A NEW DEAL FOR CORPORATE BANKRUPTCY: BRING BACK CHAPTER X

by

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In 1978 Congress decided that all corporate debtors, of whatever size, would reorganize under a single chapter 11. The new reorganization provision adopted the model of the old chapter XI, with a "debtor in possession" of its own bankruptcy estate. Among other things, this replaced chapter X, which had applied to primarily publicly traded debtors, and required an independent trustee and oversight by the U.S. Securities and Exchange Commission. But in recent years, Congress has changed direction yet again and abandoned the single chapter model to provide special reorganization provisions for small businesses. In this context, and the reality of an increasingly rough and tumble chapter 11 notable for its "creditor-on-creditor violence," I suggest it might be time to return to something like old chapter X. Large corporate debtors might be more efficiently reorganized under the oversight of an independent, neutral party.

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Table of Contents

I. Introduction

Amid the broader American deregulatory mania of the late 1970s, corporate bankruptcy took the cure.[1] In particular, the New Deal tool for reorganizing publicly traded debtors—chapter X—was sacked.[2] So was § 77, the 1933 provision for reorganizing railroads.

Going forward, all companies, large or small, publicly traded or privately held, mundane or glamourous, would reorganize under chapter 11, a revamped version of the old chapter XI.[3] One of the key features of the old chapter XI was that it allowed the company's management (the debtor) to retain control of the business while undergoing the reorganization process, rather than placing the company under a trustee's control (as was typically the case under chapter X). Chapter XI had originally been designed to reorganize small businesses, but it was co-opted by big businesses and the drafters of the 1978 Bankruptcy Code blessed that move with their new chapter 11.[4]

As with modern chapter 11, the primary goal of chapter X had been to facilitate the reorganization of troubled corporations, allowing them to restructure their debts while continuing to operate, instead of going into liquidation under chapter VII. Chapter X provided a framework under which a corporation could propose a reorganization plan, subject to approval by creditors and the court. The plan could involve modifying the company's obligations, restructuring debts, and reorganizing its management. The

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[1] For a sense of the times, *see* JENNIFER BURNS, MILTON FRIEDMAN: THE LAST CONSERVATIVE 402–05, 440, 447–48 (2023).

[2] David A. Skeel, Jr. & George Triantis, *Bankruptcy's Uneasy Shift to A Contract Paradigm*, 166 U. PA. L. REV. 1777, 1784 (2018). Chapter X, the Chandler Act of 1938, §§ 101–276, was originally codified at 11 U.S.C. §§ 501–676, and was repealed in 1978 with the enactment of the current Bankruptcy Code. Throughout this Article, I cite it as "Chapter X § __," with citation to the original Chandler Act sections, to avoid any confusion with the present Code. I follow a similar convention regarding chapter XI, originally Chandler Act §§ 301–399 and codified at 11 U.S.C. §§ 701–799 (repealed 1978). For many years, *Collier's* has included the full 1898 Bankruptcy Act, as it stood just before repeal, as an appendix.

[3] Harvey R. Miller, *The Changing Face of Chapter 11: A Reemergence of the Bankruptcy Judge As Producer, Director, and Sometimes Star of the Reorganization Passion Play*, 69 AM. BANKR. L.J. 431, 431 (1995). *See also* Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 WIS. L. REV. 729, 745 (1993); Steven B. Johnson, *Bankruptcy Reform and Its International Competitive Implications*, 9 HARV. J.L. & PUB. POL'Y 667, 673 (1986).

[4] Jonathan C. Gordon, *Government Guaranties for Corporate Bankruptcies*, 43 VT. L. REV. 251, 262 (2018).

process under chapter X involved close court supervision, and as noted, typically the court appointed a trustee to oversee the process.

Conventional wisdom portrays old chapter X as seldom used, and little missed.[5] To be sure, most bankruptcy insiders, save for the U.S. Securities and Exchange Commission ("SEC"), were eager to see chapter X go, in large part because it was in their self-interest to kill it off.[6] As one contemporary commentator observed,

> [T]he format for whacking up the fees provides an overpowering stimulus toward Chapter XI. Any attorney with so much as a passing interest in making money will opt for XI, and at the outset the choice is up to debtor's attorney.[7]

The risk of conversion to chapter X was feared by most insiders.

Chapter X was used, although not as much as it probably should have been to be sure, given the widespread evasion of its intended application.[8] And with President Carter's signature, chapter X died, and the more *laissez faire* chapter 11 took its place.[9]

But in recent years the basic premise of chapter 11 as an integrated reorganization provision for all businesses has been undone—new subchapter V, and not the original chapter 11, is the platform of choice for almost all small businesses.[10] Indeed, the subchapter currently accounts for almost half of all chapter 11 cases.[11] But cases that proceed under subchapter

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[5] *E.g.*, Katherine H. Daigle & Michael T. Maloney, *Residual Claims in Bankruptcy: An Agency Theory Explanation*, 37 J.L. & ECON. 157, 161 (1994). *But see* Benjamin Weintraub & Harris Levin, *Chapter VII (Reorganizations) as Proposed by the Bankruptcy Commission: The Widening Gap Between Theory and Reality*, 47 AM. BANKR. L.J. 323, 323 (1973) ("Amendments beneficial to Chapters X and XI can be effected within the confines of those chapters without the necessity of destroying a thirty-five year old system which has responded well to the needs of the parties whose interests are at stake. Indeed, the present problems are not such as require total restructuring.").

[6] *See* Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 MICH. L. REV. 47, 110 (1997).

[7] SIDNEY RUTBERG, TEN CENTS ON THE DOLLAR: OR THE BANKRUPTCY GAME 140 (1973).

[8] James J. White, *Death and Resurrection of Secured Credit*, 12 AM. BANKR. INST. L. REV. 139, 142 (2004).

[9] Nancy L. Ross, *Carter Expected to Sign Revised Bankruptcy Bill*, WASH. POST WP, Oct. 10, 1978.

[10] The Small Business Reorganization Act of 2019, also known as SBRA (Pub. L. No. 116-54), became effective on Feb. 19, 2020. *See* Christopher G. Bradley, *The New Small Business Bankruptcy Game: Strategies for Creditors Under the Small Business Reorganization Act*, 28 AM. BANKR. INST. L. REV. 251, 257–258 (2020).

[11] Bob Lawless, *About 44% of Chapter 11s are Subchapter V Cases*, CREDIT SLIPS: A

V follow markedly different rules than those found in the 1978 version of chapter 11.

At the same time, in the big cases, traditional chapter 11 has devolved into a playground of extreme brutality—akin to a publicly funded dueling ground; Weehawken of the federal judiciary, as it were.[12]

Many modern chapter 11 cases are often preceded by liability management exercises (LMEs)—or liability management transactions (LMTs)—which in theory buy the debtor some "runway," or time to consider its options, but most often simply set up a subsequent chapter 11 case in a way that benefits the debtor's private equity owner.[13] These LMEs can take a variety of forms; the two most common are:

- Debt exchanges where the borrower issues additional debt to an existing lender that is senior to existing debt of the same class (up-tiering)[14]
- Transfers of valuable assets to a new subsidiary, which can take on additional debt (drop-down financing).[15]

Both are facilitated by loose or non-existent covenants in borrower-friendly loan agreements, driven in large part by the massive number of collateralized loan obligations (CLOs) looking for loans to stuff into their portfolios.[16]

DISCUSSION ON CREDIT, FINANCE, AND BANKRUPTCY (MAR. 26, 2024, 7:02 PM), https://www.creditslips.org/creditslips/2024/03/about-44-of-chapter-11s-are-subchapter-v-cases.html.

[12] Diane Lourdes Dick, *Hostile Restructurings*, 96 WASH. L. REV. 1333, 1337 (2021). *See also* Daniel B. Kamensky, *The Rise of the Sponsor-in-Possession and Implications for Sponsor (Mis)behavior*, 171 U. PA. L. REV. ONLINE 19 (2024).

[13] One early article on the topic, defined liability management transactions as

> [T]hose that seek to proactively address company debts and obligations through negotiated solutions outside of a traditional in-court restructuring process but involve more than a traditional capital markets solution. Examples can range from discounted debt buy-backs and minor covenant resets to aggressive, coercive modifications of debt documents and combination new money/up-tier exchanges. These transactions can be viewed as defensive or offensive depending on the perspective of the constituent involved, and they can preemptively address capital structure issues that might otherwise result in a restructuring . . . .

Jeff Raithel, *Liability Management Overview*, 39-6 AM. BANKR. INST. J. 34 (2018).

[14] *In re* TPC Grp. Inc., No. 22-10493 (CTG), 2022 WL 2498751, at *1 (Bankr. D. Del. July 6, 2022).

[15] Jackson Skeen, *Uptier Exchange Transactions: Lawful Innovation or Lender-on-Lender Violence?*, 40 YALE J. ON REG. 408, 412–413 (2023).

[16] A CLO is a securitization created to acquire and manage a pool of high-risk loans.

Booming investment demand results in easy terms for borrowers.[17]

Some commentators, especially those enamored with private ordering, argue that perhaps the new twist on corporate reorganization is actually efficient, because it helps to avoid costly reorganization cases. But these LMEs rarely avoid bankruptcy; indeed, if that is their goal, they seem to fail miserably.[18] These transactions take up a massive amount of time and resources, just to buy a brief pause before bankruptcy happens in any event.[19] Out of all of the restructuring options available, simply handing over the keys to the creditors would seem to be a far more obvious way to avoid an expensive chapter 11 process.

LMEs instead lay out patterns for the subsequent bankruptcy that deviate from legislative norms.[20] By setting up the capital structure for bankruptcy in the pre-bankruptcy period, the bankruptcy can be conducted as a "deal," with little input from annoying legislators and their quaint notions of "public policy."[21] The deal takes the form of a restructuring support agreement ("RSA") that binds the "in crowd."[22]

As a result, the chapter 11 case often arrives fully scripted. Rather than evaluating LMEs on a standalone basis, they should be understood as strategic prequels to chapter 11 plans. A few companies manage to avoid

CLOs issue several debt layers along with equity and use the proceeds from the issuance to obtain a pool of loans. *See* Cathy Hwang et al., *The Lost Promise of Private Ordering*, 109 CORNELL L. REV. 1, 17 (2023); Carmen Arroyo & Eleanor Duncan, *CLOs Have Too Much Money and Are Running Out of Things to Buy*. BLOOMBERG (June 29, 2024, 3:00 PM), https://www.bloomberg.com/news/articles/2024-06-29/clos-have-too-much-money-and-are-running-out-of-things-to-buy-credit-weekly?utm_source=website&utm_medium=share&utm_campaign=copy.

