THE RESILIENCY OF THE EQUALITY OF CREDITORS ETHOS IN BANKRUPTCY

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"If the Bankruptcy Code were a Country and Western song, its refrain would be 'Equity is Equality.'"[1]

The language and concept of equality among creditors, which has long dominated Anglo-American bankruptcy jurisprudence and analysis has recently been cast into question by a leading bankruptcy scholar who has constructed a compelling and disquieting case for the dual propositions that the equality principle in contemporary bankruptcy law and practice is on life support and that, while the patient could easily be resuscitated, no steps should be taken to do so. Against this provocative backdrop, I attempt to make the case in this article that (to sustain the analogy) the patient may have quite a bit of life left in her and that restoring her to health would be a boon to system participants in business reorganization as well as consumer bankruptcy cases. In justification of this assertion, I identify and develop a role for the equality norm in bankruptcy that not only makes it constructive in approaching key issues in bankruptcy, but that also preserves the integrity and coherence of the system to the benefit of debtors and creditors, as well as society at large.

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[1] Kenneth N. Klee, *Tithing and Bankruptcy*, 75 AM. BANKR. L.J. 157, 157 (2001).

INTRODUCTION

"Equality of distribution" among similarly positioned creditors has consistently been recognized as a foundational value of Anglo-American bankruptcy law.[2] The only principle that rivals equality in terms of policy importance—the bankruptcy "fresh start"—is comparatively of much more recent origin, having not arrived on the scene until relatively late in the long history of bankruptcy jurisprudence.[3] By contrast, so ingrained is the canon of equality that the equitable maxim "equity is equality" has been not only employed to the point of banality, but often expressed in the obverse, i.e. "equality is equity."[4] But then if equality and equity are so deeply embedded in the bankruptcy psyche, then one rather quickly concludes their relative order is of no moment.

Against this backdrop, in a thoughtful and provocative article,[5] Professor David Skeel has advanced the heterodoxy that equality as an animating principle is losing

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[2] The Supreme Court has routinely acknowledged that, at its core, bankruptcy law enforces a principle of equal treatment between creditors with like claims. *See, e.g.*, Begier v. IRS, 496 U.S. 53, 58 (1990) ("Equality of distribution among creditors is a central policy of the Bankruptcy Code."); Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215, 219 (1941) (describing the "theme" of the bankruptcy law as "equality of distribution"); Bailey v. Glover, 88 U.S. (21 Wall.) 342, 346 (1874) ("It is obviously one of the purposes of the Bankrupt[cy] law, that there should be a speedy disposition of the bankrupt's assets. This is only second in importance to securing equality of distribution."). Commentators in the field also bend, with little or no resistance, to the equality norm. *See, e.g.*, David G. Epstein, Casey Ariail & David M. Smith, *Not Just Anna Nicole Smith: Cleavage in Bankruptcy*, 31 EMORY BANKR. DEV. J. 15, 20–21 (2014) ("The similar treatment of similarly situated creditors is a fundamental tenet of bankruptcy law. . . ."); Adam J. Levitin, *Bankrupt Politics and the Politics of Bankruptcy*, 97 CORNELL L. REV. 1399, 1454 (2012) (noting that bankruptcy policy is "built around the distributional norm . . . that similar creditors should have similar recoveries").

[3] Indeed, voluntary bankruptcy and the concept of "discharge" did not become part of the legal landscape in this country until the Bankruptcy Act of 1841, ch. 9, 5 Stat. 440, 444–45 (1841) (repealed 1843). *See* Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1395 n.5 (1985) [hereinafter *Fresh-Start Policy*] (recognizing "[t]he comparative newness of the fresh-start policy in bankruptcy law"); John C. McCoid, II, *Discharge: The Most Important Development in Bankruptcy History*, 70 AM. BANKR. L.J. 163, 164 (1996); *see also* Louis Edward Levinthal, *The Early History of Bankruptcy Law*, 66 U. PA. L. REV. 223, 225 (1918) ("All bankruptcy law . . . no matter when or where devised and enacted, has at least two general objects in view. . . . [It] seeks to protect the creditors, first, from one another and, secondly, from their debtor. A third object, the protection of the honest debtor from his creditors, by means of the discharge, is sought to be attained in some of the systems of bankruptcy, but this is by no means a fundamental feature of the law."); Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 857 (1982) [hereinafter *Non-Bankruptcy Entitlements*] (noting while bankruptcy is usually thought of as a procedure for providing relief to an overburdened debtor, "most of the bankruptcy *process* is in fact concerned with creditor-distribution questions").

[4] *See, e.g.*, Cunningham v. Brown, 265 U.S. 1, 13 (1924) ("It is a case the circumstances of which call strongly for the principle that equality is equity, and this is the spirit of the bankrupt law."); *In re* Joliet-Will Cnty. Cmty. Action Agency, 847 F.2d 430, 434 (7th Cir. 1988) ("Distribution in bankruptcy normally would result in each creditor's receiving his pro rata share of the debtor's assets ('equity is equality'). . . .").

[5] David A. Skeel, Jr., *The Empty Idea of "Equality of Creditors"*, 166 U. PA. L. REV. 699 (2018). Professor Skeel openly crafted the title of his article as a variation on the title of another provocative article from three and a half decades earlier. *See* Peter Westen, *The Empty Idea of Equality*, 95 HARV. L. REV. 537 (1982). In that piece, Professor Westen posited that, despite the endurance of the principle of equality in Western thought, in fact it is empty of content, serving only to produce confusion and logical errors. *Id.* at 560, 578–79.

its hold on contemporary bankruptcy law and practice, and that, in an even greater apostasy, we should applaud its demise.[6] In his conclusion, he does not mince his words, asserting: "A century ago the equality norm served a plausible (though much debated) [principle]. . . . [Today] the equality norm has become a costly distraction. Bankruptcy judges, professionals, and scholars would do well to foreswear the language of equality, and direct their attention to the principles that still matter."[7]

With the enactment of the current Bankruptcy Code in 1978,[8] bankruptcy moved from the backwaters to the mainstream, both as a form of individual debt relief and as an instrument in standard business planning.[9] This has caused a collision of sorts between traditional bankruptcy policy and competing social and economic goals and aspirations.[10] The need to harmonize and reconcile bankruptcy law and policy with the purposes underlying other important legal regimes, be it retirement security, environmental protection, the sanctity of domestic support obligations, or the integrity of collective bargaining agreements, has pressured the primacy of the equality principle, and doubtlessly caused some erosion in its paramountcy. On the legislative front, one sees this phenomenon in the growth of exceptions to the discharge exceptions, the expansion preference liability defenses, and the list of

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Consequently, Westen concluded that the "rhetoric of equality" should be abandoned. *Id.* at 592–93. As Skeel points out, Westen later walked back, to a degree, from the radicalness of this position. *See* Skeel, *supra*, at 741 n.229.

[6] Skeel, *supra* note 5, at 702 (asserting that, unlike consuming chicken soup if you have a cold, the equality norm in bankruptcy cannot help and actually hurts).

[7] *Id.* at 744. These principles, or at least those Skeel identifies in relation to the aspects of the bankruptcy law he examines in support of his argument, are regulating self-dealing, maximizing value, and avoiding the creation of secret liens. *Id.* at 702.

[8] Except where the context requires otherwise, references in this Article to the "Code" or the "Bankruptcy Code" are to the current law of bankruptcy, which is found in title 11 of the United States Code. 11 U.S.C. §§ 101–1532 (2018), as amended. It was enacted on November 6, 1978, as the Bankruptcy Reform Act of 1978 and governs all cases filed on or after October 1, 1979. *See* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2459 (codified as amended 11 U.S.C. §§ 101–1532 (2018)).

[9] Karen M. Gebbia, *The Keepers of the Code: Evolution of the Bankruptcy Community*, 91 AM. BANKR. L.J. 183, 240 (2017) ("The Bankruptcy Reform Act of 1978 . . . profoundly changed bankruptcy law and the bankruptcy system."). The decision in connection with adoption of the Code to eliminate the prior practice of awarding professional compensation in bankruptcy below levels prevailing for comparable services elsewhere also had a major impact on the growth in "big law" of insolvency/restructuring departments that hitherto largely did not exist. *See* H.R. REP. NO. 95-595, at 329–30 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6285–87 [hereinafter HOUSE REPORT]; *In re* NuCorp Energy, Inc., 764 F.2d 655, 659 (9th Cir. 1985) ("Congress has made it clear that the compensation of bankruptcy counsel should be commensurate with that awarded to non-bankruptcy attorneys for 'comparable services.'").

[10] Examples include tensions between bankruptcy law and environmental laws, labor laws, and corporate law doctrines such as successor liability. Journal articles attempting to find an appropriate balance in each instance include, respectively, Rudi Greenberg, *Clash of The Titans: United States Bankruptcy Code Versus Environmental Protection Legislation*, 2 J. BANKR. L. & PRAC. 3 (1993); Bruce H. Simon & Barbara S. Mehlsack, *Filing a Post-*Bildisco *Chapter 11 Petition to Reject a Labor Contract*, 52 FORDHAM L. REV. 1134 (1984); Nathan F. Coco, *An Examination of Successor Liability in the Post-Bankruptcy Context*, 22 J. CORP. L. 345 (1997).

unsecured priority claims.[11] Concomitantly, several judicially created doctrines that further disrupt equality policy have also taken root, particularly in chapter 11 cases.[12] At the same time as these trends are unfolding, the venerable characterization that the bankruptcy courts are "courts of equity" has become the target of increasing reproach and circumspection,[13] making for quite a frothy situation.

Despite these divergencies from a strict obedience to equality policy, I think it is a mistake to consign summarily the equality norm in American bankruptcy law to the dustbin of history. To do so blurs the distinction between the law of state collection remedies and bankruptcy in a fashion that trivializes the saliency and the distinctiveness of a collectivized federal debt collection procedure in contradistinction to state "grab law."[14] It also ignores the role of equality as a useful normative baseline, a point which Skeel explicitly rejects,[15] but one that represents a central thesis of this treatment.

Although equality merely for equality's sake in purely commercial matters is, as Skeel observes, a hollow pursuit,[16] that does not *ipso facto* render the equality prescript without essential content in the bankruptcy forum.[17] This, I believe, is the unwarranted leap of faith made by Skeel,[18] along with ignoring the collateral benefits

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[11] The Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, 119 Stat. 23 (2005), for instance, alone added two new categories of non-dischargeable debts (11 U.S.C. § 523(a)); an additional defense to preference liability (as well as expanding several existing defenses) (11 U.S.C. § 547(c)); and three new priorities for unsecured claims (11 U.S.C. § 507(a)), including a new administrative expense priority for certain pre-petition vendor claims (11 U.S.C. § 503(b)(9)). *See generally* Epstein et al., *supra* note 2, at 36–40 (urging that matters that undermine equality among creditors should be left to the discretion of bankruptcy judges based on the unique facts of the case rather than by blanket legislative fiat in all cases).

[12] *See* Richard M. Hynes & Steven D. Walt, *Inequality and Equity in Bankruptcy Reorganization*, 66 U. KAN. L. REV. 875, 876 (2018) [hereinafter *Inequality and Equity*] (analyzing the standards governing "judicially approved deviations from equality in" chapter 11 cases). This work is treated in more depth *infra* text accompanying notes 331–38.

[13] *See* Lawrence Ponoroff, *Whither Recharacterization*, 68 RUTGERS U. L. REV. 1217, 1222 (2016) [hereinafter *Whither Recharacterization*] (observing that "the bankruptcy courts' general equitable authority under § 105(a) has taken something of a drubbing in recent years as appellate courts have, for the most part, sought to constrain the scope of the bankruptcy courts' ability to fashion non-Bankruptcy Code rules or practices in order to more effectively carry out their statutory duties"). See also *infra* Section VI.B.2 for more detailed discussion.

[14] Under state collection law the race goes to the swiftest. *See* Susan Block-Lieb, *Fishing in Muddy Waters: Clarifying the Common Pool Analogy as Applied to the Standard for Commencement of a Bankruptcy Case*, 42 AM. U. L. REV. 337, 355–56 (1993) (observing that various state law remedies, including execution, levy, and garnishment, can trigger "a 'race to the courthouse' by a debtor's creditors, with the creditors who win the race entitled to 'grab' the debtor's assets away from the debtor's slower creditors"); Jackson, *Non-Bankruptcy Entitlements*, *supra* note 3, at 864 ("The use of individualistic remedies may lead to a piecemeal dismantling of a debtor's business by the untimely removal of necessary operating assets. To the extent that a non-piecemeal bankruptcy process (whether in the form of liquidation or reorganization) is likely to increase the aggregate pool of assets, its substitution for individualistic remedies may be advantageous to the creditors as a group."). For a more extensive discussion of the point, see *infra* Section VI.B.1.

[15] *See* Skeel, *supra* note 5, at 743.

[16] *See id.* at 741–42.

[17] The proposition that equality might serve this role effectively is discussed *infra* text accompanying notes 414–43.

[18] *See* Skeel, *supra* note 5, at 742 ("In bankruptcy, the equality norm has all of the downsides that equality has in other contexts, with none of its ostensible virtues.").

that are the derivative products of a system designed in the first instance to promote equality of creditors—products that put alternative objectives to a fair and appropriate test insofar as whether they rise to the level of compelling counterweights. In short, Skeel's contention that equality's contribution to contemporary bankruptcy conversation and analysis is diminishing at an ever-increasing pace brings to mind the text of Mark Twain's 1897 cable from London to the press in the United States that, "[t]he reports of my death are greatly exaggerated."[19] His further assertion that, as a normative matter, we should toss the sinking equality conceptualization a rock rather than a life vest is an even more dubious proposition.[20]

The Code's distributional priority scheme begins with a principle of equal distribution among unsecured creditors.[21] Equal not in the sense of the amount distributed, but in the sense that claims are paid in proportion to the percentage each represents of all such claims of the same legal character.[22] From there, the Code then sanctions certain exceptions from this general rule of pro rata sharing by recognizing a priority for ten categories of unsecured claims, themselves in order of priority.[23] In addition to priority unsecured claims, the Code preserves the priorities established between particular creditors by contract.[24] Hence, if one creditor agrees pre-filing to subordinate its claim to the priority of one or more other creditor(s), the Code will abide by that agreement.[25] And, of course, the Code recognizes property rights created under state law. That is, generally speaking, the Code gives effect to non-bankruptcy-law rules that grant a secured creditor full priority with respect to

[19] *See id.* at 744. Although oft cited as an example of Twain's wit, a recent treatment suggests the actual quote was somewhat more prosaic and has been embellished over the years. Emily Petsko, *Reports of Mark Twain's Quote About His Own Death Are Greatly Exaggerated*, MENTAL FLOSS (2018), https://www.mentalfloss.com/article/562400/reports-mark-twains-quote-about-mark-twains-death-are-greatly-exaggerated.

[20] *See* Skeel, *supra* note 5, at 744 ("Bankruptcy judges, professionals, and scholars would do well to foreswear the language of equality, and direct their attention to the principles that still matter.").

[21] *See, e.g.*, Howard Delivery Serv., Inc. v. Zurich Am. Ins. Co., 547 U.S. 651, 667 (2006) (resolving the issue of the scope of an unsecured priority category with reference to "the equal distribution objective underlying the Bankruptcy Code"); *In re* AE Bicycle Liquidation, Inc., 612 B.R. 330, 333 (Bankr. M.D.N.C. 2019) (quoting Ford Motor Credit Co. v. Dobbins, 35 F.3d 860, 865 (4th Cir. 1994)) ("The presumption in bankruptcy cases is that the debtor's limited resources will be equally distributed among the creditors."); *see also supra* note 2.

[22] The principle of pro rata distribution is deeply embedded in the Code. *See, e.g.*, 11 U.S.C. § 726(b) (2018) (distribution of property of the estate); *id.* § 1123(a)(4) (equal treatment for commonly classified claims); *id.* § 1322(a)(3) (same treatment for each claim within a particular class).

[23] *See id.* § 507(a). Among these categories, since the 2005 Amendments, domestic support obligations enjoy the highest rung. *See id.* § 507(a)(1)(A). In turn, this priority itself has two levels, depending on whether the claimant is a direct beneficiary of the obligation or a governmental unit by virtue of an assignment. *See id.* § 507(a)(1)(B). There are also three types of claims that enjoy a "super priority" over the section 507(a) priority claims, including (1) administrative expenses in a case converted to chapter 7 over administrative expenses in the initial case (11 U.S.C. § 726(b)), (2) with court approval, for a post-petition credit extension (11 U.S.C. § 507(b)), and (3) for a creditor earlier granted adequate protection that proves to be inadequate (11 U.S.C. § 507(b)).

[24] *See id.* § 510(a).

[25] *See id.*

property of the debtor taken as collateral for such creditor's claim.[26] Subject to these important exceptions, the Code then declares and enforces a principle of equality among all nonpriority unsecured claims.[27] This is the "equality is equity" aphorism routinely recited by courts and commentators.[28] Finally, the Code places equity holders, who were never creditors to begin with—unless their debt claims had been recharacterized earlier in the case[29]—at the bottom of the priority ladder.[30]

As currently constructed, the Bankruptcy Code may do a rather uninspired job in terms of determining when the equality principle must yield to the support claim of an ex-spouse or the long-term lender who receives a large payment in advance of the bankruptcy filing.[31] In spite of this, the acknowledgement of the principle—even if implemented in a less than optimal fashion—and its place at the nucleus of the bankruptcy order serve as a constraining influence on (1) the ever-present effort of particular types of creditors to advance their cause at the expense of and to the detriment of other like creditors;[32] and (2) the risk that, in service of other emulous social goals and objectives, the bankruptcy law will lose its distinct identity.[33]

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[26] *See id.* § 507(b). While this proposition has been questioned from time to time, e.g., Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857 (1996), the position of secured lenders in bankruptcy has remained inviolate. Technically, there are no "secured creditors" in bankruptcy per se, only creditors holding secured claims measured by the value of the underlying collateral not unsecured. *See* 11 U.S.C. § 506(a)(1). The most oft-cited explanation for full priority is that the Fifth Amendment Takings Clause constrains what Congress can do to the security rights of lienholders. *See* United States v. Sec. Indus. Bank, 459 U.S. 70, 76–77 (1982). This is the principle that liens pass through bankruptcy unaffected. Long v. Bullard, 117 U.S. 617, 620–21 (1886); Dewsnup v. Timm, 502 U.S. 410, 417 (1992). *But see* Charles J. Tabb, *The Bankruptcy Clause, the Fifth Amendment, and the Limited Rights of Secured Creditors in Bankruptcy*, 2015 U. ILL. L. REV. 765, 766 (2015) (questioning the constitutional limits on affecting the rights of secured creditors).

[27] *See* 11 U.S.C. § 508.

[28] *See, e.g.*, Cunningham v. Brown, 265 U.S. 1, 13 (1923) ("It is a case the circumstances of which call strongly for the principle that equality is equity, and this is the spirit of the bankrupt law.").

[29] Under this doctrine, the bankruptcy court has the authority to reclassify a debt claim that, in real economic substance, is a capital contribution to the firm, to an equity interest. *See generally* Ponoroff, *Whither Recharacterization*, *supra* note 13, at 1217. Recharacterization in relation to equality is also discussed *infra* Section IV.D.

[30] *See* 11 U.S.C. § 1129(b)(2)(B)(ii).

[31] These are essentially legislative policy judgments and, as such, are always subject to political influences and considerations. For instance, it is not implausible to suspect that the elevation of domestic support obligations to the highest unsecured priority tier by the 2005 Amendments may have had less to do with solicitude for the ex-spouses of deadbeat moms and dads than it had to do with forging bipartisan support for what was very much a creditors' bill. *See* CHARLES JORDAN TABB, LAW OF BANKRUPTCY 677 (5th ed. 2021). The 2005 Amendments were widely (and not inaccurately) criticized as having been bought and paid for by the consumer credit industry. *See, e.g.*, 151 CONG. REC. S2216 (daily ed. Mar. 8, 2005) (statement of Sen. Durbin); 151 CONG. REC. H2084 (daily ed. Apr. 14, 2005) (statement of Rep. McDermott) ("Credit card companies demanded . . . a provision that says credit card debt will survive bankruptcy and compete on an even basis with kids and moms for the limited dollars left in bankruptcy.").

[32] *See generally* Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 VA. L. REV. 1235 (2013) (arguing that bankruptcy is not the static, contractarian institution that dominated much of the early law and economics thinking about bankruptcy, but a dynamic process that is rife with rent-seeking behavior by creditors who seek new rules or doctrines that elevate the priority of their claims).

[33] *See infra* text accompanying notes 419–20.

I also believe that the Code's equality-colored distributional scheme, even with the statutory and judicially created deviations that form the core of Skeel's attack on equality writ large, advances satisfactorily the underlying purposive objects of the bankruptcy law, such as maximizing the value of the estate and orderly distribution of the debtor's assets. That is to say, the imperfections that do exist in bankruptcy practice are not, as Skeel maintains, either left harmlessly unresolved or actually made worse by a commitment to the ethos of equality.[34] Concomitantly, neither is it the case that the equality norm is disassociated with the policies that Skeel believes *should* matter but, in his view, are eclipsed by obeisance to the language of equality.[35]

To support these propositions, Part I begins with a brief, and, as such, certainly incomplete, overview of the rudiments of Professor Skeel's arguments in relation to the relative unimportance of an equality standard in bankruptcy proceedings. Part II examines in some detail two of the four examples Skeel uses to demonstrate how easily the equality command is circumvented, thus purporting to support his contention that equality represents an unsound foundation on which to build our bankruptcy law. In each case, I present a defense of equality as playing a more central role than Skeel ascribes to it, pointing out as well that the fact that the dictates of equality can be evaded to one degree or another does not alone render the equality theme meaningless or unhelpful in the analysis.

Next, Part III surveys various normative theories of bankruptcy that have been put forth since enactment of the Code and finds them, despite their otherwise very different outlooks on the bankruptcy environment, devoid of any suggestion that the equality principle no longer serves a purposeful role in bankruptcy. Instead, they all find either some nutritive justification for its existence or simply accept the equality norm as a given. Part IV lays out four other components of current bankruptcy practice that I believe are animated principally by the equality imperative and that are not so easily circumvented. Part V addresses two further circumstances—one in the individual consumer context and the other in the reorganization setting—where I contend equality serves a commendatory mediating role in resolving recurring bankruptcy issues. Finally, Part VI takes on the ultimate question raised by Professor Skeel of whether there is anything left for equality. My conclusion, quite different than his, is that equality represents a critical pivot point not only in the application of key bankruptcy concerns, but also in how we ideate the exceptionalism of our bankruptcy law. Therefore, jettisoning the conception and language of equality from the bankruptcy lexicon would have a corrosive effect on the bankruptcy system, do a disservice to the constituents it exists to serve, and dilute the benefits that derive from having a uniform federal law to deal with the fallout from financial failure and distress.

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[34] Skeel, *supra* note 5, at 702 (noting that "equality language is unnecessary but harmless" in some contexts, while in others "its historical pedigree and rhetorical resonance have been pernicious").

[35] *See id.* at 703 ("[T]he real issues . . . are policing self-dealing, reducing the risk of 'secret liens,' or maximizing the value of the debtor's assets.").

