BEAUTY IS IN THE EYE OF THE BONDHOLDER: A BUNDLE OF RIGHTS THEORY OF ENFORCEABILITY OF CHAPTER 11 VOTING ASSIGNMENTS

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INTRODUCTION

> "[A] 'fundamental basis' or a 'fruit of an agreement' is often in the eye of the beholder, whose vision may change along with the market, and who may with hindsight, imagine a different bargain than the one he actually and initially accepted with open eyes."[1]

In many failed companies, there are two or more priorities of unsecured debt. Often, the rights of unsecured debtholders are governed by indenture agreements. The "normal" indenture agreements are a hundred or so pages in length, containing numerous defined terms and are written in a fashion confusing to all but the most specialized readers. It is no wonder indenture agreements are only given a careful perusal after the issuing company has experienced financial difficulties. Unlike fingerprints, modern indenture agreements are remarkably similar. Modern indenture agreements provide "senior" debtholders with a panoply of rights and remedies vis-a-vis "junior" debtholders.

Outside of bankruptcy, contractual priority theoretically reflects certain assumptions of risk. The higher the risk assumed by a creditor, presumably the higher the interest rate the risk-enhanced creditor should receive. As a result, contractually agreed priorities should provide each creditor compensation for the insolvency risk each creditor bears.[2] Generally, the bankruptcy process allows junior creditors to extract concessions from senior creditors.[3] This article provides an analysis of the enforcement of many of the rights and remedies given to senior debtholders in an indenture agreement. The risks associated with the exercise of the rights granted in indenture agreements are examined from both the viewpoint of senior and junior bondholders. Section I discusses the statutory framework upon which indenture agreements are analyzed in a chapter 11 case. Section I also describes some of the provisions contained in indenture agreements and why such provisions assume importance in a chapter 11 case. The ability of a senior debtholder to vote on behalf of a junior debtholder is addressed in Section II. Also, in Section II we propose a new "bundle of rights" theory of enforcement of voting assignment terms in indenture and subordination agreements. In our view, this bundle of rights theory is consistent with the statutory framework of the Bankruptcy Code, as well as with established bankruptcy jurisprudence on the recognition and treatment of the rights of parties that precede bankruptcy.

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[1] Metro. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1520 (S.D.N.Y. 1989).

[2] *See* STANLEY F. REED, THE ART OF M&A: A MERGER ACQUISITION BUYOUT GUIDE 185–95 (1st ed. 1989).

[3] *See* Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439, 452–53 (1992) (discussing the opportunities for junior creditors to cause reallocation of contractual priorities in a chapter 11 case).

I. THE BANKRUPTCY CODE

A. Overview

Bankruptcy law has undergone a metamorphosis since the early 1970's.[4] In 1973, when the Commission on the Bankruptcy Laws of the United States filed its report with Congress evaluating the bankruptcy laws,[5] the statutory bankruptcy system was 75 years-old, outdated, and had not been revised since the Great Depression.[6] After extensive hearings, Congress enacted the Bankruptcy Reform Act of 1978 (the "Bankruptcy Code"),[7] which contained important new substantive, procedural, and jurisdictional provisions that fundamentally restructured bankruptcy law.[8]

Unless contrary to public policy, parties—creditors for the purposes of our analysis—are free to characterize their relationship and embody such relationships in contracts. Absent a specific bankruptcy or public policy to the contrary, bankruptcy courts normally enforce the relationship entered into by the parties according to the terms of the contract creating the relationship.[9] Beginning in the early 2000's, business financing began to evolve from the traditional lending structure that primarily relied upon secured lending structured with multiple lenders; tranches of debt emerged, and capital structures concurrently evolved into

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4 *See generally* Charles J. Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5 (1995).

5 The Commission on the Bankruptcy Laws of the United States was formed in 1970 to "study, analyze, evaluate, and recommend changes [to current bankruptcy law] in order for such [bankruptcy laws] to reflect and adequately meet the demands of present technical, financial and commercial activities." Act of July 24, 1970, Pub. L. No. 91-354, § 1(b), 84 Stat. 468, 468 (1970).

6 *See* Tabb, *supra* note 4, at 5–30 (discussing the history of bankruptcy law and in particular the enactment of the Bankruptcy Act of 1898 which "remained in effect for eighty years, until being replaced by the Bankruptcy Reform Act of 1978").

7 11 U.S.C. §§ 101–1330 (2012).

8 For an insightful discussion of the Bankruptcy Reform Act of 1978 and the broader history of the evolution of bankruptcy law in the United States, see Tabb, *supra* note 4.

9 *See infra* Section II(B) (explaining the rights and obligations of the parties to a bankruptcy case are initially established by applicable nonbankruptcy law (either state or federal)); Butner v. United States, 440 U.S. 48, 54 (1979) (holding "property interests are created and defined by state law," and in the absence of some federal interest, "there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding"); Raleigh v. Illinois Dept. of Revenue, 530 U.S. 15, 20 (2000) ("Creditors' entitlements in bankruptcy arise in the first instance from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code."); Mark N. Berman & David Lee, *The Enforceability in Bankruptcy Proceedings of Waiver and Assignment of Rights Clauses Within Intercreditor or Subordination Agreements*, 20 J. BANKR. L. & PRAC. ART. 1 (2011), *reprinted in Bankruptcy Law Alert: Developments in Bankruptcy Law*, NIXON PEABODY LLP 1, 8 (Jan. 24, 2012), https://www.nixonpeabody.com/-/media/Files/Alerts/142217_Bankruptcy_Alert_01_24_2012.ashx (explaining the interpretation of the provisions of a subordination agreement by a bankruptcy court is generally an exercise "of contract interpretation guided by state law contract interpretation rules[,]" and "[w]here the drafting is clear, but for the question of bankruptcy public policy, the courts have generally been willing to enforce the agreement as written[]"). Additionally, the Bankruptcy Code specifically provides that a subordination agreement is enforceable in bankruptcy, "to the same extent that such agreement is enforceable under applicable nonbankruptcy law." 11 U.S.C. § 510(a) (2012).

more layers of complexity than could have been envisioned by Congress in 1978.[10] Four of the five chapters of the Bankruptcy Code present options toward one of the major goals of the statute: financial rehabilitation.[11] A plan of reorganization consummated under chapter 11 of the Bankruptcy Code will allow a corporate debtor's business to continue. The chapter 11 reorganization plan generally provides the amount and manner of payments on the various claims[12] against, and interests in, the corporate debtor.[13] Section 1129(a) of the Bankruptcy Code contains 16 subsections, all but one of which must be met before a plan can be confirmed.[14]

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[10] *See* American Bankruptcy Institute, *ABI Commission to Study the Reform of Chapter 11*, 23 AM. BANKR. INST. L. REV. 1, 12 (2015) ("Today's financial markets, credit and derivative products, and corporate structures are very different than those existing in 1978 when Congress enacted the Bankruptcy Code.").