[17] Harriet Clarfelt & Antoine Gara, *Companies Slash Borrowing Costs on $400bn of U.S. Junk Loans*, FIN. TIMES (June 25, 2024), https://www.ft.com/content/866cfe14-0512-4411-b843-7aa0bf8a642a.

[18] Prominent examples include Serta, J. Crew, Incora, and Robertshaw, among others.

[19] *See* Vincent S.J. Buccola, *Efficacious Answers to the Non-Pro Rata Workout*, 171 U. PA. L. REV. 1859, 1873 (2023).

[20] Diane Lourdes Dick, *Tactical Restructurings*, 93 FORDHAM L. REV. 1, 4–5 (2024); Samir D. Parikh, *Creditors Strike Back: The Return of the Cooperation Agreement*, 73 DUKE L.J. ONLINE 1, 4 (2023).

[21] Oscar Couwenberg & Stephen J. Lubben, *Mitigating by Monitoring: Saving Corporate Restructuring from Controllers' Opportunism*, 98 CHI.-KENT L. REV. 361, 364 (2023); Melissa B. Jacoby, *Corporate Bankruptcy Hybridity*, 166 U. PA. L. REV. 1715, 1730 (2018).

[22] Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 TEX. L. REV. 1079, 1098 (2022); Edward J. Janger & Adam J. Levitin, *Badges of Opportunism: Principles for Policing Restructuring Support Agreements*, 13 BROOK. J. CORP. FIN. & COM. L. 169 (2018).

chapter 11, but the LME always has the likely chapter 11 in mind.

Moreover, the assumption that a battle among creditors effects nobody besides the sophisticated parties—at the very heart of the efficiency argument—ignores cases like Toys "R" Us, where the employees were the collateral damage of the "to the death" fight between equity-owning sponsors and distressed debt investors.[23] And even if an "expensive" chapter 11 case is avoided, the transaction in question quite often just replaces the bankruptcy case with non-bankruptcy litigation over the deal, which itself can be quite expensive.[24] In many cases, LMEs face both a subsequent chapter 11 case *and* hard-fought litigation—hardly a recipe for efficient restructuring.[25]

Corporate bankruptcy and reorganization exist as the solution to the faults of state debtor-creditor law. State law prizes individual action, vigor, and speed. Creditors recover in the order in which they are able to reduce their claims to judgments and then execute those judgments against the debtor's assets. When the debtor's assets are simple and plentiful, this system works reasonably well. Namely, if the debtor prizes its assets, it will make a strong effort to pay its creditors before the assets are taken from it; the state system encourages the proper incentives.

But in a large corporate enterprise, the debtor's assets achieve most of their value as a whole. Just as a single piece of a jigsaw puzzle has no real utility by itself, one delivery van of a larger furniture retailer is worth far more inside the retailer's corporate box than when sold separately on *Craig's List*.

Moreover, when the debtor-company's assets are inadequate—there is not enough to go around—the state law debtor-creditor system encourages the worst in unsecured creditors. Namely, at the point of insolvency, state debtor-creditor law pits them against each other in an unforgiving, winner-takes-all competition.

A creditor who takes the debtor's assets at midnight, beats the creditor who shows up at 12:01. At the first whiff of trouble, creditors must be ready to pounce. The effect is to push the race to the courthouse ever sooner, so that

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[23] *Private-Equity Firms' Role in Toys "R" Us Collapse Questioned by Lawmakers*, AM. BANKR. INST. J., Aug. 2018, at 8.

[24] Jonathan Randles, *Invesco Battles Bain Over Debt-Deal Double-Cross*, BLOOMBERG (Apr. 18, 2024, 7:30 AM), https://www.bloomberg.com/news/articles/2024-04-18/creditor-betrayals-pit-invesco-against-bain-in-bankruptcy-rumble?srnd=homepage-americas&sref=iG6l757t.

[25] *In re* Wesco Aircraft Holdings, Inc., No. 23-90611, 2024 WL 156211, at *1 (Bankr. S.D. Tex. Jan. 14, 2024), supplemented, No. 23-90611, 2024 WL 255855 (Bankr. S.D. Tex. Jan. 23, 2024).

even a not quite insolvent debtor might be dismembered.

Corporate bankruptcy, especially corporate reorganization, exists to solve both problems. Modern chapter 11 holds the debtor together as a bankruptcy estate, comprising "all the . . . property, wherever located and by whomever held,"[26] and protects that estate with an "automatic stay" that thwarts attempts by individual creditors to obtain any further judgments and executions in non-bankruptcy courts.[27]

Corporate bankruptcy is an extremely powerful tool, that can also be repurposed for other ends, especially by those who seek to control a corporation's business.[28] The power of forcing all creditors into a single judicial proceeding and imposing a reorganization on dissenting creditors by majority vote, leaves open the chance to take value from some investors and give it to others.[29]

In large part the development of modern, brutal chapter 11 is the natural result of the elasticity of the statute enacted in 1978.[30] Extreme suppleness has made corporate reorganization a playground for large, sophisticated, strategic investors—while often leaving smaller players out in the cold. But even the larger players will certainly reach a point, as they arguably have in recent years, where the effort spent outfoxing their equally sophisticated counterparties operates as a drag on the larger system.[31] That is, so much time is spent trying to avoid being fleeced, and trying to fleece others, that modern chapter 11 can no longer be said to be "efficient" under any reasonable conception of that term.[32] Not only is chapter 11 a negative cost-benefit proposition in a holistic sense, but may not even benefit the more sophisticated players.[33]

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[26] 11 U.S.C. § 541(a).

[27] *Id.* § 362.

[28] *See generally* STEPHEN J. LUBBEN, TO PROTECT THEIR INTERESTS: THE INVENTION AND EXPLOITATION OF CORPORATE BANKRUPTCY (forthcoming 2026) (presenting a historical argument that corporate reorganization has always been a tool for obtaining corporate control).

[29] Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 VA. L. REV. 1236, 1250–70 (2013).

[30] Hon. Leif M. Clark, *Chapter 11—Does One Size Fit All?*, 4 AM. BANKR. INST. L. REV. 167, 183 (1996) (noting that "the extraordinary flexibility of chapter 11 has proven itself in handling a wide panoply of business enterprises—and business problems").

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

[32] *Cf.* James Fallows Tierney, *Investment Games*, 72 DUKE L.J. 353, 442 (2022).

[33] Although somewhat beyond the scope of this article, I would observe that it is conceivable that distressed debt lawyers have, over time, figured out ways of making money

Under the existing Code, courts have the conjectural ability to stop the current abuse, but they are understandably hesitant to use those powers. For example, pre-bankruptcy liability management transactions that set up unequal treatment of creditors in the resulting bankruptcy are already prohibited by the terms of chapter 11.[34] For the court to figure out if such a violation is actually happening would involve a rabbit hole of litigation, while alternatively they are presented with a deal that "everyone likes."

Because the foundational concept of chapter 11 has been cracked with the advent of subchapter V, I argue that the time has come to reconsider the basic premise of chapter 11. In particular, maybe the New Dealers were right—a single corporate reorganization tool is not capable of being all things to all people and working in all cases. In the case of a comprehensive reorganization, that has real implications for small creditors and other stakeholders (like employees, vendors, and communities). In particular, there is a need for an independent voice that can tell the court what is "really happening." Thus, we need a return to something like chapter X, where large company reorganization is under a more rigid structure, with clear rules and meaningful oversight.

I part company with the New Dealers, in both the precise terms of what such a "chapter X" should look like, and their decision to make chapter X the only reorganization tool available to large corporate debtors. Rather, we should expand the menu.

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that is not to the principals' overall advantage. This includes extending the restructuring process (*e.g.*, buying some extra time through LMEs) and aggressive structuring or litigation positions in bankruptcy court. Thus, while chapter 11 perhaps initially had a valuable function that accorded with Congressional goals in drafting it, over time, lawyers found ways of working within the letter of chapter 11 but further and further from its spirit (with the deviations often being to the lawyers' advantage and just justifiable enough to clients and courts). That is, while the article largely focuses on the incentives of equityholders to manipulate chapter 11, other actors have similar incentives as well. I am grateful to Ilya Beylin for helping me develop this point.

[34] Stephen J. Lubben, *Holdout Panic*, 96 AM. BANKR. L.J. 1, 21 (2022) ("Hidden in all the nooks and crannies of the RSA is a generalized assault on section 1123(a)(4)."). Section 1123(a)(4), in full, provides:

> (a) Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall—
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> (4) provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest[.]

11 U.S.C. § 1123(a)(4).

There probably should be a tool for those hedge fund A versus private equity fund B cases that some commentators imagine modern chapter 11 is all about. Unlike current chapter 11, the new forum for such cases should have reinforced guardrails: keep clear of the trade creditors, the employees, customers, and the retail investors. When retail investors are mixed with institutional investors in a single class, all members of the class must be treated equally. If the "deal" implodes, courts should show little respect for any pre-bankruptcy shenanigans that hurt third parties.[35]

And we need a third tool as well, for those rare cases that old chapter XI was actually designed for, and 1978's chapter 11 probably had in mind: cases that involve small cap companies, too big for subchapter V, but with relatively normal capital structures that have not been perverted by modern financial engineering. Shareholders, secured lenders, trade creditors and landlords—just the basics.

In short, counting current subchapter V, I would split chapter 11 into four distinct tools. At the heart of it all, a new and improved version of the old unloved chapter X, along with an American scheme of arrangement provision (also for large debtor-companies), a chapter 11–style provision, and a subchapter V provision.

Part II of this article provides a brief overview of the role of corporate restructuring in a developed economy, like the United States. As noted in this introduction, a corporate reorganization system exists to overcome two main problems with "normal" debtor-creditor law: the tendency to dismember the debtor and the competition among creditors to be the first to do so. To achieve its goals, corporate restructuring must be broad in scope and flexible in nature to allow a full resolution of the problem.[36] A corporate reorganization system that is either too narrow or too fixed will be evaded by some sizable number of creditors. A broad, flexible system is however subject to abuse, absent vigilant oversight.

Part III next synthetizes several decades of corporate bankruptcy history, from the first codification of corporate reorganization in 1933, to the enactment of chapters X and XI in 1938, to the current Bankruptcy Code's replacement of everything with chapter 11 in 1978. It argues that the complaints about chapter X were overstated and largely advanced by self-interest. To be sure, chapter X was far from perfect, but more than four

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[35] *See* the companion paper, *American Schemes* (unpublished manuscript on file with author), for more on this.