I. EQUALITY OF CREDITORS (NOT)

An accomplished bankruptcy historian in his own right,[36] Professor Skeel begins his critique of equality by tracing the long and permeative lineage of the equality prescript in English insolvency law,[37] and then on through nineteenth-century U.S. bankruptcy legislation.[38] Skeel focuses specifically on the preference law and the "fair and equitable" standard in railroad reorganizations.[39] The equality theme is immanent throughout this history,[40] prevailing over sectarian views in the South and West that had expressed doubt over the need for a federal bankruptcy law.[41] Skeel concludes this romp through the centuries with the observation that "[b]y the middle of the twentieth century, the equality of creditors meme pervaded bankruptcy law."[42]

Notwithstanding the ubiquity of the equality of creditors shibboleth throughout the course of Anglo-American bankruptcy history, Skeel contends that modern bankruptcy law tells a rather different story.[43] To demonstrate the vacuity of the equality mantra in practice, Skeel offers several examples—including the preference law, executory contract rules, the "critical-vendor" doctrine, and certain aspects of the chapter 11 reorganization process (most notably the rules governing classification of claims)—where he observes that the mandate of equality is routinely evaded.[44] After detailing the relatively modest and easily implementable reforms that would align each of these areas with their original equality imperative,[45] Skeel considers the question of whether the game would be worth the candle.[46] This is where his dark leanings show their colors, as he resolves the question with a resounding negative.[47]

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[36] *See generally* DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA (2001).

[37] Skeel, *supra* note 5, at 704. Like early American bankruptcy law that would follow, early English bankruptcy law had very little, if anything to do with debtor protection or relief, and everything to do with the creditors getting their pound of flesh, often quite literally. *See generally* Emily Kadens, *The Last Bankrupt Hanged: Balancing Incentives in the Development of Bankruptcy Law*, 59 DUKE L.J. 1229 (2010); Michael Quilter, *Daniel Defoe: Bankrupt and Bankruptcy Reformer*, 25 J. LEGAL HIST. 53 (2004).

[38] *See generally* BRUCE H. MANN, REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE (2002). By the end of the eighteenth century, English bankruptcy law had come to adopt a mixture of promises for the cooperative debtor (including discharge) and threats for the recalcitrant debtor (including the death penalty for fraud). *See* Kadens, *supra* note 37, at 1270–72.

[39] *See* Skeel, *supra* note 5, at 709–13, both of which became linked inextricably with the idea of equality of creditors.

[40] *See id.* at 707 (describing interests in the commercial states that viewed bankruptcy as essential to the growth of the country's economy, and equality as a key feature in a properly functioning bankruptcy law).

[41] *Id.* at 705 (citing, as an example, Judge Sedgwick's opinion in *Locke v. Winning*, 3 Mass. (1 Tyng) 325, 326 (Mass. 1807), describing a "principal object of the bankrupt law" that equality of distribution of the bankrupt's estate to creditors shall be in proportion with the amount of their claims).

[42] *Id.* at 714.

[43] *Id.* (likening the multiple ways in which the equality of creditors norm can be eluded to Paul Simon's classic musical elucidation on the number of ways "to leave your lover").

[44] *See id.* at 714–20.

[45] *Id.* at 720–24.

[46] *See id.* at 723 ("Is this the way forward? Is greater creditor equality preferable to the landscape that characterizes current bankruptcy practice?").

[47] *See id.*

Skeel defends this bankruptcy impiety on the ground that the true concerns underlying these rules and doctrines are not advanced by the attention paid and deference given to the dogma of equality.[48] This flows from his belief that equality simply no longer serves as an accurate or worthwhile proxy for the real policies that lie beneath the bankruptcy regime, such as constraining self-dealing, punishing secret liens, and maximizing the value of the debtor's estate.[49] As to the last, however, to whose benefit that value accrues remains something of a mystery once equality is exorcised from the discussion and analysis, but clearly Skeel's main concern is not with the distributional consequences of bankruptcy rules.[50]

In the case of the preference law, Skeel regards any positive role for equality as long-ago evaporated,[51] and maintains that the scope of preference recovery should be limited narrowly to policing self-dealing transactions.[52] This, oddly, in the face of the steady evolution of preference doctrine from a fault-based remedy to a strict liability offense.[53] While, in his view, equality fails to offer a convincing explanation for the preference rules, Skeel allows that a more robust regime proscribing preferential transfers might be justified if the preference rules served an auxiliary function.[54] However, he finds the traditional alternate rationale—that of discouraging a race to the courthouse and the dismantling of the financially distressed debtor[55]—to be equally wanting.[56] While I agree with Skeel that the deterrence rationale for the preference rules is without much foundation, and have been on record on that point,[57]

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[48] *See id.* at 702, 724 (noting that some equality-based reforms might be beneficial but others "would make bankruptcy law worse, not better").

[49] *See id.* at 702.

[50] *Id.* at 723 (suggesting the standard of unfair discrimination in chapter 11 might be construed to allow more favorable treatment of one class of creditors over another class with claims of equal priority). The contrary view concerning unfair discrimination, that such situations should be regarded with skepticism, has been espoused by Professor Markell. *See* Bruce A. Markell, *A New Perspective on Unfair Discrimination in Chapter 11*, 72 AM. BANKR. L.J. 227, 228 (1998).

[51] *See* Skeel, *supra* note 5, at 724–25 (noting that, in the nineteenth century, the preference law might have served to level the playing field between local and out-of-state creditors due to limitations that existed at the time on taking nonpossessory security interests, both far less pressing concerns today).

[52] *See id.* at 729 ("If the equality of creditors principle were not so entrenched in bankruptcy mythology, the preference provision might be limited to its proper domain—policing self-dealing.").

[53] *See* Lawrence Ponoroff, *Evil Intentions and an Irresolute Endorsement for Scientific Rationalism: Bankruptcy Preferences One More Time*, 1993 WIS. L. REV. 1439, 1477–78 [hereinafter *Evil Intentions*] (suggesting elimination of a mens rea test from preference law was an evolutionary one, wending its way from the more demanding requirement of proving the debtor's intent to prefer, to the less demanding rule that the transferee have knowledge of the preferential result). Even the 1978 Act contained a limited knowledge/intent standard for a time. *Id.* at 1479 n.109.

[54] *See* Skeel, *supra* note 5, at 724–26 ("If preference law served another function, in addition to policing self-dealing, a broader prohibition on preferences might be justified.").

[55] *See* HOUSE REPORT, *supra* note 9, at 177–79 ("[T]he primary purpose of the preference section was to prevent the race of diligence.").

[56] Skeel, *supra* note 5, at 727.

[57] *See* Lawrence Ponoroff, *Bankruptcy Preferences: Recalcitrant Passengers Aboard the Flight from Creditor Equality*, 90 AM. BANKR. L.J. 329, 343–45 (2016) [hereinafter *Flight from Equality*] (explaining the ineffectiveness of the deterrence rationale); *see also* Brook E. Gotberg, *Optimal Deterrence and the Preference*

deterrence is not the primary driver of the Code's preference regime.[58] In fact, preoccupation with the deterrence explanation interferes with the far more compelling equality reckoning of preference liability.[59] Therefore, I find Skeel's proposal, urging that we regress to the pre-Code days when interdiction of a transfer as a preference required proof of some form of mens rea,[60] unconvincing.[61]

Insofar as executory contracts are concerned, Skeel places a spotlight on the debtor's ability to sabotage the truism of equality among nonpriority unsecured creditors by assuming the executory contract of one or more favored creditors.[62] Of course, this presumes that the chosen claim arises out of an executory contract or unexpired lease to begin with, which will only serendipitously be the case. Nonetheless, it is true that assumption creates, in effect, a secret lien in favor of such creditor(s).[63] Skeel sees this as imposing serious costs because of the inability of creditors to know ex ante whether they will be among the anointed or instead subordinated to those benighted through assumption.[64] Thus, each creditor will have to hedge against the risk that it might end up among the great unwashed.

Gap, 2018 BYU L. REV. 559, 602–13 (2018) (citing empirical evidence in support of the proposition that the preference law has little deterrent effect and offering for perspective a set of legislative modifications that might result in achieving deterrence of the sort that Congress had in mind in 1978); John C. McCoid, II, *Bankruptcy, Preferences, and Efficiency: An Expression of Doubt*, 67 VA. L. REV. 249, 262–65 (1981) (expressing deep skepticism over whether preference law serves any real deterrent effect).

58 *See* Ponoroff, *Flight from Equality*, *supra* note 57, at 340 n.52; Ponoroff, *Evil Intentions*, *supra* note 53, at 1439. That said, I am not the only one, and certainly not the first, to champion equality as the dominant policy to be served by the preference law. *See generally* Lissa L. Broome, *Payments on Long-Term Debt as Voidable Preferences: The Impact of the 1984 Bankruptcy Amendments*, 1987 DUKE L.J. 78, 115 (1987) (identifying preservation of equality as the main goal of the preference law since 1978, with deterrence playing only an incidental role); Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 748 (1985) (suggesting that, despite the legislative history discussing the aim of "deterring creditors from scrambling for advantage, it seems ridiculous to expect [the preference law to produce] deterrence"); Brook E. Gotberg, *Conflicting Preferences in Business Bankruptcy: The Need for Different Rules in Different Chapters*, 100 IOWA L. REV. 51, 64–66 (2014) [hereinafter *Conflicting Preferences*] (endorsing the premise that preference law should be driven principally by the equality of distribution rationale); Charles Jordan Tabb, *Rethinking Preferences*, 43 S.C. L. REV. 981, 1029 (1992) (urging the primacy of equality over deterrence).

59 *See* Gotberg, *Conflicting Preferences*, *supra* note 58, at 66 (noting the tendency of many of the preference exceptions, founded on a deterrence explanation of the law, to impair or destabilize the policy of ratable distribution); Ponoroff, *Flight from Equality*, *supra* note 57, at 344 (discussing "the increasingly corrosive impact that the growth of [deterrence-oriented defenses to preference recovery] has had since 1978 on the framing of a comprehensible and internally consistent preference policy"); Tabb, *supra* note 58, at 989–90, 1029 (observing the inconsistency between the simultaneous pursuit of deterrence and equality).

60 *See* Skeel, *supra* note 5, at 728 ("[T]he trustee would fare better in preference actions against insiders than with outside creditors, because it was much easier for the trustee to show insiders knew the debtor was insolvent.").

61 See *infra* Section II.A. for further discussion.

62 *See* Skeel, *supra* note 5, at 716. Assumption requires that the estate cure almost all existing defaults or provide adequate assurance of prompt cure. *See* 11 U.S.C. § 365(b)(1)(A) (2018).

63 Skeel, *supra* note 5, at 730–31. Of course, the same is true when the assumed executory contract is with a non-favored creditor, and the effect only attains if there was a pre-filing default. *See id.* at 731.

64 *See id.* Skeel uses the city of Stockton's chapter 9 reorganization as an example, explaining how assumption of an employment contract that included liability for unfunded pension obligations resulted in two

This, Skeel contends, is an example of the de facto disparity in treatment of similar claims in spite of the de jure chorus regarding the sanctity of equality so routinely sounded by courts and commentators.[65] Moreover, he sees promoting equality among pre-filing claims as a second best solution to respond to this concern,[66] favoring instead the decidedly unequal use of a priority status when the claims at issue are considered important enough to merit special protection.[67] Skeel continues that the equality norm is equally hapless in addressing the other problem that plagues the current law of executory contracts, namely, that the disfavorable treatment of damage claims arising from rejection distorts the decision-making process by creating "too great an incentive to reject."[68] He thus concludes that, although "equality of creditors is considered to be a central principle in the treatment of executory contracts,"[69] it is in fact nothing more than a false conceit, the ructions from which interfere with our ability to confront the true issues we face under the present law.[70]

Turning next to the critical-vendor doctrine,[71] Skeel suggests it too functions as a hidden, nonpredictable form of priority for the favored unsecured creditors.[72] He then outlines the steps necessary to alleviate the inequity the doctrine creates among creditors with legally indistinguishable claims, identifying the pertinent policy controlling its application to be maximizing the value of the debtor's estate.[73] He disavows an equality-based account for regulating critical-vendor payments, despite what would seem to be a high degree of compatibility between such an approach and eliminating the pernicious secret liens that critical-vendor payments create.[74] Instead, Skeel concludes that equality, while perhaps served by a narrowing of the application of the doctrine, itself contributes little to nothing in terms of properly defining when

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categories of unsecured claims—pension liabilities and bondholders—to receive radically different payouts. *Id.* at 716–17.

[65] *See supra* note 2 and accompanying text.

[66] Skeel *supra* note 5, at 731 (claiming that the relationship between equality and the uncertainty costs associated with the prospect of being subordinated to a creditor who benefits from assumption of an executory contract "is accidental at best").

[67] *Id.* (proposing that pensions claims might fall into this category).

[68] *Id.* (emphasis omitted). Under 11 U.S.C. § 365(g)(1) (2018), any damages flowing from rejection are paid as pre-petition unsecured claims.

[69] Skeel, *supra* note 5, at 732 (citing Jesse M. Fried, *Executory Contracts and Performance Decisions in Bankruptcy*, 46 DUKE L.J. 517, 522 (1996); George G. Triantis, *The Effects of Insolvency and Bankruptcy on Contract Performance and Adjustment*, 43 U. TORONTO L.J. 679, 691 (1993)); *see also* Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 279 (1989) (explaining why courts should refuse to enforce covenants not to compete in relation to the unequal impact among creditors).

[70] *See* Skeel, *supra* note 5, at 732.

[71] See *infra* notes 144–46 and accompanying text for an explanation of the critical-vendor doctrine and its origins.

[72] *See* Skeel, *supra* note 5, at 733.

[73] *Id.*

[74] *See id.*

it is appropriate to pay a pre-petition vendor in order to avoid cratering the prospects for reorganization.[75]

With respect to the scope of the unfair discrimination standard in chapter 11,[76] Skeel maintains that the rhetoric of equality is ill-suited to addressing the comparative judgments courts are required to make in assessing whether a plan proponent's differential treatment among separate classes of unsecured claims is unfair to a dissenting class.[77] Specifically, he argues that the real concern underlying unfair discrimination is, again, controlling against secret liens, not equality.[78] He reasons that if bankruptcy's standard of unfair discrimination was meant to include the principle of equal treatment, "all unsecured claims would be put in the same class. . . . [d]ifferential payouts arise only *because* the debtor . . . is permitted to place general unsecured creditors in different classes."[79] Thus, for Skeel, the Code's unfair discrimination standard is yet a further abnegation of the bankruptcy principle of pro rata sharing in reorganization cases. Together, all of these exceptions to the ethos of equality lead Skeel to conclude that the equality norm is on the cusp of disappearing in chapter 11.[80]

Skeel next shifts focus from reorganization to consumer bankruptcy and chapter 7 to see if an equality mindset might retain some spark in that setting.[81] Not surprisingly, he deduces that any productive role that the equality axiom may have served in the past has long since become obsolete.[82] In support of this position, he points (1) to the high number of individual consumer bankruptcies that are "no asset" cases,[83] and, even in cases where there are dividends, (2) to a distributional reality that belies "the equality of creditors vision."[84] Lastly, Skeel examines briefly what he describes as the "last redoubt" of equality of creditors, equal treatment within a class

[75] *See id.* (suggesting that the analysis should be driven entirely by focus on maximizing the value of the estate, and that, in assessing the credibility of the threat to withhold future services absent payment of pre-petition debt, equality is essentially a bystander doing none of the work).

[76] *See infra* Section V.B.1.

[77] *See* Skeel, *supra* note 5, at 736 (pointing out that unfair discrimination is incremental, while equality is more of an on or off affair). For further discussion of the unfair discrimination standard in chapter 11, see *infra* text accompanying notes 358–59, 367.

[78] *See* Skeel, *supra* note 5, at 735.

[79] *Id.* at 734–35.

[80] *See id.* at 720. The other aspects of current chapter 11 that Skeel identifies as destabilizing the equality norm at the plan stage are "gifting" and section 363 sales. *See id.* at 718–19. This is discussed further *infra* notes 385–91 and accompanying text.

[81] *Id.* at 736–40. Curiously, Skeel suggests that his focus theretofore had been on the utility of the equality norm in chapter 11. Of course, preference law applies to all debtor relief cases, including those arising in chapter 7.

[82] *See id.* at 738.

[83] *See id.* at 737 ("Equality of creditors has little meaning when creditors are not receiving any recovery at all.").

[84] *See supra* note 49 and accompanying text.

of claims (i.e., pari passu).[85] Not surprisingly, he finds that, even in this classic context, strict equality does not exist or is easily subverted.[86]

In sum, Professor Skeel posits a well-crafted case for the proposition that equality has always played an exaggerated role in the bankruptcy law and that continued genuflection to its dictates in the present-day bankruptcy world is nothing more than a vestigial echo of a simpler commercial economy that, for quite some time, has been in our rearview mirror. He continues, moreover, that deference to the equality norm in addressing bankruptcy issues is not always harmless.[87] Rather, Skeel submits that allegiance to the equality of creditors maxim sometimes makes things worse, and we would thus do well to be rid of it once and for all.[88]

II. EQUALITY RECONSIDERED

In attestation of his argument that the canons of equality are easily sidestepped, Professor Skeel offered the four examples noted above. In this section,[89] the ones I focus on are: (1) the Code's preference scheme, which plays a vital role in consumer liquidation as well as business reorganization cases,[90] and (2) the judicially developed critical-vendor doctrine, because its relevance is primarily limited to commercial reorganization cases.[91] In so doing, the role of and purpose for an equality ideology can begin to be examined both in the consumer and business demesnes.

A. Preference Law

While equality as an overarching norm can be observed throughout the federal Bankruptcy Code,[92] nowhere is this objective more prominently featured than in the

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[85] *See* Skeel, *supra* note 5, at 739. While the Code permits some deviation from strict equality between classes of comparable priority claims, it calls for strict equality inter se among the members of each class. *See* 11 U.S.C. § 1123(a)(4) (2018).

[86] *See* Skeel, *supra* note 5, at 739–40. The examples Skeel offers are (1) the Code's allowance of inequality where accepted by claimholders, and disparate treatment under restructuring support agreements, and (2) where the unequal treatment derives from contributions by a senior creditor or group of creditors. *See id.* at 740.

[87] *See id.* at 724.

[88] *Id.* (citing preference law, in particular, as the area of bankruptcy law where a true shift to creditor equality would make things worse).

[89] The unfair discrimination standard in both chapters 11 and 13, as well as some additional aspects of reorganization, are discussed at some length *infra* Sections V.A. & V.B.1.

[90] *See* Ponoroff, *Evil Intentions*, *supra* note 53, at 1446–47 ("Bankruptcy law must regulate preferences precisely because preferential transfers belie the bankruptcy maxim that 'equality is equity.'"). For an interesting argument that preference liability should be limited to chapter 7, see Gotberg, *Conflicting Preferences*, *supra* note 58.

[91] It is possible that in a non-consumer filing under chapter 7, the trustee might need to continue operation of the business for a time to assure the most value on liquidation, and, in that connection, might seek and receive authority to pay critical vendors. Such cases, however, are rare.

[92] *See, e.g.*, 11 U.S.C. § 726(b) (2018) (providing that, the rights of secured creditors and priority creditors aside, all general creditors of the debtor take pari passu); *id.* §§ 544, 545, 549 (listing the trustee's avoiding

Code's scheme for avoiding preferential transfers.[93] And yet, even here in the most hallowed halls of equality, Professor Skeel contends that there are several ways in which the preferred creditor might avoid recovery, thereby foiling equality policy and demonstrating its disutility. These include: (1) maneuvering things so the offending payment occurs just outside the recovery preference period, (2) successfully asserting one of the defenses in section 547(c), and (3) structuring the transaction to qualify for the section 546(e) securities safe harbor.[94] From this, Skeel conjectures the odds are quite good that the preferred creditor will be able to retain a preferential transfer notwithstanding the equality norm that the preference regime is supposedly designed to elevate.[95]

Because preference liability is so strongly associated with the bankruptcy equality ambition, if its explanatory prowess fails here, its chances for survival anywhere else are concededly dim. Thus, it merits scrutinizing more closely each of these three avenues for skirting preference recovery to assess if they truly eviscerate section 547(b) to the degree Skeel pronounces. The answer, I think, is mostly not.

First, as Skeel acknowledges,[96] because the ninetieth day prior to filing is known only retrospectively, the transferee-creditor would have to be able to control the timing of the filing to place the transfer at issue outside of the preference period. Almost inevitably, this would render such creditor an insider,[97] triggering the extended one-year preference period. That's a long time to hold together a floundering entity. Moreover, because it is often the making of a large preferential transfer that triggers an involuntary filing under section 303 of the Code,[98] the debtor is not the only one with access to the controls. In short, while the length of the preference period may be an arbitrary line drawn in the sand, it is difficult to see how manipulation of the temporal circumstances to avoid preference recovery represents a serious incursion on equality policy.

Second, are the section 547(c) preference defenses.[99] At the time of the original enactment of the Code, most of these defenses related to transactions that, although technically meeting the requirements of a preferential transfer under section 547(b), in substance did not really cause a diminution of the value of the estate to the

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powers other than preference recovery); *id.* § 553(b) (noting limitations on the right of setoff); *id.* §§ 1122(a), 1123(a)(4) (grouping "substantially similar" claims for similar treatment in chapter 11 plans); *id.* §§ 1322(a)(3), 1322(b)(1) (requiring a chapter 13 plan that classifies claims must provide equal treatment for each claim within the class and may not discriminate unfairly against or among any class or classes).

[93] *See* Skeel, *supra* note 5, at 720 (observing the preference law is "the doctrine most closely associated with . . . equality of creditors"); McCoid, *supra* note 57, at 260 (identifying "[e]qual treatment of creditors [as] the oldest and most frequently advanced goal of preference law").

[94] *See* Skeel, *supra* note 5, at 715.

[95] *Id.* at 716.

[96] *Id.* at 715.

[97] *See* 11 U.S.C. § 101(31) (defining the term "insider").

[98] *See, e.g., In re* Loggins, 513 B.R. 682 (Bankr. E.D. Tex. 2014).

[99] *See* 11 U.S.C. § 547(c) (2018).

prejudice of the nonpreferred creditors.[100] The notable exception, and the one which Skeel understandably focuses upon, is the ordinary course of business exception in section 547(c)(2).[101] Originally enacted "to leave undisturbed normal financial relations,"[102] such as monthly payments of debts for wages, utility services, or inventory and supplies purchased on short-term credit, the exception represented a relatively minor usurpation of the equality rationale supporting the preference law.[103] That all changed beginning in 1984 when Congress eliminated the requirement that the debt be incurred within forty-five days prior to the transfer.[104] While the legislative history suggests this revision was made for other reasons,[105] in 1991, the Supreme Court approved what had been the minority interpretation of amended section 547(c)(2) in the lower courts,[106] that of extending the shield of the exception to payments on long-term debts.[107] The scope of the ordinary course of business exception was expanded yet again in the 2005 Amendments,[108] to the point where today it does compromise the prime equality of creditors justification for the preference rule.

The solution, however, is not to dump the infant along with its suds when (to mix my metaphors) the parasite can be excised without killing the host. This is why I advocated initially for reduction in scope, and then later for the wholesale repeal, of

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[100] *See* Lawrence Ponoroff, *Veiling Substance in Semantics, The Knotty State of the Earmarking Doctrine*, 47 FLA. ST. U. L. REV. 337, 392 (2020) (noting several of the preference exceptions "in some fashion or another identify and safeguard transactions that really have no preferential effect").

[101] Skeel, *supra* note 5, at 715 (describing the ordinary course of business exception as shielding many otherwise preferential transactions from avoidance and recovery).

[102] HOUSE REPORT, *supra* note 9, at 373.

[103] *See id.*

[104] Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 462(c), 98 Stat. 378 (1984). The forty-five day limitation, it was surmised, suggested that the exception was originally intended as a codification of the "current expense" rule under prior law, which was rooted in the lack of true preferential effect. *See* Broome, *supra* note 58, at 89–91.

[105] *See* Broome, *supra* note 58, at 100 (describing the history leading up to the 1984 amendment to section 547(c)(2) as a reaction to complaints from "trade creditors, commercial paper issuers, and consumer lenders").

