1. Bankruptcy's logic and limits in the 21st century: some thoughts on Chapter 11's evolution and future

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I. INTRODUCTION

Now past the second decade of the 21st century, it is a sobering reminder that the Bankruptcy Code of 1978—the just-enacted statute when I first taught bankruptcy law in 1978–79—is beyond its 40th year. In recent U.S. history, that has been the life-cycle of significant bankruptcy enactments: The 1898 Bankruptcy Act; the 1938 Chandler Act; and, of course, the Bankruptcy Code of 1978. In many ways, one might have thought that the Bankruptcy Code of 1978 would be even *more* overdue for an overhaul, since bankruptcy has become, since 1978, a major topic for academic scholarship in a way that was not true (at least for an extended period) before, as well as a major growth area not just for “boutique” bankruptcy firms, but the country's major law firms as well.¹ More irons in the fire; more opportunities—or pressures—for reform.

Yet, while the Bankruptcy Code of 1978 has had several significant amendments, mostly in the area of consumer debtors²—and, on the business side, in qualified financial contracts³—there seems to be little urgency to engage in the kind of wholesale re-imagining of bankruptcy law that resulted in the major legislations of 1898, 1938, and 1978. I attribute that to three things (and from here on, I'm going to be focusing particularly on firms, not consumers, and their use of bankruptcy⁴). First, the growing experience and precedent by the time of the enactment of the 1978 Bankruptcy Code: It was, in many respects, a “mature” legal area. Second, the generally bipartisan nature of the enactment of the Bankruptcy Code of 1978⁵ that is unlikely to be replicated any time soon and that dampens responsible calls for reform. Third, and perhaps most important, the remarkable *de facto* change in bankruptcy practice that has occurred since 1978 *within* the structure of the Bankruptcy Code of 1978, and particularly reorganization practice, that has been blessed by the courts. Unlike the 1898 Act (our first “permanent” bankruptcy law), the 1938 Chandler Act (the formalization of corporate reorganizations, together with its bifurcation and insertion of the Securities and Exchange

Commission into Chapter X for larger companies), and the 1978 Code (essentially, reversing both that bifurcation *and* the role of the SEC),⁶ there is no looming *structural* reason to replace the Bankruptcy Code of 1978. That Code has shown an ability to adapt, within its existing statutory structure, to a number of major academic and practitioner developments since 1978, particularly in the use of going-concern sales and the reliance on market valuations in the context of Chapter 11.

As one who engaged—intensively—in scholarship following the Bankruptcy Code of 1978 for what now seems a remarkably brief period,⁷ then largely was absent from the discussion and debate for essentially 20 years, I would like to accomplish several things in this piece. First, is to reflect on the original premises that framed my work. Second, to discuss three academic developments that took issue with, as well as (sometimes) built on those premises, and their relevance to issues we face today. Third, to note the rather remarkable change in reorganization practice that suggests that while those premises never won the legislative war, a number of them essentially overtook reorganization practice.⁸ Fourth, to note the continued relevance of those premises to current issues—specifically, focusing on the treatment of qualified financial contracts in bankruptcy and on the role that bankruptcy law might play in the resolution of systemically important financial institutions. And, with the latter, I suggest that the ability of Chapter 11, originally designed as a negotiation framework that studiously avoided the market, to largely absorb market-based ideas through going-concern sales, may also have the ability today to absorb—or converge with—the contractarian proponents who powerfully argue that, for many firms, one can recapitalize a firm facing financial difficulties without needing bankruptcy. My conclusion then attempts to generalize from this analysis and imagine the statutory reforms that might currently be necessary or desirable. Perhaps because we do not need a major *structural* change, wholesale revision of our bankruptcy system is probably unnecessary in or around 2018—which may be a good thing given the unlikelihood of the replication of the generally bipartisan nature of the work that led to the 1978 Bankruptcy Code⁹—there may be a need to both codify, and place intelligent constraints around, generally welcome judicial developments since 1978 as well as realistically enact provisions making bankruptcy more suitable for financial institutions and what has been called the “new finance.” One need not reinvent the wheel to recognize that bankruptcy will always be a “work in progress” (a good thing for bankruptcy scholars!). At the same time, we can applaud the flexibility that has been shown to have been built into the 1978 Bankruptcy Code, together with the impact, over time, of bankruptcy scholarship on bankruptcy practice under that Code, including judicial decisions.

II. THE PREMISES BEHIND “THE LOGIC AND LIMITS OF BANKRUPTCY LAW” INsofar AS IT CONCERNED FIRMS

Since my focus is on the role of bankruptcy for firms, I set aside the important, but in my view, wholly independent, “fresh start” policy for individuals.¹⁰ Using “fresh start” to describe bankruptcy policy for both individuals and firms is unfortunate in the confusion it engenders—because they mean fundamentally different things. For individuals, the core of the fresh-start policy concerns the debtor keeping assets from exiting creditors.¹¹ For firms, a fresh-start policy means something entirely different: It means ensuring that financial failure does not lead to inappropriate liquidation.¹² But the “debtor” (often a corporate charter) does not get to free-up assets from its preexisting claimants and interest holders.

My focus here is on firms—paradigmatically, corporations—in financial distress,¹³ and not just *all* corporations, but those with more than a single claim or interest holder.¹⁴ In that context, my work started with the question of why bankruptcy law was needed at all, given that we already had a defined and robust mechanism for debt collection outside of bankruptcy, and answered that question by seeing multiple creditors going after a debtor’s assets during a time of insolvency (or potential insolvency)—when the order in which one “reached” assets would matter in terms of recovery—as a form of a collective action problem:

The grab rules of nonbankruptcy law and their allocation of assets on the basis of first-come, first-served create an incentive on the part of the individual creditors, when they sense that a debtor may have more liabilities than assets, to get in line today (by, for example, getting a sheriff to execute on the debtor’s equipment), because if they do not, they run the risk of getting nothing. This decision by numerous individual creditors, however, may be the wrong decision for the creditors as a group. Even though the debtor is insolvent, they might be better off if they held the assets together. Bankruptcy provides a way to make these diverse individuals act as one, by imposing a *collective* and *compulsory* proceeding on them. Unlike a typical common pool solution, however, the compulsory solution of bankruptcy law does not apply in all places at all times. Instead, it runs parallel with a system of individual debt-collection rules and is available to supplant them when and if needed.¹⁵

This analogy—and description—is, however, by itself, incomplete. To be sure, like most common pool examples—fishing in a lake or drilling for oil—it is a solution designed to separate what to do with assets from the question of who owns the assets. In doing that, it is also necessary to distinguish economic failure (the assets should be doing something else)—classically a liquidation—from financial failure (the assets are doing

just what they should be doing, but one needs to keep them from being pulled apart because of the incentives of creditors when a firm has too much debt (financial insolvency). At the time of writing, and still today, a classic example of this is Johns Manville's 1982 bankruptcy. Manville was hopelessly insolvent at that time, due to significant, but latent, tort liability for asbestosis products manufactured by Manville during and after the Second World War. But, at the time of its bankruptcy, Manville didn't produce asbestos-based products and, as far as one could tell, seemed to be a successful building supply company, whose assets were put to their highest and best use. But without a collective remedy such as bankruptcy, Manville would have been destroyed, turning the financial failure into the wrong asset-deployment decision.¹⁶

While that is one goal of bankruptcy, captured well by the imagery of a common pool, that imagery is incomplete in that there is a second feature of bankruptcy, also derived from its multiple ownership claims against a common pool of assets, but distinguished from most common pool problems by the fact that the multiple ownership claims have, themselves, different priority rights. The one of most interest for bankruptcy law is the distinction between debt and equity. The equity interests, who have the legal characteristic not only of claiming 100 percent of the value of the firm in excess of its liabilities but also suffering no further liability beyond the loss of the value of their interests once the firm is, in fact, insolvent. For clearly solvent companies, the equity interests legally are, and should be, the relevant decision-makers as to what to do with the assets.¹⁷ But for insolvent companies,¹⁸ equity interests are unlikely to make decisions that are in the interests of the owners (debt as well as equity) as a group. The economic incentives of equity interests in an insolvent company is to take excessive risks, since the equity interests do not have anything to lose, and a fair amount to gain, by such strategy. While it is possible to shift the decision-making interests from equity interests to creditors without a collective proceeding such as bankruptcy—and one would want to do so even if there were not multiple creditors where there was the risk of a common pool race—since bankruptcy is designed to handle the common situation of multiple creditors, it makes perfect sense to also have it be a mechanism for the transfer of decision-making rights (and equity ownership) from the old equity interests to the creditors.¹⁹

Since both of these notions—one central to bankruptcy law's existence, the other a logical corollary to the use of bankruptcy law, so created—serve the interests of creditors, I originally described bankruptcy as a "creditors' bargain."²⁰ In retrospect, although the imagery was correct, the term was infelicitous. It could be—and often was—taken as a bias in favor of creditors over debtors or other interests.²¹ At some level, that was never

true. In the corporate context, creditors are the only ones with relevant ownership claims vis-à-vis an insolvent entity. And non-ownership “interests,” as I address next, involve a nuanced understanding of rights under nonbankruptcy law.²²

What *is* correct is that I saw bankruptcy law for firms as limited to the two purposes noted above, and not as a forum to give rights to parties that would not have such rights outside of bankruptcy.²³ If workers, or a town, could not (legally) object to a firm with a single owner from shutting down, or moving operations, it struck me as *a fortiori* that the fact that bankruptcy was instituted to solve a collective action problem meant that it was an inappropriate forum to give those workers, or a town, a say in what was to be done with the debtor’s assets.

This original vision—both in its positive nature (bankruptcy’s “logic”) and in its insistence on narrowly hewing to those purposes (bankruptcy’s “limits”), ultimately spawned three distinct developments. First, there was—and remains today—a strong push-back against the view that bankruptcy was so limited. This is probably best framed, and remembered, in the now-classic “debate” between my occasional co-author, Douglas Baird, and Professor (now Senator) Elizabeth Warren.²⁴ I, stubbornly, continue to view this response as fundamentally wrong, and will develop that argument in Part IV of this chapter.