[36] *Cf.* William W. Bratton & David A. Skeel, Jr., *Bankruptcy's New and Old Frontiers*, 166 U. PA. L. REV. 1571, 1582 (2018).

decades of experience have shown us that deregulation was oversold as well. It is time to admit that the one size fits all nature of the current chapter 11 is not working: as the late Senator Byrd once said of airline deregulation, "I admit my error; I confess my unwisdom, and I am truly sorry."[37]

Part IV of this article then tackles the need for reform in light of current reality, which is simultaneously hardball, unjust, and lawless.[38] I also develop the argument that the door is now open for reconsideration of the chapter 11 project, given the enactment of a special small business reorganization tool under subchapter V. Now that the foundational premise of chapter 11, that all corporate debtors should be reorganized under a single statute, has been called into question, the other assumptions of 1978 are open for reexamination as well.

Finally, Part V of the article develops the roadmap for the way forward. There are several competing goals all subsumed within today's chapter 11, and the sooner we recognize the incompatibility of those goals the better. The time has come to whack chapter 11 against the table and parcel out the pieces to the distinct places they belong. The public policy aims of broad, company-wide restructuring never sat easily with the "player" focused world of sophisticated investors buying near defaulted debt to control a debtor during and after its reorganization. It is time to stop pretending they are all the same basic thing. They are distinct, and should be treated by separate tools, with clear lines of separation. There should be clear rules for when one tool should supplant another.

As noted earlier, I argue for three distinct reorganization tools for larger businesses, plus the continuation of something like subchapter V for small businesses. At the core of the new system would be a provision, much like old, maligned chapter X, which would provide for a comprehensive reorganization of a company's full capital structure. For publicly traded debtors, this would be the presumptive tool, but upon satisfaction of various conditions, other tools would become available. My central argument here is that the New Dealers did not err in creating chapter X, rather they erred in assuming that chapter X alone was sufficient.

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[37] Ganesh Sitaraman, *Why Airlines Don't Fly to Your City and Other Problems Washington Caused*, POLITICO (Nov. 14, 2023, 5:00 AM). https://www.politico.com/news/magazine/2023/11/14/airline-travel-washington-regulation-00126892.

[38] *See generally* Lynn M. LoPucki, *Chapter 11's Descent into Lawlessness*, 96 AM. BANKR. L.J. 247 (2022).

II. It's No Game: A Framework of Corporate Reorganization

Corporate reorganization exists as a supplement to a prior, perhaps mythical world where creditors could exercise individualistic remedies and debtor-firms' sole collective response was to liquidate.[39] In this abstract world, corporations typically have a choice of liquidation tools: either the corporate law dissolution mechanism, or insolvency or bankruptcy law, which has provided for corporate liquidation since the nineteenth century.[40]

Both individual creditor action and business liquidation are unsatisfying because they support the dismemberment of businesses that have firm-wide asset value.[41] That is, in most complex businesses, the firm as a whole is worth more than the sum of its individual parts.[42]

In a world of individualistic action, insolvency pits creditors against each other in a zero-sum struggle: more for one is less for the rest.[43] Individual creditor collection encourages withdrawals of essential assets, destroying firm-wide, synergistic value.[44]

Each creditor must bring a debt-collection suit, obtain a judgment, and locate "grabbable" debtor property.[45] Because these steps take time, and collection occurs against a shrinking pool of assets, the incentive is to act fast. With each creditor thinking this way, the date for action moves ever forward, until so many bits and pieces of the debtor-firm have vanished that there is nothing left of the once viable whole. The insistent creditors are paid in full, those who delay either from hesitancy or sympathy are left unpaid.

As one 1940s commentator noted, without a bankruptcy law, creditors

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[39] To the extent such a world ever existed in the United States, it was largely a function of Congressional hesitancy to exercise the powers granted by the Bankruptcy Clause.

[40] John A. E. Pottow, *Modular Bankruptcy: Toward A Consumer Scheme of Arrangement*, 45 CARDOZO L. REV. 721, 742 (2024). *See* William W. Bratton, Jr., *Corporate Debt Relationships: Legal Theory in A Time of Restructuring*, 1989 DUKE L.J. 92, 101 (1989); Riz Mokal, *What is an insolvency proceeding? Gategroup Lands in a Gated Community*, 31 INTERNATIONAL INSOLVENCY REV. 418, 439–40 (2022).

[41] Report of the Committee on the Judiciary, House of Representatives, to accompany H.R. 8200, H.R. Rep. No. 95–595 (Chapter 5), 95th Cong., 1st Sess. 220 (1977). See in particular page 220.

[42] Jean Braucher, *Bankruptcy Reorganization and Economic Development*, 23 CAP. U. L. REV. 499, 515 (1994).

[43] Mark J. Roe, *Three Ages of Bankruptcy*, 7 HARV. BUS. L. REV. 187, 191–92 (2017).

[44] Donald P. Board, *Retooling "A Bankruptcy Machine That Would Go of Itself*," 72 B.U. L. REV. 243, 247–48 (1992).

[45] Troy A. McKenzie, *Bankruptcy and the Future of Aggregate Litigation: The Past As Prologue?*, 90 WASH. U. L. REV. 839, 850 (2013).

> were compelled to proceed individually against the same debtor, a more costly procedure than collective action. Through their undue selfish haste and diligence, they often brought their debtor to financial ruin. While they might receive a preference in one case, they received nothing or an inequitable distribution in most. The great wholesale merchants in the chief distributing centers thought themselves more secure without a bankruptcy act. With agents and attorneys in the vicinity of every debtor, they believed they would obtain advance information, of approaching disaster, and thus a jump ahead in resorting to the local machinery of State courts. They soon discovered their rationale was discounted by reality and that they had erred . . . .[46]

In the meantime, the value of the debtor-business is dissipated. As with a bank run, the "race to the courthouse" under state debtor-creditor law is rational when viewed from the perspective of individual creditors, but collectively irrational in that it tends to destroy the debtor.[47]

Liquidation of the debtor-firm is generally more collective but still tends toward the piecemeal sale of assets—any sale as a whole is often purely accidental. Liquidators have historically been compensated by commissions, which discourages holding out for a comprehensive sale of the firm that might never come.[48] The simple reality of the time value of money encourages the trustee/liquidator to sell what they can, when they can, as fast as they can.

Further, since financial distress tends to occur in cyclical waves, as the result of broader economic declines, realizing the firm-wide value often would involve substantial delay, as the state of the economy will deactivate strategic buyers. Alternatively, any sale that might happen in a timely fashion often would involve a substantial discount to "true value."[49] That is, anything can be sold if the price is low enough, but rock-bottom prices are often value destructive.

[46] Morris Weisman, *Some Chapters of Bankruptcy History: From the Bankruptcy Clause to the Act of 1898*, 22 J. NAT'L ASS'N REF. BANKR. 99, 103 (1948).

[47] *See, e.g.*, Thomas H. Jackson, *Bankruptcy, Non-bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857 (1982).

[48] 11 U.S.C. § 326(a).

[49] Andrei Shleifer & Robert W. Vishny, *Fire Sales in Finance and Macroeconomics*, 47 J. FIN. 1343 (2011). *See also* Sarah Pei Woo, *Regulatory Bankruptcy: How Bank Regulation Causes Fire Sales*, 99 GEO. L.J. 1615, 1653 (2011).

Corporate reorganization offers a better outcome than any of the "predecessor" tools.[50] Where individual creditor action encourages early vigilance, often to the point of encouraging a run on the debtor's assets, reorganization stops unilateral collection efforts in favor of equal treatment among classes. Likewise, reorganization facilitates realization of firm-wide asset value by keeping the assets together, even when a sale as a whole might not be possible.[51]

Reorganization can work on classes or the entire capital structure, and there are current and historical examples of both types of systems, but at core the goal is to keep the debtor's assets together, to realize total value.[52] This firm-wide value—typically called the "going concern value"[53] —is only obtained by a system that is broad enough to apply to any creditor or other stakeholder who might thwart the restructuring.[54] And likewise, the reorganization system needs to be flexible enough to prevent evasion and cover unforeseen situations.[55]

Maintaining the going concern value of a business through chapter 11 or any similar restructuring system can have a positive effect on other stakeholders: employees' jobs may be saved, customers' supply chains are not interrupted, and vendors do not lose a purchaser. The ultimate goal is creditor approval of a reorganization plan that will revamp the company's capital structure, and often its operations as well.

While a reorganization structure is beneficial to creditors in general, since on average they will receive more by saving the firm-wide value from being destroyed, the temptation for individual stakeholders to cheat is immense.[56] That is, while creditors and debtors collectively benefit from rules that maximize net creditor returns, bankruptcy law must also counteract

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[50] Arturo Bris, Ivo Welch & Ning Zhu, *The Costs of Bankruptcy: Chapter 7 Liquidation Versus Chapter 11 Reorganization*, 61 J. FIN. 1252, 1269 (2006).

[51] John D. Ayer, *The Role of Finance Theory in Shaping Bankruptcy Policy*, 3 AM. BANKR. INST. L. REV. 53, 71–73 (1995).

[52] Michelle M. Harner, *Rethinking Preemption and Constitutional Parameters in Bankruptcy*, 59 WM. & MARY L. REV. 147, 195–96 (2017).

[53] John D. Ayer, *Bankruptcy As an Essentially Contested Concept: The Case of the One-Asset Cas*e, 44 S.C. L. REV. 863, 869 (1993).

[54] *See* Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 127 (1990).

[55] Jonathan C. Lipson, *The Secret Life of Priority: Corporate Reorganization After* Jevic, 93 WASH. L. REV. 631, 682 (2018).

[56] Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 825 (2004).

efforts by creditors, either unilaterally or in collusion with the debtor, to override those rules in their favor, thereby shifting losses onto other creditors.[57]

Because a reorganization system must have substantial power to alter debtor rights and obligations to achieve its ends, the system must also guard against abuse. [58] As this article notes throughout, modern chapter 11 has done a poor job of this latter task.[59]

Finally, any approach to business reorganization must strike a balance between the need to stabilize the financially distressed debtor, and the desire and expectation that creditors' and stockholders' preexisting legal rights will be honored to the greatest extent possible. This tension has long been recognized.

For example, in *Brockett* v. *Winkle Terra Cotta Co.*, the court stated:

> Reorganization of distressed corporations is primarily and principally a business (economic) problem. It is a means whereby those variously interested financially in a distressed business seek, through continuance of that business as a going concern, to work out for themselves more than they could gain by sale of the assets or of the business to others. Reorganization is occasioned by the situation that the business cannot go on as it is. If it is to continue in control of all or of some of those financially interested in it, a readjustment is necessary. Such readjustment involves suspension or alteration of some or all existing legal interests in the business and property and may involve extinguishment of some interests. It is only because of such changes in legal rights that the matter of reorganization comes into courts. [60]

The reorganization (or liquidation) of a business is not a lawsuit in the ordinary sense of a procedure designed to settle issues between individual litigants, but a complex, collective, interconnected proceeding that involves a jumble of mediation, a bit litigation, judicial prodding, and lots of corporate

[57] *See* Brook E. Gotberg, *The Market for Bankruptcy Courts: A Case for Regulation, Not Obliteration*, 49 B.Y.U. L. REV. 647, 652 (2024); Sally McDonald Henry, *Chapter 11 Zombies*, 50 IND. L. REV. 579, 580 (2017).