[106] The majority rule construed the words "ordinary course of business" to refer only to the debtor's routine business operations of selling goods or providing services, *not the long-term borrowing of money*. *See, e.g.*, CHG Int'l, Inc. v. Barclays Bank (*In re* CHG Int'l, Inc.), 897 F.2d 1479, 1484 (9th Cir. 1990).

[107] Union Bank v. Wolas, 502 U.S. 151, 162 (1991) ("In sum, we hold that payments on long-term debt, as well as payments on short-term debt, may qualify for the ordinary course of business exception to the trustee's power to avoid preferential transfers."). As to the argument that this was not Congress's intent, Justice Stevens tersely replied: "The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning." *Id.* at 158.

[108] Section 409(1) of the 2005 Amendments substituted a disjunctive connector for what theretofore had been a conjunctive connector between the subjective and objective tests of "ordinariness" in ascertaining when a preferential payment qualifies for the exception's protection. *See* Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, 119 Stat. 23, 106 (2005).

section 547(c)(2).[109] In this opinion I am hardly alone.[110] This step would also eliminate the time-consuming and wasteful litigation that the unduly broad scope of the exception has spawned.[111]

The other section 547(c) defenses to preference liability that directly subvert the equality aim were largely all added after Congress first formulated the current scheme for recovery of preferential transfers in 1978.[112] They are, for the most part, reactions to empirically unsubstantiated charges that trustees routinely use preference litigation, or threat thereof, to secure settlement on claims of dubious merit.[113] The solution to the weakening of the equality aim of the preference law could be accomplished quite easily by returning to the balance struck by the Code as originally enacted.[114] Skeel quite agrees it would not be difficult to do this, but pronounces that the effort would be not just pointless, but actually deleterious.[115] This is where we disagree most fundamentally: Skeel sees the ideal preference law as narrowly crafted to regulate deliberate self-dealing,[116] while I regard the preference rules as central to the vindication of core bankruptcy equality goals, distinct from the costly inefficiencies of state debt collection law and procedures.[117]

The third example offered by Skeel to show the preference rules can readily be given the slip is the safe harbor from preference and other trustee avoidance power recoveries in section 546(e), which provides that a "trustee may not avoid a transfer that is a . . . settlement payment . . . made by or to (or for the benefit of) a . . . financial institution . . . or that is a transfer made by or to (or for the benefit of) a . . . financial institution . . . in connection with a securities contract."[118] This provision, along with the safe harbors in section 546(f) and section 546(g), protect derivative, repurchase, and other forms of financial agreements and securities transactions from trustees' claw back efforts.[119] Together, these carve outs from avoidance liability are meant to assure the finality of most securities (and commodity) transactions and, so the

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[109] *See* Lawrence Ponoroff & Julie C. Ashby, *Desperate Times and Desperate Measures: The Troubled State of the Ordinary Course of Business Defense—and What to Do About It*, 72 WASH. L. REV. 5, 58 (1997) [hereinafter *Desperate Times*] (proposing a retention of the exception in a more limited format); Ponoroff, *Flight from Equality*, *supra* note 57, at 364, 391 (urging outright abrogation of the ordinary course of business defense).

[110] *See, e.g.*, Vern Countryman, *supra* note 58, at 817–18 (1985); Tabb, *supra* note 58, at 1035 (1992) (advocating repeal of section 547(c)(2) as undermining the operation of preference law as a rule of strict liability).

[111] *See* Ponoroff & Ashby, *Desperate Times*, *supra* note 109, at 7 n.3.

[112] *See* Ponoroff, *Flight from Equality*, *supra* note 57, at 354–57.

[113] *See supra* note 108; *see also* Charles J. Tabb, *The Brave New World of Bankruptcy Preferences*, 13 AM. BANKR. INST. L. REV. 425, 455–56 (2005) (concluding that the 2005 Amendments to the preference law weakened its normative underpinnings).

[114] To suggest that the fix is simple is *not* to also imply that getting Congress to do so would by any means be easy.

[115] *See* Skeel, *supra* note 5, at 728–29 (commenting that "it would not be hard to give the preference provision real teeth").

[116] *See id.* at 728.

[117] *See infra* Section VI.B.1.

[118] 11 U.S.C. § 546(e) (2018).

[119] *See id.* § 546(f)–(g).

explanation goes, in so doing safeguard the integrity of the public securities clearance system and the capital markets.[120]

In addition to shielding protected transactions from being unwound in subsequent avoidance actions, protected securities positions enjoy additional advantages in bankruptcy that other transactions do not.[121] Thus, *when applicable*, section 546(e) and related safe harbors represent a not trivial encroachment on bankruptcy equality policy goals generally.[122] Of course, the transfer at issue must qualify for protection in the first place, and most do not.[123] Nevertheless, the safe harbors are overly broad, and particularly after the 2005 Amendments,[124] many commentators have called for them to be reined in, if not outright repealed.[125]

Providentially, the Supreme Court did recently curtail the scope of section 546(e) in one important respect by rejecting the *conduit rule*[126] that had been adopted by several circuit courts.[127] Under this rule, the *qualifying institution* requirement in section 546(e) could be satisfied even if the only qualifying institution involved in the transaction was acting merely as an intermediary.[128] In *Merit Management Group,*

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[120] *See, e.g.*, Frank R. Edwards & Edward R. Morrison, *Derivatives and the Bankruptcy Code: Why the Special Treatment?*, 22 YALE J. ON REGUL. 91, 94 (2005) (noting Congressional and academic reliance on this argument in support of the safe harbors).

[121] These include setoff without court permission (11 U.S.C. § 362(b)(17)), the ability to be closed out free of the automatic stay (11 U.S.C. § 362(a)(7)), and insulation from bankruptcy ipso facto provisions that would otherwise negate contractual termination clauses triggered by a counterparty's bankruptcy (11 U.S.C. §§ 555, 559, 560).

[122] *See* 11 U.S.C. § 546(e)–(g).

[123] *See id.*

[124] *See generally* Edward R. Morrison & Joerg Riegel, *Financial Contracts and The New Bankruptcy Code: Insulating Markets from Bankrupt Debtors and Bankruptcy Judges*, 13 AM. BANKR. INST. L. REV. 641, 648–52 (detailing the dramatic expansion in the range of protected financial transactions brought about by the 2005 Amendments); *see also* Richard Levin & Alesia Ranney-Marinelli, *The Creeping Repeal of Chapter 11: The Significant Business Provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005*, 79 AM. BANKR. L.J. 603, 643 (2005) (arguing special treatment passed at the urging of special-interest lobbyists interferes with corporate rehabilitation).

[125] Professor Skeel is among these commentators, although his proposals are more modest than others. *See* David A. Skeel, Jr. & Thomas H. Jackson, *Transaction Consistency and the New Finance in Bankruptcy*, 112 COLUM. L. REV. 152, 173–81 (2012) (suggesting that derivatives and repos are not sufficiently different from other transactions so as to enjoy complete immunity from core bankruptcy rules). More extreme are the arguments for reform or elimination of the safe harbors entirely. *See* Peter V. Marchetti, *A Note to Congress: Amend Section 546(e) of the Bankruptcy Code to Harmonize the Underlying Policies of Fraudulent Conveyance Law and Protection of the Financial Markets*, 26 AM. BANKR. INST. L. REV. 1, 88 (2018) (arguing the broad interpretations that have been accorded to section 546(e) "have perverted the bankruptcy priority scheme in ways not contemplated or intended by Congress"); Stephen J. Lubben, *Repeal the Safe Harbors*, 18 AM. BANKR. INST. L. REV. 319, 321 (2010) (pointing out the safe harbors did not protect the financial system during the Great Recession and, since they make successful reorganization nearly impossible for financial companies, they should just be repealed).

[126] *See* Merit Mgmt. v. FTI Consulting, Inc., 138 S. Ct. 883, 896 (2018).

[127] *See, e.g.*, Lowenschuss v. Resorts Int'l Inc. (*In re* Resorts Int'l, Inc.), 181 F.3d 505, 515–16 (3d Cir. 1999), *abrogated by* Merit Mgmt., 138 S. Ct. 883; Kaiser Steel Corp. v. Pearl Brewing Corp. (*In re* Kaiser Steel Corp.), 952 F.2d 1230, 1287 (10th Cir. 1991), *abrogated by* Merit Mgmt., 138 S. Ct. 883.

[128] *See In re* Kaiser Steel Corp., 952 F.2d at 1240 (applying section 546(e) to insulate a settlement payment by a debtor to its shareholder from fraudulent transfer liability because a financial institution acted as a conduit between the debtor and the shareholder).

LP v. FTI Consulting, Inc.,[129] the Court held that the qualifying institution requirement had to be satisfied by one of the parties in interest to the transaction that the avoidance action seeks to overturn.[130]

The Court reasoned that a narrow reading of section 546(e) is supported by the statute's text, context, and focus on the substantive nature of the transfer, as well as parallel language in other sections of the Bankruptcy Code.[131] The defendants argued that section 546(e) was meant to be a "prophylactic" measure to protect the securities markets from the disruptive risk of avoidance liability.[132] The Court declined the invitation to delve into statutory intent, stating that such an argument was "nothing more than an attack on the text of the statute," and that the plain meaning of section 546(e) protected only the transfers that Congress intended to protect, which did not include the one at issue.[133]

The long-term impact of *Merit Management* is uncertain because the Court's analysis requires a fact-dependent inquiry to determine whether a challenged transfer is protected under the safe harbor.[134] Still, it stands as some solace that section 546(e) cannot be employed to end-run a preference recovery with impunity, even though the Court's ruling was not clad in raiments of equality.[135] The point again being, however, that the supposed retreat from equality is neither an all-out rout nor devoid of the occasional counterattack.

Further legislative adjustment of the safe harbors for derivative contracts and related securities transactions would be desirable to ensure the Code's underlying equality of creditors theme generally, and the preference rules in particular, are not

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[129] 138 S. Ct. 883.

[130] *See id.* at 897.

[131] *See id.* at 892–93. The Court rejected the position that every stock transaction involving a financial institution is protected under the safe harbor, observing that "[t]he transfer that 'the trustee may not avoid' is specified to be 'a transfer that *is*' either a 'settlement payment' or made 'in connection with a securities contract.' Not a transfer that involves. Not a transfer that comprises. But a transfer that is a securities transaction covered under § 546(e)." *Id.* at 894.

[132] *Id.* at 896.

[133] *Id.* at 897.

[134] The Second Circuit, for example, whose earlier precedent recognized the conduit rule (Note Holders v. Large Priv. Beneficial Owners (*In re* Tribune Co. Fraudulent Conv. Litig.), 818 F.3d 98 (2d Cir. 2016) *opinion vacated and superseded*, 946 F.3d 66 (2d Cir. 2019)), seems already to have found a path around *Merit Management*. In a revised opinion in *In re Tribune Co.* issued after *Merit Management* was handed down, the court held that, by engaging a "financial institution" as its "agent," an entity that is not otherwise covered by the section 546(e) safe harbor can immunize a transaction from attack as a constructive fraudulent transfer under section 548(a)(1)(B). *See* Note Holders v. Large Priv. Beneficial Owners (*In re* Tribune Co. Fraudulent Conv. Litig.), 946 F.3d 66, 77–78 (2d Cir. 2019). *But see In re* Greektown Holdings, 621 B.R. 797, 827 (Bankr. E.D. Mich. 2020) (criticizing the "agency analysis in *In re Tribune Co.* as it does not distinguish between mere intermediaries contracted for the purpose of effectuating a transaction and agents who are authorized to act on behalf of their customers in such transactions").

[135] *See In re* Tribune Co., 946 F.3d at 77 ("Under *Merit Mgmt.*, the payments at issue can be subject to Section 546(e) only if (1) Tribune, which made the payments, was a covered entity; or (2) the shareholders, who ultimately received the payments, were covered entities.").

unduly imperiled.[136] I think Skeel would agree with that; again, where we part ways is on the derivative (so to speak) question of whether this effort should in anywise take into account the aim of restoring the primacy of equality as the dominant motivation for the preference rules.

B. Critical-Vendor Orders

Just as Congress designated a very specific ordering of priority for payment of claims in chapter 7,[137] section 1129 sets forth a clearly defined arrangement for the payment of priority and nonpriority unsecured claims in a plan of reorganization.[138] Textually, there is no elasticity in the sinew of this priority scheme to allow a bankruptcy court to alter or create new priorities.[139] Likewise, there is no express authority to permit payment of some claims prior to and other than under the terms of a confirmed plan, except for the courts' power to equitably subordinate claims.[140] Nevertheless, it happens.[141]

It happens because equality policy is more nuanced in the chapter 11 context due to the presence of more robust policy considerations at issue in reorganization than exist in the staple liquidation case. These considerations must be accommodated along with equality of creditors desideratum. Accordingly, in an effort to achieve the benefits to creditors and other constituents of the survival and continuation of the debtor's business,[142] on occasion equality policy must flex rather more than would be

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[136] For example, limiting the securities safe harbor to transactions involving publicly-held securities might be a good start, since the capital markets, and the integrity of the system for settling trades, are not impacted nearly to the same extent when the securities at issue are privately-held. *See generally* Samir D. Parikh, *Saving Fraudulent Transfer Law*, 86 AM. BANKR. L.J. 305, 353 (2012) (noting that section 546(e) was enacted to protect the securities clearing system and the public securities markets, and the disposition of privately-held shares had nothing to do with either). Nonetheless, many courts have ruled that the safe harbor in section 546(e) protects private as well as public securities transactions from avoidance where the parties utilized the services of a financial actor. *See, e.g.*, Official Comm. of Unsecured Creditors of Quebecor World (USA) Inc. v. Am. United Life Ins. Co. (*In re* Quebecor World (USA) Inc.), 719 F.3d 94, 99 (2d Cir. 2013), *abrogated by Merit Mgmt.*, 138 S. Ct. at 896 ("[W]e expressly follow the Third, Sixth, and Eighth Circuits in holding that a transfer may qualify for the section 546(e) safe harbor even if the financial intermediary is merely a conduit.").

[137] *See* 11 U.S.C. § 726(a) (2018).

[138] Priority claims must be fully paid prior to confirmation (11 U.S.C. § 1129(a)(9)), and non-priority unsecured claims must provide for payment equal to what such claims would have received in a liquidation (11 U.S.C. § 1129(a)(7)). While unsecured claims may be separately classified, all claims within a class must be treated alike (11 U.S.C. § 1123(a)(4)).

[139] *See* 11 U.S.C. § 1129.

[140] *See id.* § 510(c). The grounds for invoking this power established in Benjamin v. Diamond (*In re* Mobile Steel Corp.), 563 F.2d 692, 700 (5th Cir. 1977), have been widely followed, even though that case was decided under the former bankruptcy law. *See* Bankruptcy Act of 1898, ch. 541, § 12(b), 30 Stat. 544 (repealed 1978).

[141] *See, e.g., In re* CEI Roofing, Inc., 315 B.R. 50, 61 (Bankr. N.D. Tex. 2004) (finding bankruptcy courts have the authority to enter "'necessary' and 'appropriate'" orders allowing for the payment of pre-petition wage and benefits in advance of plan confirmation).

[142] Such non-creditor constituents include employees, community members, and even the interests of the economy at large that are served by the continuation of the business. *See* Nathalie Martin, *Noneconomic Interests in Bankruptcy: Standing on the Outside Looking In*, 59 OHIO ST. L.J. 429, 464–77 (1998); Lawrence Ponoroff, *Enlarging the Bargaining Table: Some Implications of the Corporate Stakeholder Model for Federal Bankruptcy Proceedings*, 23 CAP. U. L. REV. 441 (1994).

true in a simple individual chapter 7 case.[143] That being so, even though the Code makes no provision to treat nonpriority unsecured claims other than pari passu, the bankruptcy courts began routinely invoking their section 105(a) "equitable powers" to approve the payment of pre-petition claims of what were perceived as "key" trade creditors/suppliers;[144] key in the sense that if they ceased doing business with the debtor, the debtor's prospects for survival would be crippled.[145] Although perceived as "necessary,"[146] it is difficult to imagine anything more contrary to the equality maxim than critical-vendor payments.

Professor Skeel suggests that Judge Easterbrook's decision in *In re Kmart Corp.*,[147] which many initially felt had delivered a mortal wound to approval of critical-vendor orders,[148] in fact has operated at most to curb the most "extravagant" critical-vendor claims, but otherwise has not meaningfully delimited the broad scope of the doctrine.[149] Underemphasized in this analysis is the fact that, prior to the Seventh Circuit's decision in *Kmart*, all of the courts of appeals' decisions to examine the issue concluded that the bankruptcy courts had no equitable authority or other basis for interfering with the Code's priority scheme by ordering the early payment of certain nonpriority unsecured debt.[150] Notably, Judge Easterbrook agreed with these courts, finding that section 105(a) could not be used to reorder the Code's

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[143] *See* Gotberg, *Conflicting Preferences*, *supra* note 58, at 86 ("In chapter 11, the policy of equal distribution will consistently take second priority on the theory that permitting the business to continue as a going concern will maximize the overall distribution for creditors and the welfare of others associated with the business. Although manifestly unfair inequities are prohibited, a strict policy of equal distribution has no place in the more flexible standards accorded to reorganizing businesses."); *see also infra* note 178.

[144] Such payments are typically authorized as part of what's known as "first day orders" on the reasoning that payment of these claims is necessary because otherwise key creditors will refuse to continue to do business with the debtor and, thereby, crush the debtor's hopes for survival. These orders usually also cover pre-petition claims of employees on the same (arguably dubious) ground. See generally DEBRA L. GRASSGREEN, ET AL., FIRST DAY MOTIONS: A GUIDE TO THE CRITICAL FIRST DAYS OF A BANKRUPTCY CASE (3d ed. 2012) for a comprehensive treatment of first-day relief.

[145] The reasoning is suspect inasmuch payments for future goods and services are entitled to full payment as administrative expense priorities. *See* 11 U.S.C. § 503(b)(1)(A) (2018). Thus, it is fair to surmise that perhaps sometimes (often?) the threat of refusing to deal with the debtor is a bluff made with the hope of obtaining preferential treatment of pre-petition obligations. Also, employee pre-filing claims enjoy a priority under the Code. *See id.* § 504(a)(4).

[146] Payment of these sorts of claims at the onset of the case is also referred to as "the necessity of payment rule" or the "doctrine of necessity." *See generally* Russell A. Eisenberg & Frances F. Gecker, *The Doctrine of Necessity and its Parameters*, 73 MARQ. L. REV. 1 (1989). For a criticism of the doctrine, see Joseph Gilday, *"Critical" Error: Why Essential Vendor Payments Violate the Bankruptcy Code*, 11 AM. BANKR. INST. L. REV. 411 (2003).

[147] 359 F.3d 866 (7th Cir. 2004).

[148] *See, e.g.*, Alan N. Resnick, *The Future of the Doctrine of Necessity and Critical-Vendor Payments in Chapter 11* Cases, 47 B.C. L. REV. 183 (2005). *But see* Douglas G. Baird, *Bankruptcy from Olympus*, 77 U. CHI. L. REV. 959, 960 (2010) (arguing that commentators have exaggerated the degree of scrutiny that *Kmart* requires of a bankruptcy judge's decision to authorize a critical-vendor order).

[149] Skeel, *supra* note 5, at 717–18 ("Although the *Kmart* decision caused a frenzy of excitement when it appeared, and perhaps has curbed some of the more extravagant claims about critical vendor status, debtors continue to make generous use of critical vendor doctrine.").

[150] *See, e.g.*, B & W Enters., v. Goodman Oil (*In re* B & W Enters.), 713 F.2d 534 (9th Cir. 1983).

priority scheme.[151] However, he opined in dicta that such authority *might* lie under section 363(b)(1), but did not decide the matter.[152]

Whether one agrees that section 363(b) could permit a deviation from the Code's distributional scheme, and it is in more than a little doubt,[153] the *Kmart* decision did caution that "it is prudent to read, and use, section 363(b)(1) to do the least amount of damage possible to priorities established by contract and by other parts of the Bankruptcy Code."[154] The opinion further limits the occasions when favored treatment for pre-petition claims might be given by laying out three stringent evidentiary requirements that must be satisfied before the bankruptcy court may enter a critical-vendor order, including that the disfavored creditors will be no less well off as they would have been in liquidation.[155] The difficulty in establishing proof on each of these requirements would seem to suggest that, if properly applied, the debtor-in-possession would rarely meet its burden of going forward.[156]

The Supreme Court was subsequently presented with an indirect opportunity to shut down critical-vendor orders in *Czyzewski* v. *Jevic Holding Corp*.[157] It did not do so and, albeit in dicta, even left the door open a crack for unequal payments at the beginning of the case.[158] However, the principal holding in the decision sent a powerful message regarding the ability of the bankruptcy courts to approve end-of-case distributions that deviate from the Code's priority scheme.[159] The bankruptcy court in *Jevic* had approved the structured dismissal of a chapter 11 case that included a settlement calling for funds to be distributed in a manner that skipped over a class

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[151] *See In re Kmart*, 359 F.3d at 871 (finding that section 105(a) does not create discretion to set aside the Code's rule about priority and distribution).

[152] *Id.* at 872. 11 U.S.C. § 361(b)(1) permits the trustee, with court approval, to use, sell, or lease property of the estate other than in the ordinary course of business.

[153] *See* TABB, *supra* note 31, at 1085 (describing the suggestion that section 363(b) might form a statutory basis to permit award of a pre-petition debt as "grievously wrong").

[154] *In re Kmart*, 359 F.3d at 872.

[155] *See id.* at 874. The other two requirements were that: (1) the creditors receiving payment would have ceased doing business with debtor if not paid, and (2) the discrimination among unsecured creditors is essential to effectuate a reorganization. *See id.*

[156] *See* Richard M. Hynes & Steven D. Walt, *Fair and Unfair Discrimination in Municipal Bankruptcy*, 37 CAMPBELL L. REV. 25, 40 (2015) [hereinafter *Fair and Unfair Discrimination*] (suggesting that critical vendor payments remain fairly common even after *Kmart*).

[157] 137 S. Ct. 973 (2017).

[158] *See id.* at 985–86. The Court expressly declined to extend the ordinary priority rules to "interim" settlements or to "first-day" distributions in chapter 11, stressing the difficulty of applying strict priority rules before the full nature and extent of the chapter 11 estate have been fully resolved. *Id.* at 983–85. The Court continued that "one can generally find significant Code-related objectives" for deviations from the Code's priority rules in connection with first-day orders. *Id.* at 985. Thus, the *Kmart* holding that requires proof that the proposed first-day payments will result, eventually, in the same or higher distributions to the non-advantaged creditors, remains the most influential authority on the issue (and, of course, the law in the Seventh Circuit).