Second, there was a growing movement that markets could do much of what Chapter 11 was designed to do—value assets and decide on their optimal deployment—better than the lengthy negotiations that dominated the early days of Chapter 11.²⁵

Third, and coming at this from a related but nonetheless distinct direction, scholars raised the question as to whether bankruptcy, even infused with market-oriented features, was needed at all, or rather the identified issues could be solved by other contractual devices.²⁶ For example, scholars proposed using convertible debt (“bail-in debt”) that would be converted to equity upon certain triggering events related to potential insolvency, as a way of both solving the issue of optimal decision-making and, at least some of the time, the issue of financial failure not leading to inappropriate economic failure.²⁷ I agree with much of this work, and indeed think it is enjoying a renaissance today in light of the current discussion about the appropriate resolution mechanism for systemically important financial institutions, but also both think its advantages over bankruptcy are muted by finding the appropriate trigger as well as not really ultimately opposed to bankruptcy as much as a new tool that can make bankruptcy more productive and efficient.²⁸ I will develop that argument, particularly in conjunction with bankruptcy as a resolution mechanism for systemically important financial institutions, in Part VI of this chapter.

III. THE IMPACT OF THE THINKING BEHIND THE LOGIC AND LIMITS OF BANKRUPTCY LAW ON BANKRUPTCY LAW AND PRACTICE

As David Skeel correctly observed in 2001, “[a]lthough the law and economics proposals have had little legislative influence, market forces play an increasingly prominent role in the Chapter 11 process, as law and economics scholars have long advocated.”²⁹ The Bankruptcy Code, itself, shows little change in its major provisions since its enactment in 1978 that can be attributed to any of the ideas I advanced. Indeed, in a number of respects, the changes that were made since then were more likely setbacks rather than advances. (I think here, particularly, of the writing into the Bankruptcy Code of numerous special, bankruptcy-only, protections for counterparties on qualified financial contracts.³⁰) And, many prominent arguments I advanced fared little better in authoritative constructions of the Bankruptcy Code’s statutory provisions. For example, I was a strong advocate for the idea that, as a part of adequate protection, secured creditors were entitled to compensation for the time value of money (an issue of some prominence in the early 1980s, and a time of high inflation). I even wrote an amicus brief in *Timbers of Inwood Forest* to make the argument,³¹ complete with reasoning as to why it was the preferred way of reading the relevant statutory sections. The argument, and the reasoning underlying it, went nowhere (at least, a 9–0 loss at the Supreme Court sure looks as though the argument went nowhere).³²

But in other respects—more incremental (as case law tends to be)—some of the arguments made by academics such as myself began to be reflected in changes in Chapter 11 practice. As originally designed by the Bankruptcy Code, Chapter 11 was clearly intended as a framework for negotiation, overseen by a bankruptcy judge who would be deciding important issues of rights, and valuations (both of assets and of claims).³³ The ownership shift from equity to creditors occurred, if at all, only at the end³⁴—a notion sharply reinforced by extended “exclusivity” periods during which time only the debtor-in-possession could file a plan of reorganization.³⁵ The idea of what a “class” of claimants could agree to, and what protections a dissenting member of that class might be entitled to, was driven by a strong distinction between a “going concern” value and a “liquidation” value.³⁶ Indeed, this distinction was thought to be at the center of the negotiations over a plan.

I suggested this model was wrong:

The key conceptual difference between a reorganization and a liquidation is that in a reorganization the firm’s assets (or most of them) are sold to the creditors

themselves rather than to third parties. The principal distinction is *not* that the assets are kept together in a reorganization; they can be kept together in a chapter 7 liquidation proceeding as well if they are sold as a unit to a third-party buyer.³⁷

Because of that, I suggested that the principal difference was that, in the third-party sale, the asset valuation issues were far easier to determine than in the situation of the assets being “sold” to the creditors themselves in a negotiated plan. “It is principally these valuation issues that lie at the core of the reorganization chapter’s provisions.”³⁸ And I went further and suggested that the distinction between the rights of a class and the rights of a dissenting creditor were unlikely to be nearly as large as seemed to be contemplated by the 1978 Bankruptcy Code itself:

“the extra value attributable to selling the business back to the prebankruptcy claimants is the difference in the value of the firm owned by them and what a third party would be willing to pay for it. . . . It is improper, even accepting this rationale for the reorganization process, to establish the baseline protection for an individual claimant as that of a piecemeal liquidation standard.”³⁹

From this, I made the (then) somewhat radical suggestion that the negotiation framework of Chapter 11 caused far more problems than it solved. Building off an idea by Mark Roe that proposed requiring a Chapter 11 reorganization to make a stock issuance to the public of 10 percent of the total stock the firm will ultimately issue, so as to gain a market valuation that would drive the distribution of those proceeds, and the remaining stock, to the prebankruptcy claimants in accordance with their priority entitlements,⁴⁰ I suggested one could eliminate Chapter 11 entirely and rely exclusively on Chapter 7:

The premises for negotiation in a Chapter 11 process seem unproven and unpromising. Roe is probably correct in suggesting that they should be eliminated. Once that point is reached, however, there seems to be no remaining justification for Chapter 11 at all There is no reason why Chapter 7 could not be used as the vehicle to sell the firm as a going concern in the same way that companies go public. The assets of the firm could be transferred to a new corporation. This new corporation could have a capital structure placed on it. A public offering of the shares in the various classes of that corporation could then be made. Such a solution avoids the interclass conflicts about distribution that pervade Chapter 11..⁴¹

At the time, the idea seemed far-fetched (or, perhaps, heretical).⁴² And, it had no influence on the statutory provisions themselves. As written, the Bankruptcy Code provisions regarding Chapter 11 look much the same today as they did upon enactment in 1978. But there *was* a revolution of

practice. Whether in response to creative lawyering, academic criticism, or judicial awareness—or, very probably, all three—while the formal structure of the Bankruptcy Code of 1978 as it applied to reorganizations, did not change in significant respects, practices pursuant to it did.⁴³ Creditors began to push for “going-concern sales” of the firm—and hence for market-based valuations of the assets of the firm. A general bankruptcy provision, almost certainly originally thought to apply generally in Chapter 7 and to the sale of stray, unwanted, assets in Chapter 11,⁴⁴ began to be used in Chapter 11 as a vehicle for the sale of the firm as a whole.⁴⁵ Almost simultaneously—and indeed, in a practical sense, related—lenders began to exert increasing control over the case by including stringent covenants in their loan agreements with the debtor. Indirectly and at times directly, these covenants effectively cut back on a debtor’s exclusivity period.

Together, these two changes had several dramatic effects. First and foremost, they severed the decision about what to do with the assets from the fights over how to distribute the value of those assets. The assets could now be sold early in a bankruptcy process, even while some fights over the validity of claims or priorities had not yet been resolved.⁴⁶ Second, and equally important, they substituted judicial valuations of the assets with market valuations. If the assets were worth more alive than dead, it was expected that the market bids would reflect this. And, finally, without asset valuations to fight about, there was no longer much room to argue about the impact of the decision concerning what to do with assets or workers or the community. A shift in practice had accomplished what market-based proponents had been unable to accomplish through legislative input.

IV. REFLECTIONS ON THE CURRENT USES (AND POTENTIAL USES) AND ABUSES OF BANKRUPTCY: THE CONTINUING RELEVANCE OF THE “LOGIC” AS WELL AS THE “LIMITS” OF BANKRUPTCY LAW

I would like to examine, from the perspective of my work now 30 years ago, as well as some of the trends I have commented on, how I believe that analysis, incorporating, of course, important work since that time, can help us understand and design a bankruptcy system that accommodates what David Skeel and I called “the new finance in bankruptcy,” through a brief examination of what *The Logic and Limits of Bankruptcy Law*⁴⁷ might have to say about the “new finance” of qualified financial contracts (repos, swaps, and derivatives) and about the optimal way to resolve systemically important financial institutions while minimizing spill-over effects to other

institutions. The first relies on understanding, in context, the attributes of “new” forms of contracts, such as repos, swaps, and derivatives; here, as before, there is an enormous amount to learn by a careful analysis of the nonbankruptcy attributes of things that are being transported into the bankruptcy forum. The second draws on the insights, and subsequent development in practice, of a Chapter 11 proceeding as involving a going-concern sale of assets, together with the strategic advantages of using, in bankruptcy, contractarian ideas such as convertible securities as both aiding in the process and providing a regulatory trigger mechanism.

Before turning to those, however, I would like to start with a cautionary tale about how the perennial perspective concerning how bankruptcy serves nonbankruptcy goals, such as job preservation, still introduces, in my view, unfortunate complications—and results. One of the premises for the model of corporate bankruptcy law that pervaded my early work was that it was essential to not ask bankruptcy law to do too much. Solving a common pool problem, shifting ownership and control, and respecting oftentimes complicated and nuanced priority issues,⁴⁸ were both important and difficult. Mixing in other policies—bankruptcy-specific policies because they did not attempt to implement, but augment, these three areas—inevitably weakened bankruptcy law’s ability as its core mission was a core part of recognizing the “limits” as well as the “logic” of bankruptcy law. That concern is probably heightened, not reduced, by more recent scholarship—and practice—that suggests debtors and creditors could devise contractual schemes to avoid bankruptcy (and thus its policies) altogether.⁴⁹

Much, but not all, of the early focus of this was on the somewhat careless use of a “fresh start” notion that bankruptcy law, and reorganization law specifically, was designed to enable firms to stay in business, thus saving jobs and the communities around them. I believe the wisdom of rejecting that notion in implementing bankruptcy law remains sound today, although I also believe that it remains engrained in the system, sometimes upending bankruptcy’s clear goals and priorities, as was the case with the Chrysler reorganization of 2008 (with the significant help of the federal government in accomplishing this distortion of bankruptcy principles). As David Skeel and I wrote in 2013, in analysing the Chrysler bankruptcy:

Throwing into bankruptcy an explicit focus on jobs, at least as an independent policy (or one that takes on a life of its own), we believe, more often than not, causes an unintended conflict with the issue of asset deployment that, at least for firms, bankruptcy is so uniquely suited to address. While we believe the concern about jobs—and job preservation—is pervasive and almost impossible to keep out of bankruptcy at one level or another as an independent focus or policy, we also think that paying heightened attention to its disruptive effects when used as an independent focus of bankruptcy is at least worthwhile, albeit

partial, palliative. To be sure, in the case of a successful reorganization, the two policies—economic efficiency and job preservation (if not growth)—tend to merge. But where the economic decision about what to do with a firm's assets points to a possible liquidation, the two policies tend to come into conflict.