[58] *Cf.* Anna Gelpern, *Bankruptcy, Backwards: The Problem of Quasi-Sovereign Debt*, 121 YALE L.J. 888, 935 (2012).

[59] *Cf.* Ralph Brubaker & Charles Jordan Tabb, *Bankruptcy Reorganizations and the Troubling Legacy of Chrysler and GM*, 2010 U. ILL. L. REV. 1375, 1378 (2010).

[60] 81 F.2d 949, 953 (8th Cir. 1936).

finance. The process is largely designed to meet the two distinct, and often contradictory, goals of insolvency law.

First, the law seeks to preserve and maximize the value of the insolvent business. Second, the law aims to ensure a fair distribution of the assets among the claimants. But even stated with this degree of generality, both goals are subject to some significant exceptions. Most conspicuously, neither is evident in the case of insolvent financial institutions.[61]

Likewise, there are many notable examples of deviations from "pure" equality. For example, a large national retail company may use chapter 11 to reject leases at locations that are no longer profitable. The landlord's claims for breach of the lease are capped by statute, prohibiting a claim for classic "expectation damages,"[62] and effectively obliging the lessor to subsidize the lessee's restructuring.[63] A similar effect can be seen when pension benefits are cut in as part of a reorganization effort to save existing jobs. These are essentially policy motivated redistributions of value, with the aim of increasing overall value.

The dissolution of a business entity provides the basic model for the priority of payment of claimants in most insolvency proceedings. In reorganization, dissolution typically provides the floor, with the hope that the restructuring will provide something better.[64]

But "something better" is typically measured by courts and legislators, and both are subject to lobbying for special treatment.[65] For example, the present "safe harbors" for derivatives in the Bankruptcy Code render the Code unusable to those financial institutions that might file a petition.[66] Moreover, they make chapter 11 extremely difficult for those real economy debtors that use derivatives as part of their business model—transportation companies with fuel hedges provide one common example.

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[61] *See generally* Stephen J. Lubben, *A Functional Analysis of SIFI Insolvency*, 96 TEX. L. REV. 1377 (2018).

[62] *Cf.* Hawkins v. McGee, 146 A. 641 (N.H. 1929).

[63] 11 U.S.C. § 502(b)(6).

[64] For example, a chapter 11 plan cannot be confirmed unless creditors or interest holders will receive at least the value that they would have received in a hypothetical chapter 7 liquidation. 11 U.S.C. § 1129(a)(7)(A). The distribution waterfall for chapter 7 liquidation is set forth in § 726 of the Bankruptcy Code.

[65] *Cf.* Charles J. Tabb, *What's Wrong with Chapter 11*?, 71 SYRACUSE L. REV. 557, 582 (2021) ("The equitable power of bankruptcy judges does not extend to empowering them to say 'Pay A before B.'").

[66] *See* Stephen J. Lubben, *Failure of the Clearinghouse: Dodd–Frank's Fatal Flaw?,* 10 VA. L. & BUS. REV. 127, 152 (2015).

Although courts must find that a reorganization is better than the hypothetical liquidation of the same debtor, the tendency to assume "betterness" is rife. After all, more than a century of reorganization culture and lore depend on it.

Ultimately, any reorganization system pursues multiple goals simultaneously, and an emphasis on any single one tends to be reductive, or even disingenuous. Any reorganization process serves not only the interests of the debtor but also the broader goals of maximizing creditor recovery, preserving jobs, maintaining market stability, and supporting economic growth. As a matter of theory some goals may be preferable over others, but as a matter of legislative reality, all these goals coexist.

III. Station to Station: Launching and Sinking Chapter X

As is well known, American corporate reorganization began with distressed railroads, the first corporations of significant size.[67] In the very early days, especially before the Civil War and immediately thereafter, distressed railroads were reorganized through the foreclosure process, whereby the purchasing creditors could start anew with the company's assets in a new corporate shell.

Foreclosures only functioned as reorganization tools in the loose sense that the buyers could "try again" with the assets, while the shareholders and junior creditors were eliminated from the picture. Foreclosures also only worked in cases where the railroad was confined to a small number of jurisdictions: a state law foreclosure only applies within the boundaries of the state, and sometimes only within a particular county.[68] As one court noted very early in the development of reorganization:

> What disastrous consequences would have resulted, if each judgment creditor had been allowed to seize and sell separate portions of the road, at different sales, in the six different Counties through which it passed, and to different purchasers! Would not this valuable property have been utterly sacrificed—the rights and interests of the creditors, as well as

[67] Peter Conti-Brown & David Skeel, *Credit Markets and the Visible Hand: The Discount Window and the Macroeconomy*, 41 YALE J. ON REG. 1, 23 (2024).

[68] De Forest Billyou, *Priority Rights of Security Holders in Bankruptcy Reorganization: New Directions,* 67 HARV. L. REV. 553, 557 (1954) ("Corporate reorganization through an equity receivership developed, not as a substitute for the liquidation of an insolvent corporation, but rather from the limitations of a simple mortgage foreclosure.").

> the objects and intentions of the Legislature in granting this charter, entirely defeated?[69]

The next stage in the history of early corporate reorganization was to combine the foreclosure with a receivership.[70] Although both foreclosures and receiverships had long historical roots predating their use in reorganization, when paired together they created a new tool.[71] In short, the receivership created a "pause," during which the receiver could spruce up the railroad, while the stakeholders negotiated the terms of the reorganization.[72]

Once both tasks were completed, a foreclosure sale would once again move the railroad's assets into a new corporate shell.[73] Typically, these reorganizations were done in federal court, under diversity jurisdiction and the federal court's equity powers, with one main receivership and a series of ancillary receiverships in each federal district where the debtor operated.[74]

The problem was that the entire system was somewhat improvised, based upon old tools repurposed for new ends.[75] The open nature of the process meant that insiders could bend it to suit their needs—not unlike modern chapter 11, as we shall see—while courts might unexpectedly decide to change the nature of the process, especially if they felt it had been pushed "too far."

Courts began to make such a move slowly, but then more broadly in the 1920s, particularly in receiverships outside of the railroad context, where the need for corporate reorganization was seen as less vital.[76] For example, Supreme Court Chief Justice Taft wrote that "we do not wish what we have said to be taken as a general approval of the appointment of a receiver under the prayer of a bill brought by a simple contract creditor simply because it is consented to at the time by a defendant corporation."[77] But that is exactly how the receivership system worked.

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[69] *Macon & W.R. Co. v. Parker*, 9 Ga. 377, 394 (1851).

[70] Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 21–22 (1995).

[71] *Duparquet Huot & Moneuse Co. v. Evans*, 297 U.S. 216, 220 (1936).

[72] Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 CORNELL L. REV. 1420, 1444 (2004).

[73] *Provisions for Non-Assenting Classes of Creditors in Bankruptcy Reorganizations*, 46 YALE L.J. 116, 121 (1936).

[74] F.H. Buckley, *The American Stay*, 3 S. CAL. INTERDISC. L.J. 733, 741 (1994).

[75] Bruce Grohsgal, *Absolute Priority Redux: First-Day Orders and Pre-Plan Settlements in Chapter 11 Post*-Jevic, 10 WM. & MARY BUS. L. REV. 61, 77–78 (2018).

[76] David A. Skeel, Jr., *An Evolutionary Theory of Corporate Law and Corporate Bankruptcy*, 51 VAND. L. REV. 1325, 1360 (1998).

[77] *Harkin v. Brundage*, 276 U.S. 36, 52 (1928).

In *First Nat. Bank v. Flershem*, Justice Brandeis stated in a footnote that "all the cases in which this Court appears to have exercised this power [of appointment of receivers and judicial sale] in aid of reorganization . . . dealt with railroads or other public utilities where continued operation of the property and preservation of its unity seemed to be required in the public interest," further calling into question the use of receiverships to reorganize any business other than a railroad or other quasi-public company.[78]

Insiders were also growing frustrated with the cost of the receivership process, and its tendency to facilitate "holdouts," who proffered objections that built off the caselaw criticisms of receiverships.[79]

At the same time, a group of reformers highlighted the rampant conflicts of interest within receiverships, which typically were run by bankers and their counsel who wore a wide selection of hats. Central to this reform movement was Max Lowenthal, whose book *The Investor Pays* tracked the management failures and professional conflicts of interest that lead up to and through the receivership of the Chicago, Milwaukee, and St. Paul Railway, the largest corporate failure of the 1920s.[80] At that time, it was also the largest "bankruptcy" in U.S. history.[81]

Lowenthal noted that the receivership appeared from the outside to involve a negotiation among a variety of constituencies, leading to a consensual reorganization. But in reality, it was a highly stage-managed process conducted by the railroad's long-time bankers, Kuhn, Loeb, and the bank's counsel, Cravath, Swaine and Moore.[82]

Those two professionals effectively selected the judge, the petitioning creditor in the receivership, and the configuration of the various committees, which were made up of representatives from financial institutions that in many cases did not own any of the securities the committee purported to represent.[83] To top it all off, Jerome J. Hanauer of Kuhn Loeb and Robert

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[78] *First Nat. Bank of Cincinnati v. Flershem*, 290 U.S. 504, 517 (1934).

[79] *Cf.* A. E. Gold, *Corporations: Participation of Old Stockholders in Reorganized Corporation After Consent Decree of Foreclosure*, 9 CORNELL L.Q. 192 (1924) ("The difficulty is that there is apparently no way by which non-assenting creditors may be compelled to accept a fair and equitable reorganization scheme.").

[80] MAX ROSENTHAL, THE INVESTOR PAYS (1933).

[81] The company filed its receivership in 1925 and reorganized as the Chicago, Milwaukee, St. Paul and Pacific Railroad in 1928—it would enter bankruptcy in 1935 and 1977 as well. The last filing would lead to the road's abandonment, after sales of the viable bits to other railroads.

[82] *Id.* at 77–78, 81, 93–94, 97, 231.

[83] *Id.* at 53, 97–101, 106, 112–119, 122–127, 132, 134.