[159] *Id.* at 981–82 (rejecting the argument that adherence to the Code's priority scheme is limited to confirmation of a plan of reorganization).

of priority unsecured creditors,[160] reasoning that because the distributions did not occur in a plan of reorganization, the standard priority rules did not apply.[161] The district court and Third Circuit affirmed,[162] but the Supreme Court reversed on the basis that the wiggle room regarding the standard priority rules that may exist with respect to interim distributions and settlements has no application in connection with final distributions, unless the affected parties affirmatively consent to the different treatment.[163]

Jevic is important because the Court has now taken a stand in favor of preserving the integrity (and has clearly articulated the central importance) of limiting non-Code authorized distributions from the assets of a debtor's estate in reorganization as well as in liquidation.[164] The decision reaffirms that the Code's priority rules, while not wholly inviolate, are an indispensable component of the bankruptcy system, qualitatively differentiating it (and with sound reason) from state debtor/creditor law.[165] It also holds the line in enforcing compliance with bankruptcy's formal distribution rules in the context of one of the more recently developed priority-evading distribution techniques, inferentially calling into question other examples offered by Skeel to show how easy it is for the debtor and favored creditors to skirt the equality norm in chapter 11.[166]

After *Jevic*, in the absence of a fully consensual structured dismissal, debtors (and lenders funding a chapter 11 case) will be relegated to the alternatives of confirming a chapter 11 plan, dismissing the case (without a structured dismissal order), or converting to chapter 7.[167] While the Court mused that a somewhat softer approach might be appropriate in evaluating critical-vendor and other interim orders entered earlier in the case, when there is still an opportunity for the non-favored creditors to recover,[168] its actual holding represents a clarion reaffirmation of the statutory

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[160] *Id.* at 980–81. The terms of the structured dismissal called for settlement payments made by secured creditors in return for a release of claims against them from the debtor to be paid to general unsecured creditors without prior satisfaction of former employees' priority wage claims under section 507(a)(4). *Id.*

[161] *Id.* at 981–82. The bankruptcy court approved the priority-skipping distributions, reasoning that nothing in the Bankruptcy Code expressly required application of the absolute priority rule to a pre-plan settlement—and the settlement maximized distributions to unsecured creditors. *See id.*

[162] *See In re* Jevic Holding Corp., No. BR 08-11006 (BLS), 2014 WL 268613, at *4 (D. Del. Jan. 24, 2014), *aff'd sub nom.* Czyzewski v. Jevic Holding Corp. (*In re* Jevic Holding Corp.), 787 F.3d 173 (3d Cir. 2015), *as amended* (Aug. 18, 2015).

[163] *Jevic Holding Corp.*, 137 S. Ct. at 984 (describing the Code's system of priority applicable to those distributions as long regarded as fundamental to the operation of the Bankruptcy Code).

[164] *See id.* at 986.

[165] *See id.* at 984, 987 (explaining the need for strict compliance with absolute priority as necessary to prevent an insider or a particular creditor from exerting their influence to gain an unfair advantage).

[166] *See id.* at 986; Skeel, *supra* note 5, at 718–20.

[167] *See Jevic Holding Corp.*, 137 S. Ct. at 983.

[168] *See id.* at 985; *see also* Vincent S.J. Buccola, *The Janus Faces of Reorganization Law*, 44 J. CORP. L. 1, 17–19 (2018) (identifying debt roll ups as part of post-petition financing and non-case-ending settlements as two additional examples where the bankruptcy courts' discretion to approve a distribution of estate assets at variance with the Code's priority rules might be recognized under the reasoning in *Jevic*).

distributional scheme in bankruptcy.[169] It also demonstrates that equality is not in the kind of full-scale exodus from the bankruptcy landscape that Skeel imagines.[170]

Beyond the *in terrorem* effect of *Jevic* on critical-vendor orders in the future, preliminary empirical work done by Professors Hynes and Walt has revealed four tentative conclusions that also belie the argument that the doctrine represents a truck-sized hole in the relevance of equality in reorganization cases.[171] Specifically, they state:

> First, critical vendor orders do occur, but they are by no means universal. The majority of firms in Chapter 11 do not appear to pay prepetition creditors prior to plan confirmation or liquidation. Second, size matters: critical vendor orders are much more common in the reorganization of larger firms than in smaller firms. Third, many critical vendor orders authorize payments to creditors who are likely to otherwise enjoy priority over general creditors. Fourth, we fail to find a discernable increase in these orders between 2008 and 2015.[172]

The complexities associated with reorganization mean that equality will necessarily play a shade of a lesser role in chapter 11 than in chapter 7[173]; sometimes inequality in the short-term will not be inequitable in the long-run.[174] Critical-vendor orders could represent such a case in a situation where the reorganization truly hinges on the cooperation of one or more creditors and there is truly no other alternative.[175] But this is a far cry from suggesting equality is habitually avoided, and that this demonstrates it is devoid of any relevance or meaning in contemporary reorganization proceedings.

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[169] *See, e.g.*, Bruce Grohsgal, *Absolute Priority Redux: First-Day Orders and Pre-Plan Settlements in Chapter 11 Post*-Jevic, 10 WM. & MARY BUS. L. REV. 61, 132 (2018) (noting that *Jevic*, while not prohibiting first-day orders, will curb excessive first-day relief orders). This fact, as well as the fact that the entire discussion of the issue was in dicta, lead me to believe that Grohsgal's statement that "[t]he *Jevic* Court . . . went out of its way to provide support for priority-skipping first-day relief" is a bit hyperbolic. *Id.* at 119. The Court really did not say or signal anything about critical-vendor payments other than that it was a *different* issue than the one before the Court in the case.

[170] *See Jevic Holding Corp.*, 137 S. Ct. at 983; *see also* Skeel, *supra* note 5, at 700.

[171] *See* Hynes & Walt, *supra* note 12 at 889–90.

[172] *Id.*

[173] *See* Gotberg, *Conflicting Preferences supra* note 58, at 83–85; *supra* note 143. I do not believe that equality is as *relatively* unimportant in chapter 11 as Professor Gotberg does. *See* Ponoroff, *Flight from Equality*, *supra* note 57, at 383–87 (critiquing the Gotberg proposal). However, it is true that equality policy must share the stage in chapter 11 with other actors that have no purchase in chapter 7.

[174] In fact, the need for more flexibility early in the case, when there are still a great many unknowns and hope runs high that reorganization will succeed, may well be what the Court had in mind in *Jevic* when it opined that there might be Code-related objectives for priority-skipping distributions early on in the case that are no longer in play at the time approval is sought for final distributions. *See Jevic Holding Corp.*, 137 S. Ct. at 985–86.

[175] Necessarily, such situations should be rare if the stringent evidentiary requirements of *Kmart* are faithfully and seriously applied. *See* Capital Factors, Inc. v. Kmart Corp. (*In re* Kmart Corp.), 359 F.3d 866, 872–73 (7th Cir. 2004); *see also supra* note 155 and accompanying text.

The decision to permit such payments must be justified under a standard that places a heavy burden on the debtor-in-possession to demonstrate why the deviation from equal treatment is warranted.[176] These cases should be rare,[177] and to the degree the bankruptcy courts may have set the bar unreasonably low, *Kmart* and now *Jevic* are operating to correct that imbalance,[178] placing a finger back on the equality side of the equation and making it appropriately more difficult to dodge, albeit without eliminating the practice outright.[179]

III. BANKRUPTCY THEORY

Nearly four decades ago, Professor Tom Jackson introduced the creditors' bargain explanation for the bankruptcy law.[180] It has ever since served as the foundational paradigm from which most modern commentators and practitioners at least begin to contemplate and comprehend the bankruptcy system in the United States.[181] Jackson's theory, developed in conjunction with Professor Doug Baird (and later Robert

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[176] *Cf.* Grohsgal, *supra* note 169, at 120 (urging that the doctrine of necessity, rather than the rule laid out in *Kmart*, is better up to the task of assuring that disfavored creditors are protected against the excesses of first-day relief). Certainly, the test is easier to satisfy than the *Kmart* test because it does not require proof of hypothetical valuations at the end of the case; I do not know, however, that this means it is more effective in assuring that disfavored creditors are not prejudiced by the proposed payment(s).

[177] The likelihood that the pre-petition vendor for whom payment is sought would really cease doing business with the debtor is small given that payment for post-filing goods and services enjoy favored treatment. *See* 11 U.S.C. § 503(b)(1)(A); *see also supra* note 149. The key is not to fall for the bluff. Likewise, it should be unusual that the same goods or services simply cannot be procured from other sources.

[178] *See* Timothy N. Lupinacci & Daniel J. Ferretti, *Recent Trends in Critical Vendor Jurisprudence Post-*Kmart, NORTON BANKR. L. ADVISER, Apr. 2009 at 1 (suggesting that, since *Kmart*, *some* courts have shown greater reluctance to authorize critical vendor payments); *see also supra* note 176.

[179] There was even some speculation that the 2005 Amendments' expansion of vendors' reclamation rights under 11 U.S.C. § 546(c), and the creation in 11 U.S.C. § 503(b)(9) of an administrative expense priority for vendors that delivered goods to the debtor in the ordinary course within 20 days prior to the commencement of the case, had eliminated the need critical vendor orders in toto. However, the argument, thus far, has gained no purchase. *See generally* Lawrence Ponoroff, *Reclaim This? Getting Credit Seller Rights in Bankruptcy Right*, 48 U. RICH. L. REV. 733, 772 n.180 (2014) (describing the argument as far-fetched). On the other hand, it was predicted, and has apparently been the case, that these changes to the Code in 2005 have, along with other factors, dramatically reduced the need for critical vendor orders. *See* Baird, *supra* note 148, at 965 n.25 (stating priority afforded by section 503(b)(9) "is usually enough to keep [vendors] sufficiently happy that a critical-vendor order is not necessary").

[180] *See* Jackson, *Non-Bankruptcy Entitlements*, *supra* note 3, at 857–58.

[181] *See* Robert E. Scott, *Through Bankruptcy with the Creditors' Bargain Heuristic*, 53 U. CHI. L. REV. 690, 692 (1986) ("The creditorsbargain conception is a powerful heuristic, one which illuminates much of the logic of bankruptcy."); Vincent S.J. Buccola, *Bankruptcy's Cathedral: Property Rules, Liability Rules, and Distress*, 114 NW. U. L. REV. 705, 711 (2019) (noting "[t]he modern theory of corporate bankruptcy law's economic justification began in the early 1980s with Thomas Jackson" and "[t]he analytic and normative power of this view has influenced a generation of scholars, lawyers, and judges").

Scott)[182] has also come in for its share of criticism,[183] most notably for its narrowness,[184] and has seen numerous attempts at supplementation over the years, including by other adherents of a law and economics approach to reorganization.[185] Nonetheless, the creditors' bargain heuristic remains one of the more cogent theoretical expositions for bankruptcy law to this day.[186] While developed to explain corporate reorganization, its fealty to value maximization applies with equal force to consumer bankruptcy, requiring only modest adjustment for the fresh start, which Jackson himself supplied.[187]

Where does equality fit into the picture? As Jackson explains in the opening of his book, *The Logic and Limits of Bankruptcy Law*,[188] by imposing a set of mandatory

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[182] *See, e.g.*, Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 103–04 (1984); Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155, 178 (1989) (creating expanded economic model based on creditors' bargain theory to evaluate bankruptcy law).

[183] James Bowers challenged Baird and Jackson's approach as being based on unsound economics. James W. Bowers, *Groping and Coping in the Shadow of Murphy's Law: Bankruptcy Theory and the Elementary Economics of Failure*, 88 MICH. L. REV. 2097, 2103–13 (1990). David G. Carlson colorfully described Jackson's book, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (1986), as "unremittingly dreadful." David Gray Carlson, *Philosophy in Bankruptcy*, 85 MICH. L. REV. 1341, 1388 (1987); *see also* TERESA E. SULLIVAN, ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA 256 (1989) (suggesting that empirical results disproving predictability of general economic models as applied to bankruptcy "should . . . act as a cautionary tale about enacting laws with little more than formal logic to support them").

[184] Westbrook, *supra* note 69, at 337 ("[T]he narrow premises of scholars like Dean Jackson are unpersuasive to many who believe bankruptcy law is more than the Creditors' Dilemma."). In response to the Baird/Jacksonian economic account, Senator (then Professor) Elizabeth Warren has argued that bankruptcy issues reflect various and complex empirical and normative concerns that cannot be reduced to a single theoretical construct. Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 811 (1987) [hereinafter *Bankruptcy Policy*].

[185] *See, e.g.*, Barry E. Adler, *The Creditors' Bargain Revisited*, 166 U. PA. L. REV. 1853, 1854 (2018) (relaying his experience that many practicing lawyers, "presumably not immersed in Jacksonian orthodoxy," believe that their clients would likely prefer a grab race to pro rata sharing). *But see* Edward J. Janger, *The Creditors' Bargain Reconstituted: Comments on Barry Adler's* The Creditors' Bargain Revisited, 167 U. PA. L. REV. ONLINE 47, 48–49 (pointing out that the creditors' bargain was a heuristic technique that imagined what certain ideal creditors *would* want under a specific set of circumstances, and not what creditors in the real world might actually want (then or now)). Professor Rasmussen sought to make the Jacksonian hypothetical contract an actual one, submitting that, by inserting a provision in a company's corporate charter, a private system of bankruptcy could be adopted by contract. *See, e.g.*, Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEX. L. REV. 51, 53–54, 100–07 (1993); *see also* Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807, 1850 (1998). More recently, Professor Baird, Casey, and Picker have attempted to bolster the creditors' bargain model by eliminating disputes over bankruptcy's distributional rules through the identification and separation of rights that are and are not sorted out in the bankruptcy arena. *See* Douglas G. Baird, Anthony J. Casey & Randal C. Picker, *The Bankruptcy Partition*, 166 U. PA. L. REV. 1675, 1677 (2018).

[186] *See* Mark J. Roe, *Three Ages of Bankruptcy*, 7 HARV. BUS. L. REV. 187, 202 (2017) (describing the model as the major theoretical innovation in bankruptcy).

[187] Jackson, *Fresh-Start Policy*, *supra* note 3, at 1426 (contending that the fresh start "heightens creditors' incentives to monitor [by] enlist[ing] creditors in the effort to oversee the individual's credit decisions even when the individual has not fully mortgaged his future").

[188] THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 3–4 (1986) [hereinafter, LOGIC AND LIMITS].

rules, bankruptcy avoids the prisoners' dilemma that state law collection remedies create by forcing 100 fishers to act as one rather than recklessly fishing out the lake in a single season.[189] Jackson's premise of course is that this is the deal the fishers would have struck ex ante if the opportunity had allowed.[190] That assumption may be open to question in reality,[191] but there can be no doubt that Jackson's model is a productive place to start the discussion of why we have a federal bankruptcy system, distinct from state law creditors' remedies.

One could legitimately say that, even so, this justification of bankruptcy does not demand equal treatment of similar claims,[192] but only that the detail of the unequal treatment be known in advance.[193] In other words, under the Jackson account, bankruptcy law exists to maximize the value of the common pool by optimizing the deployment of assets.[194] If that's the case, how those assets are deployed is not necessarily a bankruptcy question. Yet, Professor Jackson concludes that the rule of equality of distribution *would* be part of the Potemkin bargain and supplant the general grab law principles of state collection law.[195]

The creditors' bargain model, as applied to the question of creditor equality, imagines that the hypothetical negotiations that culminate in the bargain take place in an environment before the creditors' individual histories are known to them.[196] The model then asks whether these creditors would agree to a rule of selective priority or to a rule of pro rata equality in distributing the debtor's assets.[197] Not surprisingly, economic-maximizing creditors should prefer a fifty percent chance of half a loaf over a ten percent chance of a whole loaf and a ninety percent chance of no bread at all.[198] The model also justifies the equality principle on the basis that it reduces the costs of monitoring that creditors would otherwise incur in assuring their priority in the event of the debtor's default.[199]

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[189] *See id.* at 10–13.

[190] *See* Janger, *supra* note 185, at 48–49 (pointing out that the Jackson model was based on hypothetical creditors, whereas creditors in the real world always want as much as they can get, both in terms of leverage and priority).

[191] *See* Adler, *supra* note 185, at 1854.

[192] Jackson, *Non-Bankruptcy Entitlements*, *supra* note 3, at 866–67 (arguing that equality in distribution best resolves the common pool problem that an insolvent debtor's assets presents to its creditors, and deviations from this rule should exist only to promote important competing federal bankruptcy policy).

[193] Of course, access to such information is never even; there are always informational asymmetries. *See infra* text accompanying notes 431, 436.

[194] *See id.*

[195] A central claim of Jackson's creditors' bargain model is that all creditors would agree to equal priority in bankruptcy. *See* JACKSON, LOGIC AND LIMITS, *supra* note 188, at 4–15. The essence of non-bankruptcy debtor-creditor law, of course, is "first in time, first in right." *See infra* text accompanying notes 449–50; Ponroff, *Whither Recharacterization*, *supra* note 13.

[196] *See* David Gray Carlson, *Bankruptcy Theory and the Creditors' Bargain*, 61 U. CIN. L. REV. 453, 458–59 (1994) ("In creditors' bargain theory, no historical contract really exists. . . . The hypothetical contract, if it works, bears certain features in common with the utilitarianism of welfare economics.").

[197] *See* Jackson, *Non-Bankruptcy Entitlements*, *supra* note 3 at 868–69.

[198] For a contrary view, see Adler, *supra* note 185, at 1854 (stating, based on his interactions, real creditors would prefer to take their chances of winning the race of the diligent).

[199] *See* Jackson, *Non-Bankruptcy Entitlements*, *supra* note 3, at 863–64.

How persuasive one finds that defense of equality of creditors is a matter of personal taste. It has not gone down well with some.[200] Nonetheless, the point to be made is that every effort to provide an all-embracing explanation for the bankruptcy law and system has embraced the equality norm.[201] For example, in a direct challenge to the creditors' bargain theory, Professor Donald Korobkin offered a value-based, normative explanation that, according to him, accounts for bankruptcy law in all its dimensions, including those that are not explained by the creditors' bargain heuristic.[202] Under his reckoning, by working to resolve the chaos that typically accompanies financial distress, the rule of creditor equality contributes to creating and defining the "discursive space in which the estate as enterprise may realize its nature . . . , channeling creditors away from conflicts and decisions that will close off constructive possibilities for the estate."[203]

In broad stroke, the normative theories that have been advanced in the scholarly literature to explain the proper purposive goals of our system for providing bankruptcy relief have coalesced around two major camps. For the sake more of convenience than scrupulous accuracy, Professor Doug Baird dubbed the scholars comprising the two groups as, on one end of the spectrum, the "proceduralists" and, on the other end, the "traditionalists."[204]

The former perspective, epitomized by the creditors' bargain and other contractualist models,[205] is backward-looking. Its fundamental question is how to realize value for the debtor's pre-bankruptcy creditors.[206] In essence, the proceduralists view bankruptcy law as a *process* (hence their moniker) for sorting out non-bankruptcy entitlements, but these entitlements, creatures in the main of state private law, have already been established and should be respected.[207] For the

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[200] *See* Carlson, *supra* note 183, at 1350 (criticizing Jackson's defense of the proposition that similarly positioned creditors would prefer to be treated equally).

[201] Professor Skeel acknowledges that the purported disappearance of equality among unsecured creditors has attracted scant attention in the scholarly literature. *See* Skeel, *supra* note 5, at 701.

[202] *See* Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 762–64 (1991).

[203] *Id.* at 775, 782; Donald R. Korobkin, C*ontractarianism and the Normative Foundations of Bankruptcy Law*, 71 TEX. L. REV. 541, 602 (1993) ("Thus, as it informs the current bankruptcy system, the policy of distributional equality signifies a normative commitment to rational planning."); *cf.* KAREN GROSS, FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM 215 (1997) (urging that all claims not necessarily be treated as equal and that important public interests, and not just private commercial interests, should have a voice in bankruptcy negotiations and decisions); *see also supra* note 142.

[204] *See* Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 579–80 (1998).

[205] *See supra* notes 181–82.

[206] *See* Baird, *supra* note 204, at 596–97.

[207] *See, e.g.*, Charles W. Mooney, Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy As (Is) Civil Procedure*, 61 WASH. & LEE L. REV. 931, 931 (2004) (proposing a purely procedure-oriented theory of bankruptcy under which it would be "wrong . . . to redistribute a debtor's wealth away from its [cognizable] rightsholders to benefit third-party interests"); Thomas E. Plank, *The Erie Doctrine and Bankruptcy*, 79 NOTRE DAME L. REV. 633, 691–92 (2004) (suggesting the desirability, as feasible, of following *Erie* in bankruptcy cases so as to advance the development of a coherent body of national commercial law); *see also* Baird, Casey & Picker, *supra* note 185, at 1713 ("One cannot exclude the possibility that Pareto-superior transactions exist in Chapter 11 in which value will be lost unless there is a departure from bankruptcy's distributional rules. But the rarity of such cases in Chapter 11 favors a hardline rule.").

proceduralists, state law has already largely answered how losses will be distributed.[208] Reflecting a law and economics take on bankruptcy, this view worries about the ex ante cost of finance if the rules on distribution of losses change materially in bankruptcy.[209]

By contrast, the traditionalist approach is forward-looking, focused on how the losses flowing from the debtor's inability to satisfy all of its debts should be allocated among its creditors.[210] Pre-bankruptcy entitlements matter, but they are not sacrosanct; distributional questions may be revisited de novo in light of insolvency. The traditionalists factor into the analysis the ex post effects on all parties of the adoption of one rule versus another.[211] As explained by one of the foremost advocates of the traditionalist view, "federal bankruptcy law [is not] . . . bound in every instance to make the same distributional decisions that would apply" under state law or other non-bankruptcy federal law.[212] Once there are too few resources to satisfy all concerned, the policy landscape is changed, and bankruptcy takes other public policies into account in making distributional decisions.[213]

The two approaches are radically different in attitude, focus, scope, and emphasis. And yet, neither viewpoint regards equality as empty of content; both regard it as having substantive import in and relevance to the analysis. A commitment at some level to equality of creditors may indeed be the only thing the two sides can agree on. The proceduralist take would say that to avoid wasteful inefficiencies, claims of equal priority outside of bankruptcy should enjoy the same priority in bankruptcy.[214] The traditionalist view, although willing to divagate from state law distributional rules if called for by substantive policy objectives implicated by a bankruptcy case, nonetheless sees a pragmatic role for the equality norm in deciding how bankruptcy law should distribute the costs of financial failure.[215]

Even as overarching theories of bankruptcy continue to develop and expand, Professor Skeel is still largely alone in his denunciation of equality as playing a central role in bankruptcy doctrine and practice. For instance, in their interesting treatment of the relationship between governance rights and true economic interest in

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[208] *See* Jackson & Scott, *supra* note 182, at 155 ("The cornerstone of the creditors' bargain is the normative claim that prebankruptcy entitlements should be impaired in bankruptcy only when necessary to maximize net asset distribution to the creditors as a group. . . .").

[209] Kenneth Ayotte, Anthony J. Casey & David A. Skeel, Jr., *Bankruptcy on the Side*, 112 NW. U. L. REV. 255, 261 (2017).

[210] *See* Baird, *supra* note 204, at 582–83.

[211] *See* Melissa B. Jacoby, *Corporate Bankruptcy Hybridity*, 166 U. PA. L. REV. 1715, 1721–22 (2018) (pointing out that the problems to be addressed in bankruptcy and that have a stake in questions of distribution go well beyond the traditional capital structure players).

[212] *See* Jay Lawrence Westbrook, *Equity in Bankruptcy Courts: Public Priorities*, 94 AM. BANKR. L.J. 203, 207–08 (2020) (describing the views espoused by Elizabeth Warren in *Bankruptcy Policy*, *supra* note 184, at 781–82, 785).

[213] *See id.*

[214] *See supra* note 201 and accompanying text.

[215] In identifying several important features bearing on the ordering distributional priorities, Elizabeth Warren listed "similarities among creditors" as one such feature. Warren, *Bankruptcy Policy*, *supra* note 184, at 791–92; *see also* text accompanying note 202.

reorganization, Professors Janger and Levitin identify the distorting impact created by the ability of creditors to purchase claims at a discount from face value (or use the derivatives market to effectively hedge their financial downside by "shorting" the debtor).[216] They point out that, as long as governance rights are assigned based on the face amount of the creditor's claim, both practices create a "control premium" that violates the principle of equal treatment.[217]

Purposefully, to prevent this transgression on equality of creditors, Janger and Levitin propose that governance rights be assigned not relative to the face value of a specific claim held by a creditor, but instead adjusted downward to reflect the creditor's true economic position.[218] By assigning control rights consistent with the creditor's actual investment in the claim and/or its precise economic exposure in the case, equality of distribution is preserved, and no single creditor may exercise an influence within its class that is disproportionate to such creditor's net financial stake.[219] The salience of the equality standard is a given in the analysis because of its core essentiality to our system for dealing with financial distress or failure, and not just in liquidation mode where the principle of pari passu was initially established, but also in reorganization mode.[220]

IV. COUNTEREXAMPLES OF EQUALITY AT WORK IN BANKRUPTCY PRACTICE

As discussed above,[221] Professor Skeel identified several bankruptcy rules or practices, including the preference scheme and the doctrine of necessities, that he contends flout the equality narrative, and there are doubtless others.[222] This leads Skeel to his conclusion that whatever useful role the equality of creditors conception may have played a century ago,[223] in current bankruptcy practice it has become a

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[216] *See* Edward J. Janger & Adam J. Levitin, *One Dollar, One Vote: Mark-To-Market Governance in Bankruptcy*, 104 IOWA L. REV. 1857, 1862–64 (2019).

