to be an increasing problem in bankruptcy—the amateurish quality of the opinion-writing (perhaps as distinct from the results) of appellate (as distinct from trial) courts in the bankruptcy arena. Whatever its substantive virtue, Lionel seems to have been drafted not by a judge, nor even by a law clerk, but rather by a third-year law student taking a semester away from law school in lieu of taking a bankruptcy course. More precisely, it seems to be an opinion by a person who fears that he will never get another chance to write an opinion and thereby has to throw everything he knows into this one (much like the feeling you get about movie-making from Jean-Jacques Beineix's direction of Diva).
for, then it is not terribly contentious.

A final point about Lionel: the "'Hail Mary' pass" connected: The estate later sold the property for $76 million—more than half again as much as the original bid. 89

A somewhat more equivocal approach to the problem of equity control comes from the celebrated (or infamous) Johns-Manville case. 90 Both equity and debt may find solace in the somewhat oracular pronouncement of the Second Circuit here. Management was negotiating with creditors for a plan, and the shareholders decided that management was giving away too much. Accordingly, the shareholders undertook to oust management, with the hope of getting a more aggressive successor. The bankruptcy court enjoined the shareholders' action by summary judgment. On appeal, the Second Circuit reversed and remanded, for "a more elaborate inquiry into clear abuse and irreparable harm. Rather than focusing on the [shareholders'] conceded desire to enhance its bargaining position, the court should analyze the real risks to rehabilitation." 91

In other words, the shareholders hold a place at the table, even in a case where equity was, by all appearances, under water. 92 The Manville court imposed one seemingly important limitation on the shareholders' arsenal of possible motivations. Specifically, the court said that the shareholders could pressure management as "a bargaining chip in the aid of negotiation," but they could not act "to 'torpedo' the reorganization." 93 The court stated: "Unless the Equity Committee were to bargain in bad faith—e.g., to demonstrate a willingness to risk rehabilitation altogether in order to win a large share for equity—its desire to negotiate for a larger share is protected." 94 The difficulty here, of course, is that it is unclear just what other weapon the equity might have. If they cannot be obstructionist, no one needs to pay any attention to them.

In summary, it seems clear that the drafters of the Code intended that there be some leeway for the old residuary owners to maneuver the case for their own benefit. Even more to the point, it seems clear that bankruptcy judges commonly, if not universally, understand Chapter 11 as a device for giving old equity a second chance. 95 As a matter of legislative intent, it is

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89. Charterhouse Completes Acquisition for Mezzanine, PR NEWSWIRE, Nov. 1, 1985 (available on LEXIS).
91. Id. at 69.
92. Some of the valuation difficulties in Manville are set forth in LoPucki & Whitford, Bargaining Over Equity's Share, supra note 46.
93. Manville, 801 F.2d at 64.
94. Id. at 65.
95. Nimmer and Feinberg identify three factors that "capture[ ] a large majority of
not clear that these bankruptcy judges are wrong. An observer with an
instinct for order might regard this situation as a kind of legislative
solecism, crying out for congressional action to clarify the sovereign’s
mandate. However, such an interpretation misses the point of this Article,
which is that Congress may have intended the structure of Chapter 11 to be
muddy, precisely to avoid solving a problem that it did not wish to solve.

I suggested earlier that I wanted to limit myself to more or less
conventional strategies of statutory construction, rather than ascend to the
more rarified heights of theory. But one case presents a point of what might
pass for theory in a context so novel and compelling that it demands brief
notice here. The case is In re Central Ice Cream Co.,96 decided by the
Seventh Circuit in 1987. Central’s only asset was a trial court judgment
against McDonald’s for $52 million, subject to appeal. General creditors’
claims were $11 million. McDonald’s offered to settle with Central for $15
million during the pendency of the appeal. Not surprisingly, the creditors
wanted to take the money and run. They could never do any better, and they
could easily do worse. But, as is equally unsurprising, the shareholders
wanted to reject the settlement. Their residuary share of the settlement
would be only $4 million; risking $4 million to get more than $40 million
looked like pretty good odds.

Although the issue of trustee responsibility did not present itself
squarely in the Seventh Circuit, Judge Frank Easterbrook nevertheless took
the occasion to expound his views on the issue. He stated:

[The trustee’s] duty is to maximize the value of the estate, not of a
particular group of claimants. . . . It is true, as the bankruptcy judge
wrote, that spurning the settlement would expose the creditors to risk,
but this parallels the risk creditors face outside of the bankruptcy
process as firms try to maximize the expected value of the enterprise.97

Easterbrook was arguing for what is elsewhere identified as “global
wealth maximization.”98 This argument sounds innocuous enough until you
think it through. It suggests that the trustee owes a primary duty neither to
debt nor to equity, but rather that he should manage the asset pool as if the

96. 836 F.2d 1068 (7th Cir. 1987).
97. Id. at 1072. For more background on the presettlement negotiations, see In re
98. See, e.g., articles cited supra note 62.
company were financed entirely with equity. This concept is perhaps a natural outgrowth of modern financial theory. Attractive though this may be as a general principle of management, most lawyers were brought up to believe something very different: the traditional wisdom that management owes something like a fiduciary duty to equity, while it deals with debt at arm’s length. Easterbrook’s proposition seems to suggest that the claims of each constituency are equal.