[11] Chapter 7 of the Bankruptcy Code governs individual and corporate liquidations; chapter 11 governs reorganizations, generally corporations or individuals with considerable debts; and chapter 13 provides for reorganization of debts of the individual wage earner. *See* 11 U.S.C. § 109(b), (d), (e) (eligibility requirements). In addition, chapter 9 is for adjustment of the debts of a municipality; chapter 12 presents certain provisions for the adjustment of debts of a family farmer. *See id.* § 109(c), (e).

[12] The Code defines a "claim" as "a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed, undisputed, legal, equitable, secured, or unsecured." 11 U.S.C. § 101(5)(A). *Compare* 11 U.S.C. § 101(12) (defining the term "debt"), *and* 11 U.S.C. § 101(5)(A) (defining the term "claim"), *with* 11 U.S.C. § 101(16) (defining the term "equity security"), *and* 11 U.S.C. § 101(17) (defining the term "equity security holder").

[13] *See id.* § 1123 (setting forth the requirements for the contents of a chapter 11 plan).

[14] Section 1129(a) of the Bankruptcy Code provides:

> (a) The court shall confirm a plan only if all of the following requirements are met:
>
> (1) The plan complies with the applicable provisions of this title [11 USCS §§ 101 *et seq.*].
>
> (2) The proponent of the plan complies with the applicable provisions of this title [11 USCS §§ 101 *et seq.*].
>
> (3) The plan has been proposed in good faith and not by any means forbidden by law.
>
> (4) Any payment made or to be made by the proponent, by the debtor, or by a person issuing securities or acquiring property under the plan, for services or for costs and expenses in or in connection with the case, or in connection with the plan and incident to the case, has been approved by, or is subject to the approval of, the court as reasonable.
>
> (5) (A) (i) The proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and
>
> (ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy; and
>
> (B) the proponent of the plan has disclosed the identity of any insider that will be employed or retained by the reorganized debtor, and the nature of any compensation for such insider.
>
> (6) Any governmental regulatory commission with jurisdiction, after confirmation of the plan, over the rates of the debtor has approved any rate change provided for in the plan, or such rate change is expressly conditioned on such approval.

(7) With respect to each impaired class of claims or interests--

(A) each holder of a claim or interest of such class--

(i) has accepted the plan; or

(ii) will receive or retain under the plan on account of such claim or interest property of a value, as of the effective date of the plan, that is not less than the amount that such holder would so receive or retain if the debtor were liquidated under chapter 7 of this title [11 USCS §§ 701 *et seq.*] on such date; or

(B) if section 1111(b)(2) of this title [11 USCS § 1111(b)(2)] applies to the claims of such class, each holder of a claim of such class will receive or retain under the plan an account of such claim property of a value, as of the effective date of the plan, that is not less than the value of such holder's interest in the estate's interest in the property that secures such claims.

(8) With respect to each class of claims or interests--

(A) such class has accepted the plan; or

(B) such class is not impaired under the plan.

(9) Except to the extent that the holder of a particular claim has agreed to a different treatment of such claim, the plan provides that--

(A) with respect to a claim of a kind specified in section 507(a)(2) or 507(a)(3) of this title [11 USCS § 507(a)(2) or 507(a)(3)], on the effective date of the plan, the holder of such claim will receive on account of such claim cash equal to the allowed amount of such claim;

(B) with respect to a class of claims of a kind specified in section 507(a)(1), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7) of this title [11 USCS § 507(a)(1), 507(a)(4), 507(a)(5), 507(a)(6), or 507(a)(7)], each holder of a claim of such class will receive--

(i) if such class has accepted the plan, deferred cash payments of a value, as of the effective date of the plan, equal to the allowed amount of such claim; or

(ii) if such class has not accepted the plan, cash on the effective date of the plan equal to the allowed amount of such claim;

(C) with respect to a claim of a kind specified in section 507(a)(8) of this title [11 USCS § 507(a)(8)], the holder of such claim will receive on account of such claim regular installment payments in cash--

(i) of a total value, as of the effective date of the plan, equal to the allowed amount of such claim;

(ii) over a period ending not later than 5 years after the date of the order for relief under section 301, 302, or 303 [11 USCS § 301, 302, or 303]; and

(iii) in a manner not less favorable than the most favored nonpriority unsecured claim provided for by the plan (other than cash payments made to a class of creditors under section 1122(b) [11 USCS § 1122(b)]); and

(D) with respect to a secured claim which would otherwise meet the description of an unsecured claim of a governmental unit under section 507(a)(8) [11 USCS § 507(a)(8)], but for the secured status of that claim, the holder of that claim will receive on account of that claim, cash payments, in the same manner and over the same period, as prescribed in subparagraph (C).

(10) If a class of claims is impaired under the plan, at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider.

(11) Confirmation of the plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the

The confirmation of a chapter 11 plan does not, however, require that it be accepted by all claimholders and equityholders whose rights are modified by the plan.[15] Rather, a plan may be confirmed even when it is not "accepted" by all classes of claims and equity interests that are "impaired" by the plan.[16] A class of claims or interests is "impaired" under a plan unless the plan, "with respect to each claim or interest of such class,"[17] does at least one of the following:

> (1) leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest; or
> (2) notwithstanding any contractual provision or applicable law that entitles the holder of such claim or interest to demand or receive accelerated payment of such claim or interest after the occurrence of a default--
> (A) cures any such default that occurred before or after the commencement of the case under this title, other than a default

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> debtor under the plan, unless such liquidation or reorganization is proposed in the plan.
> (12) All fees payable under section 1930 of title 28, as determined by the court at the hearing on confirmation of the plan, have been paid or the plan provides for the payment of all such fees on the effective date of the plan.
> (13) The plan provides for the continuation after its effective date of payment of all retiree benefits, as that term is defined in section 1114 of this title [11 USCS § 1114], at the level established pursuant to subsection (e)(1)(B) or (g) of section 1114 of this title [11 USCS § 1114], at any time prior to confirmation of the plan, for the duration of the period the debtor has obligated itself to provide such benefits.
> (14) If the debtor is required by a judicial or administrative order, or by statute, to pay a domestic support obligation, the debtor has paid all amounts payable under such order or such statute for such obligation that first become payable after the date of the filing of the petition.
> (15) In a case in which the debtor is an individual and in which the holder of an allowed unsecured claim objects to the confirmation of the plan--
> (A) the value, as of the effective date of the plan, of the property to be distributed under the plan on account of such claim is not less than the amount of such claim; or
> (B) the value of the property to be distributed under the plan is not less than the projected disposable income of the debtor (as defined in section 1325(b)(2)) to be received during the 5-year period beginning on the date that the first payment is due under the plan, or during the period for which the plan provides payments, whichever is longer.
> (16) All transfers of property under the plan shall be made in accordance with any applicable provisions of nonbankruptcy law that govern the transfer of property by a corporation or trust that is not a moneyed, business, or commercial corporation or trust.