[217] *See id.* at 1898–99 ("While there is no general legal commitment to equal treatment outside of bankruptcy, it is a baseline distributional principle that equality of treatment is measured as of bankruptcy day once the debtor files. . . . The ability of a first mover to grab that premium at the expense of other similar creditors violates the principle of equal treatment.").

[218] *See id.* at 1866–67 (citing the inadequacy of the other tools currently available under the Code to address the inequity).

[219] *See id.* at 1896.

[220] *See infra* Section V.B.1.

[221] *See supra* text accompanying notes 51–86.

[222] *See* Skeel, *supra* note 5, at 714–20. Equitable subordination under 11 U.S.C. section 510(c) is a statutory example. The judicial practice of permitting a security interest given to collateralize post-petition to financing to extend to the lender's pre-petition unsecured debt, effectively elevating the priority of the pre-petition debt might be another. However, this practice is exceedingly rare, and invariably draws a skeptical reaction from the courts, precisely because it is contrary to the Code's express priority scheme, including equality among non-priority unsecured creditors. *See, e.g.*, Shapiro v. Saybrook Mfg. Co. (*In re* Saybrook Mfg. Co.), 963 F.2d 1490, 1494–96 (11th Cir. 1992).

[223] *See* Skeel, *supra* note 5 at 729, 743 (suggesting that, historically, equality may have served to control against discriminatory treatment among different groups of creditors (particularly in connection with the preference law)).

costly preoccupation that deflects focus and attention away from the principles and policies that really matter.[224]

However, recent years have also witnessed legislative and judicially developed rules or interpretations that reflect or reinforce an equality-based account of consumer and business bankruptcy alike.[225] Thus, they serve as counterweights to examples offered by Skeel.[226] These include: (1) key employee retention plans, (2) administrative insolvency practices, (3) priority treatment for workers' compensation premiums, and (4) recharacterization of claims. Each is touched on briefly in the material that follows.

A. KERPs

One of the more troubling practices that arose in large chapter 11 cases surrounds key employee retention plans ("KERPs"), designed, purportedly, to induce members of the debtor's senior management to remain with the company during the reorganization by offering them sizeable compensation packages.[227] Even though the numbers entailed in these programs could be far from trivial, they were commonly authorized by the bankruptcy courts.[228] While not an intercreditor issue per se, these arrangements entailed disparate treatment among members of the debtor's workforce, and also shifted, at least in the short-term, assets from creditor claims to management compensation.[229] Therefore, the non-egalitarian implications were patently clear.

In reaction, Congress enacted section 503(c)(1),[230] which places strict limitations on the permissibility and payment of this compensation as an administrative expense priority.[231] Specifically, if the plan at issue meets the statutory definition,[232] no payment thereunder may be made unless the two statutory conditions in sections 503(c)(1)(A) and (B) are satisfied.[233] Together these stipulations require not only a showing of the criticality of the manager's services to the survival of the

[224] *See id.* (noting as well that equality's "special virtues in other contexts doesn't rehabilitate it in bankruptcy"). *See generally* SKEEL, *supra* note 36.
[225] *See, e.g.*, 11 U.S.C. § 510(c) (2018).
[226] *See* Skeel, *supra* note 5, at 714–20.
[227] *See generally* Allison K. Verderber Herriott, Comment, *Toward an Understanding of the Dialectical Tensions Inherent in CEO and Key Employee Retention Plans During Bankruptcy*, 98 NW. U. L. REV. 579, 607 (2004).
[228] *See generally id.*
[229] *See id.* at 616 (describing how companies defined those "key employees" who benefited under the KERP, differently).
[230] 11 U.S.C. § 503(c)(1) (2018).
[231] *See id.* Section 503(c)(2) place similar restrictions on, respectively, severance payments and other out of the ordinary course of business payments to (or obligations incurred for the benefit of) officers, managers, and consultants retained after the filing of the case. *See id.* § 503(c)(2).
[232] These entail (1) payments to an insider, made (2) for the purpose of inducing the payee to remain in his or her current position. *See id.* § 503(c)(1).
[233] *See id.* § 503(c)(1)(A)–(B).

business, but also that the management employee in question has a bona fide offer from another employer at a higher rate of compensation.[234]

Even if these rigorous standards are met, it's not over. Section 503(c)(1)(C) goes on to limit the maximum amount that can be paid under the plan,[235] tying it to payments of a similar kind made to non-management employees for any purpose during the calendar year or, if no such payments were made, to 25 percent of any similar transfer made to the management employee to be benefitted under the plan during the prior calendar year. Like much of the 2005 Amendments,[236] the drafting of these new limitations leaves something to be desired.[237] However, the intent and underlying motivation is plain, and they cohere nicely with the equality aims of the bankruptcy law even in chapter 11. Likewise, it parallels the trend observed earlier in relation to critical-vendor payments to at least curb, if not actually eliminate, a practice that exacerbates unequal treatment.[238]

B. Administrative Insolvency

Even more directly explicable in equality terms than KERPs is the practice approved by several courts of requiring disgorgement of interim compensation paid to the professionals employed during the chapter 11 phase of a case that is later converted to chapter 7 and turns out to be administratively insolvent.[239] The equality issue arises by virtue of the fact that, if any tier of administrative expense claims cannot be paid in full, the Code calls for pro rata distribution among claimholders of like priority.[240] The question is whether professional compensation, which qualifies

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[234] *See id.*

[235] *See id.* § 503(c)(1)(C).

[236] The 2005 Amendments were notorious for their inartful drafting. *See, e.g.*, Jean Braucher, *The Challenge to the Bench and Bar Presented by the 2005 Bankruptcy Act: Resistance Need Not Be Futile*, 2007 U. ILL. L. REV. 93, 97 ("The problems with the 2005 Act are breathtaking. There are typos, sloppy choices of words, hanging paragraphs, and inconsistencies."); *In re* Trejos, 352 B.R. 249, 253–54 (Bankr. D. Nev. 2006) ("Making practical sense . . . of much of BAPCPA[] [the 2005 Amendments] requires bankruptcy judges to adopt the approach of the White Queen, and believe in 'as many as six impossible things before breakfast.'" (quoting LEWIS CARROLL, ALICE'S ADVENTURES IN WONDERLAND & THROUGH THE LOOKING GLASS, ch.5, at 157 (Bantam Classic ed. 1981) (1865 & 1871))).

[237] For example, with respect to the alternative limitations on what the debtor can pay, it is certainly conceivable that neither of the prescribed benchmarks—payments to nonmanagement employees during the current calendar year or similar transfers made to the insider/payee during the prior calendar year—will exist.

[238] *See supra* text accompanying notes 158–60. Here, as in the case of critical-vendor payments, but unlike at the end of the case, there is a chance that the investment in inequality will pay off.

[239] *See, e.g.*, Specker Motor Sales Co. v. Eisen, 393 F.3d 659, 661 (6th Cir. 2004) (affirming district court's order requiring debtors' attorney to disgorge his interim attorney fees so that the insolvent estate could distribute its funds pro rata amongst all administrative claimants).

[240] 11 U.S.C. § 726(b). In addition, section 726(b) also makes clear that, if the case is converted from chapter 11 to chapter 7, chapter 7 administrative expense claims are paid in full before chapter 11 administrative expenses receive anything. Of course, if what's left after paying the priority administrative expenses in chapter 7 is less than the sum of the administrative expenses incurred prior to conversion, then the rule of pro rata distribution kicks in. *See* Harris Winsberg & Matt Roberts, *To Disgorge or Not: 11 U.S.C. § 726(b) and Disgorgement of Interim Fee Awards*, 29 NORTON J. BANKR. L. & PRAC. 109, 111–12 (2020).

as an administrative expense,[241] paid out prior to conversion of the case is within the scope of this pro rata distribution.

In *Specker Motor Sales Co. v. Eisen*,[242] the Sixth Circuit determined that section 726(b) was appropriately read to require elimination of the de facto non-pro rata sharing of limited assets among claims of equal priority that would result if disgorgement of fees was not ordered.[243] The court went on to state:

> Equality of distribution would be vitiated if one equally situated administrative claimant—Bays [the attorney required to cough up most of his compensation]—received more than his *pro rata* [distribution among administrative claimants of equal priority]. It is understandable that this conclusion dismays Bays. . . . But his position is no different from that of anyone who provides services or credit to a bankrupt firm. . . . As the district court stated, 'counsel is a gambler in [bankruptcy] proceedings like every other administrative creditor.'[244]

It is true that other courts, probably representing a majority, disagree with *Specker Motor* and hold that the issue of disgorgement *vel non* is at the discretion of the bankruptcy court.[245] These decisions reason that, although section 726(b) appears to provide authority for compelling return of the fees, that provision in fact only delineates how funds are to be *distributed* among claimants of equal priority, it does not address the *source* of the funds.[246] Even then, however, the equality of creditors imperative may be considered as a factor in exercise of the bankruptcy court's discretion.[247]

Still other courts have questioned whether authority to order disgorgement exists at all.[248] In *In re Headlee Mangement*,[249] for instance, the court summed up the argument as follows: "The Bankruptcy Code . . . has a comprehensive system for the recovery of assets by the trustee. This scheme specifically includes provisions for the recovery of post-petition transfers,[250] and for the recovery of interim fees. . . ."[251] The fees at issue in the case were both, but, the court observed, neither set of rules

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[241] 11 U.S.C. § 503(b)(4).
[242] 393 F.3d at 662.
[243] *Id.* at 664 (citing Beigier v. IRS, 496 U.S. 53, 58 (1990)).
[244] *Id.*
[245] *See In re* Chute, 235 B.R. 700, 701–02 (Bankr. D. Mass. 1999) (collecting cases).
[246] *See In re* St. Joseph Cleaners, 346 B.R. 430, 437–48 (Bankr. W.D. Mich. 2006).
[247] *See id.* at 440–41.
[248] *See, e.g., In re* Home Serv. Corp., 533 B.R. 302, 305 (Bankr. N.D. Cal. 2015) ("There is nothing in the section [726(b)] requiring, or even suggesting, disgorgement of earned and paid chapter 11 expenses solely in order to pay chapter 7 administrative expenses in full.").
[249] 519 B.R. 452 (Bankr. S.D.N.Y. 2014).
[250] *See* 11 U.S.C. § 549 (2018).
[251] *In re* Headlee Mgmt., 519 B.R. at 459; *see* 11 U.S.C. § 330(a)(5) (2018).

called for fee disgorgement in these circumstances.[252] The court, thus, denied the trustee's motion, observing that "in the face of such comprehensive legislative schemes, [the judiciary may not] 'fashion new remedies that might upset carefully considered legislative programs.'"[253]

Headlee may have the better of it as a matter of statutory analysis.[254] Read plainly, section 726(b) requires only that the trustee distribute what assets she has in accordance with the priority ladder specified in that provision.[255] There is nothing explicit in section 726(b) that can be interpreted as conferring on the trustee or the bankruptcy court the power to inflate that pool of assets by seeking disgorgement of payments made prior to conversion.[256] Rather, it must be inferred from use of the mandatory term "shall" in section 726(b).[257]

Nevertheless, the strength of bankruptcy equality that weighed so heavy in the Sixth Circuit's analysis in *Specker Motor* is not in any way in dispute insofar as how the issue should be resolved.[258] The disagreement stems, if anything, over the proper interpretation of the statutory directive and application of principles of statutory interpretation. There are many places where the Code prescribes an unequal distribution, or a deviation from strict equality, in order to vindicate a competing policy.[259] The debate over disgorgement of fees in this situation has been conducted entirely in relation to whether Congress has tacitly addressed the question by omission of a statutory mandate.[260] That is to say, there is no disagreement over the baseline proposition that equitable distribution not only does but *should* reside at the core of the Bankruptcy Code and that, except where Congress has stated otherwise, a pro rata distribution to creditors is equitable.[261]

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[252] *See In re* Headlee Mgmt., 519 B.R. at 459.

[253] *Id.* (quoting Nw. Airlines, Inc. v. Transp. Workers, 451 U.S. 77, 97 (1981)).

[254] *See* Winsberg & Roberts, *supra* note 240, at 114–15.

[255] *See* 11 U.S.C. § 726(b) (2018).

[256] *See id.* Although it was a post-petition transfer it could not be avoided because the payment was authorized by section 363(c)(1) of the Code. *See In re* Livore, 473 B.R. 864, 870 (Bankr. D.N.J. 2012). On the other hand, it is the *statutory* responsibility of the trustee in chapter 7 to "collect and reduce to money property of the estate for which such trustee serves" so the issue is not entirely free from doubt. *See* 11 U.S.C. § 704(a)(1) (2018).

[257] *See* Specker Motor Sales Co. v. Eisen, 300 B.R. 687, 689 (W.D. Mich. 2003), *aff'd*, 393 F.3d 659 (6th Cir. 2004) ("[M]andatory disgorgement is the only reasonable and logical result if 11 U.S.C. § 726(b) is to be given any effect.").

[258] *See* Specker Motor Sales Co. v. Eisen, 393 F.3d 659, 664 (6th Cir. 2004).

[259] *See supra* text accompanying notes 10–12.

[260] *See In re* Headlee Mgmt., 519 B.R. 452, 459 (Bankr. S.D.N.Y. 2014).

[261] Ensuring an equitable distribution of a debtor's assets is regarded as one of the "twin goals" that resides at the core of the Bankruptcy Code. Moses v. CashCall Inc., 781 F.3d 63, 72 (4th Cir. 2015) ("Grounded in the Constitution, bankruptcy provides debtors with a fresh start and creditors with an equitable distribution of the debtor's assets."). If case insolvency at the administrative priority level warrants disgorgement of pre-conversion fees to ensure an *equal* distribution of assets, legislative clarification may be required, more so than ever considering the Supreme Court's emphasis in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017), regarding the sanctity of the Code's explicit priority scheme with respect to end-of-case distributions. But that point diminishes neither the resonance nor reality of equality of distribution.

C. Priority of Workers' Compensation Premium Claims

Just as the 2005 Amendments curbed one form of inequality by limiting the enforceability of KERPs, they created another by materially increasing the employee wage/benefit priorities in, respectively, sections 507(a)(4) and (a)(5).[262] This expansion related both to the amount and the period of time to which the priority pertains, although the temporal extension is largely symbolic.[263] There has never been any question that the priority in section 507(a)(5) for contributions due to an employee wage benefit plan applies to traditional items that might be substituted for wages, such as life, health, retirement, and disability insurance plans.[264] However, courts were ambivalent about an insurer's claim for unpaid workers' compensation premiums, as this insurance benefits employees injured on the job and, accordingly, could also be considered to be in lieu of wages.[265]

Eventually, the issue of priority for such premiums made its way to the Supreme Court in the form of an appeal of a decision that had allowed the priority based alternatively on the "plain text"[266] of the statute or the legislative history of the Employee Retirement Income Security Act of 1974.[267] In reversing the circuit court's determination that carrier claims were not outside the priority conferred by section 507(a)(5), the Court found that any doubt as to the meaning of the statute is "best resolved in accord with the Bankruptcy Code's equal distribution aim."[268]

Although chapter 11 provides somewhat more flexibility than chapter 7 in relation to the strictness of the equality of creditors imperative,[269] *Howard Delivery* demonstrates that does not mean reorganization is a policy free-for-all.[270] Rather, as the Court held, absent explicit statutory direction to the contrary, the Code should be interpreted and applied in a manner that coheres with equality policy.[271] This, in turn, is quite consistent with the Court's decision a dozen years later in *Czyzewski v. Jevic*

[262] 11 U.S.C. § 507(a)(4)–(5) operate in tandem. Together, they provide employees with a priority for pre-petition wages and associated fringe benefits. Section 1401 of the 2005 Amendments (1) raised the wage priority in section 507(a)(4) from $4,000 to $10,000 (since then it is indexed every three years under 11 U.S.C. § 104), and (2) extended the period to which the priority may be claimed from 90 to 180 days prior to filing. *See* Bankruptcy Abuse Prevention and Consumer Protection Act, Pub. L. No. 109-8, 119 Stat. 23, 214 (2005).

[263] It is unrealistic to expect that an employee who is not getting paid would stick around for 90 days, never mind six months.

[264] *See In re* Saco Loc. Dev. Corp., 23 B.R. 644, 648 (Bankr. D. Me. 1982).

[265] *Compare* Travelers Prop. Cas. Corp. v. Birmingham Nashville Exp., Inc. (*In re* Birmingham Nashville Exp., Inc.), 224 F.3d 511 (6th Cir. 2000) (denying priority status), *with* Emps. Ins. of Wausau v. Plaid Pantries, Inc., 10 F.3d 605 (9th Cir. 1993) (affording priority status).

[266] *See* Howard Delivery Serv., Inc. v. Ins. Co. (*In re* Howard Delivery Serv., Inc.), 403 F.3d 228, 229, 237 (4th Cir. 2005) (King, J., concurring), *rev'd*, 547 U.S. 651, 668 (2006).

[267] *Id.* at 238, 240 (Shedd, J., concurring).

[268] Howard Delivery Serv., Inc., v. Zurich Amer. Ins. Co. (*In re* Howard Delivery Serv., Inc.), 547 U.S. 651, 668 (2006).

[269] *See supra* notes 142–43.

[270] *See In re* Howard Delivery Serv., Inc., 547 U.S. at 655.

[271] *See id.* at 667.

Holding Corp.,[272] discussed earlier.[273] The *Jevic* Court opined that a settlement calling for payments at variance with the absolute priority rule cannot be approved over the objection of an impaired class of creditors.[274] The *Howard Delivery* Court held that the rules of priority should be tightly construed because they mark a departure from equal treatment of unsecured claims.[275] In both decisions the climacteric factor for the Court was the notion that the purpose of bankruptcy is to effect the equitable distribution of the debtor's estate and that distribution in bankruptcy is grounded first and foremost in egalitarian sentiments—be it among priority or non-priority claimants.

D. Recharacterization of Claims

All seven circuit courts of appeals to have addressed the question concur that the bankruptcy courts possess the authority to recharacterize a putative loan by an insider to an entity-debtor from an unsecured claim to an equity contribution.[276] The effect, of course, is that nothing may be paid in respect of that interest unless and until unsecured creditor claims have been paid in full.[277] There is, however, a sharp split among these decisions regarding the source of the bankruptcy courts' authority to exercise that power and, consequently, as to the legal framework governing recharacterization. The majority of the circuits have determined that the bankruptcy courts' general equitable authority under section 105(a) authorizes them to convert a purported loan into a capital investment when that is consistent with the true economic substance of the transaction, a determination made under a federal test.[278]

In contrast, the Fifth and the Ninth Circuits have held that the bankruptcy courts' ability to recharacterize claims resides in section 502(b), which provides for the allowance of all filed claims other than those that are "unenforceable . . . under any agreement or applicable law."[279] Citing the Supreme Court's holding in *Butner v.*

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[272] 137 S. Ct. 973 (2017).

[273] *See supra* text accompanying notes 162–71.

[274] *Jevic Holding Corp.*, 137 S. Ct. at 984.

[275] *See In re* Howard Delivery Serv., Inc., 547 U.S. at 667. Similarly, courts routinely caution that the discharge exceptions in 11 U.S.C. § 523(a) should be narrowly construed because they run counter to the other fundamental aim in bankruptcy, namely, providing the honest but unfortunate debtor with a fresh start. *See, e.g.*, Denton v. Hyman (*In re* Hyman), 502 F.3d 61, 66 (2d Cir. 2007) (citations omitted).

[276] *See e.g.*, Dornier Aviation (N. Am.), Inc. v. Off. Comm. of Unsecured Creditors (*In re* Dornier Aviation (N. Am.), Inc.), 453 F.3d 225, 231 (4th Cir. 2006).

[277] *See* 11 U.S.C. §§ 726(a)(6), 1129(b)(1)–(2) (2018).

[278] *See generally* Ponoroff, *Whither Recharacterization*, *supra* note 13, at 1229–35; PEM Entities LLC v. Levin (*In re* Providence Grande Olde Liberty, LLC), No. 13-01563, 2014 WL 6901052, (4th Cir. Dec. 5, 2014), *cert. granted* 137 S. Ct. 2326, *cert. dismissed* 138 S. Ct. 41 (2017).

[279] Grossman v. Lothian Oil, Inc. (*In re* Lothian Oil, Inc.), 650 F.3d 539, 543 (quoting 11 U.S.C. § 502(b)) *cert denied*, 132 S. Ct. 1573 (2012); *see* Off. Comm. of Unsecured Creditors v. Hancock Park Cap. II, L.P. (*In re* Fitness Holdings Int'l, Inc.), 714 F.3d 1141, 1148 (9th Cir. 2013).

United States,[280] these courts go on to conclude that the "applicable law" governing whether recharacterization is warranted derives from appropriate state law.[281]

The issue of whether recharacterization occurs under a state or federal standard is of more than passing consequence, both in individual cases and in connection with the larger question of the proper division of authority between state and federal law in bankruptcy.[282] For the time being, however, the widespread approbation of the doctrine writ large is a strong endorsement of the equality norm. Regardless of where the source of the bankruptcy courts' authority is located, the justification for the doctrine is strongly rooted in assuring that a subordinate ownership interest is not bootstrapped into an unsecured claim, upsetting the cornerstone distributional edict of equality of creditors.[283] Later, I will suggest how the equality maxim might be employed to resolve this split of authority.[284]

V. THE PROWESS OF EQUALITY

Surely, it is possible to locate other instantiations of bankruptcy dogma and interpretation that align more or less with equality or, contrarily, that are animated by other purposive aims, such as the disapprobation of secret liens or self-dealing.[285] Doing so, however, does little to advance the analysis. The real question is not whether equality plays a pivotal role in bankruptcy law and practice—it undeniably does—but what role *should* equality play in our thinking about the existing and future contours of the bankruptcy law? Professor Skeel's view is that the concept no longer performs any valuable service in protecting against discriminatory treatment among different groups of creditors, in maximizing the value of the estate, in effecting the goals of consumer bankruptcy, or seemingly in addressing any other important bankruptcy concern.[286] Even more discreditably from the perspective of bankruptcy orthodoxy, in some areas he asserts that the strong rhetorical power of equality detrimentally diverts attention away from the true concerns that underlie key areas of bankruptcy doctrine.[287]

Clearly, the equality principle does not serve the same purposes in bankruptcy that it serves in other social and political arenas where its powerful human rights overtones and moral dimensions help to advance basic democratic goals.[288] It does not necessarily follow from this, however, that the concept of equality cannot and

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280 440 U.S. 48 (1979).

281 *See In re* Fitness Holdings Int'l, 714 F.3d at 1148; *In re* Lothian Oil, Inc., 650 F.3d at 542.

282 *See In re* Lothian Oil, 650 F.3d at 542–43; *In re* Fitness Holdings Int'l, Inc., 714 F.3d at 1147–48.

283 *See generally In re* Lothian Oil, Inc., 650 F.3d 539.

284 *See infra* text accompanying notes 491–92.

285 These are the considerations, along with maximizing the value of the estate, that Skeel believes should occupy our attention rather than our obsession with equality. *See* Skeel, *supra* note 5, at 702. The Code's approach for avoiding untimely recorded security interests is another example that comes to mind. *See* 11 U.S.C. § 547(e) (2018).