IV. NEW VALUE

In explicating the problem of the one-asset case, it would be useful to examine a number of sub-issues that have helped either to illuminate or complicate the debate. These issues include the classification of claims,

99. Two strains of modern financial theory in particular are implicated. One is the Modigliani-Miller thesis, which teaches that assets and liabilities are fundamentally independent of each other, and the asset side of the balance sheet cannot be changed by manipulating the liability side. See, e.g., Franco Modigliani & Merton H. Miller, The Cost of Capital, Corporation Finance and the Theory of Investment, AM. ECON. REV. 261 (1958); Franco Modigliani & Merton H. Miller, Reply to Heins and Springle, 59 AM. ECON. REV. 592 (1969). At least in this rendering, the thesis sounds innocuous enough that it is probably hard for a younger reader to imagine why anyone would think it controversial.


100. “Typically, state law provides that a company’s board of directors owes a fiduciary duty to the shareholders of the corporation and/or the corporation.” Davis et al., supra note 43, at 2 (emphasis added). The Davis article seems to presuppose a primary duty to shareholders, but what can be the meaning of the phrase in italics?. The idea of the primacy of equity seems to underlie most of the important finance literature, as well. See, e.g., Stewart C. Myers, Determinants of Corporate Borrowing, 5 J. FIN. ECON. 147 (1977).

101. For an argument from a somewhat different standpoint for a fiduciary duty to bondholders, see Lawrence E. Mitchell, The Fairness Rights of Corporate Bondholders, 65 N.Y.U. L. REV. 1165 (1990). Mitchell’s article contains a helpful bibliography of earlier discussions, id. at 1169 n.11; see also Andrew E. Bogen et al., Landmarks on an Unmapped Terrain: Defining the Rights of Debtholders, PRENTICE HALL L. & BUS. INSIGHTS, Jan, 1991, at 19; Cook & Schwartz, supra note 64, at 22.

102. The point here is that in order to confirm a plan, the court must find that there is at least one consenting class. 11 U.S.C. § 1129(a)(10) (1988). In a one-asset case, the dominant creditor by definition opposes the plan. The trick is to manufacture a class that
the allocation of rents and profits, and the applicability of the section 1111(b) option. To keep this Article manageable, however, I will bypass these other topics and concentrate on what seems to be the essential sub-issue in the one-asset case: that Olympian among bankruptcy puzzles, the so-called “new value” problem. I have unburdened myself before on the topic of “new value,” and, although my basic position has not changed, there are several reasons for rehashing the matter here. First, the understanding of the topic has grown through a number of valuable scholarly contributions, together with some court decisions. But still, to my mind, nobody has gotten it quite right.

The problem is easily stated. Suppose a plan proponent wants the

will accept the plan, without being found culpable of impermissible gerrymandering. The argument would be that the gerrymandering cases are almost always driven by the court’s sympathy with, or hostility to, the underlying plan. Happily, David Gray Carlson is dealing with that issue at length elsewhere in this Symposium. See David G. Carlson, The Classification Veto in Single-Asset Cases Under Bankruptcy Code Section 1129(a)(10), 44 S.C. L. REV. 565 (1993).

103. See, e.g., Sarah H. Reynolds, A New Look at Secured Creditors’ Rights to Rents and Profits: Is the Pendulum Swinging Back?, 15 CEB REAL PROP. L. REP. 257 (1992). Once again, the argument would be that the characterization of rents and profits tends to get subsumed in the larger question of the propriety of a one-asset case.


107. See cases cited infra notes 113-115.

108. Typically the plan proponent is the debtor, or the residuary owners of the debtor, but not always. Creditors may also propose plans in some cases. On the other hand, debtor cramdowns will almost always need some sort of new-value component; creditor...
court to confirm a plan that proposes to pay less than 100% of the claims of some class. Confirmation is proper, of course, if the class consents. However, the proponent may win confirmation even without consent (i.e., "cram down"), but with a catch. The catch is that no junior claim or interest may receive or retain any property on account of such junior claim or interest—the "absolute priority rule." The typical junior class is the class of equity holders. Equity interests have repeatedly sought to evade (or cabin, depending on your analysis) the cram-down limitation by proposing to pick up the residuary ownership in exchange for "new value."

The so-called "new value rule" allegedly arose as a gloss on pre-1978 reorganization law. The rule (if there is one) is apparently not restricted to one-asset cases, although it frequently arises in them and may be pivotal to their success. In 1988 the Supreme Court was invited to hold that this "exception" had been "overruled" by the 1978 Bankruptcy Code, but the Court explicitly refused. Since then any number of cases have endorsed, rejected, or questioned the rule; however, as a mat-

cramdowns almost never do.