[15] *See id.* § 1129(a)(8), (b)(1) (providing a chapter 11 plan can be confirmed without unanimous acceptance by all classes if the plan does not "discriminate unfairly" and is "fair and equitable").

[16] *See id.* § 1129(b).

[17] *See id.* § 1124.

> of a kind specified in section 365(b)(2) of this title or of a kind that section 365(b)(2) expressly does not require to be cured;
> (B) reinstates the maturity of such claim or interest as such maturity existed before such default;
> (C) compensates the holder of such claim or interest for any damages incurred as a result of any reasonable reliance by such holder on such contractual provision or such applicable law;
> (D) if such claim or such interest arises from any failure to perform a nonmonetary obligation, other than a default arising from failure to operate a nonresidential real property lease subject to section 365(b)(1)(A), compensates the holder of such claim or such interest (other than the debtor or an insider) for any actual pecuniary loss incurred by such holder as a result of such failure; and
> (E) does not otherwise alter the legal, equitable, or contractual rights to which such claim or interest entitles the holder of such claim or interest.[18]

The statutory provision that permits a plan to be confirmed over the opposition of a dissenting class (or classes) of claims or interests is often referred to as the "cram-down" provision.[19] The Bankruptcy Code attempts to protect dissenting claimholders and equityholders within the dissenting classes who will be bound by a chapter 11 plan by requiring that, in order for the plan to be confirmed, the value of the property to be received under the plan by any holder of a claim or interest who does not accept the plan, and by a class that does not accept the plan, must meet certain statutorily defined standards of adequacy.[20] The cram-down provision provides that, upon request by the plan proponent, the court must confirm the plan over the dissent of a class of claims or interests, "if the plan does not discriminate unfairly, and is fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."[21]

In determining whether the plan discriminates unfairly, the primary focus is upon classification, and treatment of claims and interest vis-a-vis other claims and interests.[22] Generally, similar claims must receive similar treatment under the

[18] *Id.* § 1124(1)–(2)(E). The Code does provide an exception to the general definition of impairment in cases where, pursuant to 11 U.S.C. § 1123(a)(4), "the holder of a particular claim or interest agrees to less favorable treatment of such particular claim or interest[.]" *Id.* § 1123(a)(4).

[19] *See generally* Kenneth N. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133, 134 (1979) (discussing in detail the mechanisms of the "cram-down" power under 11 U.S.C. § 1129(b)).

[20] *See* 11 U.S.C. § 1129(a)(7), (b)(1).

[21] *See id.* § 1129(b)(1).

[22] *See id.* § 1123(a)(1), (a)(4) (explaining a plan should designate claims into classes and then treat those classes similarly).

plan.[23] Section 1129(b)(2) of the Bankruptcy Code sets forth the test to determine whether a plan is fair and equitable with respect to secured claims, unsecured claims, and equity interests.[24] To be fair and equitable to a class of unsecured claims, the chapter 11 plan must provide that each claimholder will receive property having a present value equal to the amount of its allowed claim.[25] If, however, such unsecured claims are not paid in full, then no class of claims or interests junior to that of the dissenting class may receive or retain any property under the plan.[26] In other words, if the class is impaired, each claim within the class must be paid in full or, if paid less than full, no class junior may receive anything under the plan.[27] This provision of the Code implements the absolute priority rule[28] from the dissenting class down. The plan may satisfy the claims of unsecured creditors under a cram-down through the use of cash, notes, stock, or other assets, or a combination thereof.[29]

II. ASSIGNMENT OF VOTING RIGHTS

Courts and scholars are divided over the issue of whether to enforce indenture provisions which purport to assign the voting rights of subordinated creditors to senior creditors.[30] This division has resulted in a bankruptcy jurisprudence on this issue that is full of inconsistencies in both analysis and results.[31] The first part of this section will discuss the existing theories of analysis in case law and scholarship (which we classify into two categories) on the enforceability of indenture provisions

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[23] *See id.* § 1123(a)(4) ("Notwithstanding any otherwise applicable non bankruptcy law, a plan shall – provide the same treatment for each claim or interest of a particular class, unless the holder of a particular claim or interest agrees to a less favorable treatment of such particular claim or interest.").

[24] *See id.* § 1129(b)(2).

[25] *See id.* § 1129(b)(2)(B)(i).

[26] *See id.* § 1129(b)(2)(B)(iii).

[27] *See id.*

[28] *See* Klee, *supra* note 19, at 143 n.81 ("The absolute priority rule is a 'fixed principle' contained within the fair and equitable test. Under that rule, a class must be provided for in full before any junior class may participate, whether or not the class dissents.").

[29] *See, e.g.*, Williams v. Hibernia Nat'l Bank (*In re* Williams), 850 F.2d 250 (5th Cir. 1988); H.R. REP. NO. 95–595, at 221 (1977), *as reprinted in* 1978 U.S.C.C.A.N. 5963, 6180 ("The plan determines how much creditors will be paid, and in what form (cash, property, or securities, for example)[.]").

[30] *See, e.g., In re* Aerosol Packaging, LLC, 362 B.R. 43, 46 (Bankr. N.D. Ga. 2006) (interpreting 11 U.S.C. § 510(a) as permitting broad enforcement of subordination clauses, including voting assignment provisions); *In re* Hart Ski Mfg. Co., Inc., 5 B.R. 734, 736 (Bankr. D. Minn. 1980) (holding voting assignment provisions are not enforceable under 11 U.S.C. § 510(a)); *In re* Itemlab, Inc., 197 F. Supp. 194, 198 (E.D.N.Y. 1961) (holding the person entitled to collect the claim should be the person entitled to vote the claim); Cameron M. Fee, *Disenfranchisement Under Section 510(a) of the Bankruptcy Code*, 90 AM. BANKR. L.J. 467, 469–70 (2016) (analyzing contemporary theories on the enforcement of voting assignments under the Bankruptcy Code); Daniel C. Cohn, *Subordinated Claims: Their Classification and Voting under Chapter II of the Bankruptcy Code*, 56 AM. BANKR. L.J. 293, 315–16 (1982) (arguing bankruptcy courts can and should decline to enforce voting assignment clauses); James L. Lopes, *Contractual Subordinations and Bankruptcy*, 97 BANKING L.J. 204, 217 (1980) (to similar effect).