We take seriously the issue of job creation—and the dislocations caused by job termination—but think that pressing this into bankruptcy as an independent policy along with asset deployment asks too much of bankruptcy. The issue of jobs, if inconsistent with the issue of asset deployment, should generally be addressed transparently and humanely through other vehicles. Bankruptcy's solutions for the use of assets are necessarily “micro,” whereas too often the focus on “jobs” in bankruptcy has unintended, and indeed perverse, “macro” implications.⁵⁰

My concern today for this is exacerbated—perhaps not in the case of a huge corporation such as Chrysler with multiple constituencies and the federal government as large players both in terms of the lenders as well as Chrysler itself⁵¹—but the important, but smaller, corporations that can devise nonbankruptcy solutions that, while perhaps not optimal, are better for the participants than emergence into this bankruptcy potpourri.⁵² So, on this “big picture” issue, I remain convinced that bankruptcy law has both its “logic” *and* its “limits.”

Recently, in an interesting and perceptive article, after noting that the model I outlined in this chapter (self-consciously focused on firms) was, itself, developed in the context of corporate bankruptcies and not individual bankruptcies (a point on which I agree), it went on to suggest:

Politics is hardly missing from business bankruptcy. The Bankruptcy Code is replete with explicit special-interest provisions relating to business bankruptcy (e.g., the treatment of certain financial contracts, shopping center leases, airplane leases, utilities, collective bargaining agreements, as well as numerous implicit special interest provisions), but these provisions have been largely ignored by the creditors' bargain literature.⁵³

While I agree that not every “special interest” provision of the Bankruptcy Code has been given rigorous analysis⁵⁴—and I agree there are many provisions that are the result primarily of special interests—I continue to believe that some of the heuristic devices developed thirty years ago *are* useful for examining these provisions, some of which, because of the complicated details of nonbankruptcy priorities, are in fact justified, and others that are not.

To show the continued relevance of paying attention to how nonbankruptcy attributes are mapped into the bankruptcy forum (and goals), and how those attributes remain relevant to “new” forms of contracts, I'd like to look specifically at the first of Professor Levitin's list of special-interest provisions: The “treatment of certain financial contracts,” which I take to

be a reference to the numerous provisions added since the 1980s insulating these contracts from many of bankruptcy law's core provisions.⁵⁵ I do so through a look at their attributes, and whether there are any special features that bankruptcy law appropriately takes into account. In doing so, I conclude—and give a summary of the analysis leading to that conclusion—that the Bankruptcy Code's current treatment of qualified financial contracts indeed demonstrates “special interest” legislation, but that not all of it is necessarily inappropriate (while much of it assuredly is).

V. THE ATTRIBUTES OF LIABILITIES AND EXECUTORY CONTRACTS: AN ANALYSIS OF THE TREATMENT OF QUALIFIED FINANCIAL CONTRACTS IN BANKRUPTCY⁵⁶

Prominent financial innovations of the past thirty years—most particularly, swaps and other derivatives contracts⁵⁷ and repurchase agreements (repos)⁵⁸—were insulated from core bankruptcy provisions such as the automatic stay, which prohibits creditors from terminating their contracts or seizing and selling collateral,⁵⁹ thanks to a series of legislative amendments creating what are often described as “safe harbors” or “exemptions” for these contracts.⁶⁰ To understand my critique of these provisions, one needs, I believe, to start with my original work on assets, liabilities, and executory contracts, and their relationship to “contracts” more broadly.

Bankruptcy, of course, does not treat all contracts “the same” either in terms of the application of the automatic stay or in terms of the estate's ability to assume. Contracts that have been completed by one party or another are either “assets” (if completed by the debtor)⁶¹ or “liabilities” (if completed by the other party).⁶² And if the contracts remain materially uncompleted by both parties—and thus have elements of both assets and liabilities—they fall into a third category: executory contracts.⁶³ It is, for that reason, only for executory contracts that it makes conceptual sense to talk about the debtor's “choice” between assumption (i.e., a belief that the asset value exceeds the liability) or rejection (i.e., a belief that the asset value is less than the liability) of the contract.

Loans to a debtor are, effectively, “breached” upon the filing of a petition in bankruptcy by the debtor. The value of the breached loan is calculated as of that moment—as is the value of any collateral that may be securing the loan. With respect to the typical executory contract under Bankruptcy Code Section 365, the debtor may either “assume” or “reject” the contract,⁶⁴ and may do so at any time during the bankruptcy case unless, on motion, the court orders the decision to be made at an

earlier point.⁶⁵ If the debtor rejects the contract, it is presumably because the debtor views the contract as a net burden. If the debtor assumes the contract, it is presumably because the debtor views the contract as valuable on net and the contract is treated as if it is one made by the debtor-in-possession (an “expense of administration”). This assumption⁶⁶ can be accomplished despite any contractual provision that is considered to be an “ipso facto” clause; that is, a clause providing that the contract is breached (or terminated) because of “the insolvency or financial condition of the debtor at any time before the closing of the case” or “the commencement of a case under this title.”⁶⁷ These provisions may not be perfect—they seem, for example, to give the debtor a one-way option during the bankruptcy proceeding to see if the contract turns out to be valuable—and the other party to the contract may be faced during this interregnum with a decision whether to continue to work on the contract at some expense to that party.⁶⁸ But for present purposes, my point is more basic: For this kind of contract, these rules, whether properly part of the creditors’ bargain or not, are clear and apply across the board.⁶⁹

To be complete, there is a third category—a variation on the second—that is exemplified by classic insurance contracts as well as real estate leases. In these contracts, even if the debtor does not ultimately assume the contract, the debtor receives a “use” benefit during the period between the commencement of the bankruptcy case and a decision to assume or reject the contract. A debtor that uses real property during a bankruptcy proceeding should, and under the Bankruptcy Code would, be required to pay for that use, irrespective of any ultimate decision to assume or reject.⁷⁰ Similarly, a debtor whose building is insured should be required to pay for that insurance coverage during a bankruptcy proceeding, again irrespective of any ultimate decision to assume or reject.

With this as background, it is now possible to examine, for bankruptcy purposes, repos, swaps, and derivatives. As a matter of attributes, repos are essentially secured loans. Under the analysis above, they would accordingly belong in the category of classic loans. A second, conceptually quite different, type of contract is epitomized by swaps and various other forms of derivatives. At their core, they ordinarily are hedges—analytically indistinguishable from a contract to purchase widgets on June 1st at a certain price—and comfortably fit within the category of classic executory contracts. As executory contracts, their attributes would suggest, accordingly, that the debtor can choose to assume or reject them and the decision to assume can be made irrespective of “ipso facto” clauses. Those that function like an insurance policy would be given the additional protection of payments for the use of the “insurance” during the pendency of the bankruptcy case.

Using a rough look at attributes *does* suggest that the wholesale exemption of qualified financial contracts from bankruptcy's core provisions is not justified. But that is not to say that they do not have additional attributes that warrant attention, and perhaps statutory protection. Start with repos. As mentioned earlier, repos, in common with other loans, would be automatically "breached" as of the filing of the petition in bankruptcy, and the claim and the value of the collateral would be determined as of that moment. From that point forward, the debtor would have no further obligation to post collateral, but would need to provide adequate protection for the collateral's value as of the filing of the petition.⁷¹ The counterparty could exercise recoupment rights, and would have rights of setoff, although it would need relief from the automatic stay in order to exercise the statutorily-recognized setoff right.⁷²

With the possible exception of requiring the counterparty to gain court permission before exercising its setoff rights, this treatment strikes me as unexceptional. To the extent the collateral was insufficient, the counterparty would be unsecured, and would need to stand in line with other unsecured creditors. The essential point is that the counterparty knows its situation as of the moment of bankruptcy, and can proceed accordingly.

That said, I do think the Bankruptcy Code's automatic stay is, in some respects, overbroad. For example, to the extent the repo buyer is in possession of collateral, it should be able to quickly realize on this collateral. In most cases, the collateral is either cash or cash-like, highly liquid, assets for which there is almost no firm-specific value.⁷³ In those cases, there are few, if any, reasons, for delay. Valuation disputes are minimal to nonexistent when the collateral is cash or cash-like, and there is nothing "firm-specific" about the collateral, meaning that the ordinary justification for the automatic stay as applied to secured creditors simply does not exist. Indeed, if done as a matter of recoupment—that is, closing out on a single repo contract itself—the Bankruptcy Code would allow the counterparty to proceed without first going to court. For repo creditors that do not have a right of recoupment, there could be either an exception for such contracts from first needing court permission or a presumption of a quick determination upon a motion being made. In either case, the "exceptions," if such they are, to current bankruptcy rules are, at most, minor—and probably should be approached not by creating a "special" rule for repo counterparties, but using the occasion to examine, more generally, the application of the automatic stay to collateral (especially cash-like and other non-firm-specific collateral) in possession of a secured party—a place where the use of markets is not reflective of bankruptcy law language or practice.

Because of the range of functions they serve, the treatment of swaps and derivatives under core bankruptcy principles would be more variegated than with repos. While most swaps would be characterized as ordinary executory contracts, swaps also are used for financing and different kinds of insurance purposes (in which case they would be insurance-like executory contracts).

Most swaps, because they entail ongoing obligations by both sides, are simply ordinary executory contracts for bankruptcy purposes. The most troublesome feature of this result is that, as noted earlier, it may give a debtor time to speculate without consequence (if the hedge turns out to be “in the money,” the debtor assumes; if the hedge turns out to be a bad deal, the debtor rejects).

While strategic use of the debtor's executory contract powers is a conceptual concern with *all* classic executory contracts, it may have particular bite in transactions that are themselves designed, explicitly, as hedges rather than as the buying and selling of a good. The Bankruptcy Code is not wholly consistent in how it currently treats this concern with respect to executory contracts in other contexts. For example, even though much of the undesirable nature of the delay option is mitigated by a requirement of compliance with the terms of the lease prior to assumption or rejection, Section 365(d) sets time limits on the debtor's decision in cases of unexpired leases of nonresidential real property where the debtor is the lessee.⁷⁴ Given the likely reality that the parties to swaps and derivatives are sophisticated players, a short period in which to assume or reject may be a desirable modification,⁷⁵ there is no particular reason for an extended stay on hedge contracts while the debtor is given an extended opportunity to choose whether to assume.