110. As will be set forth more fully below, the adversaries on this issue cannot even agree on whether "new value" counts as a "rule" or an "exception" to a rule. I call it a rule here for convenience only, trusting that I will not prejudge the result.

111. See Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106 (1939). Case is often treated as if it involved Chapter X of the old Bankruptcy Act; in fact, it involved its predecessor, § 77B. But by the time Case was decided, Chapter X was already in force, and everyone has always assumed that Case's validity was not affected by the statutory change. In an earlier article, I suggested that the new-value rule was an illusion under the old Code in that no case ever actually applied it. See Ayer, supra note 105, at 1016. In the same vein, Judge Frank Easterbrook says that new value was "100% dicta" under the Act. Kham & Nate's Shoes No. 2, Inc. v. First Bank, 909 F.2d 1351, 1360 (7th Cir. 1990). Randy Haines argues that the principle was, in fact supported by Ecker v. Western Pac. R.R., 318 U.S. 448, 485-87 (1943) (section 77), and Mason v. Paradise Irr. Dist. 326 U.S. 536, 541-43 (1946) (Chapter XI).


ter of final authority, the question today remains open.\footnote{116}

On close scrutiny of the cases, it appears that there is not one new-value rule, but two. One is the matter of whether the old equity owners may buy the property when there is no higher bidder. The other is the question whether equity can buy the property in the absence of bidding. A moment’s reflection will suggest that these are two different propositions and that they can be justified, if at all, on entirely different principles. With a couple of exceptions to be noted below, this distinction does not seem to have figured prominently in the literature up to now, but the cases look a lot different.\footnote{117}

To clarify the point, it is useful to examine \textit{In re Jartran, Inc.},\footnote{118} an

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115. \textit{In re Snyder}, 967 F.2d 1126, 1128-31 (7th Cir. 1992); Travelers Ins. Co. v. Bryson Properties, XVIII (\textit{In re Bryson Properties, XVIII}), 961 F.2d 496, 503-05 (4th Cir.), \textit{cert. denied}, 113 S. Ct. 191 (1992); Kham & Nate’s Shoes No. 2, Inc. v. First Bank, 908 F.2d 1351, 1361 (7th Cir. 1990); see also \textit{In re E. I. Parks No. 1 Ltd. Partnership}, 122 B.R. 549, 557-58 (Bankr. W.D. Ark. 1990) (concluding that plan was too vague and that issue would be determined in the context of a modified plan, if necessary).

116. The Supreme Court recently granted certiorari to a Ninth Circuit case that endorsed the new-value exception to the absolute priority rule. U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership, 114 S. Ct. 681 (1994), \textit{granting cert. to 2 F.3d 899} (9th Cir. 1993). Perhaps the Court will provide some definitive guidance on this troublesome issue.

117. Others have attempted to subdivide the new-value issue, but not in precisely the same way that is set forth here. Baird and Jackson, for example, distinguish between two-party and three-party cases. See Baird & Jackson, \textit{supra} note 106. David A. Skel argues that the absolute priority rule and the new-capital exception may be viewed as surrogates for two different interests: protection of creditors’ rights, and the need for successful reorganization. See Skel, \textit{supra} note 6. Reformulated, the point would be that the court’s tolerance of new value is a function of which of those interests it sees as paramount. In an important article, Professor Warren argues in favor of letting the old equity buy the property when there is no higher bidder. See Warren, \textit{supra} note 106. She introduces some stimulating perspectives drawn from issues that have arisen with regard to self-dealing among managers of solvent corporations. But there is no suggestion that these issues have figured in the debate over new value in bankruptcy. And Professor Warren virtually ignores the fact that many or most of the new-value cases do not involve open bidding. Other useful discussions include Markell, \textit{supra} note 106, at 96 (describing rule as a “catachresis”), Kenneth N. Klee, \textit{Cram Down II}, 64 AM. BANKR. L.J. 229 (1990); James H. Franklin et al., \textit{Survey: Absolute Priority and the Continued Vitality of the “New Value Exception”}, 1 J. BANKR. L. & PRAC. 591 (1992).

118. 44 B.R. 331 (Bankr. N.D. Ill. 1984).
early and important "new value" case under the Code. In *Jartran*, the
developer had apparently run into financial trouble. Frank B. Hall & Co., Inc.
(Hall) bought most of Jartran's equity on credit and filed for Chapter 11
relief the same day. Hall ran the company for over three years before Judge
Fisher confirmed the third modification of the debtor's fifth plan, under
which Hall proposed to retain all the equity in exchange for cash and some
commitments, although creditors would not be paid in full. Judge Fisher
made many findings in his 80-page opinion, but perhaps the most important
is that, although the debtor had engaged in a "thorough marketing ef-
fort, . . . [n]o viable offers materialized other than that of Hall."119

Having waded through 50 pages of text, the patient reader may be
excused for asking why anyone could possibly object to Hall's plan; the
choice seemed to be Hall's plan or no plan at all. Judge Fisher does not
specifically answer this question, but one can infer an answer from the face
of the opinion. The objecting creditor was U-Haul, a competitor rental
company who almost certainly stood to profit from Jartran's demise. Judge
Fisher seems to have said, in effect, that U-Haul would not be able to scotch
an otherwise viable plan merely to gain a competitive advantage. This rule
seems particularly plausible in a case like *Jartran*, where there are other
interests at stake.