Swaine of Cravath wrote the reorganization plan at the Greenbrier Hotel in advance of the receivership, with essentially no input from the railroad or anyone else (including the members of the not-yet-formed committee that supposedly proposed it).[84]

The two divergent strands of receivership criticism, combined with the pressing needs for a functional reorganization system as the Great Depression grew in severity, led to the codification of the corporate bankruptcy process, beginning with the enactment of § 77 for railroads at the tail end of the Hoover administration.[85] Although the provision pioneered the "debtor in possession" concept of no trustee in reorganization when it was enacted in 1933, a 1935 amendment put trustees back in place.

Oversight of this process was a joint effort of the district court and the Interstate Commerce Commission.[86] Cases were notoriously long; the Missouri Pacific filed the first case under the statute in 1933 and exited bankruptcy in 1956.[87]

Section 77B was the broader counterpart to § 77, allowing for the reorganization of non-rail corporation under a federal statute.[88] Enacted in 1934, one commentator observed that:

> Perhaps the outstanding contribution of Section 77B is its provisions dealing with the plan of reorganization. The judge

[84] *Id.* at 241–243, 279.

[85] Julie A. Veach, *On Considering the Public Interest in Bankruptcy: Looking to the Railroads for Answers*, 72 IND. L.J. 1211, 1217–1218 (1997).

[86] Louis Loss & Raymond Vernon, *When-Issued Securities Trading in Law and Practice*, 54 YALE L.J. 741, 781 (1945).

[87] MoPac's reorganization is the subject of Chapter 5 of LUBBEN, TO PROTECT THEIR INTERESTS, *supra* note 28. *See also* Florence de Haas Dembitz, *Progress and Delay in Railroad Reorganizations Since 1933*, 7 LAW & CONTEMP. PROBS. 393, 407, 411–16 (1940) (discussing factors that delayed railroad reorganizations, which she attributed to both an overworked ICC staff and a process that was overly focused on litigation, in place of negotiation). By the 1970s, another commentator argued that "section 77 is inadequate to deal with the present situation. It neither provides the tools nor creates the circumstances necessary for the successful reorganization of railroads under today's conditions. This is not to criticize those who drafted section 77 and the 1935 amendments . . . . However, as things stand today section 77 is too limited in its scope, too formal in its approach, and too circumscribed in its procedures to permit the formulation of a sound plan of reorganization under contemporary circumstances." Richard J. Barber, *Railroad Reorganization, Section 77, and the Need for Legislative Reform*, 21 UCLA L. REV. 553, 554 (1973); *see also* Joseph C. Simpson, *Comments on the Railroad Reorganization Provisions of the Bankruptcy Act of 1973*, 30 BUS. LAW. 1207, 1216–17 (1975).

[88] Stephen J. Lubben, *Fairness and Flexibility: Understanding Corporate Bankruptcy's Arc*, 23 U. PA. J. BUS. L. 132, 156–58 (2020).

> is given complete jurisdiction to determine whether the plan is fair and equitable. The acceptance of a plan by two-thirds of a class of creditors, or by a majority of a class of stockholders, binds the remaining members of the class if the court finds the plan to be fair and equitable.[89]

Like the first version of its railroad counterpart, § 77B also permitted the debtor to remain in possession of its own estate, without a trustee.[90]

Though § 77B has obvious similarities with modern chapter 11, it was not warmly embraced by the New Dealers, who felt that it reflected too much of the old receivership system.[91] As one commentator summarized:

> Many of the evils of friendly receiverships were carried into 77B reorganizations by way of debtors in possession or friendly trustees. Control of the distressed corporation permitted the old management not only to insulate itself from potential prosecution for its previous practices but to maintain a position of prestige and power, from which it could influence security holders to support its plan and projects. Thus were made possible the intrenchment of officers, efficient or inefficient, the suppression of investigations into the conduct of the old management, honest or dishonest, and the foisting of unfair plans upon masses of innocent investors, helplessly unorganized, or hopelessly uninformed.[92]

Thus, in 1938 § 77B was pronounced inadequate, and replaced by the chapters X, XI, and XII of the Bankruptcy Act, while § 77's railroad reorganization provisions remained intact.[93] In the five years from 1933 to

[89] John Gerdes, *Section 77B, The Chandler Bill And Other Proposed Revisions*, 35 MICH. L. REV. 361, 363 (1937).

[90] *Developments in the Law*, 49 HARV. L. REV. 1111, 1147 (1936).

[91] *See* Roger S. Foster, *Conflicting Ideals for Reorganization*, 44 YALE L. J. 923, 924 (1935) ("It is not altogether clear how sweeping has been the reformer's victory in the recent changes in reorganization practice."); E. Merrick Dodd, Jr., *Reorganization Through Bankruptcy: A Remedy for What?*, 48 HARV. L. REV. 1100, 1135 (1935).

[92] Alfred B. Teton, *Reorganization Revised*, 48 YALE L.J. 573 (1939).

[93] Richard E. Mendales, *Intensive Care for the Public Corporation: Securities Law, Corporate Governance, and the Reorganization Process*, 91 MARQ. L. REV. 979, 988 (2008); G. Eric Brunstad, Jr., *Bankruptcy and the Problems of Economic Futility: A Theory on the Unique Role of Bankruptcy Law*, 55 BUS. LAW. 499, 517 (2000). An initial revision of § 77B was drafted by the newly formed National Bankruptcy Conference. When the SEC's famous reports on receiverships came along, the NBC draft was revised to reflect most of the SEC's proposed changes. John Gerdes, *Corporate Reorganizations: Changes Effected by Chapter*

1938, the United States went from no business reorganization statutes to four of them.

Chapter X required the appointment of a disinterested trustee in almost all cases where debts exceeded $250,000, and likewise the plan had to be submitted to the Securities and Exchange Commission for its recommendations.[94] For the plan to be approved, it had to comply with the "absolute priority rule," which requires payment according to liquidation priorities, based on the full face amount of claims—secured creditors before unsecured creditors, unsecured creditors before shareholders.[95]

The trustee was the key feature of the new statute. As one contemporary author explained:

> The trustee is required, at the direction of the judge, to investigate the debtor's acts, conduct, property, and financial condition, and to explore the feasibility of continuing the business. He must report to the judge all facts pertaining to fraud, misconduct, mismanagement or other forms of irregularity, and any causes of action open to the estate. He may, if the judge directs, examine any director or officer of the debtor or any other witness having knowledge concerning the subject matter of the investigation.[96]

And although concerns were often raised that trustee might not have any real ability to operate a large business,[97] the statute did allow for the retention of a former officer or other employee as co-trustee, to be focused solely on operations.[98] Often these officers were instead retained as consultants to the

*X of the Bankruptcy Ac*t, 52 HARV. L. REV. 1, 2 (1938).

[94] Chapter X § 156. For the SEC's role, see Chapter X § 172. *See also* Dalia T. Mitchell, *From Vulnerable to Sophisticated: The Changing Representation of Creditors in Business Reorganizations*, 16 N.Y.U. J.L. & BUS. 123, 152 (2019); David A. Skeel, Jr., *An Evolutionary Theory*, *supra* note 76, at 1914. ("[T]he Chandler act also gave broad-ranging authority to the SEC to ensure that investors' interests were adequately represented.").

[95] Chapter X § 174, required a plan to be "fair and equitable" and "feasible." The former had been interpreted under § 77B to invoke the absolute priority rule. Jonathan C. Lipson, *The Expressive Function of Directors' Duties to Creditors*, 12 STAN. J.L. BUS. & FIN. 224, 252 (2007); Julie L. Friedberg, *Wanted Dead or Alive: The New Value Exception to the Absolute Priority Rule*, 66 TEMP. L. REV. 893, 908 (1993). *See generally* Gerdes, *Corporate Reorganizations*, *supra* note 93.

[96] Vincent L. Leibell, Jr., *The Chandler Act-Its Effect Upon the Law of Bankruptcy*, 9 FORDHAM L. REV. 380, 395 (1940).

[97] Such objections were raised from the start. Teton, *supra* note 92, at 575.

[98] Chapter X § 156, second sentence.

trustee.[99]

The trustee was tasked with proposing a plan.[100] At a hearing, the judge would consider the plan along with any alternatives and modifications suggested by the parties.[101] In large cases, the plan or plans the judge considered worthy of further consideration were submitted to the SEC for an advisory report.[102]

Upon receipt of the SEC report and finding that the plans in question complied with the statute, the court would submit them to the creditors and shareholders for a vote. Approval of creditors holding two-thirds in amount of claims in each class was required. If the debtor was insolvent, shareholder approval was unnecessary, but in solvent cases a majority of shares in each class had to vote in favor of a plan.[103]

Solicitation of votes was accompanied by a summary of the plan or plans presented, along with the SEC report.[104]

"Although it was the purpose of Chapter X to give reorganization procedures a good scrubbing . . . . Corporate debtors increasingly [found] it possible to avoid the pervasive regulation of Chapter X by the use of the arrangement procedure prescribed in Chapter XI of the Bankruptcy Act."[105]

That is, whereas the drafters seemed to assume that most debtors would file under chapter X and small debtors would have to be compelled to use the simpler chapter XI—which only addressed unsecured creditors[106]—the very opposite ended up being true.[107] A debtor filing under chapter X had to confirm that it could not be reorganized under chapter XI, but there was

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[99] Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 YALE L.J. 437, 454 (1992).

[100] Chapter X § 169.

[101] *Id.* § 167(6).

[102] *Id.* § 172.

[103] *Id.* § 179.

[104] *Id.* § 175.

[105] Richard W. Jennings, *Mr. Justice Douglas: His Influence on Corporate and Securities Regulation*, 73 YALE L.J. 920, 939 (1964). *See also* Melvin Robert Katskee, *The Calculus of Corporate Reorganization Chapter X v. XI and the Role of the SEC Assessed*, 45 AM. BANKR. L.J. 171 (1971).

[106] Chapter XI § 306. *See also* Gerdes, *Corporate Reorganizations*, *supra* note 93, at 5.