Title II of the Dodd-Frank Act includes a one-plus day halt on termination (which will function similarly to a stay in this context) in resolution proceedings.⁷⁶ I believe that a similarly truncated stay—perhaps three business days—should be workable in bankruptcy even in complex cases. It is important to recognize that the managers of a troubled financial institution will not begin thinking about which swaps to assume and which to reject for the first time the day they file for bankruptcy. Knowing that they only have three days to work with, a debtor's managers will have an incentive to plot their executory contract decisions long before they actually file. Moreover, the Dodd-Frank Act's requirement that systemically important financial institutions prepare wind-down plans on a regular basis, even while they are healthy, will aid in the ability quickly to sort out which swaps to assume, as will the increased transparency the new regulation should bring to the derivatives markets.⁷⁷

VI. CHAPTER 11, GOING CONCERN SALES, CONVERTIBLE SECURITIES, AND BANKRUPTCY AS A RESPONSE TO TROUBLED FINANCIAL INSTITUTIONS

While, as discussed above, it is almost certainly the case that the original intent of Section 363 of the Bankruptcy Code—a provision providing for the use, sale, and lease of property of the estate—was to permit piecemeal sales of unwanted property, following the enactment of the Bankruptcy Code of 1978, Chapter 11 practice began, over time, to move in the direction of both (a) pre-packaged plans and (b) plans whose essential device was a going-concern sale of some or all of the business, leaving the original equity and much of the debt behind—with the proceeds of the sale forming the basis of their distribution according to the absolute priority rule.⁷⁸ It doesn't fit perfectly, but it has been used, repeatedly, as a way of creating a viable business outside of bankruptcy while the claimants, left behind, wind up as the owners of the estate of the former business entity.

But at the time of, and following, the 2008 financial crisis, American bankruptcy law was thought to be wholly inadequate to deal with the financial failure—and resulting systemic consequences—of a large financial institution. This built on a longstanding exclusion from bankruptcy of major financial institutions—banks and insurance companies⁷⁹ (albeit for very different reasons).⁸⁰ Indeed, the exclusion of qualified financial contracts from most of bankruptcy's essential provisions may have been fueled by a similar view that such financial contracts, often used by financial institutions (and thus not familiar to bankruptcy practitioners who were not prepared to oppose those amendments), were simply beyond the purview or competence of bankruptcy law.⁸¹

Thus, it isn't surprising, when Congress turned to deal with the repercussions of the 2008 financial crisis, bankruptcy largely wasn't a player in those discussions. Rather, based on a not-altogether appropriate analogy to depository banks,⁸² the FDIC was thought to be the obvious entity to deal with the resolution of a troubled systemically important financial institution. This was reinforced, in part, by the international scope of those institutions and the unfortunate reality (borne in part from not really understanding the mature dynamics of U.S. bankruptcy law vis-à-vis bankruptcy systems in their own countries) that foreign regulatory authorities defaulted to a view that regulatory, rather than bankruptcy-induced, market-based solutions, were obviously preferable.

As a result—or I think substantially as a result—the U.S. “solution” became Title II of the Dodd-Frank Act, which borrowed many

bankruptcy provisions and concepts, but left resolution firmly in the hands of the FDIC. But, then, an interesting development began to occur.

Two dominant—but, in actuality, very similar—proposals began to be developed, one in Europe, the other by the FDIC in the United States. Europe has focused on a “one-entity” recapitalization via bail-in⁸³ while the FDIC has focused in its “single point of entry” (SPOE) proposal for Title II of the Dodd-Frank Act on a “two-entity” recapitalization.⁸⁴ Under the FDIC’s approach, a financial institution’s holding company (the single point of entry) is effectively “recapitalized” virtually overnight by the transfer of its assets, contracts, and liabilities, *except* for certain long-term unsecured liabilities, to a new bridge institution. The bridge institution then forgives intercompany liabilities or contributes assets to recapitalize its operating subsidiaries.⁸⁵ Because of the splitting off of the long-term unsecured debt, the bridge institution, in the FDIC’s model, looks very much like a financial institution holding company following a European-like “bail in”; the major difference is that in the “bail in,” the financial institution holding company before and after the recapitalization is the same entity (thus, the one-entity recapitalization), whereas in the FDIC’s SPOE proposal, the “recapitalized” bridge institution is legally different than the pre-SPOE financial institution holding company (thus, the two-entity recapitalization).

Both solutions involve a rapid recapitalization of a financial institution at the holding company level (or, indeed, the rapid recapitalization of an operating covered financial corporation, although the focus has been on financial institutions with a holding company structure), in which—in the course of a very short period of time—it is intended that the financial institution, through the recapitalization, would (a) likely be solvent, (b) appear so to market-participants, and (c) be subject to market discipline, although that third point is mitigated somewhat by the FDIC’s continued authority over the bridge institution and its decisions.⁸⁶

I believe this approach is a significant break-through, most prominently because, in a very short period, it promises the ability to accomplish both the substantive—a recapitalization that makes (under all but extreme circumstances) the holding company (or its replacement) solvent again—and the informational—an immediate ability for the market to recognize, and react to, the resulting entity’s solvency (in terms of liquidity provision, ordinary dealings, and the like).⁸⁷

But it also brings back into play what I view to be a natural question of whether bankruptcy law could be revised so as to make it a sensible alternative to either SPOE under Title II of the Dodd-Frank Act or bail-in—and thus bring about substantial convergence. After all, as outlined above, it seemed to me the “bones” of a responsible bankruptcy structure

was already embedded in bankruptcy law and practice. Once again, while Section 363 of the Bankruptcy Code, permitting the “sale” of assets, may not have been envisioned in 1978 as a mechanism for a going-concern sale of some or all of a business, over the ensuing 30 (plus) years, it had become such a mechanism. While it doesn’t fit perfectly, without modification, to the situation of complex systemically important financial institutions, it has been used, repeatedly, as a way of continuing a business outside of bankruptcy while the claimants, left behind, wind up as the owners of the estate of the former business entity.

Its current use differs in two key, and interrelated, ways from an envisioned response to the FDIC’s rapid recapitalization under its SPOE proposal for Title II of the Dodd-Frank Act. First, current practice using going concern sales effectively transfers assets (and assumed executory contracts) to a new owner under Bankruptcy Code Section 363. Liabilities are, presumptively, left with the estate and, indeed, the core of the reorganization process following the sale is the sorting out of disputed claims and the allocation, pursuant to the absolute priority rule, of the proceeds of the sale (presumptively cash or marketable securities). To be sure, liabilities *can* be transferred. For example, secured debt might go with the assets. And, under the “doctrine of necessity,” *some* unsecured claims may be transferred.⁸⁸ But the assumption of liabilities is the exception, not the rule.⁸⁹ This is in sharp contrast with the rapid recapitalization envisioned by something such as the FDIC’s SPOE proposal, where virtually *all* assets, contracts, and liabilities—except for pre-identified capital structure debt—are transferred to the new entity.

Second, unlike current practice, the FDIC’s SPOE proposal’s “sale” isn’t to an existing third-party, and it doesn’t follow an auction. But this difference, rather than being troublesome, is actually a natural consequence of the idea of a recapitalization. However problematic going-concern sales may be when the buyer is one of the parties,⁹⁰ or when an auction isn’t used, in cases where the assets are largely being severed from the liabilities, here the *essence* of the transfer is a recreation of the debtor that existed the moment *before* bankruptcy in a new entity that is identical *except* for the pre-identified debt that is left behind in the debtor’s estate together with the former equity holders. The payment, at least originally, for the transfer is in the equity ownership of the *new* entity. There is little room for strategic manipulation because it really *is* the replication, albeit formally using two entities, of a one-entity recapitalization.⁹¹

Through this “expanded” sale concept, bankruptcy law—with certain regulatory or contractual preconditions—could do everything the FDIC is proposing under the Dodd-Frank Act’s Title II with SPOE and, perhaps, could do it better.⁹² That is, it could accomplish, via a “quick sale” of a

financial institution holding company to a bridge company⁹³ (with market valuations postponed until later) a recapitalization that would be (a) quick, (b) with the resulting bridge company in a much stronger financial position that (c) would be recognized as such by the market. In addition, it could immediately provide the assurance as well that the bridge company (not itself in bankruptcy) was subject to market discipline and was not under the control of a judge overseeing the bankruptcy of the original holding company.

Bankruptcy law is, in my view, indeed up to the task, although implementing this “quick sale” will, in turn, depend on either regulatorily-required or contractually-based “bail in” or subordinated debt (that can be left behind without doing violence to the absolute priority rule) and by specific provisions in the Bankruptcy Code itself designed to implement a transfer to a new entity over a weekend. Among them are provisions—expansions, really, on rules already existing with respect to executory contracts under Section 365 and property of the estate under Section 541. But the rules need refinement so as to permit assets, liabilities, contracts, and permits to be transferred to the bridge company notwithstanding restrictions on transfer, or change-of-control provisions, or the like. In essence, a number of rules need to be in place to ensure that, but for the recapitalization, the bridge company has all of the rights and liabilities that the holding company had the moment before the commencement of the bankruptcy case.⁹⁴

To be a credible alternative to SPOE under Title II, I believe at least three major changes or clarifications are essential. First, there must be sufficient loss-absorbency built into the capital structure of the holding company.⁹⁵ That is, there must be debt, known in advance, that can be “left behind” in any going-concern sale to a new entity, and thereby effectively converted into a potentially equity-like claim against the residual value of that new entity. It can be identified unsecured debt, bail-in debt, or subordinated debt. This requires legal or regulatory rules that will require such loss-absorbency capital *or* the realization (in its own self-interest) by financial institution holding companies, that to create “credible” resolution plans (“living wills”) under Title I of the Dodd-Frank Act,⁹⁶ they will need to hold either contractually subordinated or “bail-in” debt—or comparable regulatorily-identified and required unsecured debt—that can be left behind (or converted) upon the transfer to the bridge company. Second, there needs to be change, or clarity, in any such recapitalization transfer, that not just assets, but executory contracts, debts (other than those scheduled to be “left behind”), and operating licenses and permits can be transferred to the new company notwithstanding “ipso facto” clauses, anti-assignment clauses, change-of-control provisions, and the like—and

that those same rules apply to comparable assets, liabilities, and rights of subsidiaries that are not in bankruptcy but are “assets” of the holding company that are transferred in the recapitalization sale.⁹⁷ This particularly, but not exclusively, requires changes in the existing Bankruptcy Code provisions regarding qualified financial contracts along the lines of what was previously discussed.⁹⁸ Third, there needs to be a mechanism, known in advance, to have this recapitalization transfer occur within a very short period, such as within 48 hours of the filing of the petition.⁹⁹

All of this takes place without wholesale revision of the Bankruptcy Code, and draws, albeit in a different context, upon the now-commonplace use of going concern sales in Chapter 11 via the use of Section 363. To be sure, the sale is not a market-based sale to a third party (following an auction), but, rather, a judicially-authorized transfer of all of the debtor’s assets, liabilities, and contracts (excepting pre-identified debt) to a new entity that “pays” for the transfer by giving full equity ownership of the new entity to the debtor’s estate. That said, the potential abuses of a sale to “oneself” are largely dealt with by pre-announced priority rules that, in essence, leave everything in place *except* for the convertible debt, and the resulting impact on the equity ownership of the firm.