A similar situation existed in *In re U.S. Truck Co.*,120 where the
adversary was an arm of the Teamsters Union. The court seems to have
taken for granted that no one else wanted the company at any price,
although the court made no specific finding on this point. The old owners
undertook to contribute $100,000, which the court found to be sufficient for
its "new" interest. Once again, the real question is: why should the creditor
object if the old owners were the highest available bidders? And once again,
the answer seems to be that the objecting creditor had an interest aside from
its interest on the face of the contract. Although the court does not spell out
the point in full, it does declare that "rejection will benefit [the Union's]
members in the ongoing employment relationship."121 Apparently, the
Union hoped to use rejection as leverage to reinstate it collective bargaining
agreement with the debtor.122 This inference gets further support later in
the opinion when the court considered the possibility that, postconfirmation,
the debtor may divert business to a sister company and thus eliminate

119. Id. at 381.
120. Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. (*In re
U.S. Truck Co.*), 800 F.2d 581 (6th Cir. 1986).
121. Id. at 587.
122. This inference gains support from the more thorough account of the facts in the
jobs. Moreover, in discussing the feasibility of the plan, the court remarked, "If [the union workers] are truly concerned about feasibility, they are also able to help achieve it."124

In re Potter Material Service, Inc.125 is also in this vein, albeit not so clearly. Again, the critical fact seems to have been that there was no competing bidder, hence no one willing to pay more than the old equity owner. The difference between Potter, on the one hand, and Jartran and U.S. Truck, on the other, is that there is no suggestion as to why the creditors in Potter might be willing to risk torpedoing the case. On closer scrutiny, it appears that they had no such interest; rather, they seem merely to have been trying to squeeze out a higher valuation. If the creditors had won, they would have nonetheless settled with the old equity owners, thereby allowing equity’s continued participation for a higher stake.126

Another case that fits this category is In re Star City Rebuilders, Inc.,127 where the court said that the residual owner might retain the equity because it had "no value." On its face, this determination seems indefensible: if the equity has no value, why would the old owners go to court to claim it? Indeed, the Supreme Court has since expressed its disapproval of the "no value" analysis, Justice White expressing himself with something close to impatience.128 But on a second look, Justice White may have spoken to quickly; reformulated, the "no value" point may have more viability than may appear at first blush. Dotting a few I's and crossing a few T's, one could interpret Judge Pearson's opinion in Star City as saying that the equity had no value to anyone else. In other words, the old equity owners have a higher "reserve price" than any other bidder. This happens all the time in bargains. There is never any reason in principle to suppose that the buyer is paying his own maximum reserve price for the desired item; all he has to do is to outbid the second-best bid.129

123. U.S. Truck, 800 F.2d at 589.
124. Id. at 590.
126. Potter and U.S. Truck are perhaps the strongest and most-cited circuit court authority for the new-value exception. In Anderson v. Farm Credit Bank (In re Anderson), 913 F.2d 530 (8th Cir. 1990), the court affirmed an unreported district court decision that found a new-value exception; however, the court of appeals opinion contains no analysis or discussion. Since Potter, the Seventh Circuit in dicta has blown hot and cold on the continuing validity of the new-value exception. Compare Kham & Nate's Shoes No. 2, Inc. v. First Bank, 908 F.2d 1351 (7th Cir. 1990) with In re Snyder, 967 F.2d 1126 (7th Cir. 1992).
129. As the story goes: "I don't have to outrun the bear, I just have to outrun you."
Potter, Jartran, and U.S. Truck are also “no value” cases in this sense. If Justice White really meant what he said in Ahlers about “new value,” then these cases are no longer good law. But it is not clear that Justice White understood the full implications of rejecting the “no value” principle; hence, it is not at all clear that his airy dismissal would hold in another case.

In re Outlook/Century, Ltd. also supports, at least indirectly, the distinction set forth here, even though the court refused to recognize the new-value exception. The debtor was a limited partnership that owned an office building with a market value of $11.7 million. The debtor had secured debt of $18 million, and the only unsecured claim was for $450,000. On the secured creditor’s motion for relief from the automatic stay, the court framed the issue on the predicate that it must give relief if no plan can be confirmed as a matter of law. The court stated that a plan based on contribution of new capital would not justify the equity holders’ retaining an interest. In a footnote, the court distinguished the situation in which the old equity owners bid in at sale: “Such a situation does not implicate the new value exception at all, because debtor would not retain or receive property ‘on account of’ its equity interest, if it purchased at a sale that was open to other purchasers and at which the debtor had no advantage.” Thus, the court implicitly seems to have assumed that plans like those in Jartran, Potter, or U.S. Truck are permissible. However, the Outlook/Century court would regard these cases as irrelevant to, rather than an application of, the new-value exception.