[107] Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 AM. BANKR. L.J. 227, 232 (1998); Chaim J. Fortgang & Thomas Moers Mayer, *Trading Claims and Taking Control of Corporations in Chapter 11*, 12 CARDOZO L. REV. 1, 12 (1990).

little to move a debtor instead filing under chapter XI into chapter X.[108]

Thus, the New Dealers assumed that all publicly traded companies would obviously come under chapter X, but many tried to file under chapter XI.[109] This move was taken to its logical if ridiculous extreme when in 1975 W.T. Grant, with more than $1 billion in outstanding debt, and thousands of small shareholders, filed under chapter XI.[110]

Although the rights of shareholders and of both secured and unsecured creditors were subject to modification in chapter X,[111] only the rights of unsecured creditors could be revised in chapter XI.[112] SEC participation was limited to the right to file a motion for dismissal; there was no provision for an independent trustee.[113]

From 1952 onward, chapter XI did not require plans to comply with the so-called "absolute priority rule," thereby opening up the possibility that bondholder claims might be reduced or even fully discharged while shareholders remained in place.[114] Only the debtor could propose a plan, but because any effort to impair secured creditors or shareholder would require their consent, plans were largely collaborative.[115] Approval by a majority in number and amount was required to confirm the plan.[116]

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[108] *See, e.g.*, Chapter X § 147 (providing for conversion of cases to chapter XI); *see also id.* § 146 (defining bad faith under chapter X to include cases where "adequate relief would be obtainable by a debtor's petition under chapter XI of the Act"). *See* Robert J. Rosenberg, *Beyond Yale Express: Corporate Reorganization and the Secured Creditor's Rights or Reclamation*, 123 U. PA. L. REV. 509, 517 (1975). The Supreme Court did try to fashion a counterpart to the conversion rule, and Congress purported to codify it, but with confusing results. Grayson-Robinson Stores, Inc. v. Sec. & Exch. Comm'n, 320 F.2d 940, 947–49 (2d Cir. 1963).

[109] *Discretion Properly Exercised in Relying on Business Prospects to Allow Chapter XI Arrangement of Large Public Corporate Debtor*, 64 COLUM. L. REV. 155, 156 (1964).

[110] McKenzie, *Bankruptcy and the Future of Aggregate Litigation: The Past As Prologue*?, *supra* note 45, at 880. Grants' bankruptcy is the subject of Chapter 6 of LUBBEN, TO PROTECT THEIR INTERESTS, *supra* note 28. Ironically, a decade earlier, Judge Friendly, no great fan of chapter X and the SEC's role therein, had written "[n]o one would doubt that a seriously embarrassed giant corporation, with secured and unsecured publicly held debt, trade and other general creditors, and preferred and common stock, 'needs' reorganization under Chapter X." Sec. & Exch. Comm'n v. Canandaigua Enters. Corp., 339 F.2d 14, 18 (2d Cir. 1964).

[111] Chapter X § 216.

[112] Chapter XI § 356.

[113] *Id.* § 328. Even this was only added in 1952.

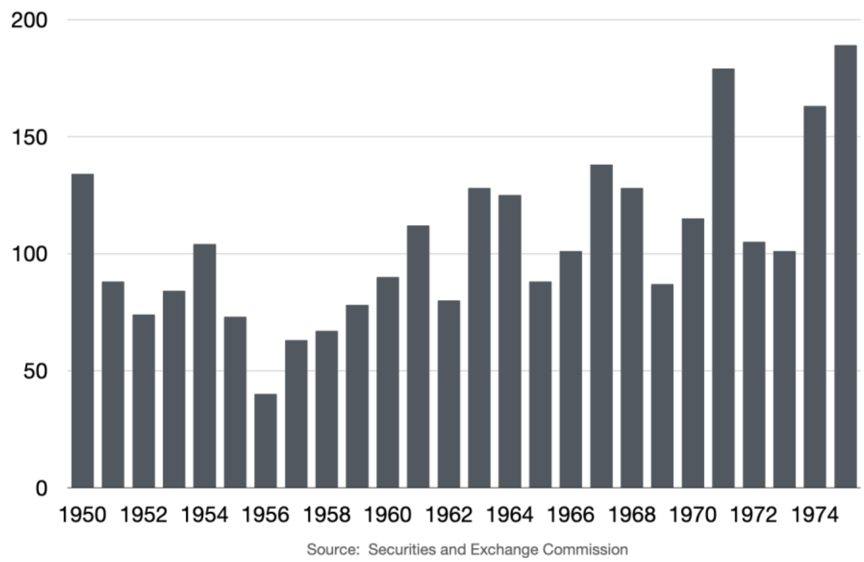
[114] *Id.* § 366, 66 Stat. 433, amending 52 Stat. 911 (1938).

[115] *Id.* §§ 321–23; *see also id.* § 363.

[116] *Id.* §§ 357(1), 362(1).

It would be incorrect to say that nobody used chapter X.[117] As shown below, there was an average of just over 105 (median, 101) cases a year after 1950, and 127 (median, 115) for 1965 through 1975.[118] Given that chapter X targeted publicly traded debtors, the small numbers of cases was probably inevitable—on average, chapter X cases were about ten percent of the total business bankruptcy cases during the postwar period.

Figure 6.1: Number of Chapter X Cases



Nevertheless, it is commonly said that "nobody" wanted to use chapter X, and this argument was frequently trotted out to support the law's replacement by chapter 11 in 1978.[119] The reality is somewhat more complex: because the trustee would superintend existing management, and trustee's counsel would replace the debtor's law firm, there was nobody associated with the debtor that was likely to embrace a chapter X filing.[120]

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[117] *See generally* Jacob J. Kaplan, et al., *The Reorganization of the Waltham Watch Company: A Clinical Study*, 64 HARV. L. REV. 1262 (1951).

[118] The table is reproduced from LUBBEN, *supra* note 28.

[119] *See, e.g.*, Jessica R. Graham, *Institutional Capture: Why We're Overdue for A New Bankruptcy Act*, 19 N.Y.U. J.L. & BUS. 409, 414 (2023).

[120] William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737, 748 (2001). *Cf.* Dennis F. Dunne, *The Revlon Duties and the Sale of Companies in Chapter 11*, 52 BUS. LAW. 1333, 1336–37 (1997).

Likewise, secured creditors and shareholders could only be consensually adjusted in chapter XI, so they were unlikely to push for a chapter X, which contained a cramdown provision.[121] Ultimately the SEC was the only significant party that had any incentive to invoke chapter X, and they were fighting against everyone else in the case, perhaps even the judge, since chapter X cases went to the district court, while chapter XI cases stayed in front of bankruptcy judges.[122]

In short, the conventional wisdom that nobody wanted to use chapter X has some truth to it, but that tells us little about how well the provision actually worked.[123] We should keep in mind that "nobody" here means the large, insider actors, who opposed chapter X for selfish reasons.

The legitimate potential problems with chapter X seemed to be the identity of the trustee and the role of the SEC. The statute provided little guidance about the appointment of trustees, other than the requirement that they be disinterested.[124] Disinterested was defined by § 158 as somebody who was *not*:

- A creditor or stockholder;
- An underwriter of any of the debtor's outstanding securities;
- At the time of or within two years before the filing of the bankruptcy, a director, officer, employee or attorney of the debtor or "any such" underwriter.

Additionally, as a final "catch-all," a potential trustee was interested (not disinterested) if they had:

> an interest materially adverse to the interests of any class of creditors or stockholders by reason of any other relationship to, connection with, or interest in, the debtor or such underwriter, directly or indirectly.

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[121] Edward S. Adams, *Governance in Chapter 11 Reorganizations: Reducing Costs, Improving Results*, 73 B.U. L. REV. 581, 589 (1993).

[122] Lawrence P. King, *The History and Development of the Bankruptcy Rules*, 70 AM. BANKR. L.J. 217, 228 (1996). *See* A. Mechele Dickerson, *Privatizing Ethics in Corporate Reorganizations*, 93 MINN. L. REV. 875, 890 (2009). Like the U.S. Trustee's office today, the SEC was frequently dismissed as a party with no economic stake in the case. Sec. & Exch. Comm'n v. Canandaigua Enters. Corp., 339 F.2d 14, 15 (2d Cir. 1964).

[123] *Cf.* Benjamin A. Berringer, *"It's All Just A Little Bit of History Repeating:" an Examination of the Chrysler and GM Bankruptcies and Their Implications for Future Chapter 11 Reorganizations*, 7 N.Y.U. J.L. & BUS. 361, 370 (2010).

[124] Chapter X § 156.

In short, the old candidates for receivers—the company's president or general counsel, for example—were largely excluded. But otherwise, the district court could appoint almost anyone they it pleased, which sometimes led to suggestions of poor choices, perhaps influenced by questions of patronage.[125]

Although legal commentary, particularly in the latter years of chapter X, often suggested that such was often the case, § 162 did provide that "or upon application at any other time, objection may be made . . . to the retention of a trustee because he (the trustee) is not qualified or is not disinterested." While fear of alienating the judge clearly might discourage marginal objections, this provision would seem to provide an easy way to block a trustee that was patently incompetent, unqualified, or biased.

With regard to the SEC, the common complaint of some commentators was that the agency moved too slowly.[126] As noted, the SEC was to comment on the proposed plan in larger cases, and many complained that the agency lacked sufficient staff to respond in a timely fashion.[127] The SEC was hesitant to staff up in its reorganization section, given that work was very cyclical. One judge on the Second Circuit also noted that the SEC spent much time fighting efforts to sneak into chapter XI that consumed resources that might have been used elsewhere in the bankruptcy sphere.[128]

The SEC and trustee issues were largely solvable, but in 1978 Congress instead replaced chapter X with modern chapter 11, which looked a lot like old chapter XI, except it now applied to the entire capital

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[125] Martin I. Klein, *Chapter XI of the Bankruptcy Act: A Retailer's Biggest Markdown*, COMMERCIAL LAW JOURNAL 82, NO. 5 31, 60–61 (May 1977); Henry S. Blum, *The Chandler Act and the Courts*. AMERICAN BAR ASSOCIATION JOURNAL 27, NO. 4 232, 234 (1941).

[126] Troy A. McKenzie, *The Mass Tort Bankruptcy: A Pre-History*, 5 J. TORT L. 59, 66 (2012). *Contra* Jerome Frank, *Epithetical Jurisprudence and the Work of the Securities and Exchange Commission in the Administration of Chapter X of the Bankruptcy Act*, 18 N.Y.U. L. Q. REV. 317, 322–23, 334 (1941) ("We think we can say that the injection of the Securities and Exchange Commission into the reorganization cases has not substantially delayed the consummation of these proceedings; that in some cases it has demonstrably accelerated it; that in others any delay has been insignificant in amount compared to the benefits derived from the Commission's participation; and that there is generally no feeling on the part of the Bar that the Commission's participation has unnecessarily protracted reorganizations."); William J. Rochelle Jr. & Jack H. Balzersen, *Recommendations for Amendments to Chapter* X, 46 AM. BANKR. L.J. 93, 94–95 (1972) (arguing that delay was an inevitable product of giving all parties voice).

[127] Daniel J. Bussel, *A Third Way: Examiners as Inquisitors*, 90 AM. BANKR. L.J. 59, 78 (2016).