[31] *See* Lopes, *supra* note 30, at 204 ("Contractual subordinations, although commonly used, are inconsistently and confusingly dealt with by the bankruptcy courts.").

assigning voting rights of junior creditors to senior creditors, and the results obtained by these analyses. Generally, the existing analyses focus either on the extent to which section 510(a)[32] does or does not permit the enforcement of a voting assignment provision, or whether the plain meaning of section 1126(a),[33] notwithstanding section 510(a), is determinative of the enforceability of the voting assignment. In the second part of this section, we propose a theory of enforcement of voting assignment provisions where the scope of the creditor's allowed claim under section 502 is determinative of whether that creditor is the "holder" of the claim for the purposes of voting under section 1126(a).

In our view, the determination of who is the "holder" of a claim for the purposes of voting presents what is essentially a conflicts-of-law problem relating to the scope of the senior and junior creditor's respective bankruptcy claims. Conflicts-of-law problems are often, "fitting occasions for observing the classic admonition to begin at the beginning."[34] In the context of determining whether a voting assignment is enforceable, to "begin at the beginning" means the starting point of any analysis must be to ascertain the scope of the creditor's rights (and, therefore, its "claim") under applicable nonbankruptcy law—the source of those rights.[35] Thus, a senior creditor will be permitted to vote the claim of a junior creditor according to their agreement, to the extent such vote by the senior creditor is in good faith and is consistent with the preservation of its rights under the subordination agreement. By integrating consideration of the scope of the allowed claim under section 502 into the analysis of the enforceability of voting assignments, our theory ensures that due consideration is given both to the Supreme Court's existing bankruptcy jurisprudence, as well as bankruptcy policy. At first blush, this analysis may seem complex; however, once the underlying theory of analysis is explained, the practical application is very simple. Furthermore, our theory resolves many of the conflicts and ambiguities that plague the existing analyses which depend upon interpretive philosophy and discerning congressional intent.

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[32] 11 U.S.C. § 510(a) provides: "A subordination agreement is enforceable in a case under this title to the same extent that such agreement is enforceable under applicable nonbankruptcy law."

[33] *Id.* § 1126(a) provides: "The holder of a claim or interest allowed under section 502 of this title may accept or reject a plan. If the United States is a creditor or equity security holder, the Secretary of the Treasury may accept or reject the plan on behalf of the United States."

[34] Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156, 169 (1946) (Frankfurter, J., concurring).

[35] *See id.* at 169–70 ("Parties are in a bankruptcy court with their rights and duties already established . . . . Obligations to be satisfied out of the bankrupt's estate thus arise, if at all, out of tort or contract or other relationship created under applicable law.").

A. Bankruptcy Law and Policy and the Enforcement of Any Indenture Term Requiring the Transfer or Assignment of Subordinated Creditors' Voting Rights to Senior Creditors

The case law and scholarship on the issue of voting assignments in bankruptcy is relatively limited. However, those cases and articles which have analyzed the enforceability of voting assignment provisions have focused upon the scope and application of either section 510(a) or, conversely, the scope and application of section 1126(a) and its relationship to how section 510(a) is applied.[36] Under the current "Expansive Theory" of enforcement, section 510(a) is interpreted broadly as allowing the enforcement of a voting assignment provision in a subordination agreement so long as at least one provision of the subordination agreement deals with priority of payment.[37] Proponents of the Expansive Theory have reasoned that, because section 1126(a) does not contain any language stating that the right to vote is non-assignable, the subordination agreement, including the voting assignment provision therein, must be enforced if it is valid under applicable nonbankruptcy law. However, other courts and scholars take the position that voting assignments are unenforceable. The "Non-Enforcement Theory" holds that the plain language of section 1126(a) renders voting assignment provisions unenforceable, and that section 510(a) only affects priority of payment.[38]

1. The Expansive Theory of Enforcement of section 510(a)

Section 510(a) of the Bankruptcy Code provides that "subordination agreements" are enforceable in bankruptcy.[39] Proponents of the Expansive Theory of enforcement of section 510(a) broadly construe the term "subordination agreement," such that if at least one clause in the agreement subordinates the priority of distribution on a claim, the entire agreement, including a clause which purports to assign the right to vote on the chapter 11 plan, is enforceable under section 510(a).

For example, in *Blue Ridge Investors, II, LP v. Wachovia Bank, N.A. (In re Aerosol Packaging, LLC)*,[40] the bankruptcy court addressed whether a voting assignment provision of a subordination agreement executed between the senior creditor, the subordinated (junior) creditor, and the debtor was enforceable to allow the senior creditor to vote the claim of the subordinated creditor.[41] Both the senior creditor and the subordinated creditor submitted voting ballots as the "holder" of the subordinated creditor's claim.[42] The senior creditor voted the subordinated creditor's

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[36] *See* Fee, *supra* note 30, at 468–69.
[37] *See infra* Part II(A)(1).
[38] *See infra* Part II(A)(2).
[39] 11 U.S.C. § 510(a) (2012).
[40] *See In re* Aerosol Packaging, LLC., 362 B.R. 43, 45 (Bankr. N.D. Ga. 2006).
[41] *Id.* at 44.
[42] *Id.*

claim in favor of the plan.[43] The subordinated creditor voted to reject the plan.[44] If the court recognized the vote of the subordinated creditor, the subordinated creditor would be deemed to have rejected the plan and, as a result, the court would have to conduct a valuation proceeding to determine the value of any collateral alleged to secure the subordinated creditor's claim.[45] The subordinated (junior) creditor argued that "as the holder of its claim, only [it was] entitled to vote the claim pursuant to 11 U.S.C. § 1126(a) . . . ."[46] The subordinated creditor further argued that the voting assignment could not be enforced because neither the senior creditor nor the debtor had any interest "in preserving or protecting" the subordinated creditor's interests.[47] The bankruptcy court enforced the voting assignment provision of the subordination agreement.[48] The court held that section 1126(a) "grants a right to vote to a holder of a claim, but does not expressly or implicitly prevent that right from being delegated or bargained away by such holder" and, because the subordination agreement was enforceable under Georgia law, the subordination agreement, including the voting assignment provision contained therein, was enforceable pursuant to section 510(a).[49] The court also noted that the subordinated creditor was not without remedy because the subordinated creditor could "free itself from the ongoing effect of the Subordination Agreement by paying the [senior] claim in full in cash."[50]

2. The Non-Enforcement Theory

The Non-Enforcement Theory holds that the plain language of section 1126(a) renders voting assignment provisions unenforceable. Section 1126(a) of the Bankruptcy Code provides, in relevant part, "[t]he holder of a claim or interest allowed under section 502 of this title may accept or reject a plan."[51] The Non-Enforcement Theory generally rests upon three points of argument.