In any event, there does not appear to be any case in which the court rejects a “new value” plan where old equity appears to be the highest and best bidder. A much different sort of problem arises when the debtor

This “reserve price” analysis has some nuances that are worth noting. Suppose the residuary owners would pay $100 while the “next best” reserve price is $90. In principle, the unpaid creditor (or creditor group) ought to be willing to push the bidding all the way up to $100, secure in the knowledge that the residuary owners will take it at that price. The real world of imperfect information is more sticky than that, of course. In a more typical case, the creditors will have to play a game of chicken with the debtor, bidding up the property as far as they dare while weighing the prospect that the residuary owners will outbid them against the possibility that the residuary owners will fold and leave the creditors stuck with it.

132. Going over similar ground, James J. White gives a shrewd account of facts and possible motivations in these cases, but he seems to be bent mainly on endorsing creditor hardball. It is not clear that he takes account of the stakes of competing creditors. See White, supra note 106.
is not necessarily the highest bidder—where, typically, the residual owners are trying to claim a stake in the reorganized company while resisting all efforts to submit it to any competitive valuation.

There is yet another class of "new value" cases where the motivations are entirely different, even though the stakes may be the same. These are the cases in which the old equity is trying to hold onto the assets without showing that she is, in fact, the highest and best bidder. There are basically two strategies here. One is to try to show that what the old owners are getting is not "on account" of their former stake. The other (less visible, but still apparent to the careful observer) is to suggest that the old owners ought to be permitted to stay in even if they are taking on account of their old claim. On this second kind of "new value" issue, there is a real split of authority, but cases on both sides of the issue may be instructive.

The core strategy in these cases is to try to "run with the hare and hunt with the hounds": to find some way to show that old creditors are getting all of the old value, and that the new value is just that—payment for something other than what creditors are entitled to. The difficulty is that the value of the enterprise must be the discounted present value of the prospective future income stream.133 In order to constitute an internally consistent notion of value, courts must find something that will belong to the postdischarge debtor that does not also belong to the present creditors. Judges have shown marvelous ingenuity in trying to square this circle, but their approaches have largely been unpersuasive.

One such effort, noteworthy only because it is better than most, is Judge Lief Clark's opinion in the much-noted Greystone case.134 The old equity owners proposed a $500,000 equity infusion "to be used both to fund payments to creditors and for future operations."135 The objecting secured creditor offered to pay off trade debt and to finish some project improvements, but refused to provide working capital unless it took over ownership. Judge Clark stated that the creditor therefore did "not represent a viable

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135. Id. at 561.
alternative source of working capital for the future of the entity.”\textsuperscript{136}

Moreover, Case itself (as quoted by Judge Clark) insists that the plan must preserve the “full right of priority against the corporate assets.”\textsuperscript{137} Accordingly, Judge Clark’s decision would seem to require a holding that there is some sort of property right that is available to the old equity, but not to the dissenting creditor.

Is this in fact what he holds? It is hard to tell; he dances around the issue, but never quite embraces it. However, he seems to draw a distinction between the discounted present value of the prospective future income stream and the contingent right to enjoy some kind of unexpected return. He notes that the old investors are willing to invest some $500,000 for the right to enjoy that option; and he notes that the project “would be $500,000 poorer without it.”\textsuperscript{138}

But this analysis seems mistaken in two respects. First, it is an error to distinguish the discounted present value of the prospective future cash flow from the supposed unexpected return. Properly understood, the present value impounds the market’s best guess as to the prospective income under all contingencies.\textsuperscript{139} Thus, the contingent right to enjoy the gain should already be implicit in the discounted present value. Second, it is wrong to imply that the creditor is refusing to provide working capital. On Judge Clark’s own recital, the creditor’s refusal extended only to the situation where the old equity owners remain in control. That leaves open the possibility that the creditor might be perfectly willing to provide working capital so long as it enjoyed the option of gain implicit in control.

Judge Clark adds a tantalizing footnote, suggesting (somewhat indirectly) that he understands the full bite of his new-value conception:

It is important to emphasize that, due to the nature of the Case capital infusion exception, it is inappropriate to approach the problem as though the ownership of the enterprise were up for sale. That is simply not the issue at all. Instead, the question is whether there is an available source of capital to fund the plan. By the time one gets to the Case extension, one is already \textit{beyond} whether the plan itself is otherwise proper. In other words, the issue of where to get the cash to make the plan work is not an opportunity to undermine the plan. Instead, if the plan \textit{fails}, then another party in the case with standing

\textsuperscript{136} Id. at 577.


\textsuperscript{138} Greystone, 102 B.R. at 580.

\textsuperscript{139} For a standard exposition of the essentials here, see Brealey & Myers, supra note 41, at 4-5 and passim.
may propose an alternative plan. At confirmation, the court is not at liberty to "conduct an auction" of the equity.\textsuperscript{140}

This sounds suspiciously like bootstrapping, in that he lets the alleged new-value contribution rest on a plan whose validity is, for the moment, presumed rather than decided. It also suggests that Judge Clark understood the need to try to justify his unwillingness to permit market valuation.