[128] Grayson-Robinson Stores, Inc. v. Sec. & Exch. Comm'n, 320 F.2d 940, 953 (2d Cir. 1963) (Clark, J., dissenting from denial of rehearing in banc).

structure.[129] The debtor would normally remain in possession of its estate and the SEC had no formal role (although it could appear and comment on most issues if it so desired).[130]

In theory this new and improved reorganization provision would facilitate cheaper, faster, and earlier reorganization. But the 1978 Code was drafted in the early days of private equity and modern debt instruments.[131] Although the extreme flexibility of chapter 11, which it inherited from chapter XI, allows the statute's continued use to this day, the flexibility has also enabled something resembling anarchy, as we shall see.[132]

The similar notion that chapter 11 would encourage earlier filings, since management would not be displaced with a trustee, is undercut by the host of modern chapter 11 debtors that file only after having granted third and fourth liens on their assets.[133] That an important recent appellate opinion struggles with the fate of the "1.5 lien" lenders—lenders inserted between preexisting first and second lien lenders—tells us all we need to know about modern capital structures, and whether debtors are filing to reorganize any earlier than W.T. Grants did in 1975.[134] Taking on more debt, gambling for a turnaround, is still very attractive to insiders.

IV. Dancing with the Big Boys (Nothing is Embarrassing)

Modern chapter 11 practice has been heavily criticized by academics of all stripes.[135] On the other hand, case participants have been more hesitant to cast blame, in part because the creditor who is sunk today might be on the other side tomorrow.

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[129] Michael A. Gerber, *Commentary: The Election of Directors and Chapter 11–the Second Circuit Tells Stockholders to Walk Softly and Carry a Big Lever*, 53 BROOK. L. REV. 295, 315 (1987); Mendales, *supra* note 93, at 990.

[130] David A. Skeel, Jr., *The Past, Present and Future of Debtor-in-Possession Financing*, 25 CARDOZO L. REV. 1905, 1914 (2004); *see also* Kelli A. Alces, *Enforcing Corporate Fiduciary Duties in Bankruptcy*, 56 U. KAN. L. REV. 83, 91 (2007).

[131] Harvey R. Miller, *Chapter 11 Reorganization Cases and the Delaware Myth*, 55 VAND. L. REV. 1987, 2014 (2002).

[132] *See* Laura N. Coordes, *Bankruptcy Overload*, 57 GA. L. REV. 1133, 1149 (2023).

[133] A. Mechele Dickerson, *The Many Faces of Chapter 11: A Reply to Professor Baird*, 12 AM. BANKR. INST. L. REV. 109, 133 (2004). *See* John Wm. ("Jack") Butler, Jr., Chris L. Dickerson, Stephen S. Neuman, *Preserving State Corporate Governance Law in Chapter 11: Maximizing Value Through Traditional Fiduciaries*, 18 AM. BANKR. INST. L. REV. 337, 340 (2010).

[134] *In re* MPM Silicones, L.L.C., 874 F.3d 787, 792 (2d Cir. 2017).

[135] *See, e.g.*, Dick, *supra* note 12, at 1333.

The basic structure of modern corporate bankruptcy involves the debtor teaming up with one group of favored creditors to allow that group to extract extra value from the case—to the detriment of other stakeholders.[136] The debtor benefits by ensuring a quick chapter 11 process. Sometimes the "debtor" is really the debtor's private equity sponsor, who benefits from quick approval of a plan that allows the sponsor to retain at least some of their investment in the debtor.[137] That strategy often involves putting a bit of new money into the debtor, but the sponsor gets to do so without any real market test on that investment.[138]

Modern chapter 11 is thus fully Hobbesian: nasty, brutish, and short.[139] Some argue that the brutality is unobjectionable, given that the pain is only distributed among sophisticated players. That assumes that the costs of these creditor-on-creditor battles are internal to the battles. The reality appears to be quite different. A reorganization designed to extract value from creditor A and give it to creditor B has no necessary relationship to the reorganization that would best suit the debtor-firm.[140]

The adoption of a sub-optimal reorganization plan has obvious costs to the debtor, which may face the need for future (costly) reorganization as a result.[141] But such ill-defined reorganizations also foist costs onto other creditors, whose recoveries are not what they should have been, and other stakeholders like employees and even shareholders, who face uncompensated risks going forward that they might have otherwise avoided if the debtor had been properly restructured in the first instance.[142]

To the extent that the "they are all sophisticated" argument merely means that such deals should be entitled to a bit more deference than traditional cases, without any grand claims about efficiency, one might accept that, provided that the system restructuring system contains guardrails to

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[136] Edward J. Janger & Adam J. Levitin, *The Proceduralist Inversion—A Response to Skeel*, 130 YALE L.J. FORUM 335, 354 (2020).

[137] Jared A. Ellias & Robert J. Stark, *Bankruptcy Hardball*, 108 CALIF. L. REV 745, 748 (2020).

[138] Buccola, *supra* note 31, at 40.

[139] Diane Lourdes Dick, *Alliance Politics in Corporate Debt Restructurings*, 39 EMORY BANKR. DEV. J. 285, 287 (2023).

[140] Diane Lourdes Dick, *The Chapter 11 Efficiency Fallacy*, 2013 B.Y.U. L. REV. 759, 812 (2013).

[141] Several recent retail debtors—such as Rite Aid and JoAnn—provide examples.

[142] *See* Vincent S.J. Buccola & Joshua C. Macey, *Claim Durability and Bankruptcy's Tort Problem*, 38 YALE J. ON REG. 766, 815 (2021).

protect innocent third parties. Modern chapter 11 lacks such features.[143]

There is another aspect of modern chapter 11 that can never be justified. Namely, there is a good argument that much of modern reorganization practice involves base appropriation from disfavored groups of creditors.[144] If the debtor and another group of creditors simply conspire to steal value from other creditors, that behavior is objectionable even if the "outsiders" are sophisticated distressed debt investors.[145]

Why should the government—through chapter 11—facilitate such behavior?[146] The facile response is that the creditors should have protected themselves by contract. In many cases the creditors thought they had done so.[147] The courts' crabbed reading of contracts—and hesitancy to embrace obvious solutions like the implied covenant of good faith and fair dealing—have thwarted such efforts.[148]

The proponents of these deals pick and choose which parts of chapter 11 they want to follow, using what is useful and ignoring those pieces that might lead to more balance or transparency.[149] As one noted commentator recently summarized, "proponents of bankruptcy à la carte (including financial institutions, hedge funds, private-equity funds, and their restructuring professionals) misappropriate value meant for a more diffuse

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[143] Pamela Foohey & Christopher K. Odinet, *Silencing Litigation Through Bankruptcy*, 109 VA. L. REV. 1261, 1314–18 (2023).

[144] Skeel & Triantis, *supra* note 2, at 1811.

[145] *Cf.* Anthony J. Casey, *Bankruptcy's Endowment Effect*, 33 EMORY BANKR. DEV. J. 141, 157 (2016).

[146] Jacoby, *supra* note 21, at 1723.

[147] Elisabeth de Fontenay, *Complete Contracts in Finance*, 2020 WIS. L. REV. 533, 543 ("In disputes between corporate borrowers and their creditors . . . courts frequently revert to the mantra that creditors should have protected themselves from the disputed outcome by contract, and therefore their failure to do so implies that the borrower should carry the day.").

[148] Jared A. Ellias & Elisabeth de Fontenay, *Law and Courts in an Age of Debt*, 171 U. PA. L. REV. 2025, 2031, 2054–55 (2023). *See also* Royce de R. Barondes, *Vestigial Literalism in the Interpretation of Corporate Financing Instruments*, 15 Transactions: TENN. J. BUS. L. 239, 288 (2014) ("A number of factors . . . result in courts relying to a lesser extent on the evident purposes of contractual provisions in interpreting corporate financing instruments . . . . One consequence is tedious literalism-hyperliteralism-may reign in interpreting corporate financing instruments.").

[149] Vincent S.J. Buccola, *Unwritten Law and the Odd Ones Out*, 131 YALE L.J. 1559, 1559 (2022) (reviewing DOUGLAS G. BAIRD, THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS (2022)) (arguing reorganizers have "mastered the art of ignoring or interpreting away 'written law' inconsistent with their core commitments" accounting for "a variety of persistent norms and tensions of reorganization practice not attributable to statute or judicial precedent").

group of stakeholders and capture it for themselves."[150]

At the very moment that large-scale corporate reorganization is in disarray, Congress has abandoned the 1978 decision to compel all non-rail corporations to reorganize under a single chapter 11.[151] Instead, small businesses are now like railroads in that they have a special subchapter of chapter 11 all their own.[152]

One of the unique features of the subchapter V process is that a trustee is appointed to assist the debtor in possession with the process, including negotiating a plan for reorganization and providing general advice to the debtor, creditors and the bankruptcy court.[153] So much for the fear of trustees.

More to the point, now that business reorganization has been disaggregated, it should open the door to reconsidering the decision in 1978 to put all business debtors in a single chapter.[154] In particular, while Congress was debating a new bankruptcy law in the late 1970s, the Senate proposed a chapter 11 that would have had an overlay of special rules for publicly traded companies, while the House strongly pushed for chapter 11 as enacted, with the same rules applicable to all companies.[155] Among the special rules the Senate proposed was a trustee in publicly traded cases, but they ultimately settled for the rather weak tea of § 1104(c) of the Code, which seemed to require an examiner when requested in all large cases. Even that concession took a recent appellate decision (decades after enactment) to confirm what

[150] Melissa B. Jacoby, *Shocking Business Bankruptcy Law*, 131 YALE L.J.F. 409, 411 (2021).

[151] *See* Frederick Tung, *Confirmation and Claims Trading*, 90 NW. U. L. REV. 1684, 1713 (1996).

[152] 11 U.S.C. §§ 1181–1195. The debtor must have $3 million or less in aggregate noncontingent, liquidated secured and unsecured debts as of the petition date. 11 U.S.C. §§ 101(51D), 1182. Following the onset of the pandemic, the limit was temporarily lifted to $7.5 million, but for cases commenced on or after June 21, 2024, the applicable debt limit is the original limit enacted in the SBRA, as adjusted under 11 U.S.C. § 104—currently $3,024,725. If more than one company are filing for bankruptcy, the subchapter V debt limit applies to the "group of affiliated debtors." Subchapter V is not available to an any debtor that is subject to the reporting requirements under § 13 or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m, 78o(d)), or any affiliate of such a corporation.

[153] 11 U.S.C. § 1183. *See also* STEPHEN J. LUBBEN, AMERICAN BUSINESS BANKRUPTCY: A PRIMER ch. 21 (2d ed. 2021).