286 *See* Skeel, *supra* note 5, at 741–43.

287 *Id.* at 724.

288 *Id.* at 740–41.

does not serve other valuable functions in the bankruptcy arena. In my view, the equality norm and the rhetoric of equality continue to perform an important mediating role in the ritualized dance that denotes the calibration of bankruptcy goals with other social and economic policies.[289] It also provides a not trivial theme that guides the development of bankruptcy law and policy in, if not always an entirely consistent fashion, then at least with a modicum of overall harmony and balance, as I attempt to illustrate in the remainder of this section.

A. Individual Bankruptcy Cases

The courts' approach to separate classification of student loan debt in chapter 13 provides a paradigmatic illustration of the function that equality persists in carrying out in consumer bankruptcy cases.[290] The starting point is section 523(a)(8), which delineates educational loans as one of the categories of non-dischargeable debt in an individual bankruptcy case, subject only to exception in situations where continuation of the debt would pose an "undue hardship."[291] Based on a widely followed Second Circuit decision,[292] undue hardship has been construed as an exceedingly exacting standard that is rarely met.[293]

The next stop on the sojourn is section 1322(b)(1), which permits a chapter 13 plan to designate different classes of unsecured claims, as provided in section 1122, provided the plan does not discriminate unfairly against a class so designated.[294] Like so many bankruptcy rules, it is a Goldilocks rule.[295] Clearly, the statutory language implies that some discrimination will be tolerated, but of course not too much.[296] "Fairness," which is essentially a binary term, is not much help as a standard. In general, therefore, the courts have struggled to establish the parameters of "unfair discrimination," adopting a variety of different tests.[297]

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[289] *See infra* Section VI.A.

[290] *See, e.g.*, Brunner v. N.Y. Higher Educ. Servs. Corp., 831 F.2d 395 (2d Cir. 1987). Later, I address classification issues in chapter 11. *See infra* Section VI.B.1.

[291] 11 U.S.C. § 523(a)(8) (2018).

[292] *See Brunner*, 831 F.2d at 395.

[293] *See generally In re* Birrane, 287 B.R. 490, 497 (B.A.P. 9th Cir. 2002) (noting "the *Brunner* test 'is intended to effect the clear congressional intent . . . to make discharge of student loans'" a harder climb than other nonexcepted debts) (citations omitted); *cf. In re* Rosenberg, 610 B.R. 454, 458–59 (Bankr. S.D.N.Y. 2020) ("Over the past 32 years, many cases have pinned on *Brunner* punitive standards that are not contained therein."), *leave to appeal granted sub nom*. Rosenberg v. Educ. Credit Mgmt. Corp., No. 20-CV-688 (CS), 2020 WL 1048599 (S.D.N.Y. Mar. 4, 2020), *aff'd in part, rev'd in part and remanded sub nom*. Rosenberg v. Educ. Credit Mgmt. Corp., No. 20-CV-00688 (PMH), 2021 WL 4461341 (S.D.N.Y. Sept. 29, 2021).

[294] *See* 11 U.S.C. § 1322(b)(1). An exception is made for claims for a consumer debt on which an individual is liable with the debtor on such debt. *Id.*

[295] *See generally* Nancy B. Rapoport, *Telling the Story on Your Timesheets: A Fee Examiner's Tips for Creditors' Lawyers and Bankruptcy Estate Professionals*, 15 BROOK. J. CORP. FIN. & COM. L. 359, 363 (2020) (referencing the classic tale of Goldilocks and the Three Bears to describe the Goldilocks approach as a balance of finding what is "just right" versus "not enough" or "too much").

[296] *See* 11 U.S.C. § 1332(b)(1).

[297] *See, e.g., In re* Crawford, 324 F.3d 539, 542 (7th Cir. 2003) (reviewing various tests and despairing of finding any of them to be satisfactory, thus leaving the determination to a case-by-case approach).

From the perspective of a chapter 13 debtor carrying student loan debt, it is obviously desirable that as much as possible of the aggregate plan payments allocated to unsecured claimants be devoted to retirement of the non-dischargeable student loans. Thus, the temptation has been to separately classify the educational debt claim(s) and provide a more favorable payout to student loan providers.[298] In spite of their disagreement over how to measure unfair discrimination generally, this is one area where the cases have been considerably more consistent, and, irrespective of one's personal views on whether educational debt should be more readily discharged,[299] it is instructive to see how and why.

The leading case on the issue remains the First Circuit Bankruptcy Appellate Panel's decision in *In re Bentley*.[300] The approach taken in *Bentley* was to adopt a "baseline" test, fundamentally founded on two core principles: (1) because student loans are not priority claims, they are not intrinsically entitled to more favorable treatment than other nonpriority unsecured claims, and (2) chapter 13 is predicated on the assumption that unsecured creditors will receive pro rata distributions from the debtor's plan payments earmarked for nonpriority unsecured claims.[301]

The egalitarian overtones of these propositions resonate clearly, and they imply that deviations from the equality norm will not be brooked easily. The bankruptcy court's decision in *In re Harding*[302] is illustrative. The debtor initially attempted to justify separate classification of her student loan debt, and continuation of her regular monthly payments thereon, based on the "cure and maintain" option in section 1322(b)(5) because the last payment on those obligations was due after the final payment called for under the plan.[303] While acknowledging that, read in isolation, section 1322(b)(5) seems to allow just such an option,[304] the court felt obliged to construe section 1322 as a whole, requiring the cure and maintenance option in subsection (b)(5) to be harmonized with the proscription against "unfair" discrimination in subsection (b)(1).[305] Because the effect of the proposed separate classification would have been to favor the providers of the educational loans at the expense of the debtor's other non-priority unsecured creditors, the court concluded that the plan could only be approved if the proposed scheme was not "unfair."[306]

While conceding the absence of a universally-accepted test of fairness,[307] the *Harding* court noted the generally accepted view that discrimination based *solely* on

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[298] Of course, this is true of any non-dischargeable debt, which is why discrimination based solely on non-dischargeability is unfair. *See, e.g.*, Groves v. LaBarge (*In re* Groves), 39 F.3d 212, 214 (8th Cir. 1994).

[299] *See, e.g.*, Nathalie Martin, *Bringing Relevance Back to Consumer Bankruptcy*, 36 EMORY BANKR. DEV. J. 581, 605 (2020) (urging reconsideration of the treatment of student loans).

[300] *In re* Bentley, 266 B.R. 229 (B.A.P. 1st Cir. 2001).

[301] *Id.* at 240–43.

[302] 423 B.R. 568 (Bankr. S.D. Fla. 2010).

[303] *See id.* at 571 (quoting 11 U.S.C. § 1322(b)(5) (2018)).

[304] *Id.* at 571.

[305] *Id.* at 573.

[306] *Id.* at 574.

[307] *In re* Crawford, 324 F.3d 539, 542 (7th Cir. 2003) (conceding the lack of a "good test").

non-dischargeability is unfair.[308] The debtor attempted to distinguish the current situation from that general line of cases by urging consideration of the significant late fees and penalties that would accrue during the course of her five-year plan if payments were not maintained.[309] In balancing the relevant bankruptcy goals of fresh start, repayment of student loan debt, and fairness among creditors as a whole, the court found that discrimination in favor of student loan obligations furthered the first two congressional aims.[310] However, the court continued that "[t]he third aim weighs heavily against discrimination because of the significant harm to remaining unsecured creditors."[311] Thus, the court concluded that the intrusion upon equal treatment of the debtor's creditors that would result if the plan was confirmed *alone* outweighed the other benefits that would have been served by the separate classification.[312]

Most courts to have spoken to the issue agree with *Harding* that paragraph (1) of section 1322(b) places a limit on paragraph (5), and therefore allow cure and maintenance of an unsecured long-term debt, such as a student loan, *only if* such a plan provision does not unfairly discriminate against other unsecured claims.[313] There is some directly contrary authority, primarily relying on an isolated (some might call a myopic) reading of subsection (b)(5).[314] Other cases allowing separate classification are distinguishable on their facts.[315] Differential treatment may also be allowed where the debtor is using discretionary income, i.e., beyond projected disposable income, to fund greater payments toward the non-dischargeable educational debt,[316] thus not

[308] *In re* Harding, 423 B.R. at 575. Pointing to its earlier decision in *In re* Kalfayan, 415 B.R. 907 (Bankr. S.D. Fla. 2009), the court continued that non-dischargeability can, however, be a *factor* in the analysis. *Id.*

[309] *Id.* at 577 (noting that imposition of such fees, if permissible, would exceed, according to the debtor, twenty-five percent of the current loan balance). However, these were really bookkeeping entries only as they likely would be uncollectible due to the operation of the automatic stay. *Id.*

[310] *Id.* at 576.

[311] *Id.*

[312] *Id.* at 579 (pointing out that "[t]hose discriminated against [other unsecured creditors] would *forever* lose their fair pro rata distribution. This permanent and substantial harm cannot outweigh Sallie Mae having to defer its full contractual recovery by a few short years").

[313] *See, e.g., In re* Jordan, 555 B.R. 636, 649 (Bankr. S.D. Ohio 2016); *In re* Precise, 501 B.R. 67, 71–72 (Bankr. E.D. Pa. 2013). These courts reason generally that if Congress had intended the two paragraphs to be independent of each other it would have drafted section 1322(b)(5) as stating "notwithstanding paragraphs (1) and (2)" rather than only "notwithstanding paragraph (2) of this subsection." *See, e.g., In re* Boscaccy, 442 B.R. 501, 506 (Bankr. N.D. Miss. 2010).

[314] *See In re* Truss, 404 B.R. 329, 334 (Bankr. E.D. Wis. 2009) (stating that if a debtor proposes to cure and maintain an unsecured claim, then it is not for the court to consider the fairness to other creditors: "[s]uch a provision is authorized by statute"); *In re* Cox, 186 B.R. 744, 746 (Bankr. N.D. Fla. 1995).

[315] The opinion of the court in *In re* Engen, 561 B.R. 523 (Bankr. D. Kan. 2016) provides a good example. The debtors' plan proposed delaying or reducing potential distributions to non-student loan general unsecured creditors. *In re* Engen, 561 B.R. at 539. However, because those unsecured creditors had received a net pre-petition eighty-three percent dividend at the expense of the student loan claimants and taxes, the court found the net effect of the debtors' proposed discrimination was actually to equalize distributions between the student loan claims and the debtors' other pre-petition unsecured debt. *Id.* at 539–40.

[316] *See, e.g., In re* Bennett, 615 B.R. 384, 400 (Bankr. N.D.N.Y. 2020). Some courts have also begun to recognize authority to grant a partial discharge from student loan debt. *See, e.g., In re* Modeen, 586 B.R. 298, 305–06 (Bankr. W.D. Wis. 2018).

violating the baseline proposition of pro rata distribution among non-priority unsecured creditors.[317]

As in connection with many other aspects of consumer bankruptcy, equality provides the threshold consideration for evaluating the appropriateness of the debtor's proposed classification of claims in a chapter 13 plan.[318] Professor Skeel's more general assertion that, ultimately, the equality norm is unhelpful and unnecessary to the analysis in "consumer bankruptcy" and "Chapter 7 liquidations"[319] because, inter alia, most consumer filings are no-asset cases and/or the asset distributions that do occasionally occur are seldom distributed equally because of priority unsecured claims,[320] strikes me as dodging, not dealing with, the issue. It has never been suggested, nor is it true, that equality means perfect equality. Second, the distributional norms that govern a system matter whether there is a distribution in a given case or not. In fact, Skeel's argument brings to mind Michael Shermer's explanation of how creationists duplicitously use gaps in evolutionary theory in an attempt to debunk its validity; to wit: "When I debate creationists, they present not one fact in favor of creation and instead demand 'just one transitional fossil' that proves evolution. When I do [offer evidence] . . . they respond that there are now *two gaps* in the fossil record."[321]

So, too, does Skeel abnegate the importance of the equality standard in consumer bankruptcy by pointing to instances of unequal distributions or situations where equality simply cannot be implemented—situations that no one denies occur—without offering any justification for his own theory that equality is nonconstructive in resolving consumer bankruptcy issues and persists only as vestigial anachronism of an earlier commercial economy.[322] Likewise, he offers nothing to take its place, instead suggesting that different bankruptcy doctrines are animated by sundry concerns unrelated to equality,[323] a point that is more opinion than fact. It also leaves us with a state of affairs that is denuded of any reliable distributional baseline from which to analyze the effectiveness of any particular bankruptcy rule. Instead, the exercise calls for de novo exploration and review in every situation. That strikes me as a recipe for entropy, not systemic discipline and consonance.

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[317] *See supra* text accompanying note 305.

[318] *In re* Bentley, 266 B.R. 229, 240 (B.A.P. 1st Cir. 2001).

[319] Skeel, *supra* note 5, at 736. Skeel's separate treatment of the two subjects is a bit odd in that most consumer bankruptcies *are* chapter 7 liquidations. Skeel does not address chapter 13 at all.

[320] *Id.* at 736–39.

[321] MICHAEL SHERMER, SKEPTIC: VIEWING THE WORLD WITH A RATIONAL EYE 230 (1st ed. 2016).

[322] *See* Skeel, *supra* note 5, at 738 (noting that the nineteenth century view of bankruptcy was predicated on the assumption that most of the debtor's creditors would be unsecured).

[323] *See supra* note 7 and accompanying text.

B. Business Cases

1. Chapter 11

Although he considers it now obsolete, Professor Skeel does concede that a chapter 7 liquidation more closely resembles the conception of bankruptcy that historically accounted for the equality among creditors principle than chapter 11 cases do.[324] It is, thus, in chapter 11, in particular, where he decries the distorting effect of what he views as the wrongheaded obsession with the equality norm.[325] And, indeed, when we turn from simple consumer liquidation to business reorganization, the picture that emerges becomes cloudier because we have added to the equation the policy of business survival and the collateral interests of non-creditor constituents.[326] Those factors do not, however, necessarily translate into the conclusion that equality no longer offers a functional or rational explanation for many structural aspects of the process.

In addition to its basic rehabilitative aim for the debtor, chapter 11 seeks to accomplish two goals for creditors: value maximization and fair distribution of that value.[327] Value maximization is important to creditors because it increases the size of the pie. It says nothing explicitly about how it is sliced but has been regarded nonetheless as facilitated by a regime that embraces equality of creditors as a core value.[328] Equality, on the other hand, is at the center of fair distribution in bankruptcy, as summed up in the "equity is equality" maxim.[329]

There are other utile roles for equality to play in chapter 11, notably including with respect to classification of claims. While classification of unsecured claims is permitted in chapter 13 for unsecured claims, chapter 11 plans *must* classify claims and interests.[330] Moreover, classification bears not only on dividend distribution, as in chapter 13, but also on plan voting,[331] a feature absent from chapter 13.[332] Section 1123(a)(4) calls for all claims *within* a class to receive the same treatment—another bow to equality.[333] Section 1122(a), in turn, provides that, "a plan may place a claim . . . in a particular class only if such claim . . . is substantially similar to the other claims or interests of such class."[334] Thus, the statute requires that claims within a given class must be substantially similar and treated equally; however, it does not

[324] Skeel, *supra* note 5, at 738 (describing liquidation cases as "more closely resembl[ing] the conception of bankruptcy that gave rise to the equality of creditors norm").
[325] *See id.*
[326] *See supra* note 142 and accompanying text.
[327] *See* Melissa B. Jacoby & Edward J. Janger, *Tracing Equity: Realizing and Allocating Value in Chapter 11*, 96 TEX. L. REV. 673, 682 (2018) [hereinafter *Tracing Equity*].
[328] *See supra* notes 201–04 and accompanying text.
[329] *See supra* note 4 and accompanying text.
[330] *See* 11 U.S.C. § 1123(a)(1) (2018).
[331] *Id.* § 1126(c)–(d).
[332] *Id.* § 1322(a)(3) (allowing permissive classification).
[333] *See id.* § 1123(a)(4).
[334] *Id.* § 1122(a).

expressly provide anywhere that substantially similar claims may *not* be placed in separate classes.[335]

Does the fact that the Code, by implication, permits substantially similar claims to be classified separately suggest equality has no purchase in the business reorganization setting because of the primacy of other values?[336] It does not, any more than it does in chapter 13. First, section 1122(a) has consistently been interpreted to prohibit separate classification of like claims unless there is some solid business or economic justification, pertinent to the reorganization, to warrant the distinction.[337] The courts' widespread expression of opprobrium for creation of a separate class of similar claims solely in order to meet the confirmation requirement of section 1129(a)(10)[338] (that at least one impaired class has accepted the plan) is illustrative of the disfavored bias exhibited towards unequal treatment of like claims.[339]

Doubtless, this gloss the courts have etched on to the statute represents a curtsey to equality.[340] However, the more pertinent inquiry is whether that fealty is misguided. I would maintain it is not. Permitting separate classification of like claims, i.e., deviation from the equality precept, without good cause and sound reason, would not hasten the prospects for successful reorganization but rather, I believe, would produce only counterproductive collisions of interests, unnecessary jockeying for position, and internecine squabbling among and between creditors and the debtor. The situation is, moreover, much trickier than in chapter 13 because, after expiration of exclusivity, any party in interest can propose a plan of reorganization in chapter 11.[341]

The second reason that the absence of a preclusion in section 1122(a) against separate classification of substantially similar claims does not necessarily signal a lesser role for equality in chapter 11 is that, in a non-consensual plan, section 1129(b)(1) grafts equality back into the equation.[342] Specifically, that provision stipulates that, in order to cram down a plan against one or more dissenting

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[335] *See, e.g.*, John Hancock Mut. Life Ins. Co. v. Route 37 Bus. Park Assocs., 987 F.2d 154, 158 (3d Cir. 1993) ("Section 1122(a) expressly provides only that claims that are not 'substantially similar' may not be placed in the same class; Section 1122(a) does not expressly provide that 'substantially similar' claims may not be placed in separate classes.").

[336] *See id.*

[337] *See* Tabb, *supra* note 31, at 1108; Barakat v. Life Ins. Co. of Va. (*In re* Barakat), 99 F.3d 1520, 1526 (9th Cir. 1996) ("[A]bsent a business or economic justification, separate classification of unsecured claims solely on their right to make a § 1111(b)(2) election is an impermissible classification in violation of § 1122(a).").

[338] *See, e.g.*, Phoenix Mut. Life Ins. Co. v. Greystone III Joint Venture (*In re* Greystone III Joint Venture), 995 F.2d 1274 (5th Cir. 1991).

[339] *See* Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co., (*In re* U.S. Truck Co., Inc.), 800 F.2d 581, 586 (6th Cir. 1986) (warning of potential abuses that could arise from failing to restrict classification of creditors under section 1122(a)).

[340] That is, equality serves as the norm and it is incumbent on the plan proponent to come up with good reason for treating like claims differently. *But see* Bruce A. Markell, *Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification*, 11 BANKR. DEV. J. 1, 25–26 (1995) (taking the contrarian view that, even though the plan proponent bears the burden of obtaining confirmation, a creditor opposing the differential classification should bear the burden of demonstrating improper classification).

[341] *See* 11 U.S.C. § 1121(a)–(c) (2018). In chapter 13, the debtor alone can file a plan.

[342] *See* 11 U.S.C. § 1129(b)(1).

classes of creditors,[343] the plan must, as to each such class, not "discriminate unfairly."[344] Section 1129(b)(1) further requires that the plan be "fair and equitable."[345] Clarified in section 1129(b)(2)(B) as it relates to unsecured claims, the fair and equitable requirement can only be satisfied either if the plan proposes to pay the dissenting class in full or no class junior in priority receives anything under the plan on account of the claims comprising that junior class.[346] Known as the "absolute priority rule," this requirement ensures that the plan conforms to the Code's scheme of distributional priorities.[347] The point is an important one, but as such reinforces the equality principle only tacitly.[348]

The "no unfair discrimination" standard, on the other hand, plainly relates to equality of creditors and properly so.[349] As in chapter 13,[350] the unfair discrimination standard does not mean there can be no discrimination among classes of equal rank, but rather that any such discrimination must be unprejudiced.[351] In this context, "fairness" has not been given an expansive interpretation.[352] This is due to a recognition that the "'[u]nfair discrimination" standard for cramdown of a proposed chapter 11 plan over the objection of an impaired, dissenting class operates to make certain that the dissenting class will receive *relatively* equal value to the value given to all other similarly situated classes.[353] In other words, the bankruptcy standard of unfair discrimination begins with a predisposition toward the principle of equal treatment, but allows for some divergence upon a proper showing.[354] This is quite consistent with the position I advance generally in making the case for the continuing dominion of the equality norm understood not in an absolute sense but in a "bankruptcy sense."[355]

This stringent conceptualization of unfair discrimination in chapter 11 complements the aforementioned standard of intraclass equality among creditors, namely, that claims placed in the same class must either be treated identically, absent consent by the holders of disfavored claims to their inferior treatment.[356] In their own right, the tests to determine if the plan proponent's proposed discriminatory treatment

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343 Acceptance by a class of claims is governed by 11 U.S.C. § 1126(c).

344 *Id.* § 1129(b)(1).

345 *Id.* For a discussion of the development of the absolute priority rule in reorganization, see *Louisville Tr. Co. v. Louisville, N.A. & C. Ry. Co.*, 174 U.S. 674 (1899).

346 *See* 11 U.S.C. § 1129(b)(2)(B).

347 *See id.*

348 Rather, it relates to adherence to the system of priority that dictates the payment hierarchy in chapter 11. As discussed earlier, see *supra* text accompanying notes 161–71, it was the integrity of this scheme that was at issue in *Czyzewski v. Jevic Holding Corp.*, 137 S. Ct. 973 (2017).

349 *See* 11 U.S.C. § 1129(b)(1).

350 *See supra* Section V.A.

351 11 U.S.C. § 1322(b)(1).

352 *See In re* Armstrong World Indus., 348 B.R. 111, 121 (D. Del. 2006) (quoting *In re* Johns-Manville Corp., 68 B.R. 618, 636 (Bankr. S.D.N.Y. 1986)).

353 *See id.*

354 *See id.*

355 *See infra* Section VI.A.

356 *See* 11 U.S.C. § 1123(a)(4); *In re* Simmons, 288 B.R. 737, 747 (Bankr. N.D. Tex. 2003) (stating that the test provides a horizontal standard to fairness).

between classes of equal priority rank—almost invariably unsecured creditors—while necessarily forgiving of some divergence, is nonetheless infused with a bias or presumption against interclass inequality.[357]

Many recent decisions follow the approach developed by Professor (and former Judge) Bruce Markell.[358] Under this test, a rebuttable presumption of unfair discrimination arises if there is "another class of the same priority" as the dissenting class and "a difference in the plan's treatment of the two classes that results in either (a) a materially lower percentage recovery for the dissenting class (measured in terms of the net present value of all payments), or (b) regardless of percentage recovery, an allocation under the plan of materially greater risk to the dissenting class in connection with its proposed distribution" than to the other class of equal priority.[359]

Various other tests that have been developed to gauge the fairness of a plan's proposed discrimination all employ, to one degree or another, an inquiry into whether there is a reasonable basis for the discrimination, whether the debtor can confirm and consummate a plan without the proposed discrimination, and whether the discriminatory treatment has been proposed in good faith.[360] Thus, it is not simply the extent of the disparity in treatment between one class of claims and a second co-equal class; it is also whether the discrimination, even if slight, is necessary and justifiable.[361] However, the extent of the disparity still matters a great deal and affects the level of scrutiny the court is likely to afford to the discrepant treatment between co-equal classes.[362] This is because section 1129(b)(1)'s unfair discrimination standard is ultimately intended to assure that the deviation from equality is not only necessary, but also narrowly tailored to accommodate the goal of achieving a successful reorganization.[363] Once more, then, equality operates not as a categorical imperative, but with considerable relevance in imposing some orderliness on an inherently fluid process.[364]

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[357] *See In re* City of Detroit, 524 B.R. 147, 256 (Bankr. E.D. Mich. 2014).