Having gone this far, why stop here? This “quick sale” approach, while drawing on the vast change in corporate reorganization practice since the enactment of the Bankruptcy Code in 1978, may, in light of Europe’s bail-in proposals, overcomplicate things. In essence, the bankruptcy recapitalization proposal I just outlined—like the FDIC’s proposal for use of “single point of entry” under Title II of the Dodd-Frank Act—accomplishes a recapitalization through the use of two entities (i.e., the “continuing” entity is a new corporation), whereas European bail-in proposals, following much more closely earlier academic proposals for the use of convertible securities as a way to reorganize *outside* of bankruptcy,¹⁰⁰ essentially are designed to accomplish a one-entity recapitalization (i.e., the continuing entity is the same legal entity as before). Returning to those convertible debt proposals as an alternative to bankruptcy, it is possible to imagine bankruptcy being a system designed to (a) be the triggering mechanism for the conversion of the debt to equity itself and (b) ensure that contractual provisions of others in a relationship with the debtor do not trigger a withdrawal right upon that conversion. In that world, no new entity is needed, and there is essentially no need for either a “sale” or a reorganization process. In its extreme form, a financial institution would enter bankruptcy at one instant, have the conversion of debt to equity simultaneously occur (as well as the override of ipso-facto provisions, change-of-control provisions, cross-default clauses and the like), with the financial institution exiting bankruptcy at the next instant. It follows the nonbankruptcy convertible

debt proposals, but uses a quick “bath” in bankruptcy as the legal mechanism to tie up loose ends and ensure everyone is bound.¹⁰¹

Whether this is desirable is debatable. It puts three distinct ideas (or alternatives) in play: (1) a two entity bankruptcy-based solution;¹⁰² (2) a single-entity bankruptcy-based solution;¹⁰³ and (3) a nonbankruptcy contractually-based single-entity solution.¹⁰⁴ The resolution of that issue depends on how one feels about several factors. Ones that come to mind include: First, the relative merits of a nonbankruptcy trigger to the conversion versus using a bankruptcy filing; second, the need to have bankruptcy law be the mechanism that overrides the ability of other entities to declare default and “run” (versus contractual or other nonbankruptcy mechanisms that accomplish this);¹⁰⁵ and, third, whether the external world would view a two entity recapitalization differently than a one entity recapitalization (i.e., would the emergence of a “new” company give more confidence to third parties than a recapitalized “old” company?). Whatever its resolution, what it suggests to me is how much bankruptcy practice has evolved since 1978, and how the interplay between new ideas for handling insolvent firms, such as convertible debt, and the bankruptcy process should not be viewed as an “either”—“or” choice, but a more complex dynamic in which both processes might co-exist alongside each other, with a debtor (or regulator) making an initial choice between them through contract terms (or, in the case of regulatory oversight, devices such as the Dodd-Frank Act Title I’s “living wills”).

VII. CONCLUSION

The Bankruptcy Code of 1978 got a lot of things right, and also introduced a framework in Chapter 11 that, pretty much unbeknownst to its drafters at that time, could be adopted to a sale-based, as well as a negotiation-based, model of reorganization that meshed well with academic and practitioner shifts. Has the increasing focus on contractually-based ways of accomplishing a reorganization (or recapitalization) outside of bankruptcy rendered Chapter 11 significantly less important? In some ways, at least for certain firms, the answer may be “yes.” But there is still a significant role for Chapter 11. Some firms aren’t going to be suitable for recapitalization using a form of convertible debt.¹⁰⁶ Other firms are going to need a mechanism to bind various parties, or clean up loose ends that can’t easily be dealt with contractually, and thus need bankruptcy’s Chapter 11 as a short-term process.¹⁰⁷ And others, yet, may find judicial supervision of certain aspects preferable than hard-to-define nonbankruptcy triggering mechanisms.

The growth of those nonbankruptcy reorganization/recapitalization alternatives, however, makes more urgent understanding of bankruptcy law's limited purposes. Placing other policies in bankruptcy when they do not apply to sole owners, or to firms that have in place contractual mechanisms to reorganize/recapitalize outside of bankruptcy, reduces its ability to be successfully used when necessary (and leads to perhaps inefficient avoidances of it).

But while we don't need, from the perspective of a firm's use of bankruptcy, a 2020 "overhaul" of bankruptcy law, since there is no structural shift such as existed at the time of the 1978 Bankruptcy Code that isn't already largely embraced by current practices, there are useful changes that could be made. Some are in the nature of cleaning up "special interest" exceptions to devices of the new finance that, at the time those provisions were added to the Bankruptcy Code, were little understood, but now can be analysed, with some clarity, in terms of fundamental attributes and their bankruptcy consequences.¹⁰⁸ Some are in the nature of both statutorily-validating and constraining in various ways the nature of going concern sales as a primary mechanism of the reorganization of firms under Chapter 11.¹⁰⁹ And some may be not just considering how to make bankruptcy work as a part of the resolution framework for financial institutions, but how some of those ideas (in particular, a rapid one-or two-entity recapitalization that relies on convertible or subordinated debt) may be yet another alternative for *any* firm that wishes, contractually, to so structure itself through the use of convertible or subordinated debt as to be a candidate for such a rapid recapitalization.

All of these would be facilitated, in my view, by careful amendments to the current Bankruptcy Code. The resulting Code, even more so than today's, would bear little resemblance in practice, at least for publicly-traded and other larger firms, to the structure and process that was envisioned in the design of Chapter 11 in 1978. But it is the genius of those 1978 revisions, and a testament to the burgeoning academic focus on reorganization and its alternatives since then, that so much has been accomplished *within* the existing structure of Chapter 11—and more can be accommodated without wholesale revision. For a statute nearing its 40th birthday, that is a remarkable accomplishment, indeed.

NOTES

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- 1. This is painting with a broad brush. The rise of major firms such as Cravath, Swaine & Moore was due in significant part to its work in railroad restructuring 100 years ago,

R. Swaine, *The Cravath Firm and its Predecessors* (Vol 2) 169–75 (1948); *see generally* Douglas Baird, *Elements of Bankruptcy* 64–74 (3rd ed. 2001), and scholarly debates over absolute versus relative priority was an important part of the literature around 1930, *see* James Bonbright & Milton Bergerman, *Two Rival Theories of Priority Rights of Security Holders in a Corporate Reorganization*, 28 Colum. L. Rev. 127 (1928). But there was a clear “return” of bankruptcy to mainstream (or main street) practice following the 1978 Bankruptcy Code. David Skeel, *Debt's Dominion: A History of Bankruptcy Law in America* 221 (2001) (hereafter David Skeel, *Debt's Dominion*) (“[i]n stark contrast to the bankruptcy bar under the old Bankruptcy Act, most of the honorees [in a 1992 article of the *National Law Journal*] now worked for the nation's most prestigious law firms.”). And that was true in the academy as well, *id.*, 228 (“[i]n the law schools, bankruptcy had for many years been as much a backwater as bankruptcy practice. . . . All of this changed in the wake of the 1978 Code.”).

2. Some amendments were made in 1984; significantly greater amendments were made with the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005.
3. *See* Part V, *infra*.
4. And, even there, on larger (often publicly-traded) firms for the most part. Without reintroducing a Chapter X-Chapter XI-like division, many of the developments I will be talking about here do not really apply to a “mom and pop” store, even when it is in corporate form.
5. Putting aside, perhaps, the issue about the status of bankruptcy judges. *See infra*, note 9.
6. All of these developments are recounted in David Skeel's definitive book, David Skeel, *Debt's Dominion*, *supra* note 1.
7. Starting with Thomas Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 Yale L.J. 857 (1982) (hereafter Thomas Jackson, *Creditors' Bargain*) and (symbolically, although not actually) culminating with Thomas Jackson, *The Logic and Limits of Bankruptcy Law* (Harvard 1986) (hereafter Thomas Jackson, *Logic and Limits*).
8. As David Skeel correctly noted, David Skeel, *Debt's Dominion*, *supra* note 1, at 213: ‘Law-and-economics scholars and their insights had remarkably little influence on [legislative reform], but actual bankruptcy practice has taken on many of the market-oriented characteristics that these scholars had advocated.’
9. *Id.*, at 132 (‘the [National Bankruptcy Conference] and the other reform proponents achieved sweeping reform with remarkably little controversy. Although the Democrats controlled both Congress and the presidency, the legislation had widespread support on both sides of the aisle. Only on the question of whether bankruptcy judges should be given Article III status . . . did tempers frequently flare.’).
10. Which has become increasingly controversial, and is likely to be the first place bipartisanship would break down in any overhaul of bankruptcy law today. Again, David Skeel's recounting of the difference between the 1978 Bankruptcy Code and subsequent debates over consumer bankruptcy reforms is a useful starting point. *Id.*, at 187 (‘[t]he congressional debates on the 1978 Code seem almost Zen-like in their tranquility from our vantage point more than two decades later. . . . [T]he vast majority of the debates and hearings drew little attention. . . . The debates over consumer bankruptcy at the dawn of the new century could not be more different.’).
11. Via discharge, which frees up human capital, and exemptions. *See* 11 U.S.C. §727(a) (1) (hereinafter, Bankruptcy Code) (limiting Chapter 7 discharge to individuals); §522 (listing exempt property).
12. Thomas Jackson, *Logic and Limits*, *supra* note 7, at 4. The language used sometimes seemed to conflate the ideas. For example, consider the prominent statement in the 1978 House report: ‘The purpose of a business reorganization case . . . is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders.’ H.R. Rep. No. 95-595, at 220 (1978). I would add “yes, but only in cases where there was financial

failure but not economic failure.” See Barry Adler, Douglas Baird & Thomas Jackson, *Cases, Problems, and Materials on Bankruptcy* 28 (4th ed. 2007) (hereafter, Barry Adler, Douglas Baird & Thomas Jackson, 4th Ed.) (“Understanding that financial and economic distress are conceptually distinct from each other is fundamental to understanding Chapter 11 of the Bankruptcy Code.”). While the “rights” of corporations in particular areas has become a contentious issue in recent years—e.g., campaign financing (see *Citizens United v. Federal Election Commission*, 558 U.S. 310 (2010)) or religious free exercise rights (see *Burwell v. Hobby Lobby Stores, Inc.*, 573 U.S. ____ (2014))—none of these issues translates over to the question of freeing up human capital, which is the essence of what the fresh-start policy does for individuals.