First, under the plain meaning rule of statutory interpretation, since: (1) section 1126(a) of the Bankruptcy Code contains no terms which would limit a creditor's right to vote due to the provisions of a subordination agreement; and (2) section

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[43] *Id.*
[44] *Id.*
[45] *Id.* at 45.
[46] *Id.* at 46.
[47] *Id.* The subordinated creditor further explained,

> The bankruptcy and non-bankruptcy rights which the Debtor proposes to waive and/or impair certainly affect [the subordinated creditor] and [the subordinated creditor] has a substantial interest to protect such rights, including, without limitation, seeking a determination as to its secured claim under Section 506 of the Bankruptcy Code and preserving its rights, claims, defenses, and causes of action against non-debtor entities.

Id. at 46–47.
[48] *Id.* at 47.
[49] *Id.*
[50] *Id.*
[51] 11 U.S.C. § 1126(a) (2012).

510(a) of the Bankruptcy Code does not specifically limit the operation of section 1126(a) to preclude subordinated creditors' voting; section 1126(a) unambiguously preserves subordinated creditors' right to vote on chapter 11 plans.[52]

Second, as a matter of global bankruptcy policy, divesting subordinated bondholders of all their bargaining power by barring their votes on chapter 11 plans would destroy the entire statutory scheme, which envisions negotiated sacrifices of value by senior creditors in order to achieve consensual plans. The legislative history of the Bankruptcy Code provides, in relevant part:

> The parties are left to their own to negotiate a fair settlement. The question of whether creditors are entitled to the going-concern or liquidation value of the business is impossible to answer . . . . [N]egotiation among the parties after full disclosure will govern how the value of the reorganizing company will be distributed among creditors and stockholders. The bill only sets the outer limits on the outcome: it must be somewhere between the going-concern value and the liquidation value.
>
> Only when the parties are unable to agree on a proper distribution of the value of the company does the bill establish a financial standard. If the debtor is unable to obtain the consents of all classes of creditors and stockholders, then the court may confirm the plan anyway on request of the plan's proponent, if the plan treats the nonconsenting classes fairly. The bill defines "fairly" in terms of the relative rights among the classes. Simply put, the bill requires that the plan pay any dissenting class in full before any class junior to the dissenter may be paid at all. The rule is a partial application of the absolute priority rule now applied under chapter X and requires a full valuation of the debtor as the absolute priority rule does under current law. The important difference is that the bill permits senior classes to take less than full payment, in order to expedite or insure the success of the reorganization.[53]

Courts and scholars adopting this interpretation take the position that if subordinated creditors have no right to vote on chapter 11 plans, senior creditors will ignore them rather than seek consensual plans.[54] Since the subordinated

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[52] *See, e.g.*, Patterson v. Shumate, 507 U.S. 753, 757 (1992) (citing United States v. Ron Pair Enters., Inc., 489 U.S. 235, 241 (1989)).

[53] H.R. Rep. No. 595, 95th Cong., 2d Sess. 224, *reprinted in* 1978 U.S. Code Cong. & Admin. News 5963, 6183–84; *see also* S. Rep. No. 95-989, 95th Cong., 2d Sess. 74 (1978); 4 COLLIER ON BANKRUPTCY ¶ 510.03 at 510-6 (Alan N. Resnick & Henry J. Sommer eds.,15th ed. rev. 1992).

[54] At least two commentators have argued that bankruptcy courts can and should decline to enforce voting assignment clauses that totally deprive subordinated creditors of any role in chapter 11 plan negotiations. In a 1982 article on subordinated claims, one commentator argues,

bondholders will have no procedural means of protecting themselves through adversarial process, they will lack bargaining power, and future chapter 11 cases involving significant amounts of publicly traded debt will uniformly result in the formation of bargaining coalitions between management and senior bondholders. The coalitions will agree to generate artificially low enterprise valuations so a greater proportion of the reorganized concern can be delivered to the senior bondholders without violating the fair and equitable rule of section 1129(b) of the Bankruptcy Code. Subordinated bondholders will lack votes, and may lack standing, to challenge the valuation in bankruptcy court. In conclusion, transfers or assignments of voting rights will eventually destroy every existing procedural

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> [s]enior creditors, particularly the beneficiaries of contractual subordination, will argue that subordinated creditors should never be able to block confirmation of a plan. The argument will be pressed with particular vehemence when the subordination agreement explicitly provides that it will be enforced by assignment, that subordinated claims will be voted by senior creditors and that senior creditors owe no contractual or fiduciary obligation to subordinated creditors. Yet precisely because it attempts to leave subordinated creditors with no rights whatsoever, this type of agreement is its own worst enemy. The Bankruptcy Code requires enforcement of a subordination agreement only "to the . . . extent that such agreement is enforceable under applicable nonbankruptcy law." *The general principle is well established that courts may decline to implement draconian contractual remedies even when agreed upon without duress or coercion by parties with equal bargaining power . . . . Under similar principles*, *the bankruptcy courts should decline to enforce remedial provisions of subordination agreements that hurt subordinated creditors more than is necessary to serve senior creditors' legitimate needs*.
>
> . . . .
>
> . . . *The relationship between the debtor and even a subordinated creditor is such that*, *no matter what the subordination contract says*, *the debtor's shareholders should not be permitted to receive or retain any property under the reorganization plan unless the subordinated creditors consent or their interests are otherwise fairly protected. Unrestricted voting of subordinated claims by senior creditors robs the subordinated claimants of the opportunity to decline to assent*, *without providing any other protection for their interests. An unrestricted voting provision in a subordination agreement should not be enforced*, *and agreements that do not provide for unrestricted voting should not be interpreted to require it.*

Cohn, *supra* note 30, at 315–16 (emphasis added) (citations omitted). Similarly, in a 1980 article on the same issue, another commentator states the following:

> The *Itemlab* court determined that the senior creditor should be allowed to vote the claim of the junior creditor in consenting to an arrangement that did not purport to take into account the subordination agreement. What if an arrangement is proposed that classifies creditors according to their relative priorities and purports to take into account all subordination agreements? Should the senior creditors be allowed to vote the claims of the junior creditors? The answer would clearly appear to be no. *A negotiated plan of arrangement could never be reached if the subordinated creditors did not have the power to block confirmation if they were not satisfied with the arrangement. A contrary result would not conform with the policy and purpose of the bankruptcy law*.

Lopes, *supra* note 30, at 217 (emphasis added).

safeguard against debtors paying senior bondholders more than in full and maximizing the amount of bond debt crammed down in chapter 11.