The same flavor emerges from the first true new-value case under the Code, \textit{In re Landau Boat Co.}\textsuperscript{141} In \textit{Landau Boat}, the old equity owners\textsuperscript{142} undertook to pay a ten-percent dividend to unsecureds, to contribute $35,000 as new working capital, and to make a loan commitment of unspecified value. A creditor asserted that the investment was insufficient because the debtor, based on capitalized earnings, was worth more than the equity holders were paying for it. The court rejected this objection and stated that the investors were "making a substantial investment which

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The process is governed by a complex standard of valuation which has come to be known as 'reorganization value.' It is subtly but substantially different from traditional going concern value. Although also established through the multiplication of an earnings figure by a capitalization rate, reorganization value emphasizes projected earnings of the debtor after it merges from the ashes following reorganization. Past earnings are taken into account, along with other factors, but only for the purpose of projecting future earnings. This is on the theory that the debtor's value, and hence those seeking a share in it, should not suffer from management's errors of the past. A fact finder is subject to reversal if he places too much emphasis on the debtor's track record without taking sufficient account of its future after the reorganization. One writer furnishes this definition: "Reorganization value is what some appraisers believe the current market value of the distressed company ought to be if the present were like the future they foresee." This is quite different from how a price is arrived at in the actual sale of a business, where a seller's prediction of future improvements seldom increase the price. . . .

Reorganization value is . . . an expansive concept of value . . . devised in order to facilitate a finding of solvency and hence permit participation by stockholders [in the reorganized company].

\textit{Id.} at 1010 (citations omitted).


142. Judge Pelofsky refers to certain unspecified "new investors." But elsewhere he says that "shareholders of the corporation presently holders of the debtor's stock" had offered to purchase the new issue. The plan also provided that creditors had the right to buy in if they wanted to, but there is no suggestion that any did.

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exceeds any value which can be realized from the business in the foreseeable future.”

In the context of the present discussion, the holding in *Landau* seems vulnerable on two points. First, Judge Pelofsky seems to have accepted the old equity’s value testimony without submitting it to the test of the market. And second, he seems to have missed the point on value, permitting some of the old equity’s new contribution to remain in the corporation, rather than being paid to new creditors.

An even balder approach occurs in *In re Tallahassee Associates*, L.P. The court stated that failing to recognize new value “would, in many instances, subvert the very process of reorganization which the rule was intended to promote.” But this is bootstrapping again: the purposes (if any) of the Code must be derived from the rules it sets forth, not vice-versa.

The difficulties in coming up with a defensible exception in the face of this kind of evidence may help to explain the rich and sophistical store of qualifications, conditions, etc., on which courts have based the new-value rule. The canonical formulation is that of Justice Douglas in *Case v. Los Angeles Lumber Products Co.*:

[In an earlier case] this Court stress[ed] the necessity, at times, of seeking new money “essential to the success of the undertaking” from the old stockholders. Where that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made.

This is passably straightforward, but in gloss the rule becomes much more florid; not just any new value will do. Rather, as one judge recently recited the standard formulation, the contribution must be: “(a) money or money’s worth of (b) substantial (c) new value, (d) reasonably equivalent to the extent of old equity’s proposed participation in the reorganized debtor, and (e) necessary to such reorganization.”

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145. *Id.* at 717. But the court refused confirmation, holding that the contribution was insufficient.
146. 308 U.S. 106 (1939).
147. *Id.* at 121.
Another court used the phrase "substantial and essential."\textsuperscript{149} In \textit{In re Yasparro}, Judge Thomas Baynes observed that the \textit{Potter} requirement of substantiality was not in \textit{Case}. As he correctly noted, the "substantiality" rule is inconsistent with the idea of "reasonably equivalent."\textsuperscript{150} Furthermore, as the court in \textit{In re Johnson} stated, the new-value exception is supported by a strong policy consideration: "to permit the infusion of new capital in a reorganized entity in order to assure that the entity is kept alive."\textsuperscript{151} But this rationale is erroneous because it confuses the new-value problem with the problem of continued operation of the entity. It seems to assume something like the compulsory continued participation that the court has rejected.

One other case that deserves notice is \textit{In re Bjolmes Realty Trust, Inc.},\textsuperscript{152} which represents perhaps the most interesting effort to have it both ways on the issue. \textit{Bjolmes} is in many respects a classic one-asset case. The debtor was a limited partnership, and the objecting creditor held the first mortgage. The debtor proposed to retain the property for a "new value" contribution without paying the senior debt in full. Judge Queenan, after an unusually thorough and informed discussion of the background of the rule, held that the he would not confirm a plan unless the old equity owners put the property up for auction, in effect allowing for a holding along the lines of \textit{Jartran, Potter}, or \textit{U.S. Truck}. However, at the last minute, he limited himself, holding that the auction would take place among existing creditors only.\textsuperscript{153} Judge Queenan made no effort to explain why, if an auction is needed at all, it should be so limited.\textsuperscript{154}