13. Thus, I agree in general contours with the notion that “the creditors’ bargain has been developed by scholars whose primary focus is business bankruptcy, whereas the theory’s critics have tended to focus on consumer bankruptcy, where social policy issues are more pronounced,” Adam Levitin, *Bankrupt Politics and the Politics of Bankruptcy*, 97 Cornell L. Rev. 1399, 1455 (2012). When looking at individual bankruptcy issues, as I did in Thomas Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 Harv. L. Rev. 1393 (1985) (hereafter, Thomas Jackson *Fresh-Start*), I would not wish to describe its outcome principally in terms of a “creditors’ bargain” (nor do I think I did).
14. A corporation with one equity owner and no debt will, obviously, never face insolvency and thus will never use bankruptcy—another way of saying, as I discuss later, that while the corporation may face economic failure (the assets should be doing something else), it will never—as long as it stays in a debt-free condition—face financial failure. And a firm with multiple equity owners and no debt also has no business in bankruptcy as a place to resolve ownership disputes among the equity owners (although, since voluntary petitions have no preconditions, Bankruptcy Code §301, in theory such a case could end up, inappropriately in my view, in bankruptcy; presumably, the underlying dispute would be decided by nonbankruptcy law).
15. Thomas Jackson, *Logic and Limits*, *supra* note 7, at 12–13.
16. Many, including me, wrote about the issues, particularly dealing with the latent, unknown, claimants, raised by the Johns Manville bankruptcy. See Mark Roe, *Bankruptcy and Mass Tort*, 84 Colum. L. Rev. 846 (1984); Thomas Jackson, *Translating Assets and Liabilities to the Bankruptcy Forum*, 14 J. Legal Studies 73 (1985) (hereafter, Thomas Jackson, *Translating*); David Skeel, *Debt’s Dominion*, *supra* note 1, at 217–21.
17. Subject, of course, to governing laws, contracts, and debt instruments.
18. As well as nearly insolvent companies.
19. See Robert Clark, *The Interdisciplinary Study of Legal Evolution*, 90 Yale L.J. 1238, 1250–54 (1981). This reflects nonbankruptcy policy. *Credit Lyonnais Bank Nederland v. Pathe Communications Corp.*, 1991 Del. Ch. LEXIS 215 (Del. Ch. Dec. 30, 1991). It is oftentimes, however, not easy to enform these rights outside of an insolvency proceeding. See *North American Catholic Educational Programming Foundation, Inc. v. Gheewalla*, 930 A.2d 92 (Del. 2007); Thomas Jackson & David Skeel, *Bankruptcy and Economic Recovery*, in Martin Baily, Richard Herring & Yuta Seki, *Financial Restructuring to Sustain Recovery* 97, 102 (Brookings 2013) (hereafter, Thomas Jackson & David Skeel, *Economic Recovery*). Because bankruptcy almost certainly will result in this shift, optimal timing of bankruptcy is another area of concern. See Barry Adler, Vedran Capkun & Lawrence Weiss, *Value Destruction in the New Era of Chapter 11*, 29 J. Law Econ. Organ. 461 (2013); Thomas Jackson & David Skeel, *Economic Recovery*, *supra* note 19, at 101–10. I raised this problem in Thomas Jackson, *Logic and Limits*, *supra* note 7, at 193–208.
20. Thomas Jackson, *Creditors’ Bargain*, *supra* note 7.
21. Perhaps aided by my vigorous support for the absolute priority rule, including my visible defense of full economic compensation for secured creditors, seeming to suggest to some that I favored secured creditors. See *infra* notes 31–2.
22. See, e.g., my early work criticizing the use of bankruptcy to reject collective bargaining agreements originally approved by *National Labor Relations Board v. Bildisco*

- & *Bildisco*, 465 U.S. 513 (1984). My criticism first appeared in Thomas Jackson, *Translating*, *supra* note 16. And my analysis of the “fresh-start policy” for individuals was driven by a vastly different heuristic—that of cognitive and volitional psychology. See Thomas Jackson, *Fresh-Start*, *supra* note 13.
23. Even for parties that *do* have rights within bankruptcy, academic scholarship continues to debate whether the absolute priority rule accurately reflects those rights. See Anthony Casey, *The Creditors' Bargain and Option-Preservation Priority in Chapter 11*, 78 U. Chi. L. Rev. 759 (2011); Douglas Baird & Donald Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 Yale L.J. 1930 (2006).
 24. Elizabeth Warren, *Bankruptcy Policy*, 54 U. Chi. L. Rev. 775 (1987); Douglas Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. Chi. L. Rev. 815 (1987) (hereafter Douglas Baird, *Reply to Warren*). While Elizabeth Warren was, early on, the most visible critic (and the passage of time made her even more so), there were many other critics. See, e.g., Karen Gross, *Taking Community Interests into Account in Bankruptcy: An Essay*, 72 Wash. U.L.Q. 1031 (1994); Donald Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 Colum. L. Rev. 717 (1991).
 25. See *infra*, Part III.
 26. Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 Yale L.J. 1807 (1998); Alan Schwartz, *Bankruptcy Workouts and Debt Contracts*, 36 J. Law & Econ. 595 (1993). See also *infra* Part IV.
 27. See Viral Acharya, Barry Adler, Matthew Richardson & Nouriel Roubini, *Resolution Authority*, in Viral Acharya, Thomas Cooley, Matthew Richardson & Ingo Walter (eds), *Regulating Wall Street: The Dodd-Frank Act and the New Architecture of Global Finance* (Wiley 2011) (hereinafter “Acharya, Adler (etc.), *Resolution Authority*”); Barry Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 Stan. L. Rev. 311 (1993); Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 Yale L.J. 1043 (1992).
 28. David Skeel, *Markets, Courts & the Brave New World of Bankruptcy Theory*, 1993 Wis. L. Rev. 465 (1993). Some can be imported directly into bankruptcy, as I propose *infra* Part VI with respect to a “quick sale” resolution of a troubled systemically important financial institution. And, even when bankruptcy can be avoided altogether through some of these new contractual devices, it will remain important to have bankruptcy rules as efficient and clear as possible, as the effectiveness of the out-of-court devices may well take place “in the shadow” of what *would* occur in bankruptcy. See University of Rochester Roundtable on Preserving Value in Chapter 11, 16(2–3) J. Applied Corp. Fin. 8, 14 (2004) (comments of Thomas Jackson) (hereafter Rochester Roundtable).
 29. David Skeel, *Debt's Dominion*, *supra* note 1, at 227.
 30. Notably, Bankruptcy Code §§362(b)(6), (7), (17), (27); 546(e), (f), (g), (j); 555; 556; 559; 560; 561.
 31. Thomas Jackson, Brief for Amicus Curiae in *United Savings Associates of Texas v. Timbers of Inwood Forest Associates, Ltd.* (1987).
 32. *United Savings Association of Texas v. Timbers of Inwood Forest Associates, Ltd.*, 484 U.S. 365 (1988).
 33. Bankruptcy Code §1129.
 34. *Id.*, §1141.
 35. *Id.*, §1121(b), (c).
 36. *Id.*, §1129(a)(7)(A)(ii) (a plan can be confirmed if dissenting claimants receive or retain value that is not less than it would retain “if the debtor were liquidated under Chapter 7”); §1129(b)(1), (2) (a plan can be confirmed over the objection of a class, §1129(a)(8), if the court determines that the class is receiving value that equals the full amount of their claims or no junior class receives anything on account of its claims or interests).
 37. Thomas Jackson, *Logic and Limits*, *supra* note 7, at 211. Here, I was being consistent with my law student note, in which I suggested a reorganization, like any liquidation procedure, involves two steps: First, the assets of the firm are sold; second, the claims

- against the debtor are paid out of the proceeds of this sale, *see* Note, *Giving Substance to the Bonus Rule in Corporate Reorganizations: The Investment Value Doctrine Analogy*, 84 Yale L.J. 932, 943–6 (1975).
38. Thomas Jackson, *Logic and Limits*, *supra* note 7, at 212.
 39. *Id.*, at 214–15.
 40. Mark Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 Colum. L. Rev. 527 (1983).
 41. Thomas Jackson, *Logic and Limits*, *supra* note 7, at 223. This, obviously, refers particularly to publicly-traded and other sizeable firms—the target of Professor Roe’s proposal.
 42. Although I was far from the only voice suggesting a market-based approach to, or replacement for, Chapter 11. Others, both from the legal side, *e.g.*, Mark Roe, *supra* note 40; Douglas Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. Legal Studies 127 (1986), and from the economic side, *see* Lucian Bebchuk, *A New Approach to Corporate Reorganizations*, 101 Harv. L. Rev. 775 (1988); Michael Jensen, *Corporate Control and the Politics of Finance*, 4(2) J. Applied Corp. Fin. 12 (1991), were making similar arguments.
 43. *See* David Skeel, *Debt’s Dominion*, *supra* note 1, at 213: ‘Law-and-economics scholars and their insights had remarkably little influence on the 1994 commission . . . but actual bankruptcy practice has taken on many of the market-oriented characteristics that these scholars have advocated.’ *See also* Rochester Rountable, *supra* note 28, at 14 (comments of Thomas Jackson); Douglas Baird & Robert Rasmussen, *The End of Bankruptcy*, 55 Stan. L. Rev. 751 (2002) (hereafter Douglas Baird & Robert Rasmussen, *End*).
 44. David Skeel, *From Chrysler and General Motors to Detroit*, <http://ssrn.com/abstract=2491022> at 5 (2014) (hereafter David Skeel, *Detroit*) (“The drafters of the Bankruptcy Code assumed that debtors might use [section 363(b)] to sell a few of their assets—say, a piece of equipment the debtor no longer needs. They did not seem to have imagined that a debtor might use section 363 to sell *all* of its assets.”).
 45. The provision is Bankruptcy Code §363, providing for the “use, sale, or lease of property” of the estate. The major cases heralding the new era were *In re Lionel Corp.*, 722 F.2d 1063 (2nd Cir. 1983) and *In re Braniff Airways*, 700 F.2d 935 (5th Cir. 1983). *See* David Skeel, *Detroit*, *supra* note 44, at 4 (‘After the current bankruptcy laws were enacted in 1978, debtors were restructured through a traditional reorganization process, not by sales. . . . By the mid-1990s, however, sales became an increasingly routine strategy for resolving financial distress.’); Douglas Baird & Robert Rasmussen, *Chapter 11 at Twilight*, 56 Stan. L. Rev. 673 (2003) (hereafter Douglas Baird & Robert Rasmussen, *Twilight*); *see also* Douglas Baird, *The New Face of Chapter 11*, 12 Am. Bankr. Inst. L. Rev. 69 (2004); Douglas Baird & Robert Rasmussen, *End*, *supra* note 43.
 46. The Bankruptcy Code explicitly allows the assets to be sold “free and clear” of many, if not most, claims; Bankruptcy Code §363(f). For an argument that overriding doctrines of successor liability may make sense under certain circumstances, *see* Thomas Jackson, *Translating*, *supra* note 16, at 94–7.
 47. Thomas Jackson, *Logic and Limits*, *supra* note 7.
 48. *See*, for example, my discussion of state law that created rights that were “like a lien,” even though never called anything like that, such as in *Chicago Board of Trade v. Johnson*, 264 U.S. 1 (1924), analysed in Thomas Jackson, *Translating*, *supra* note 16. In 1986, I criticized much of Bankruptcy Code §365(f), as then written, Thomas Jackson, *Logic and Limits*, *supra* note 7, at 113–18. Similarly, several years later, Douglas Baird and I analysed issues around technology licensing agreements, the decision in *Lubrizol Enterprises v. Richmond Metal Finishers*, 756 F.2d 1043 (4th Cir. 1985) (holding such an agreement as executory in its entirety), and Congress’ 1988 response in enacting Section 365(n). Douglas Baird & Thomas Jackson, *Cases, Problems, and Materials on Bankruptcy Law* 247–58 (2nd ed. 1990) (hereafter Douglas Baird & Thomas Jackson, 2d Ed.)