Third, some courts have held that waivers of rights to participate in or commence bankruptcy proceedings are void as against public policy.[55] These courts have held that the collective and compulsory nature of bankruptcy proceedings should preclude attempts to "opt out" of the system by limiting creditors' votes on chapter 11 plans or debtors' use of chapter 11.[56] Much case law under the former Bankruptcy Act, and some under the Bankruptcy Code, explicitly holds that waivers of rights to participate in or commence bankruptcy proceedings are void as against public policy.[57]

The Non-Enforcement theory can be traced to the bankruptcy court's opinion in *In re Hart Ski Mfg. Co.*[58] In *In re Hart Ski Mfg. Co.*, a seller of collateral subordinated its right to payment by the debtor to the debtor's finance company.[59] Post-petition, the seller moved for adequate protection or to lift the automatic stay, and the finance company argued that the subordination agreement precluded the seller's motion.[60] In dicta, the court delineated several bankruptcy rights which could not be waived in a contractual subordination agreement:

> The intent of § 510(a) (subordination) is to allow the consensual and contractual priority of payment to be maintained between creditors among themselves in a bankruptcy proceeding. There is no indication that Congress intended to allow creditors to alter, by a subordination agreement, the bankruptcy laws unrelated to distribution of assets.
>
> The Bankruptcy Code guarantees each secured creditor certain rights, regardless of subordination. *These rights include the right to*

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[55] *See In re* Intervention Energy Holdings, LLC, 553 B.R. 258, 265 (Bankr. D. Del 2016).

[56] *See id.* at 263.

[57] *See, e.g.*, Klingman v. Levinson, 831 F.2d 1292 n.3 (7th Cir. 1987); Fallick v. Kehr, 369 F.2d 899, 904 (2d Cir. 1966); *In re* Levy, 127 F.2d 62, 63 (3d Cir. 1942); Trego v. Wright, 111 F.2d 990, 991 (6th Cir. 1940); *In re* Sponsor Realty Corp., 48 F. Supp. 735, 739 (S.D.N.Y. 1943); *In re* Hudson Coal Co., 22 F. Supp. 768, 769–71 (M.D. Pa. 1938); *In re* Los Angeles Lumber Prods. Co., 24 F. Supp. 501, 515–16 (D. Cal. 1938), *aff'd*, 100 F.2d 963 (9th Cir. 1939), *rev'd on other grounds*, 308 U.S. 106 (1939), *reh'g denied*, 308 U.S. 637 (1939); *In re* Weitzen, 3 F. Supp. 698, 699 (S.D.N.Y. 1933); *In re* Markizer, 66 B.R. 1014, 1018 (Bankr. S.D. Fla. 1986); *In* re Tru Block Concrete Prods., Inc., 27 B.R. 486, 492 (Bankr. S.D. Cal. 1983) ("It is a well settled principle that an advance agreement to waive the benefits conferred by the bankruptcy laws is wholly void as against public policy."); *In re* Peli, 31 B.R. 952, 955 (Bankr. E.D.N.Y. 1983); *In re* George, 15 B.R. 247, 248–49 (Bankr. N.D. Ohio 1981); *In re* Kriger, 2 B.R. 19, 23 (Bankr. D. Or. 1979); Rietbrock v. Studds, 54 N.W.2d 899, 900 (Wis. 1952); Sigmon Furniture Mfg. Co. v. Massey, 137 P.2d 793, 795 (Okla. 1943); Crandall v. Durham, 152 S.W.2d 1044, 1045 (Mo. 1941); Meyer v. Price, 165 N.E. 814, 816–17 (N.Y. 1929); Fed. Nat'l Bank v. Koppel, 148 N.E. 379, 380 (Mass. 1925); Blasdel v. Fowle, 120 Mass. 447, 448 (1876); Siragusa v. Prudential Milk Co., 29 N.Y.S.2d 29, 30 (N.Y. Sup. Ct. 1941); Conway & Duncan v. F.P. Kirkendall & Co., 218 S.W. 34, 35 (Tex. Civ. App. 1919). *But see infra* Section II(B).

[58] 5 B.R. 734, 736 (Bankr. D. Minn. 1980).

[59] *Id.* at 735.

[60] *Id.* at 734–35.

> *assert and prove its claim, the right to seek Court ordered protection for its security, the right to have a stay lifted under proper circumstances, the right to participate in the voting for confirmation or rejection of any plan of reorganization, the right to object to confirmation, and the right to file a plan where applicable.* The above rights and others not related to contract priority of distribution pursuant to Section 510(a) cannot be affected by the actions of the parties prior to the commencement of a bankruptcy case when such rights did not even exist. To hold that, as a result of a subordination agreement, the "subordinor" gives up all its rights to the "subordinee" would be totally inequitable.[61]

The court's reasoning in *In re Hart Ski Mfg. Co., Inc.*, with respect to the scope of section 510(a), would be adopted by other courts and extended to the issue of the enforceability of voting assignments.

The bankruptcy court in *In re 203 North LaSalle Street Partnership*[62] addressed the issue of the enforceability of a voting assignment provision of a "Consent and Subordination Agreement" (the "Subordination Agreement") entered into between the debtor's two primary secured creditors—the debtor's general partner, North LaSalle Street Limited Partnership ("North LaSalle") and Bank of America.[63] The court determined that section 1126(a), which provides that "the holder of a claim" may vote to accept or reject a plan, governed the parties' voting rights and the voting assignment provision of the Subordination Agreement was unenforceable.[64] The court reached its decision based on the general understanding "that prebankruptcy agreements do not override contrary provisions of the Bankruptcy Code."[65] Thus, "the fact that North LaSalle could vote its claim as part of a

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[61] *Id.* at 736 (emphasis added).

[62] 246 B.R. 325, 331 (Bankr. N.D. Ill. 2000).

[63] *Id.* at 326–27. In *In re 203 North LaSalle Street Partnership*, the debtor owned fifteen floors of a commercial office building (the "Property"). *Id.* at 327. In 1987, the debtor obtained a loan from Bank of America secured by a first nonrecourse mortgage on the Property. *Id.* In 1988, the debtor obtained a second nonrecourse mortgage loan from North LaSalle. *Id.* Concurrent with the execution of the loan agreement with the debtor, North LaSalle entered into an inter-creditor agreement with Bank of America, which provided that North LaSalle's loan was subordinate to Bank of America's loan. *Id.* In 1992, in consideration for Bank of America waiving certain of its rights under its loan documents, North LaSalle and Bank of America entered into a "Consent and Subordination Agreement" (the "Subordination Agreement"). *Id.* The Subordination Agreement included a provision that Bank of America could vote North LaSalle's claim in any reorganization proceeding during the debtor's bankruptcy, before a plan was proposed. *But see id.* at 328 (discussing the procedural history of the case, specifically how Bank of America filed an adversary complaint for declaratory judgment that, among other things, provided Bank of America the right under the Subordination Agreement to vote the claim of North LaSalle in the anticipated confirmation proceedings).