[154] Laura N. Coordes, *Bespoke Bankruptcy*, 73 FLA. L. REV. 359, 378 (2021). *Cf.* Anne Lawton, *Chapter 11 Triage: Diagnosing A Debtor's Prospects for Success*, 54 ARIZ. L. REV. 985, 990 (2012).

[155] Save for railroads, which like small businesses today, have always had special rules contained in a subchapter of chapter 11.

was originally and obviously intended.[156]

Given the tensions in modern chapter 11, and the decision to move away from the unitary model adopted in 1978, this is an opportune time to reconsider the decision to abandon chapter X, or something like it (such as the Senate proposal).

V. Where Are We Now?

It has been suggested by many leading commentators and practitioners that we are overdue for a new bankruptcy law. This is profusely conceded, at least regarding business bankruptcy, because the assumptions and conclusions that motivated the present law no longer hold.

A central problem for corporate reorganization is the court's inability to discern what is really going on.[157] On the one hand, the court is presented a plan, all pre-scripted by a pre-bankruptcy deal, that most everyone seems to support. On the other hand, the judge is then faced with a small group of creditors who may be making legitimate arguments about the deal or might simply be classic "holdouts" looking for better treatment.[158] How is the judge to know which is which? The parties do not come to court sporting appropriately colored hats, jerseys, or distinctive facial hair.

Further confounding the situation is the reality that the more courts tend to adopt the deal placed before them, the less likely creditors are to object, since doing so will be seen as throwing good money after bad. What is the point of funding an objection if the court is going to approve the plan anyway? That in turn shrinks the size of the objector pool and pumps up the numbers who "consent," all the while telling us very little about what is actually going on in the case.

In such a world, the chapter X style trustee makes a lot of sense, as the trustee can provide the court with independent insight on what is "really happening."[159] To be sure, we might want to refine the role, learning from the complaints under the old law.

Before developing the last point further, the first step is to

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[156] *In re* FTX Trading Ltd., No. 23-2297, 2024 WL 204456 (3d Cir. Jan. 19, 2024). Moreover, courts can still neuter the provision by providing the examiner with a minuscule budget. One might question whether that reflects a good faith attempt to implement Congressional intent.

[157] Janger & Levitin, *supra* note 22, at 174.

[158] Jonathan M. Seymour, *Against Bankruptcy Exceptionalism*, 89 U. CHI. L. REV. 1925, 1968 (2022).

[159] James J. White, *Harvey's Silence*, 69 AM. BANKR. L.J. 467, 478 (1995).

disaggregate chapter 11 into its constituent parts. The solution lies in three distinct reorganization tools for larger businesses, plus the continuation of something like subchapter V for small businesses.

At the core of the new system would be a provision, much like old, maligned chapter X, which would provide for a comprehensive reorganization of a sufficiently large company's full capital structure. For publicly traded debtors, this would be the presumptive tool, but upon satisfaction of various conditions, other tools would become available.

Traditional chapter 11 would remain for cases that involve small cap companies, too big for subchapter V, but with relatively normal capital structures that have not been perverted by modern financial engineering. This is the group of cases that Congress seemed to have in mind when it drafted chapter 11 back in 1978.[160]

For the large debtors, another option beyond the full restructuring offered by the "chapter X" style provision might be a balance sheet restructuring provision. Implementing something like the British scheme of arrangement tool in a context where the restructuring would leave untouched employees, retail investors, and other non-financial creditors would provide space for modern style reorganizations, in a somewhat more orderly environment than prevails today.[161] Notably, British "schemes" allow for a class by class restructuring of the firm, without the need to put the entire enterprise into a reorganization procedure.[162]

Moreover, such a statutory structure might better justify the "light touch" that many bankruptcy courts already apply to today's RSA driven chapter 11 cases. There remains, of course, the broader question of whether creditor-on-creditor attacks are something that the federal government should facilitate through statute. A quick capital structure reorganization tool might make sense in any event, even if we decide that such revamps should be done in "good faith." We might want to encourage such restructuring to occur earlier than they do at present.

Turn back to the question of what a revived chapter X would look like. Part of the difficulty in enforcing the existing terms of chapter 11 is that in a debtor-in-possession system, there is no dispassionate party that can tell

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[160] *See* LoPucki, *supra* note 3, at 746.

[161] Retail investors would be entitled to equal treatment when mixed in a class with institutional investors.

[162] Sarah Paterson & Adrian Walters, *Chapter 11's Inclusivity Problem,* 55 ARIZ. ST. L.J. 1227, 1272 (2023).

the bankruptcy court the story of the case.[163] Everyone who appears before the court is by definition pursuing some goal—leaving the judge overseeing a chapter 11 as isolated from the reality of the process a receivership judge in the 1880s.[164] The only information that comes to the judge is what the parties want the court to know.

Standing alone, that suggests that our new trustee need not be a full, chapter 7-style trustee—something like the Canadian monitor would probably suffice.[165] That is, somebody to provide an independent voice, and not necessarily fully take charge of the debtor-company.

But what else might a chapter X do to reform corporate reorganization? It is widely believed that many modern corporate debtors routinely forgo viable causes of action against former management or controlling shareholders. Indeed, bipartisan legislation was recently proposed to address the problem.[166]

In a world where many debtor-companies are owned by private equity firms, and management is appointed by those firms, this hesitancy is not surprising, given that bringing such suits would be the equivalent of suing "friends and family." Thus, it might make sense to charge the trustee with examining and litigating (or settling) the estate's causes of action.

In general, we might conceive of the trustee as taking over the power of the board, but not that of the officers and other management. As such, it might also make sense for the trustee to have broader powers to approve transactions—without separate approval by the court—than the debtor in possession presently possesses.[167] That in turn might reduce the number of court appearances in reorganization, with corresponding reductions of time and expense. A wide range of transactions that are presently the subject of formal motions might instead be simply noticed on the court's docket after approval by the trustee.

A key question is who should propose the trustee? Canadian examiners are put forth by the debtor, which raises the question of whether

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[163] *See* Michelle M. Harner & Jamie Marincic, *Committee Capture? An Empirical Analysis of the Role of Creditors' Committees in Business Reorganizations*, 64 VAND. L. REV. 749, 788–90 (2011).

[164] *See* Douglas G. Baird, *Bankruptcy's Quiet Revolution*, 91 AM. BANKR. L.J. 593, 593 (2017) (discussing how a restricting support agreement can interfere with the flow of information needed to apply Chapter 11's substantively).

[165] Michelle M. Harner, *The Search for an Unbiased Fiduciary in Corporate Reorganizations*, 86 NOTRE DAME L. REV. 469, 501–02 (2011).

[166] David Skeel, *Bankruptcy's Identity Crisis*, 171 U. PA. L. REV. 2097, 2125 (2023).

[167] *Cf.* 11 U.S.C. §§ 363(c), 1107, 1108.

there is true independence, because one could presume that debtor's counsel has a large say in hiring. As noted, under old chapter X the court picked the trustee, which had its own problems, while under modern chapter 11 the rarely appointed trustees are selected by the U.S. Trustee, after consultation with parties in interest and subject to the court's approval.[168] In theory such a trustee could be elected, but that is even more uncommon.[169]

Under old § 77, the court picked a trustee from a list provided by the Interstate Commerce Commission. Presumably a similar system utilizing the U.S. Trustee in place of the Interstate Commerce Commission ("ICC") would work well, especially if the U.S. Trustee had a stable of prospective trustees ready to go.

Alternatively, the trustees could be employees of the U.S. Trustee, working "in house." But modern political sensibility suggests little viability to the notion of "bureaucrats as trustees."

Finally, notice that while I refer to my revised public company reorganization chapter as "chapter X," the SEC is nowhere to be found. The SEC, like the ICC in railroad reorganizations, was to comment on the plan and its inherent fairness.[170] There would seem to be no reason why the modified trustee, as outlined herein, could not take on this task. Handing the work to an understaffed and underfunded administrative agency seems to offer little upside.[171]

New chapter X would be mandatory—except perhaps when reorganization was successful under the "scheme" mechanism—and trustees would always be appointed. But in many other respects, it would continue key features of present-day big-case chapter 11.

VI. Conclusion

Chapter 11 has become a rough and tumble sort of place. In part this is because the corporate reorganization provisions were designed for a simpler sort of debtor, in a simpler time. Today hedge funds, private equity funds distressed debt funds, and CLOs all clash in a world where capital

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[168] Fed. R. Bankr. P. 2007.1.

[169] 11 U.S.C. § 1104(b).

[170] Samir D. Parikh, *The Improper Application of the Clear and Convincing Standard of Proof: Are Bankruptcy Courts Distorting Accepted Risk Allocation Schemes?*, 78 U. CIN. L. REV. 271, 301 (2009); Bratton & Skeel, *supra* note 36, at 1577.

[171] A point I would have made even before the current Administration's efforts at deregulation by layoff.

structures are as complex as ever.[172] Chapter 11 plans are often "pre-cooked" before the case even commences, so that a bankruptcy judge is presented with a meal that is nearly complete. Without a good picture of what is really going on, it is quite daunting to say, "Throw it all out and start over."[173]

One of the core ideas of the 1978 Bankruptcy Code was that all businesses would reorganize under a single chapter of that Code.[174] Now that small businesses have been carved out of the larger whole, it is time to consider if the 1978 model works anymore, especially given the concerns with the state of big business reorganization. This article has begun the discussion by suggesting that it is time to unpack chapter 11 in a way that revives something that looks a lot like old chapter X.

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[172] Kenneth Ayotte & Christina Scully, *J. Crew, Nine West, and the Complexities of Financial Distress*, 131 YALE L.J.F. 363, 363–66 (2021); Jared A. Ellias, *Do Activist Investors Constrain Managerial Moral Hazard in Chapter 11?: Evidence from Junior Activist Investing*, 8 J. LEGAL ANALYSIS 493, 500 (2016).

[173] The problem is not new. The SEC noted in its reports on equity receiverships that prearranged reorganizations put tremendous pressure on courts to approve the reorganization, and avoid the costs of sending the parties back to "square one." S.E.C., *Report On The Study And Investigation Of The Work, Activities, Personnel And Functions Of The Protective And Reorganization Committees*, Part I, p. 871 (Adelaide Rosalia Hasse ed., 1936–1940).

[174] Although not well-remembered today, not everyone thought this was a good idea. *E.g.*, Arthur L. Moller, *Chapter 11 of the 1978 Bankruptcy Code or Whatever Happened to Good Old Chapter XI*, 11 ST. MARY'S L.J. 437, 438 (1979) ("One of the most drastic, and probably the least successful, provisions of the new Bankruptcy Code is the consolidation of Chapters VIII, X, XI, and XII of the Bankruptcy Act into a single chapter, chapter 11 of the Code.").