\textsuperscript{149} \textit{In re Creekside Landing, Ltd.}, 140 B.R. 713, 717 (Bankr. M.D. Tenn. 1992). \textit{Creekside} also says that the money must be unavailable from any other source. \textit{Id.} at 717 (citing \textit{In re Jartran, Inc.}, 44 B.R. 331, 379 (Bankr. N.D. Ill. 1984); Official Creditors’ Comm. v. Potter Material Serv., Inc. (\textit{In re Potter Material Serv., Inc.}), 781 F.2d 99, 102 (7th Cir. 1986)). But the \textit{Creekside} court then seems to go on and ignore its own holding. \textit{See also In re Yasparro}, 100 B.R. 91 (Bankr. M.D. Fla. 1989). In \textit{Yasparro} the court stated that “a ‘substantial’ contribution appears to be less than a ‘reasonably equivalent’ contribution.” \textit{Id.} at 97. But it might be more.

\textsuperscript{150} \textit{Yasparro}, 100 B.R. at 97.


\textsuperscript{153} \textit{Id.} at 1010.

\textsuperscript{154} At least one possible reason exists: in the case of a major publicly held company, it is likely that putative bidders with big dreams and no real possibility of performance will be able to destroy the plan process by distraction. But it seems unlikely that this sort of factor would work in this case; and in any event, there is no suggestion that this was what Judge Queenan had in mind.
Decisions rejecting the new-value exception are at least as numerous as those in support of it, but they are conceptually not as interesting. Judges who reject the rule tend to view it in large part as a matter of "plain meanings," construing any effort to inject a new-value rule as an effort to distort the face of the text.\(^{155}\) However, "plain meaning" is more slippery a concept than it seems. Of course, there is no single phrase in the Code that says, in so many words, "The old equity owners may retain an interest on a contribution of new value." But that is not the end of the inquiry. There was no language of this sort in old Chapter X or old section 77B either. If new value was good law under the predecessor statutes, then arguably it plainly remains so today.\(^{156}\) The new-value exception may be part of the Code, even absent language of this sort, if it is consistent with the plain meaning of the statute taken as a whole.\(^{157}\) Thus, for example, the Code provides that no junior class may retain an interest under a cram-down plan "on account of [its] claim or interest."\(^{158}\) On the other hand, if the retention is "on account of" something else, then the retention may be justified within the plain meaning of the Code. The question, thus, becomes: what sorts of retentions are "on account of [a prior] claim or interest"? This, too, may be a matter of plain meaning, although it is not always clear exactly how plain the meaning might be.

It is not surprising, then, that courts which reject the new-value exception support themselves with something other than bald declarations of

\(^{156}\) Cf. In re SLC Ltd. V., 137 B.R. 847, 852 (Bankr. D. Utah 1992) (holding that lack of any legislative history expressly eliminating the exception compels a finding that it survives) (relying on Dewsnup v. Timm, 112 S. Ct. 773 (1992)); Penn Mut. Life Ins. Co. v. Woodscape Ltd. Partnership (In re Woodscape Ltd. Partnership), 134 B.R. 165, 168 (Bankr. D. Md. 1991) (stating that the new-value principle is not an "exception," but "an acknowledgement by courts that it is possible for new equity to be invested in a reorganizing enterprise"). Judge Thomas Carlson offers an interesting, but unpersuasive, response on this point. He argues that the § 77B exception was "judicially created," and that Congressional failure to specify "new value" counts as a rejection of the rule. In re Outlook/Century Ltd. 127 B.R. 650, 651 (Bankr. N.D. Cal. 1991). But this assumes that Case and its kin were somehow inconsistent with the statute as it stood. There is no satisfactory basis for any such assumption.  
\(^{157}\) In this same vein, in an earlier article I criticized discussions of new value that seemed to turn on whether the principle had been overruled by the new Chapter 11. See Ayer, supra note 105, at 1016-19. I argued that the language on all critical points was identical before and after the adoption of the new Code. I also argued that no case actually applied "new value" under the old Code. Neither of these points seems to have influenced the debate.  
plain meaning. One popular interpretative device is to compare the structure of Chapter 11, taken as a whole, with the structure of old Chapter X. On this inquiry, judges typically attach meaning to the fact that Congress in new Chapter 11 did away with the old unanimity requirement, instead permitting confirmation with respect to a particular class on the appropriate majority vote.159

Representative, and perhaps the most notorious, of these opinions is Judge Edith Jones' opinion in Greystone.160 Judge Jones, speaking for a three-judge panel, reversed Judge Lief Clark's decision, which is discussed above. Judge Jones' opinion is interesting in that it does not purport to rest on unvarnished statutory plain meaning. Rather, she begins by saying it is "not obvious" that new value survives into the new Code, noting that the new reorganization provisions "differ markedly from the prior law."161 But she goes on to note that Chapter 11, unlike old Chapter X, allows less-than unanimous consent, and that "this increased flexibility arguably renders the Case exception unnecessary."162 She goes on to say that the rest of the argument is "mere wordplay," and that Greystone's attempt to retain ownership is predicated on its status as the old equity owner; therefore, it must be on account of its status.163 Judge Jones seems to take it as axiomatic that new value and absolute priority cannot coexist.