[64] *Id.* at 331.

[65] *Id.* The court further explained its reasoning, stating that "since bankruptcy is designed to produce a system of reorganization and distribution different from what would obtain under nonbankruptcy law, it would defeat the purpose of the Code to allow parties to provide by contract that the provisions of the Code should not apply." *Id.*

subordination agreement [did] not provide a basis for disregarding § 1126(a)."[66] Furthermore, the court held that section 510(a), "in directing enforcement of subordination agreements, does not allow for waiver of voting rights under § 1126(a)."[67] The court extended the reasoning from *In re Hart Ski Mfg. Co., Inc.* that the Code "guarantees each secured creditor certain rights, regardless of subordination . . . including the right . . . to participate in the voting for confirmation or rejection of any plan of reorganization,"[68] and determined that subordination under section 510(a) "affects the order of priority of payment of claims in bankruptcy, but not the transfer of voting rights."[69]

B. The "Bundle of Rights" Theory of Chapter 11 Voting Assignments

We contend that, contrary to the current analyses which emphasize the relationship between sections 510(a) and 1126(a), the primary focus in determining whether to enforce a voting assignment provision of a subordination agreement should be based on an analysis of the rights and obligations of the parties as those rights are defined in the agreements that create the senior and junior creditors' respective allowed claims. In interpreting the language of section 1129(a), the existing analyses assume that the right of a creditor to vote on a plan is a unique bankruptcy right that is not dependent upon any source other than the Bankruptcy Code. Because of this fundamental assumption, the debate between proponents of the respective analyses is whether the plain language of either section 510(a) or section 1129(a) is determinative of the enforceability of a voting assignment provision. In our view, the assumption that the right to vote depends only on bankruptcy law fails to examine how the bankruptcy right of the holder of a particular "claim" to vote on a plan of reorganization arises not from the Bankruptcy Code, but rather from the impairment of the legal obligations from which the bankruptcy "claim" itself is created, which are dependent upon applicable non-bankruptcy law.

Thus, the enforceability analysis must begin first with an examination of what it means to be a "holder" of a "claim" in bankruptcy. In circumstances where the subordination agreement between the senior and junior creditor, and the voting assignment provision contained therein, are incorporated into each of the senior and junior creditors' loan agreements between each of them and the common debtor, the right of the senior creditor to vote the claim of the junior creditor becomes a substantive right in the whole bundle of rights associated with the senior creditor's claim. Therefore, for the purposes of voting under section 1126(a), the senior

[66] *Id.* In support of its holding, the bankruptcy court cited *Klingman v. Levinson*, in which a panel of the Seventh Circuit Court of Appeals noted that "it would be contrary to public policy to allow a debtor 'to contract away the right to a discharge.'" *Id.* (quoting Klingman v. Levinson, 831 F.2d 1292, 1296 n.3 (7th Cir. 1987)).

[67] *Id.*

[68] *In re* Hart Ski Mfg. Co., 5 B.R. 734, 736 (Bankr. D. Minn. 1980).

[69] *In re* 203 N. LaSalle St. P'ship, 246 B.R. at 331.

creditor is the "holder" of the junior creditor's claim. Furthermore, we endeavor to show that, contrary to certain assertions by proponents of the Non-Enforcement Theories, enforcement of the voting assignment does not leave the junior creditor without remedy to protect its interest in the debtor's bankruptcy because the junior creditor retains certain rights as a "party in interest," which rights cannot be prospectively waived by pre-bankruptcy agreement as a matter of law.

1. The Allowed Claim: Defining A Creditor's Rights in Bankruptcy

Before the estate can be administered under the provisions of the Code governing administration, the existence of claims against the estate must be ascertained. The commencement of a case by the filing of a bankruptcy petition creates an estate comprised of "all legal or equitable interests of the debtor in property as of the commencement of the case,"[70] among other specific interests in property.[71] Like the Bankruptcy Code, generally, there are two overarching purposes of the creation of a bankruptcy estate: (1) to protect the interests of the debtor's creditors; and (2) to facilitate the debtor's "fresh start."[72] The consolidation of a debtor's assets into a single estate allows the debtor's unsatisfied obligations to creditors to be paid "in an equitable and orderly process."[73] The participation of creditors in the administration of the bankruptcy estate is predicated upon the Code provisions governing the filing and allowance of "claims" against the estate,[74] and generally, only creditors with allowed claims have standing to participate in the administration of the estate.[75] In some cases, a claim will be allowed with minimal court involvement, such as where no party in interest objects to a filed proof of claim.[76] In chapter 11 cases, all that is required by the Code for a claim to be

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[70] 11 U.S.C. § 541(a)(1) (2012).

[71] *See generally id.* § 541 (defining property of the bankruptcy estate).

[72] *See* Andrews v. Riggs Nat'l Bank of Washington, D.C. (*In re* Andrews), 80 F.3d 906, 909 (4th Cir. 1996).

[73] *Id.* at 909–10.

[74] 11 U.S.C. § 501(a) ("A creditor . . . may file a proof of claim. An equity security holder may file a proof of interest."). The purpose of filing of a proof of claim is to alert the court, the debtor, the trustee, and other parties in interest that the creditor holds a claim and will participate in the distribution of the debtor's bankruptcy estate. *See also* 3 COLLIER BANKRUPTCY PRACTICE GUIDE ¶ 50.01 (Richard Levin & Henry J. Sommer eds., 2019) ("The proof of claim identifies the claimant, sets forth the amount that the creditor claims is owed, and furnishes supporting information regarding the manner in which the claim arose and how the amount of the claim was calculated.").

[75] *See* 4 COLLIER ON BANKRUPTCY ¶ 501.01 (Richard Levin & Henry J. Sommer eds., 16th ed. 2019) (providing an overview of section 501 and stating "the primary purpose" of filing a proof of claim is "to share in any distribution" of the estate's assets); 7 COLLIER ON BANKRUPTCY ¶ 1126.02 (Richard Levin & Henry J. Sommer eds., 16th ed. 2019) ("[T]o be considered for participation, voting and distribution, a party must file a claim or interest as provided in Bankruptcy Rule 3003(c)(2).").