[358] Markell, *supra* note 50, at 249. Traditionally, courts applied a four-factor test. *See* Liberty Nat'l Enters. v. Ambanc La Mesa Ltd. P'ship (*In re* Ambanc), 115 F.3d 650, 656 (9th Cir. 1997); *In re* Dow Corning Corp., 244 B.R. 696, 700 n.3 (Bankr. E.D. Mich. 1999) (listing cases applying the four-factor test). *See generally* Denise R. Polivy, *Unfair Discrimination in Chapter 11: A Comprehensive Compilation of Current Case Law*, 72 AM. BANKR. L.J. 191, 196–208 (1998) (collecting and discussing cases applying the various tests).

[359] Markell, *supra* note 50, at 249.

[360] *See, e.g., In re* Lernout & Hauspie Speech Prods., N.V., 301 B.R. 651, 660 (Bankr. D. Del. 2003).

[361] 7 COLLIER ON BANKRUPTCY, ¶ 1129.03[3][a], at 1129-67–68 (Richard Levin & Henry J. Sommer eds., 16th ed. 2021); Markell, *supra* note 50, at 228.

[362] *See, e.g., In re* Unbreakable Nation Co., 437 B.R. 189, 203 (Bankr. E.D. Pa. 2010) (explaining why the difference between 1.5% and 1.25% in a proposed distribution to two classes was not unfair discrimination).

[363] *See infra* note 364. Expressing the point with somewhat greater pliancy is the recent decision in *In re* Tribune Co., 972 F.3d 228 (3d Cir. 2020), concluding that the unfair discrimination standard in chapter 11 is "rough justice" and "[i]t exemplifies the Code's tendency to replace stringent requirements with more flexible tests that increase the likelihood that a plan can be negotiated and confirmed. This flexibility is balanced by the Code's inherent concern with equality of treatment." *Id.* at 245.

[364] This is consistent with the role I assign equality more broadly under the Code. *See infra* text accompanying notes 430–38.

2. Chapter 9

The spate of municipal bankruptcies in recent years has created another challenge to the incipient function of equality in ascertaining unfair discrimination. In these cases, courts have often permitted significantly greater pro rata recoveries to municipal employees and retirees than to other classes of unsecured creditors of equal priority.[365] As such claims enjoy no statutory priority, this treatment can only be justified based on acquiescence by the disfavored creditors or a determination that the differing treatment among creditors with common priority claims did not constitute unfair discrimination.[366] The latter explanation is the route Judge Rhodes took in the City of Detroit chapter 9 case.[367] He reasoned that, "relying upon the judgment of conscience," courts have the discretion to apply a more lenient standard of unfair discrimination in chapter 9 than in other relief chapters because "the purpose of chapter 9 is to restructure the municipality's debt so that it can provide adequate municipal services."[368] Professor Skeel points to the Detroit case as a further example of the decline of equality.[369]

However, as Professors Hynes and Walt have ably explained, the proposition that unfair discrimination has a different meaning under different debtor relief chapters is a fallacy.[370] They continue that "[t]he choice of bankruptcy relief has nothing to do with the requirement that the reorganization plan not unfairly discriminate against a class of claims. Although the different bankruptcy chapters offer different types of relief for debtors, the standard of unfair discrimination applicable in those chapters remains the same."[371] Beginning from the central proposition that bankruptcy's standard of unfair distribution includes the principle of equal treatment as the norm, they demonstrate that none of the handful of circumstances that have been recognized in the case law as constituting a "fair" deviation from the principle of equality between co-equal classes justifies permitting more favorable treatment for municipal employees and retirees.[372]

To be certain, one can recognize the intense political pressure municipal reorganizations place on the court and the sympathetic appeal that attaches to often lowly-paid city workers and to retirees.[373] But bankruptcy equality is about the legal character of the claim, and neither its amount nor the identity of its holder.[374] When

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[365] *See* Hynes & Walt, *Fair and Unfair Discrimination*, *supra* note 156, at 26–27.
[366] *See id.* at 28.
[367] *See In re* City of Detroit, 524 B.R. 147 (Bankr. E.D. Mich. 2014).
[368] *Id.* at 256.
[369] *See* Skeel, *supra* note 5, at 719–20; *see also infra* text accompanying notes 384–96 (examining the practice of "gifting" as a mechanism for subverting absolute priority in chapter 11).
[370] Hynes & Walt, *Fair and Unfair Discrimination*, *supra* note 156, at 31.
[371] *Id.*
[372] *Id.* at 33, 69.
[373] *See id.* at 44.
[374] *Id.* at 43 ("Courts reason that the character of the creditor or nature of its claim is not a permissible basis for favorable treatment unless the Code gives the creditor's claim priority."). The authors further point out that one might say the same about tort victims, but their unsecured claims enjoy no special priority. *Id.* at 29.

the latter circumstances drive the unfair discrimination analysis, the court is effectively substituting its own priority scheme for the one adopted by Congress.[375] It may be a better scheme on the merits, but it is still ad hoc and ultra vires.[376] Those systemwide adulterations outweigh any salutary benefits that may accrue in the individual case. Similarly, one might be critical of some of the lines Congress has drawn between priority and non-priority claims, but its role in doing so is unquestioned and Supreme Court precedent in recent years has resisted most attempts by the bankruptcy courts to extend their equitable powers in contravention of Code language,[377] whether to create new remedies or reorder existing priorities.[378]

3. Gifting

Another means Skeel identifies by which some creditors might be favored in reorganization, and equality stymied in the process, is through the practice developed by ever-creative chapter 11 lawyers of what has come to be termed "gifting."[379] The gambit entails a transfer of value from a secured class to a class of unsecured creditors (or old equity), despite the existence of one or more intermediate or co-equal dissenting classes that have not been paid in full.[380] The argument goes that gifting from a secured class does not violate the fair and equitable standard of section 1129(b)(1) because absolute priority only applies to dissenting classes and those junior to them.[381]

However, the practice is a ruse that sabotages the waterfall effect that absolute priority is intended to promote.[382] Thus, by and large, it has been frowned on by the

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[375] *See id.* at 51.

[376] *See id.*

[377] *See generally* Law v. Siegel, 571 U.S. 415, 420–22 (2014) (stating the bankruptcy court cannot surcharge an exemption as a remedy for costs incurred in establishing the bad faith of the debtor in the face of a statutory proscription to the contrary). For further discussion, see *infra* Section VI.B.2.

[378] *See* United States v. Noland, 517 U.S. 535, 543 (1996) (rejecting subordination under section 510(c) on a categorical basis rather than based on case-specific proof of inequitable conduct).

[379] *See* Skeel, *supra* note 5, at 718–20, 733–34.

[380] *Id.*

[381] *See* Off. Unsecured Creditors' Comm. v. Stern (*In re* SPM Mfg. Corp.), 984 F.2d 1305, 1313 (1st Cir. 1993). The point being that nothing prevents a senior secured class from allocating its distribution in whatever manner it chooses to do so.

[382] *See* Anthony J. Casey, *The Creditors' Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759, 763–64 (2011) ("[T]he 'absolute priority rule' . . . provides that assets in bankruptcy must be distributed in strict adherence to the contractual priority that exists for liquidation outside bankruptcy. Thus, senior secured creditors must be paid in full before junior creditors recover a penny."). *But see* Jacoby & Janger, *Tracing Equity*, *supra* note 327, at 721–22 (challenging not just the prudency but the actual belief that chapter 11 in fact establishes a single waterfall).

courts[383] as well as by commentators,[384] and is not nearly the subversion of equality that Skeel insinuates.[385] The widespread condemnation for gifting derives, just as it did for the Supreme Court in *Jevic*,[386] from the effect that, functionally, it operates to award priority to a non-priority claim or interest in direct contravention of the absolute priority rule.[387]

That the courts have narrowly construed judicially developed exceptions to the Code's priority scheme, including, notably, equality of creditors, does not necessarily mean that it is normatively appropriate to do so.[388] In fact, that is Skeel's thesis in a nutshell.[389] He argues we should craft the preference law to regulate self-dealing, we should allow unequal payments among vendors when shown that it will maximize the value of the estate, and that we should bar discrimination under section 1129(b)(1) as unfair when its impact is to create an unforeseeable priority.[390] In other words, in Skeel's view, equality no longer has an oar to pull on, if and when it ever did, in addressing bankruptcy issues, and that continued adherence to the reverberations that

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[383] *See, e.g.*, Dish Network v. DBSD No. Am., Inc. (*In re* DBSD No. Am., Inc.), 634 F.3d 79, 99 (2d Cir. 2011) (opining the Supreme Court has repeatedly held that the absolute priority rule was intended to proscribe precisely this sort of transaction); *In re* Armstrong World Indus., 432 F.3d 507, 513 (3d Cir. 2005) (holding that a plan cannot give junior claimants distributions over the objections of a senior impaired class). *But see In re* Nuverra Envtl. Sols., 590 B.R. 75 (D. Del. 2018) (drawing a distinction between impermissible "vertical gifting," where a class of claims is deprived of a gift while a more junior class receives a gift, and "horizontal gifting," where two or more classes of claims that are pari passu in priority receive a gift but the gifting distribution may vary among the classes).

[384] *See, e.g.*, Bruce A. Markell, *The Clock Strikes Thirteen: The Blight of Horizontal Gifting*, 38 BANKR. L. LETTER 1, 11 (2018) (describing gifting as "court-sanctioned graft"); Reuben E. Dizengoff, Note, *Beyond Gifting: Harmonizing the Devolution of Reorganization Plan Gifts and The Evolution Of Sale Gifts*, 39 CARDOZO L. REV. 787, 804 (2017) (stating that "the courts have all but eliminated gifting in the Chapter 11 plan context as a means to give part of a creditor's distribution to a junior creditor"); Amy S. Timm, Note, *The Gift that Gives Too Much: Invalidating a Gifting Exception to the Absolute Priority Rule*, 2013 U. ILL. L. REV. 1649, 1678 (concluding based on pre-Code authority and applicable legislative history to the Code that Congress did not intend to allow for such an exception). The 2014 Final Report of the American Bankruptcy Commission to Study the Reform of chapter 11 also calls for abolition of gifting. *See generally* Am. Bankr. Inst., *ABI Commission to Study the Reform of Chapter 11*, 23 AM. BANKR. INST. L. REV. 1, 259 (2015) [hereinafter *The Commission Report*].

[385] *See* Skeel, *supra* note 5, at 718–19. More troubling are priority-evading techniques that can be employed in connection with the sale of substantially all of the debtor's assets under section 363. *Id.* at 718, 733–34. Sales in lieu of reorganization have come to be the norm and courts have held that once a secured creditor has bought the assets of the debtor, those assets were properly categorized as the creditor's—no longer the estate's—property. *See id.* at 718. Thus, the distribution of those assets did not have to comply with the absolute priority. *See, e.g., In re* ICL Holding Co., 802 F.3d 547, 556–58 (3d Cir. 2015). This suggests serious attention be given to the ABI Commission's recommendations that such sales, inter alia, (1) comply with all provisions of the Bankruptcy Code, and (2) be proposed in good faith. *See The Commission Report*, *supra* note 384, at 216–17. This would help to mitigate the exercise of undue influence by major secured creditors at the expense of equality of creditors. *See id.* at 201; *see also* Ralph Brubaker & Charles J. Tabb, *Bankruptcy Reorganizations and the Troubling Legacy of Chrysler and GM*, 2010 U. ILL. L. REV. 1375, 1390–91 (urging that courts should never approve sales that purport to make distributional allocations among the parties).

[386] Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 979–80 (2017).

[387] *See id.* at 986.

[388] *See* Skeel, *supra* note 5, at 719.

[389] *See id.* at 724.

[390] *See generally id.*

emanate from the rhetoric of equality serve no purpose other than to cause us to stray from the surest course.[391] It is to the soundness and defensibility of that assertion to which attention is turned in the final section of this treatment.

VI. IS EQUALITY WORTH IT?

A. The Mediating Role of Equality

In addition to the statutorily authorized departures from equality, such as the unsecured creditor priorities of section 507, there are certainly other situations where courts will deviate from equality, usually in reorganizations, in a fashion not explicitly contemplated by the statute.[392] Professor Skeel identified a number of common plan practices as examples.[393] Professors Hynes and Walt have added roll-ups[394] and substantive consolidation[395] to the list.[396] However, rather than conclude from this that equality no longer matters in bankruptcy, they undertake to explain when it is appropriate for the courts to sanction these divagations from equal treatment of like creditors.[397] While noting that a few courts flatly prohibit any deviation at all from the statutorily-prescribed priority rules,[398] Hynes and Walt observe that such departures occur when the courts perceive the deviation to be either Pareto or Kaldor-Hicks efficient.[399] As between these alternative standards for evaluating priority-skip rules, they conclude the Pareto standard is most common and preferable.[400] That is to say, they believe departures from the equality ethos can be defended, but they should not be undertaken when they will render any single interested party worse off.[401]

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[391] *See id.* at 744.

[392] *See, e.g., In re* World Health Alts. Inc., 344 B.R. 291 (Bankr. D. Del. 2006).

[393] *See* Skeel, *supra* note 5, at 718–20.

[394] *See* Hynes & Walt, *Inequality and Equity*, *supra* note 12, at 882.

[395] When a court exercises its discretion to substantively consolidate the cases of two or more affiliated debtor-entities, the assets and liabilities of the entities are combined. Because it is necessarily true that the dividend to unsecured creditors in each case would not have been identical, the effect is to prejudice the creditors of the entity that would have paid the largest dividend since the dividend from the pooled estate will necessarily be less. Nonetheless, the Supreme Court has sanctioned the use of substantive consolidation as a mechanism for accomplishing the central aims of the Code. *See* Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215, 219 (1941).

[396] Hynes & Walt, *Inequality and Equity*, *supra* note 12, at 882–87.

[397] *See id.* at 897.

[398] *Id.*

[399] *Id.* An outcome can be said to be Pareto optimal when the result of the deviation is that one party is better off, and no other party is worse off. *Id.* The authors cite the test for approving critical vendor orders in *In re* Kmart, 359 F.3d 866, 873–74 (7th Cir. 2004), as insisting upon a Pareto efficient result with its requirement that the deviation from equality "at least leave [the disfavored creditors] no worse off." Hynes & Walt, *Inequality and Equity*, *supra* note 12, at 897–98.

[400] A Kaldor-Hicks test will tolerate the worsening of one party's position if it can be demonstrated that the gains flowing departure of the standard priority rules substantially outweigh the harm to the disadvantaged creditor(s). *Id.* at 898–99. With strong utilitarian overtones, a Kaldor-Hicks analysis overlooks negative distributional considerations. *See id.* at 899.

[401] *See id.* at 918.

Hynes and Walt acknowledge that Skeel would surely disagree and suggest that a Kaldor-Hicks approach ought to regulate the exercise of the courts' discretion to break from equality.[402] "For example, David Skeel recently recommended that, where not prohibited by the Bankruptcy Code, courts should approve the trustee's decisions that maximize asset values of the estate and therefore maximize aggregate creditor recoveries."[403] The same might be said of his position to proscribe pre-bankruptcy transfers that prefer one creditor over its similarly positioned co-creditors only when there is evidence of self-dealing.[404] The distributional impact of leaving other eve-of-bankruptcy transfers undisturbed does not enter into the equation.[405]

The Hynes and Walt analysis demonstrates that there can be a principled manner in which to understand departures from Code priorities ex post that do not leave the canon of equality denuded of meaning.[406] However, I doubt seriously that judges think in these terms ex ante, i.e., while in actual the process deciding individual cases. It is not that they are unmindful of either distributional consequences or the relative equities entailed by a decision one way or the other. Rather, I think, they are engaged in more of a gestalt exercise, balancing what is to be gained, what is to be lost, and at what cost. Mindfully or not, they must consider both forms of efficiency, as well as their responsibility to minimize the disruptions to the congressionally established ordering of priorities. Nevertheless, the Hynes and Walt thesis shows that it is possible to understand the occurrence of departures from equality in a structured, coherent, and consistent fashion.[407] If that is so, then the equality of creditors norm retains meaningful content in spite of these divergences.[408]

In this section I propose a less elegant, but I believe more realistic, explanation for the occasional inconstancy in the application of the standard rules of priority. Bankruptcy law is fraught with friction and policy strains, including the most basic tension between creditors' rights (value) and debtor protection (fresh start). However, the bankruptcy law must also accommodate conflicting interests external to the debtor/creditor paradigm. The already inconsistent internal bankruptcy policies of fresh start, value maximization, and protection of creditor entitlements must compete with non-bankruptcy social policies, whether it be environmental protection, promoting competition, spurring innovation, domestic relations considerations, and the list goes on.[409] In business reorganization, there are added policy considerations to be entertained, including the network of disparate non-creditor constituents with

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[402] *Id.* at 909.
[403] *Id.*
[404] *See supra* text accompanying note 53.
[405] *See* Hynes & Walt, *Inequality and Equity*, *supra* note 12, at 909.
[406] *See id*. at 917–18.
[407] *See id.* at 876.
[408] Of course, some of priority deviations, like 11 U.S.C. § 503(b)(9), thwart equality without any apparent justification, but that is the prerogative of the legislative body and part of the ongoing discourse in connection with bankruptcy reform efforts.
[409] *See supra* note 10 and accompanying text.

an arguable stake in business survival, such as employees, suppliers, ancillary service businesses, and community interests.[410]

Bankruptcy is a system, but it is not a closed one. It must regularly interact with the external environment in which it operates and that it serves. This means the system is subject, at any given time, to a variety of influences, including of the political, economic, social, and even technological kind. This is healthy. Bankruptcy cannot be an effective medium for dealing with financial failure and distress unless these influences are regularly calibrated into the system's response. And yet, bankruptcy must also retain an allegiance to its core internal values. It must have its own center. The question then becomes how to strike not just an appropriate but also a predictable balance in resolving all of the clashes in agenda and aspiration that inevitably occur in bankruptcy cases generally, and in chapter 11 in particular.

The leitmotif, I would suggest, is equality of creditors as the benchmark; but equality understood not in the conventional sense of either rigid, absolute equivalence or moral imperative. Rather, I propose understanding and imagining equality in a "bankruptcy-sense," that is, one that employs the principle as an operational default rule, as establishing a prima facie case for a particular outcome with the burden then on any other proposed outcome to challenge and refute.

Bankruptcy-sense equality is not about being identical in status, rights, or entitlements. It has no cultural resonance, and it is not inescapably triumphal in every instance. In a sense, then, that aphorism that "equity is equality" is, if not a fallacy, then at least an exaggeration.[411] Equity connotes fairness and justice, and surely no one seriously supposes that fairness to creditors requires that they must always and without exception be treated with perfect parity. Necessarily, the Code contains a rough and ready system of priority that determines the order in which the bankruptcy court will distribute assets of the estate.[412] The starting point is equality of creditors. However, in a complex commercial world, these rules cannot be applied in a wholly static, inflexible, and formalistic manner reminiscent of the positivist tradition in law.[413] There simply needs to be some play in the joints of the system.

At the same time, however, that discretion cannot be wholly free-wheeling and open-ended. It needs to be disciplined by reference to a recurrent theme that is always operating in the background and that provides a measure of stability and certainty to the process. Put another way, there needs consistently to be a weight on one side of the scale, lest every distributional decision in bankruptcy become a return-to-square-one exercise thoroughly lacking in guidance and bereft of any stability. Equality, I submit, is that force. It gives ballast to the system so that it is not bouncing hither and yon in an ad hoc series of rules and decisions that are shorn of any interconnectedness or congruence. It is also the "weight" that makes the most sense

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[410] Warren, *Bankruptcy Policy*, *supra* note 184, at 786. *See also supra* note 142.

[411] *See supra* note 4.

[412] *See* 11 U.S.C. § 507 (2018).

[413] *See* ANTHONY J. SEBOK, LEGAL POSITIVISM IN AMERICAN JURISPRUDENCE 75–76, 80 (1998) (describing the "Langdellian" view of treating law as a science, a view as to which the legal realism movement could be seen reacting).

because equality of creditors implements the bankruptcy goal of value maximization in the aggregate as well as equitable treatment.[414] Simultaneously, it minimizes the prospect for costly and disruptive pre-filing creditor maneuvers that would otherwise inevitably ensue as insolvency approaches.[415] Lastly, by supplanting the state law of creditor remedies when there are insufficient fish and loaves to go around, it also makes the debtor an honest broker since the debtor can neither influence nor gain advantage by undertaking to favor one creditor over other like creditors.[416]

Skeel rejects the utility of this presumption-oriented approach, noting that the creditors that extol equality, both historically and in the contemporary bankruptcy regime, are not in need of the special protection that the principle offers, unlike the beneficiaries of equality in other non-bankruptcy contexts.[417] Moreover, he submits that the preoccupation with equality is not simply innocuous, as it ends up "protecting creditors who do not seem to need extra help [and] . . . can have pernicious consequences."[418] For example, Skeel spurns the language of equality as explaining the persistence of the Code's preference rules, which he regards as costly, ineffective, and indefensible.[419] Again, if this were a priori true, Skeel would have a point.[420] However, not everyone shares that view of the preference law. Congress did not when it enacted the Bankruptcy Code.[421] I have openly criticized subsequent amendments of that law that have made it easier for truly preferred creditors, innocent or not, to escape liability.[422] Furthermore, concerns about trustees using the preference law as a bludgeon have now, at least to some extent, been addressed by the Small Business Reorganization Act of 2019,[423] which quietly added new language to section 547(b) requiring the trustee, as a prerequisite to bringing a preference claim, to exercise "reasonable due diligence in the circumstances of the case and taking into account a party's known or reasonably knowable affirmative defenses under subsection (c). . . ."[424]

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[414] *See* Jackson, *Non-Bankruptcy Entitlements*, *supra* note 3, at 864–65.
[415] *See id.* at 863–64.
[416] *See id.* at 861–64.
[417] Skeel, *supra* note 5, at 743.
[418] *Id.* (pointing to preference law and executory contracts as the "starkest" examples).
[419] *See supra* Section II.A.
[420] *See* Bebchuk & Fried, *supra* note 26, at 880.
[421] The legislative history accompanying the Bankruptcy Reform Act of 1978 identified the dual purposes of the preference section as deterring creditor collection activity on the eve of bankruptcy, and, more importantly, "to facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor." HOUSE REPORT, *supra* note 9, at 177–79.
[422] *See* Ponoroff, *Flight from Equality*, *supra* note 57, at 394 (urging an application of the preference law that applies "equally to transactions wholly devoid of improper motivation as well as to transfers precipitated by deliberate effort to circumvent the distribution rules in bankruptcy").
[423] *See* Small Business Reorganization Act of 2019, Pub. L. No. 116-54, 133 Stat. 1079 (codified as amended at 11 U.S.C. §§ 1181–1195).
[424] *Id.* at 1085. It is unclear what meets the requirements of due diligence and what the consequences are for failing to meet them. That will have to be developed in the case law. However, clearly this language was added in response to the belief that trustees frequently bring preference actions simply for their nuisance and settlement value. *See* Ponoroff, *Flight from Equality*, *supra* note 57, at 348 n.92.