Other holdings support Judge Jones in her exegesis.164 Another court recalled that the drafters of the Code had considered and chosen not to specify the typical new-value scheme, thus compelling a conclusion that they meant not to adopt it.165

V. SUMMARY: AGAINST PYRRHONISM

The point of this exercise has been to suggest that in one arena, at least, there is no pattern or predictability to bankruptcy cases. If I am correct, how is that no one has made this argument before? Several reasons suggest themselves. One has to do with the nature of scholarship. Scholars and

159. See id. § 1126.
161. Id. at 1282.
163. Greystone, 995 F.2d at 1283.
teachers get paid for creating categories, not for denying the existence of categories. We remember Newton not for telling us that the earth and an apple were different, but that they were the same.\textsuperscript{166} So the great names of the law, such as Williston and Langdell, are those who propounded unifying theories that cut through the welter of doctrine.

Something similar holds among practicing lawyers. As lawyers, we spend our time identifying points of sameness from the ruck of disparity. If two superficially similar instances seem to differ, we are inclined to take it as a failure of intellect, or even of character, on our part; and it may be. Or, it may just as well be an error or a purposeful refraction on somebody else’s part.

I do not mean to deprecate the value of abstraction. Certainly if we did not abstract and simplify, we could never speak or think at all, because no two things are precisely alike; everything is unique. The reader can be assured that there is indeed a category called “bankruptcy” and that useful generalizations can be made about it. But unifying principles come in many forms. And while I deny that there is any “core idea” to govern the one-asset bankruptcy case, I do suggest that there is an intelligible reason for the lack of a core idea; and this intelligible reason may perfectly well constitute a “core idea” all its own. The difficulty, if there is one, is only that we have moved to a separate logical plane.

In an earlier draft, the title of this Article was “Bankruptcy as an Evasion.” But I do not wish to be misunderstood. As a concept, evasion needs a press agent. To impute evasion to bankruptcy might be understood as accusing bankruptcy of having failed to meet some obligation that it should serve. This is not at all what I mean. Rather, let me make clear that I have no particular hostility to evasions: I think they can serve a useful purpose in the law, and in society. If each of us knew what the rest of us were thinking—really thinking—at any given moment, we would probably be at war all the time.

There are good reasons for shoving problems under the table and for making the rally ‘round symbols of unity.\textsuperscript{167} You pay a price for this sort of thing, of course, but I am not so sure the price is always as high as we

\textsuperscript{166} In another of Newton’s fields, optics, he asserted the same sort of sameness under the seeming diversity of color. It was left to Goethe, in revulsion against Newton’s attempt to impoverish the world of sense, to propose a theory of color that emphasized difference rather than sameness. We remember Goethe as an artist, not a scientist, and his theory of color scarcely at all. For a fascinating account of Goethe and Newton, see \textit{Theodore Roszak, Where the Wasteland Ends} (1972).

\textsuperscript{167} See \textsc{Peter Marris, Loss and Change} (1974) on how Charles II preserved the security of the Jewish community in England in the years before the Civil War by making sure the issue never surfaced. (Or, if you can’t find that, how Queen Elizabeth I maintained an unsteady religious peace by making sure never to face the issue).
suppose it is. For example, it is probably true that the world is a somewhat less predictable place than it would be if the rules were neater. But from the standpoint of litigation, I suspect that good lawyers probably exercise a palpable (and marketable) skill in narrowing the bounds of uncertainty, whatever the stated general rules. And from the standpoint of transaction planning—I doubt very much that the limited partners who face huge partnership rollups gave much thought, one way or another, to the question whether they would be able to hang onto their assets through the bankruptcy process—the likelihood is that they did not think about the downside much at all. And if they did, they probably figured that if the problem arose, they would fight like the devil with means to be selected as the opportunity presented itself when the time came.

Finally, there is good reason to believe that “clear” rules are never as clear as they seem. The more precise and specific, the more energy the parties expend in developing means of coping with the resulting inconvenience.\footnote{168. Take the topic of “offer and acceptance,” which virtually every law student studies in her first-year contracts course. Every well-taught law student should learn two kinds of things: (1) a set of rules and sub-rules governing offer and acceptance; and (2) a system of devices and strategies for avoiding the force of offer and acceptance rules when they prove inconvenient. This two-tiered lesson is summarized in the familiar principle that a “good” answer to a first-year law exam ought “to go either way,” \textit{i.e.}, to be argued at least as well from one side as from the other, and perhaps best of all, from both.}

“What is truth? said jesting Pilate, and would not stay for an answer.”\footnote{169. \textsc{Sir Francis Bacon}, \textit{Essays}, "Of Truth."} Bacon’s jibe is understood to reflect badly on Pilate, but perhaps he knew more than we give him credit for. Holmes said that it is the genius of the common law to decide the case first and think of the reason afterwards. Justice is not only blind; at times she seems developmentally disabled as well. In a perfect world, you might want more. But in a perfect world, you would not need justice at all.