49. See sources cited *supra* notes 26–7.
50. Thomas Jackson & David Skeel, *Economic Recovery*, *supra* note 19, at 110–11. This article contains greater detail about the relationship between “saving” Chrysler jobs (but not necessarily jobs overall, given the overcapacity in the automobile industry) and the abuses of the bankruptcy process. On the latter, see Mark Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 Mich. L. Rev. 727 (2009) (hereafter Mark Roe & David Skeel, *Chrysler Bankruptcy*); Todd Zwicki, *Chrysler and the Rule of Law*, Wall Street Journal (May 13, 2009); See Barry Adler, *A Reassessment of Bankruptcy Reorganization after Chrysler and General Motors*, 18 Amer. Bankr. Inst. L. Rev. 205 (2010) (hereafter Barry Adler, *Reassessment*) (with a proposed amendment to Bankruptcy Code §363); see also www.scribd.com/doc/14952818/Objection-to-Chrysler-Sale-Motion (brief filed on May 4, 2009 in the Southern District of New York bankruptcy court by Chrysler’s non-TARP secured lenders).
51. Interestingly, in Chrysler itself, it is unclear how much damage to bankruptcy principles I advocate was ultimately done. While the bankruptcy judge’s opinion permitting the sale under dubious procedures and restrictions was affirmed in a hasty decision by the Second Circuit, *In re Chrysler LLC*, 576 F.3d 108 (2d Cir. 2009) (argued on June 5, 2009, decided on June 5, 2009, with an opinion issued after-the-fact on August 5, 2009—when its reasoning could hardly contradict its already-issued judgment), the Supreme Court, on December 14, 2010, granted certiorari, vacated the Second Circuit’s opinion and directed that the Second Circuit dismiss the suit as moot. *Ind. State Police Pension Trust v. Chrysler LLC*, 130 S.Ct. 1015 (2010). As a consequence, the Second Circuit’s opinion has no precedential value. *United States v. Munsingwear*, 340 U.S. 36 (1950). This rather remarkable step—since the Supreme Court in July had issued, and then lifted, a stay, following the Second Circuit’s ruling (and prior to the Second Circuit’s written opinion justifying that ruling), allowing the sale to be consummated, 129 S.Ct. 2275 (2009)—has led some to speculate that the Supreme Court’s vacating the Second Circuit opinion six months after the court lifted the stay allowing the sale to go forward “was an expression of its disagreement with the Second Circuit’s interpretation of the requirements of §363(b).” Fred David, *Interpreting the Supreme Court’s Treatment of the Chrysler Bankruptcy and Its Impact on Future Business Reorganizations*, 27 Emory Bankr. Dev. J. (2010). This is at least plausible, since at the time the Supreme Court lifted the stay and allowed the transaction to be consummated, the Second Circuit had not yet written its opinion explaining its reasons for affirming the bankruptcy judge’s decision to allow the sale to go forward as then structured.
52. Thirty years ago, citing *Butner v. United States*, 440 U.S. 48, 54–5 (1978) (“[u]niform treatment of property interests . . . serves . . . to discourage forum shopping, and to prevent a party from receiving “a windfall merely by reason of the happenstance of bankruptcy”,” I talked about this in terms of “forum shopping.” Thomas Jackson, *Logic and Limits*, *supra* note 7; see also Douglas Baird, *Reply to Warren*, *supra* note 24, but it is clear to me now that it isn’t just alternative *judicial* forums that are in play. Rather, and perhaps more important, is “bailout” shopping, particularly where the federal government is a creditor, or otherwise interested party (for whatever reason), of an insolvent firm—such as in the case of Chrysler’s 2008 bankruptcy.
53. Adam Levitin, *supra* note 13, at 1455.
54. But many *were* questioned using exactly the same heuristic. See *supra* note 22.
55. These provisions are listed *supra* note 30.
56. The arguments here are more fully fleshed out in David Skeel & Thomas Jackson, *Transaction Consistency and the New Finance in Bankruptcy*, 112 Colum. L. Rev. 152 (2012) (hereafter David Skeel & Thomas Jackson, *Transaction Consistency*). See also Thomas Jackson, *Bankruptcy Code Chapter 14: A Proposal*, Kenneth Scott & John Taylor (eds), *Bankruptcy Not Bailout* 25 (2012) (hereafter Thomas Jackson, *Chapter 14 1.0*); Darrell Duffie & David Skeel, *A Dialogue on the Costs and Benefits of Automatic Stays for Derivatives and Repurchase Agreements*, in Kenneth Scott & John Taylor, (eds), *infra*, at 133.

57. The major forms of swaps include credit default swaps, interest rate swaps, and currency swaps. A credit default swap functions like insurance, with one party (the protection seller) promising the other party (the protection buyer) a payment in the event a third party (the reference entity) that is the subject of the contract experiences a “credit event” such as default or bankruptcy. With an interest rate swap, one party agrees to pay one form of interest (such as a fixed interest rate) and the other pays a different rate (such as an interest rate that varies based on the prime rate). With a currency swap, one party agrees to pay a specified amount of one currency (such as dollars) and the other promises a different currency (such as euros). In each case, the obligations are usually netted out at the end of the contract, and one party pays the other the difference.
58. In a repurchase or “repo” transaction, one party sells securities to the other, and promises to buy them back at a specified time in the future. Repos are generally used for financing, and are very similar to a secured loan with securities as collateral.
59. Bankruptcy Code §362(a).
60. *Supra* note 30.
61. Bankruptcy Code §541.
62. Or, in bankruptcy terms, “claims,” Bankruptcy Code §101(5).
63. The classic definition is that of Vern Countryman, *Executory Contracts in Bankruptcy* (pt. 1), 57 Minn. L. Rev. 439, 460 (1973) (an executory contract is “a contract under which the obligation of both the bankrupt and the other party to the contract are so far unperformed that the failure of either to complete performance would constitute a material breach excusing the performance of the other”); *see also* Thomas Jackson, *Logic and Limits*, *supra* note 7, at 105–18.
64. Bankruptcy Code §365(a). If the debtor wishes to assume a contract or lease, it must “cure[], or provide[] adequate assurance that [it] will promptly cure” any default, compensate the other party for any losses, and “provide[] adequate assurance of future performance.” Bankruptcy Code §365(b).
65. Bankruptcy Code §365(d). The debtor generally has considerable discretion when it makes its decision whether to assume or reject a contract or lease. One of the few exceptions is nonresidential leases, which are subject to a 210-day limit. Bankruptcy Code §365(d)(4).
66. As well as assignment.
67. Bankruptcy Code §365(e).
68. *See* Douglas Baird & Thomas Jackson, (2nd ed.), *supra* note 48, at 278 (describing the parties’ incentives during this period).
69. In these situations, the other party’s major remedy is to seek a court order requiring the debtor to assume or reject the contract.
70. *See, e.g., In re Thompson*, 788 F.2d 560, 563 (9th Cir. 1986).
71. Adequate protection is required by Bankruptcy Code §362(d)(1) and defined by Bankruptcy Code §361.
72. Bankruptcy Code §362(a)(7) (the filing of the petition operates as a stay of “the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor”). While the setoff is *stayed* (absent court permission), the *right* of setoff is expressly recognized, as tantamount to a secured claim, by Bankruptcy Code §553. If the off-set arises out of the same transaction, it has been considered “recoupment,” not “setoff,” and thus not subject to the rules of Bankruptcy Code §553 (or §362(a)(7) as well). *See In re Holyoke Nursing Home, Inc.*, 372 F.3d 1, 3 (1st Cir. 2004).
73. This is particularly so in the wake of the 2008 financial crisis, which has prompted a shift back to cash-like collateral for derivatives, and sharply diminished repos based on mortgage-backed securities and other less liquidate collateral. If there are exceptions to the example in the text—for example, a concern of a cascade of defaults upon the removal of a financial institution’s securities, they should be articulated and debated.
74. Under Bankruptcy Code §365(d)(4), 120 days. There are also time limits for such a