Skeel also suggests that, so long as disclosed in advance, the excision of equality language from the bankruptcy conversation would cause no "pernicious consequences."[425] Rather, informed creditors would simply adapt to the new normal by adjusting their terms of credit.[426] In theory, that makes sense. In reality, the adjustments would be far from even or perfect. Asymmetrical informational advantages and vastly different bargaining power among creditors belie the argument.[427] Large, powerful creditors would adjust, small trade creditors would be much less likely or able to do so.[428] And, of course, non-consensual creditors have no opportunity to adjust for either favored or disfavored status.[429] So, I doubt whether equality language advantages the large, powerful creditor; in fact, I believe just the opposite is true.[430]

Furthermore, far from serving no consequential role in bankruptcy, I would argue that bankruptcy-sense equality, understood as the consistent baseline or point of departure for further discussion of what inequalities will be tolerated, is what makes the bankruptcy system just that, a *system*, as opposed to random and arbitrary set of rules. As Professor Skeel observes,[431] a similar justification for equality was put forth over 35 years ago by Dean Chemerinsky[432] in response to Peter Westen's provocative article,[433] the title of which inspired the title for Skeel's own article.[434] But, of course, Westen, and those who jousted with him, were discussing equality in a very different context.[435] Skeel rejects the rebuttable presumption thesis in the bankruptcy context.[436] Equality, however, as the presumptive choice, has not been examined either as a way of thinking about bankruptcy doctrine and practice, or in response to recent efforts to explain when departures from the equality norm in bankruptcy are principled.[437]

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425 Skeel, *supra* note 5, at 743.
426 *See id.* at 723.
427 *See* Bebchuk & Fried, *supra* note 26, at 914.
428 *See id.* at 887.
429 *See id.* at 885.
430 *See id.* at 882–91 (describing a variety of creditor categories that cannot adjust their claims to account for the risk inherent to them in the rule of full priority of secured claims).
431 Skeel, *supra* note 5, at 741.
432 *See* Erwin Chemerinsky, *In Defense of Equality: A Reply to Professor Westen*, 81 MICH. L. REV. 575, 582 (1983).
433 *See* Westen, *supra* note 5, at 542.
434 *See* Skeel, *supra* note 5, at 704 n.19.
435 The debate spurred by Professor Westen's article was largely focused on the value of the equality concept in the social and individual context, and not in a purely commercial context. *See* Chemerinsky, *supra* note 432, at 586 (positing that "to the extent that as a society we rightly believe that we should care about certain differences among people and want to eliminate some of those disparities, equality is a morally necessary concept").
436 Skeel, *supra* note 5, at 741–42 (suggesting, without much by way of explanation, that whatever value the approach offers in other settings, its "benefits completely disappear in the bankruptcy context").
437 Although other efforts to develop a working theory to explain these deviations have been undertaken, none have been grounded in the ethos of equality. *See, e.g.*, Hynes & Walt, *Inequality and Equity*, *supra* note 12.

B. Bankruptcy Exceptionalism

In 2008, Professor Jonathan Lipson published an article intended to identify the considerations relevant to the development of a constitutional theory of bankruptcy.[438] A recurring theme Lipson exposed, and suggested ultimately should illuminate any constitutional theory of bankruptcy, is bankruptcy exceptionalism.[439] While having different meaning in different milieux, for Lipson the nexus of bankruptcy exceptionalism is the tendency of the bankruptcy law to produce constitutional anomalies that, when challenged, have largely been tolerated.[440] I believe that, outside the constitutional arena, there are two additional examples of the exceptionalism of the federal bankruptcy system, each of which calls for retention of equality of creditors as the focal point in the discussion of bankruptcy practice and policy.

1. Collectivism

Bankruptcy exceptionalism first finds instantiation in the manner in which the system serves as a superior alternative to state debt collection law and practices once the debtor is no longer able to pay all of its bills.[441] Save for the infrequent use of state law receiverships or assignments for the benefit of creditors,[442] state collection remedies focus narrowly on the relationship between the debtor and each of the debtor's individual creditors.[443] There is no attention to intercreditor issues or rights, and no concern for equity inter se among creditors, never mind non-creditor constituents.[444] Instead, for unsecured creditors, these remedies operate piecemeal, independent of one another, and without concern for the welfare of creditors as a group.[445] Unsecured creditors enjoy no claim to a ratable share of the debtor's unencumbered assets; those that get to the trough first feed until sated, while all others go hungry.[446]

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[438] *See* Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605 (2008).

[439] *See id.* at 611–12.

[440] *See id.* at 670.

[441] *See* Block-Lieb, *supra* note 14, at 407.

[442] *See generally* Geoffrey L. Berman & Catherine E. Vance, *Model Statute for General Assignments for the Benefit of Creditors: The Genesis of Change*, 17 AM. BANKR. INST. L. REV. 33, 33 (2009) (describing the process as "a useful tool in managing debtor-creditor relationships and as a vehicle for the orderly liquidation of a business outside of bankruptcy").

[443] *See supra* note 14 and accompanying text.

[444] *See* Jackson, *Non-Bankruptcy Entitlements*, *supra* note 3, at 864.

[445] *See* Craig H. Averch & Michael J. Collins, *Avoidance of Foreclosure Sales as Preferential Transfers: Another Serious Threat to Secured Creditors?*, 24 TEX. TECH L. REV. 985, 994 (1993) (stating "non-bankruptcy [state] 'grab' law generally rewards the first creditors to win the race of diligence"); *see also* JACKSON, LOGIC AND LIMITS, *supra* note 188, at 10 (noting that exercise "of individual creditors remedies may be bad for creditors *as a group*" once the debtor becomes insolvent).

[446] *See* Averch & Collins, *supra* note 445, at 994.

In sharp contrast, bankruptcy readjusts this temporally sequential ordering of private rights under state law.[447] That is, bankruptcy is designed to improve on winner-take-all state collection remedies by facilitating the orderly, value-maximizing sale of the debtor's assets in chapter 7, and by preserving the ongoing business value of a chapter 11 debtor while its capital structure is overhauled.[448] In other words, bankruptcy is exceptional in that it creates value and, in the process, doffs a hat to fairness.[449] Moreover, particularly in chapter 11, bankruptcy can also factor into the equation those interests that are affected by the case but that have no cognizable claim in a strict legal sense.[450] Thus, bankruptcy is simply a "more better" remedy in the event of financial insolvency, more equitably and effectively (not to mention uniformly) addressing issues in these circumstances than is possible under non-bankruptcy alternatives.[451]

However, for bankruptcy's collective process to work successfully as a superior alternative to compulsory state process upon insolvency, the organon for discussion must begin with the proposition that pre-petition unsecured creditors are treated with substantial equality in terms of both "what they can [and cannot] do during the bankruptcy case," and, even more critically, "in terms of what they receive from the bankruptcy case."[452] That premise can be rebutted, as it has been on occasion in the legislative arena, and so, too, can it be in the judicial arena, but its existence provides discipline to a process that would otherwise run the risk of offering no particular advantage to creditors, either individually or as a group, over state collection law.[453] Without that discipline, creditors would inevitably jockey for position in advance of insolvency with the hope of securing a preferred position relative to competing creditors and interests.[454] The erosive impact on the advantages of an orderly bankruptcy option would be considerable.[455]

Once equality of creditors is eliminated as a governing principle in bankruptcy discourse—leaving the only predictable form of priority as contracted for in the way of security or subordination—the distinction between state collection remedies and bankruptcy becomes blurred. When that occurs, value is lost, in much the same way that value is lost under non-bankruptcy grab law as "creditors may expend time, money, and effort to be the first to secure a claim to a particular asset, resulting in

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[447] This is the collective aspect of bankruptcy, but, of course, the system does much more than that. *See* Lipson, *supra* note 438, at 612 ("Bankruptcy constitutes a significantly public mechanism for the creation and destruction of a whole host of private rights, including those that are creatures of state private law. Indeed, its greatest power—the discharge of debt—can be seen as the conversion of a private right (a debt claim) into a public one (a permanent injunction against its collection).").

[448] *See* Jacoby & Janger, *Tracing Equity*, *supra* note 327, at 687.

[449] For a detailed contemporary discussion of entitlements to this bankruptcy-created value (and how it should be allocated in chapter 11), see Jacoby & Janger, *Tracing Equity*, *supra* note 327, at 682–87.

[450] *See supra* notes 142–43 and accompanying text.

[451] *See generally* Jackson, *Non-Bankruptcy Entitlements*, *supra* note 3.

[452] *See* Epstein, et al., *supra* note 2, at 22.

[453] *See id.* at 20–21.

[454] *See id.* at 21.

[455] *See* Jackson, *Non-Bankruptcy Entitlements*, *supra* note 3, at 861–63.

overinvestment in monitoring the firm's financial condition, wasteful litigation, and high collection costs."[456] Going back to Professor Jackson's parable of the fishers and the lake,[457] a collectivized regime demands that the price for 100 fishers acting like one is substantial equality in distribution of the fish taken from the lake. The reward is sustainability. This illustrates why a bankruptcy regime guided by the ethos of equality is needed to constrain the inevitable exercise of self-interested behavior by individual creditors—behavior that undermines both fresh start and rehabilitation policy.[458]

This does not mean one must also subscribe to the rigidity of the Jacksonian and related contractarian accounts of bankruptcy.[459] Even those that embrace a more expansive role for the bankruptcy order, with its own substantive policy aims and distributional priorities,[460] recognize the prudency of conducting the discourse with reference to the ethos of equality. The point to be underscored is the quintessence of the equality theme in differentiating bankruptcy and non-bankruptcy remedies, regardless of where one locates the normative fulcrum in terms establishing the contours and parameters of bankruptcy policy.

2. Equitable Authority

Equality may also productively inform another aspect of bankruptcy exceptionalism, namely, the issue of the bankruptcy courts' equitable powers.[461] As noted earlier,[462] in spite of the hackneyed bromide that "the bankruptcy court is a court of equity,"[463] in recent years the Supreme Court has rather dramatically cut back on the scope of the bankruptcy courts' equitable authority under section 105(a) and elsewhere.[464] Nevertheless, while the equitable authority of the bankruptcy courts may be an unsettled conundrum,[465] surely the courts must possess *some* discretion to

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[456] Marshall Tracht, *Contractual Bankruptcy Waivers: Reconciling Theory Practice and Law*, 82 CORNELL L. REV. 301, 316 (1997).

[457] *See supra* text accompanying notes 188–90.

[458] *See id.*

[459] *See, e.g.*, Baird, et al., *supra* note 185, at 1676 (beginning from the proposition that the central aim in "Chapter 11 is to vindicate [Jackson's] creditors' bargain").

[460] *See, e.g.*, Westbrook, *supra* note 212, at 211–12 (focusing on the importance of non-commercial and non-private public interests in chapter 11 that should have a seat at the bargaining table); *see also supra* note 142.

[461] *See generally* Michelle M. Harner & Emily A. Bryant-Álvarez, *The Equitable Powers of the Bankruptcy Court*, 94 AM. BANKR. L.J. 189, 194–97 (2020).

[462] *See supra* note 13 and accompanying text.

[463] *See generally* Adam J. Levitin, *Toward a Federal Common Law of Bankruptcy: Judicial Lawmaking in a Statutory Regime*, 80 AM. BANKR. L.J. 1, 1 (2006) ("Judges and litigants regularly cite the 'court of equity' maxim to justify a particular conclusion or result that lacks specific statutory authorization.").

[464] The most notable instance being the Court's opinion in *Law v. Siegel*, 571 U.S. 415 (2014).

[465] *See* Harner & Bryant-Álvarez, *supra* note 465, at 190. This article serves as an introduction to an entire journal issue devoted to the scope of the bankruptcy courts' equitable powers and whether a bankruptcy court is a court of equity at all. *Compare* Alan M. Ahart, *A Stern Reminder that the Bankruptcy Court Is Not a Court of Equity*, 86 AM. BANKR. L.J. 191, 191 (2012) (asserting that the Supreme Court's decision in *Stern v. Marshall*, 164 U.S. 462 (2011) corroborated that the bankruptcy courts are not courts of equity), *with* Randolph

add gloss to the sterile language of the statutory text when necessary to preserve the integrity of the process or prevent its degradation.[466] Stated another way, if bankruptcy is exceptional in offering a constitutionally-mandated federal alternative to state collection rules, then the courts in bankruptcy must, in the words of section 105(a), have the discretion to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title," which extends beyond simply the ability of courts to correct their own mistakes.[467] Almost by definition, the act of balancing discordant interests and making choices among discrepant policy considerations ordains that bankruptcy courts have some latitude in fashioning outcomes in individual cases based on the underlying equities.[468]

It is in this connection that I would propose equality can serve a strategic role in reaching a *modus vivendi* as to when the bankruptcy courts' exercise of their equitable powers crosses the ephemeral line separating the proper use of section 105(a) to avoid an inequitable result at variance with core bankruptcy values from judicial action that represents an intolerable modification, expansion, or contraction of a clear statutory prescription.[469] It is, to be sure, not the only principle operating in pursuit of the boundaries circumscribing the courts' section 105(a) powers.[470] However, as in bankruptcy law more generally,[471] equality offers a predictable and yet still constraining yardstick.

As an example, the bankruptcy courts' use of their equitable authority to recharacterize a putative debt to a subordinate equity position when that is, as a matter of economic reality, consistent with the underlying substance of the interest would

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J. Haines, *The Conservative Assault on Federal Equity*, 88 AM. BANKR. L.J. 451, 455 n.23 (2014) (referring to the arguments favoring a limitation on the equitable powers of the bankruptcy courts as "formalistic" and observing that the "jurisdictional amendments in 1978 and 1984 were indisputably intended to broaden, not narrow, the bankruptcy courts' jurisdiction").

466 *See* Marrama v. Citizens Bank of Mass., 549 U.S. 365, 375 (2007) (holding the bankruptcy court possessed authority under section 105(a) to preclude bad faith conversion of the case). Yet, there remains considerable confusion between the meaning of equity in bankruptcy and its relationship to the inherent powers of the court and judicial discretion. *See* Laura N. Coordes, *Narrowing Equity in Bankruptcy*, 94 AM. BANKR. L.J. 303, 305 (2020) (distinguishing equity and discretion in bankruptcy); Diane Lourdes Dick, *Equitable Powers and Judicial Discretion: A Survey of U.S. Bankruptcy Judges*, 94 AM. BANKR. L.J. 265, 286 (2020) (finding that seventy-one percent of judges responding to a survey perceived a difference between equitable powers and discretion to act).

467 *Cf.* Bruce A. Markell, *Courting Equity in Bankruptcy*, 94 AM. BANKR. L.J. 227, 240, 256–62 (2020) (setting forth "obvious," "tolerable," and "debatable" uses of equity).

468 *See generally* Epstein, et al., *supra* note 2, at 51–52 (urging that matters that undermine equality among creditors should be left to the discretion of bankruptcy judges based on the unique facts of the case rather than by blanket legislative fiat in all cases).

469 *See* Coordes, *supra* note 466, at 315–18 (proposing the interpretative role equity plays in a statutory setting).

470 For example, the bankruptcy courts' power to exercise their equitable authority to extend the automatic stay to non-debtors when necessary, in service of preserving the prospects of a successful reorganization in chapter 11, is well recognized. *See, e.g.*, Caesars Ent. Operating Co., v. BOKF, N.A. (*In re* Caesars Entm't Operating Co.), 808 F.3d 1186, 1187 (7th Cir. 2015) ("Though section 105(a) does not give the bankruptcy court carte blanche . . . it grants the extensive equitable powers that bankruptcy courts need in order to be able to perform their statutory duties.").

471 *See supra* text accompanying notes 420–21 (discussing the mediating role of equality in bankruptcy).

fall on the permissive side of that line.[472] To allow an equity contribution to be elevated to the level of an unsecured claim that takes pari passu with other true unsecured claims offends the equality norm. This not only provides a justification for the doctrine in the first instance, but is also a principled basis for resolving the current split in the circuits over the source of the bankruptcy courts' authority to invoke doctrine in the first instance.[473]

Clearly, section 105(a) cannot be used to justify the creation of new rights or to empower the bankruptcy courts to act as "roving commission[s]" of righteousness.[474] It might, however, be used to sanction the judicial creation of a remedy when there has been a glaring breach of the critical policy underlying a statutory bankruptcy rule.[475] By contrast, use of section 105(a) to allow a practice that promotes inequality, such as approval of critical-vendor order,[476] would be far more suspect, at least on this metric.

Professor Bruce Markell has observed: "[a]lthough the Code stands as a hard boundary on equitable discretion in bankruptcy, there remains space for a court legitimately to find exceptions to general rules. . . . Courts and counsel . . . have used equity's exceptions to fashion procedures and practices designed to implement the Code's implicit policies."[477] It is difficult to conceive of a policy that is historically more prominent and vital to a healthy bankruptcy order than the construct of equality among creditors.

The margins of the bankruptcy courts' equitable powers are a work in progress.[478] We lack consensus over even what we mean by equity in bankruptcy,[479] let alone the proper scope of that authority. For now, I am simply suggesting that one way to structure, and perhaps even constructively move, that dialogue along is to focus on equality as an important discriminating norm regulating and regularizing the equitable powers of the bankruptcy court. Consistent with the position taken

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[472] *See, e.g.*, Redmond v. Jenkins (*In re* Alternate Fuels, Inc.), 789 F.3d 1139, 1147 (10th Cir. 2015). Another example is the judicially created "earmarking" defense to the trustee's preference recovery power, which applies when the transfer at issue does not interfere with the equality of creditors norm. *See* Ponoroff, *supra* note 100, at 354–60.

[473] *See supra* text accompanying notes 292–94. Even the Supreme Court in *Law v. Siegel*, recognized that "in some circumstances a bankruptcy court may be authorized to dispense with futile procedural niceties in order to reach more expeditiously an end result required by the Code." 571 U.S. 415, 426 (2014).

[474] Wells Fargo Bank of Tex., N.A. v. Sommers (*In re* AMCO Ins.), 444 F.3d 690, 695 (5th Cir. 2006) (quoting Mirant Corp. v. Potomac Elec. Power Co. (*In re* Mirant Corp.), 378 F.3d 511, 523 (5th Cir. 2004)).

[475] *See, e.g.*, Marrama v. Citizens Bank of Mass. (*In re* Marrama), 430 F.3d 474, 477 (1st Cir. 2005), *aff'd* 549 U.S. 365 (2007) (observing that the bankruptcy court is "duty bound to take all reasonable steps to prevent a debtor from abusing or manipulating the bankruptcy process"); *In re* Arthur B. Adler & Assocs., 588 B.R. 864, 874 (Bankr. N.D. Ill. 2018) (opining that the Supreme Court's decision in *Siegel* "did not strip bankruptcy courts of their authority pursuant to" section 105(a), but only "requires the court to be mindful . . . to avoid contravening the Bankruptcy Code").

[476] *See supra* text accompanying notes 154–55.

[477] *See* Markell, *supra* note 467, at 255–56.

[478] *See supra* note 474.

[479] *See* Coordes, *supra* note 466, at 304–05 (discussing "[d]isagreement over equity's meaning in bankruptcy").

earlier,[480] this is not to suggest that equality must always carry the day, an approach that itself belies the fluid nature of "equity" in the first place.[481] Rather, it is to propose that equality provides a baseline or, even more colloquially, a thumb on the scale that bankruptcy judges can routinely rely upon in resolving inevitable conflicts between competing policies and interests that are neither expressly permitted nor prescribed by the black letter of the Code.[482]

The bankruptcy arena is where the most difficult social and economic problems of our day, those that find no solution elsewhere, often end up for resolution.[483] That, too, is an exceptional aspect of our bankruptcy system. To imagine that role can be accomplished successfully if bankruptcy judges are rigidly restrained from occasionally coloring outside the lines of the statutory text is fanciful. The statute surely puts a fence around the corral, but it does not, and cannot, anticipate every situation that will arise or every spin that creative lawyers will put on ambiguous statutory text.[484] Within the confines of that corral, bankruptcy judges must have the ability to construe and apply that statute in a fashion that is consistent with the fundamental values underlying its enactment, none of which have deeper roots or more thrumming expressiveness than the ethos of equality of creditors. It is not always where the discussion ends, but it should be where it starts, both for reasons of its intrinsic resonance as a core value, and because of the cogency it imposes on the process from one case to the next.

CONCLUSION

Of course, those whose interests are not served by the extant priority scheme, including the equality of creditors principle, will seek to subvert it both in Congress and the courtroom.[485] The fact that they sometimes succeed is not reason to abandon the principle. To the contrary, it is reason to strengthen it, as I have urged, for example, in connection with the preference law.[486]

Still and all, equality does not represent the kind of apodictic foundation in the bankruptcy law that it enjoys in other arenas, such as in the realm of constitutional review of governmental laws or policies that impinge on protected rights. Rather, it is the mechanism by which bankruptcy responds most effectively to the problem of

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[480] *See supra* text accompanying notes 430–38.

[481] Despite the frequently invoked aphorism, sometimes equality is not equity. *See* Westbrook, *supra* note 212, at 218–22 (using the *City of Detroit* bankruptcy case as an example).

[482] *See* Markell, *supra* note 467, at 255–56.

[483] *See* Lawrence Ponoroff & F. Stephen Knippenberg, *The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 NW. U. L. REV. 919, 961–66 (1991).

[484] *See* Lawrence Ponoroff, *The Dubious Role of Precedent in the Quest for First Principles in the Reform of The Bankruptcy Code: Some Lessons from the Civil Law and Realist Traditions*, 74 AM. BANKR. L.J. 173, 201–02 (2000) (illustrating the point by analogy to the practice of judges in civil law systems to resolve the unanticipated case by reference to the statute); *see also* Coordes, *supra* note 469, at 315–19 (proposing a role for equity in an arena, like bankruptcy, governed by a comprehensive statutory scheme).

[485] Roe & Tung, *supra* note 32, at 1241–42.

[486] *See supra* note 429 and accompanying text.

insolvency and financial adversity. Equality serves as a touchstone, an initial point of reference for examining the merit (or demerits) of particular bankruptcy rules and practices as they arise in a dynamic setting.

Contrary to the assertion that the preoccupation with equality of creditors interferes with other important bankruptcy aims, the equality theme assures coherence and harmony in a system that is abounding with competing aims and populated by system participants with vastly different and often conflicting interests. The equality norm provides a dependable lifeline that prevents us from drifting too far from safe waters. It is neither inviolate nor is it unreservedly hegemonic. It is, however, ultimately the conscience of the system that keeps us as close to honest as could be hoped for.

Bankruptcy-sense equality places the burden on the competing principle, whatever it might be, and that is where it belongs. The fact that sometimes Congress or the courts get it wrong, either because of successful rent-seeking or simply because of poor decision-making, does not draw attention away from the fact that equal treatment among similar claimants was the default position. This is what makes the bankruptcy regime distinct, and a necessary component of a sophisticated free-market economy. Without this underlying hum, a system that is already a messy amalgam of mismatched and clashing interests would be no more than a cobbled collection of disjointed rules subject to being randomly pushed and pulled from one case to the next. That kind of ad hocery might prove felicitous on any given day to a particular debtor or creditor, but, in the aggregate, it would do a disservice to creditors and debtors alike.

It has been my contention that equality of creditors remains a vital and powerful part of the justification for our bankruptcy system for a variety of reasons, ranging from a commitment to fairness, to maximizing economic utility, to enhancing the prospects for debtor survival through reorganization, etc. Particularly in chapter 11, equality must share the stage with other considerations, concerns, and values. Yet, it remains the featured player and the dominating characteristic of American bankruptcy law, nowhere near being ready for consignment to the litter basket.

At bottom, the Bankruptcy Code is "designed to enforce a distribution of the debtor's assets in an orderly manner . . . in accordance with established principles rather than on the basis of the inside influence or economic leverage of a particular creditor."[487] Equality, understood not in a social or cultural rights context, but in the *bankruptcy sense* of where, in the first instance, we look for the solution to any particular problem that arises, remains the most advantageous weapon for gainfully and effectually vindicating those considerations that matter most in a bankruptcy case.

[487] *See* H.R. REP. NO. 103-835, at 33 (1994), *as reprinted in* 1994 U.S.C.C.A.N 3340, 3341.