- decision on residential real property or personal property in Chapter 7, Bankruptcy Code §365(d)(1).
75. If rejected, the discussion about counterparty rights regarding collateral for repos would apply here as well.
76. P. Law No. 111–203, Stat. 1376 (hereafter Dodd-Frank Act) §210(c)(10)(B).
77. The Dodd-Frank Act requirement of wind-down plans (“living wills”) is Dodd-Frank Act §167(d). The Dodd-Frank Act also pushes towards a regime in which most swaps would be traded on an exchange of “swap execution facility” and cleared on a clearing house. Such a move would almost certainly permit rapid valuations of swaps, again facilitating the ability to make decisions regarding such swaps within a three-day stay period.
78. David Skeel, *Debt’s Dominion*, *supra* note 1, at 227; Barry Adler, Douglas Baird & Thomas Jackson, 4th Ed., *supra* note 12, at 466–7 (‘between [1983 and 2003] a sea change occurred through which an auction of the debtor’s assets has become a commonplace alternative to a traditional corporate reorganization’).
79. Bankruptcy Code §109(b)(2).
80. Depository banks are resolved by FDIC processes. *See* Federal Deposit Insurance Corporation Improvement Act of 1991, Pub. L. No. 102-242, 105 Stat. 2236 (1991) (codified as amended in scattered sections of 12 U.S.C.). The FDIC acts as a guarantor of the vast majority of a bank’s claims and is, in effect, the residual owner of the bank’s assets, so lodging resolution with it is, at least, defensible. The exclusion of insurance companies seems to stem from a (shaky) notion that they should be resolved by state insurance regulators. *See* David Skeel, *The Law and Finance of Bank and Insurance Insolvency Regulation*, 76 Tex. L. Rev. 723 (1998).
81. David Skeel & Thomas Jackson, *Transaction Consistency*, *supra* note 56, at 158–62 (recounting the parade of amendments, their rationale, and lack of opposition); Edward Morrison & Joerg Riegel, *Financial Contracts and the New Bankruptcy Code: Insulating Markets from Bankruptcy Debtors and Bankruptcy Judges*, 13 Am. Bankr. Inst. L. Rev. 641, 644–5 (2005).
82. *See* Thomas Jackson & David Skeel, *Bankruptcy, Banks, and Non-Bank Financial Institutions* (Wharton Fin. Inst. Cent. Workshop, Feb. 8, 2010); Thomas Jackson & David Skeel, *Dynamic Resolution of Large Financial Institutions*, 2 Harv. Bus. L. Rev. 435 (2012).
83. *See generally*, Financial Stability Board, *Progress and the Next Steps Towards Ending “Too-Big-to-Fail,”* Report of the Financial Stability Board to the G-20 at www.financialstabilityboard.org/publications/r_130902.pdf (Sept. 2013); Thomas Huertas, Vice Chairman, Comm. of European Banking Supervisors and Dir., Banking Sector, U.K. Fin. Services Autho., *The Road to Better Resolution: From Bail-Out to Bail-In*, speech at The Euro and the Financial Crisis Conference (Sept. 6, 2010); Clifford Chance, *Legal Aspects of Bank Bail-Ins* (2011). In part, this difference in focus is driven by general differences in financial institution capital structures between Europe and the United States.
84. Federal Deposit Insurance Corporation, *The Resolution of Systemically Important Financial Institutions: The Single Point of Entry Strategy*, 78 Fed. Reg. 76614 (Dec. 18, 2013).
85. *Id.*
86. *Id.*, at 76616–76618.
87. *See* John Bovenzi, Randall Guynn & Thomas Jackson, *Too Big to Fail: The Path to a Solution* (Bipartisan Policy Center, Failure Resolution Task Force May 2013).
88. *See In re KMart Corp.*, 359 F.3d 866 (7th Cir. 2004); *Miltenberger v. Logansport, C. & S.W. Railway Co.*, 106 U.S. 286 (1882). Here, in particular, this transfer is a priority-enhancing action for those unsecured claimants of an insolvent entity. Thus, the doctrine needs to be closely policed to ensure that the transfer is in the interest of the other unsecured creditors. *See* Barry Adler, Douglas Baird & Thomas Jackson, 4th Ed., *supra* note 12, at 446 (“the payment is made because of the benefit that will

- accrue to the estate as a whole”). The prototype case may be the transfer of consumer warranty claims in the case of a durable-goods manufacturer.
89. David Skeel, *Detroit*, *supra* note 44, at 6 (“[i]n most cases, . . . the portion of the overall price paid by the buyer that consists of the assumption of debt is comparatively small”).
 90. Kenneth Ayotte & David Skeel, *An Efficiency-Based Explanation for Current Corporate Reorganization Practice*, 73 U. Chi. L. Rev. 425, 465–7 (2006).
 91. There may be a particular concern with improving the position of an undersecured creditor in either situation. My own suggested “remedy” for this is to have secured claims transferred on a non-recourse basis to the new entity, and any deficiency claim also “left behind” in the debtor’s estate. This is spelled out in greater detail in Thomas Jackson, *Building on Bankruptcy: A Revised Chapter 14 Proposal for the Recapitalization, Reorganization, or Liquidation of Financial Institutions*, in Kenneth Scott, Thomas Jackson & John Taylor, (eds), *Making Failure Feasible: How Bankruptcy Can End “too Big to Fail”* (Hoover Institution Press 2015) (hereafter Thomas Jackson, *Chapter 14 2.0*).
 92. Thomas Jackson, *Resolving Financial Institutions: A Proposed Bankruptcy Code Alternative*, Vol. 1, Issue 1, *Banking Perspective* (2014).
 93. Which may not be strictly necessary, *see infra* text at notes 100–101.
 94. Details of the kinds of rules I envision are spelled out in Thomas Jackson, *Chapter 14 2.0*, *supra* note 91.
 95. This is a point emphasized in John Bovenzi, Randall Guynn, Thomas Jackson, *supra* note 87. *See also* Daniel Tarullo *Toward Building a More Effective Resolution Regime: Progress and Challenges* (Oct. 2013) at 10–12; Acharya, Adler (etc.), *Resolution Authority*, *supra* note 27, <http://www.federalreserve.gov/newsevents/speech/tarullo20131018a.htm>; Financial Stability Board *Progress and the Next Steps Towards Ending “Too-Big-to-Fail,”* Report of the Financial Stability Board to the G-20 at www.financialstabilityboard.org/publications/r_130902.pdf (Sept. 2013). In my view, this is equally necessary for an effective use of a single point of entry strategy under Title II of the Dodd-Frank Act; FDIC ex post discretion is the other (not very palatable) alternative.
 96. Dodd-Frank Act §165(d).
 97. Existing Bankruptcy Code §§365 and 541 cover some, but not all, of these areas.
 98. *See* Daniel Tarullo *supra* note 95, at 10–12.
 99. A 2013 Senate Bill, which, among other things, proposes a new Chapter 14 for the Bankruptcy Code to handle a rapid recapitalization sale (a Section 1406 “special transfer”), provides detailed implementation provisions for the second and third points. *See* S. 1861 (Dec. 2013). A House Judiciary Subcommittee introduced a similar bill in 2014, H. 5421, that passed the House late in 2014 on a voice vote. After minor modifications, a similar bill, H. 2947, again passed the House in 2016. The Hoover Institution’s Resolution Project has made a comprehensive proposal (dubbed “Chapter 14 2.0”) that picks up many of the ideas from its original proposal, Thomas Jackson, *Chapter 14 1.0*, and adds to it features necessary to implement a rapid recapitalization sale. *See* Thomas Jackson, *Chapter 14 2.0*, *supra* note 91.
 100. *See supra*, notes 26–8.
 101. Think of it as a legally-devised “pre-package plan” on steroids!
 102. Such as described in Thomas Jackson, *Chapter 14 2.0*, *supra* note 91; and proposed in S. 1861 (Dec. 2013), H. 5421 (Sept. 2014), and H. 2947 (Feb. 2016).
 103. Such as just described.
 104. Such as proposed (in a different context) in sources cited *supra* notes 26–7. *See also* John Coffee, *Systemic Risk After Dodd-Frank: Contingent Capital and the Need for Regulatory Strategies Beyond Oversight*, 111 Colum. L. Rev. 795 (2011).
 105. A “blended” approach—melding contractual provisions with regulatory “muscle”—seems to be emerging with respect to staying cross-default and early termination rights in cases of qualified financial contracts of G-18 firms when one of them is subject to a resolution action. *See* <http://www2.isda.org/newsroom/press-releases> (Oct. 11, 2014)

- announced by The International Swaps and Derivatives Association of its Resolution Stay Protocol. While this, by its current terms, would not apply to a private resolution, the idea could certainly be expanded to cover that context.
106. For example, a firm overwhelmed by tort liability, particularly historically-based tort liability, as was the case in Johns Manville's bankruptcy of 1982. It isn't clear to me whether a Chrysler or a General Motors could have contractually held enough convertible or subordinated debt, or bound enough parties, to make a nonbankruptcy resolution possible.
 107. Even if an enlightened debtor can avoid contractually committing to "ipso facto," cross-default, or change-of-control provisions, there may be certain situations where it cannot avoid facing such provisions (such as, perhaps, in a government-issued regulatory permit with a change-of-control provision). The latter question is whether these restrictions are "lien like" and thus survive bankruptcy, or whether they are inapplicable to the kind of change-of-control outcomes envisioned here. And, sales that guarantee clean title may be desirable, and difficult to achieve outside of bankruptcy. See Douglas Baird & Robert Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. Pa. L. Rev. 1209, 1251 n. 128 (2006) ("Similar [clean title] assurances are harder to provide outside of bankruptcy. To be sure, Chapter 11 was never intended to be a forum for senior lenders to sell assets and ensure buyers that they would receive clean title. Nevertheless, having some such forum seems a sensible idea."). With respect to this last point, see *supra* note 46.
 108. See *supra*, Part V.
 109. See, for example, Barry Adler's proposed amendment to Bankruptcy Code §363 in light of Chrysler's bankruptcy, Barry Adler, *Reassessment*, *supra* note 50, Mark Roe & David Skeel's proposal for required auctions, Mark Roe & David Skeel, *Chrysler Bankruptcy*, *supra* note 50, at 767, Kenneth Ayotte's and David Skeel's concerns about sales in which the same party serves as both lender and buyer, Kenneth Ayotte & David Skeel, *supra* note 90, at 465–7, or Douglas Baird's suggested limits on "gift-ing" and other procedural safeguards, Douglas Baird, *Lessons from the Automobile Reorganizations*, 4 J. Leg. Anal. 271 (2012).

EDITOR'S NOTES

The content of this chapter was drafted prior to the United States House of Representatives' proposed deregulation of systemically important financial institutions ("SIFIs") in the Financial Choice Act and proposed special chapter of the Bankruptcy Code for SIFIs in the Financial Institutions Bankruptcy Act.

The latter Act, at least, is testament to the influence of ideas developed by Jackson and summarized in this chapter.