[76] 11 U.S.C. § 502(a) provides:

> A claim or interest, proof of which is filed under section 501 of this title, is deemed allowed, unless a party in interest, including a creditor of a general partner in a partnership that is a debtor in a case under chapter 7 of this title [11 U.S.C. §§ 701 *et seq.*], objects.

deemed allowed—other than a claim scheduled as disputed, contingent, or unliquidated[77]—is that the claim be listed on the debtor's schedules.[78] In cases where a claim objection is filed, the bankruptcy court must determine whether the claim should be disallowed under one of the disallowance provisions of section 502.[79] The latter process involves a more comprehensive inquiry into the nature of the asserted claim,[80] whereas the former process does not involve any such inquiry, at least at the time when the claim is deemed allowed. In both circumstances, however, the existence and characterization of the "claim" itself is determined by the existence and scope of a right to payment under nonbankruptcy law.[81]

The term "debt" is defined as meaning "liability on a claim."[82] The Code defines a "claim" as "a right to payment, whether or not such right is reduced to judgment, liquidated, unliquidated, fixed, contingent, matured, unmatured, disputed,

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See also Richard I. Aaron, *Introduction—Legal and Equitable*, *Future and Contingent*, *Secured and Unsecured Claims*, 1 BANKR. L. FUNDAMENTALS § 8.1 (2017) ("The Code simply requires that the debtor file schedules listing creditors, and permits the creditor, the debtor or even the trustee to file a proof of claim. All of the claims filed are allowed unless a specific objection is made.") (footnotes omitted).

[77] *See* 11 U.S.C. § 1111(a); FED. R. BANKR. P. 3003(b)(1).

[78] *See* 11 U.S.C. § 1111(a) (providing a claim or interest listed in the chapter 11 schedules is deemed filed under section 501 if it is listed in the schedules and not designated as disputed, contingent or unliquidated); 7 COLLIER ON BANKRUPTCY ¶ 1126.02 (Richard Levin & Henry J. Sommer eds., 16th ed. 2019). Bankruptcy Rule 3003 of the Federal Rules of Bankruptcy Procedure provides, in pertinent part:

> The schedule of liabilities filed pursuant to § 521(1) of the Code shall constitute prima facie evidence of the validity and amount of the claims of creditors, unless they are scheduled as disputed, contingent, or unliquidated. It shall not be necessary for a creditor or equity security holder to file a proof of claim or interest except as provided in subdivision (c) (2) of this rule.

FED. R. BANKR. P. 3003(b)(1); *see also* 9 COLLIER ON BANKRUPTCY ¶ 3003.02 (Richard Levin & Henry J. Sommer eds., 16th ed. 2019) ("Schedule of Liabilities and List of Equity Security Holders.").

[79] *See* 11 U.S.C. § 502(b) (setting forth nine bases for a claim to be disallowed). To the extent that a claim falls within any of these paragraphs, upon proper objection and after notice and a hearing, the bankruptcy court will disallow the claim. *Id.*

[80] The filing of an objection to a proof of claim "creates a dispute which is a contested matter" under Bankruptcy Rule 9014 and "must be resolved after notice and opportunity for hearing upon a motion for relief." Lundell v. Anchor Constr. Specialists, Inc., 223 F.3d 1035, 1039 (9th Cir. 2000) (citation omitted). Upon objection, the proof of claim provides "some evidence as to its validity and amount" and carries over a "mere formal objection." *Id.* The objector must produce sufficient evidence "tending to defeat the claim by probative force equal to that of the allegations in the proofs of claim themselves." *Id.* (quoting Wright v. Holm (*In re* Holm), 931 F.2d 620, 623 (9th Cir. 1991)). The claimant must "prove the validity of the claim by a preponderance of the evidence." *Id.* "The ultimate burden of persuasion remains at all times upon the claimant." *Id.*

[81] *See* Raleigh v. Illinois Dep't of Revenue, 530 U.S. 15, 20 (2000) ("The 'basic federal rule' in bankruptcy is that state law governs the substance of claims[.]") (quoting Butner v. United States, 440 U.S. 48, 57 (1979)).

[82] 11 U.S.C. § 101(12) (2012); *see also* Johnson v. Home State Bank, 501 U.S. 78, 84 n.5 (1991) ("'[D]ebt[]' . . . has a meaning coextensive with that of 'claim[.]'") (citing Pennsylvania Dept. of Public Welfare v. Davenport, 495 U.S. 552, 558 (1990)); *see also* New Jersey v. Anderson, 203 U.S. 483, 492 (1906) ("Debts are obligations for the payment of money founded upon contract, express or implied.").

undisputed, legal, equitable, secured, or unsecured."[83] Thus, reading these provisions together, the Code broadly defines "debt" as liability on virtually any type of "right to payment."[84] A "creditor" is an "entity that has a claim against the debtor that arose at the time of or before the order for relief concerning the debtor."[85] However, the Code does not define either "right to payment" or "arose." This is one of the instances where nonbankruptcy law is determinative, and because "nonbankruptcy law" is largely state law, "the Code expressly and impliedly depends on state law."[86] Put another way, the Code, "depends on nonbankruptcy law for the determination of who is a creditor eligible to receive a share of the debtor's prepetition property."[87] This means that to meet the Code's definition of a "creditor" eligible to receive distribution from the bankruptcy estate, a "right to payment" must exist under nonbankruptcy law, and the time when that right to payment "arises" must also be determined by nonbankruptcy law.[88] The priority of a creditor's claim in the bankruptcy distribution scheme, on the other hand, is a matter of bankruptcy law.[89] Generally, each respective creditor's priority in the distribution of the estate assets is determined by the scope and characterization of the creditor's allowed claim.[90] Thus, to determine where a particular claim falls in the Code's distribution scheme, a bankruptcy court must first determine the essential nature of the legal obligation under applicable nonbankruptcy law, and characterize the claim accordingly (*e.g.*, as a tax, debt, or equity interest).[91] As previously discussed, a

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[83] 11 U.S.C. § 101(5)(A); *see also* 4 COLLIER ON BANKRUPTCY ¶ 502.02 (Richard Levin & Henry J. Sommer eds., 16th ed. 2018) ("Explicit in the concept of filing a proof of claim is the idea that the proof of claim must set forth a 'claim.' 'Claim' is defined broadly under the Code. Issues related to the existence of a claim are discussed elsewhere in this Treatise. The intent behind the definition of 'claim' was to deal with 'all legal obligations of the debtor, no matter how remote or contingent.'") (footnotes omitted).

[84] *See* 11 U.S.C. §§ 101(12), 101(5)(A).

[85] *Id.* § 101(10)(A).

[86] Thomas E. Plank, *Bankruptcy and Federalism*, 71 FORDHAM L. REV. 1063, 1075 (2002).

[87] *Id.*

[88] *Id.* at 1104 ("A person who signs a note or purchases good on account incurs an obligation to pay, and the payee has a right to payment that arose at the time of the signing of the note or the purchase of the goods. If the obligor later files a bankruptcy petition, the payee becomes a 'creditor' with a right to payment that arose before the commencement of the case.").

[89] *See* 11 U.S.C. § 507 (setting forth the general priority of claims in bankruptcy).

[90] *See, e.g., id.*; *id.* § 725(a) (giving first priority to creditors with secured claims); *id.* § 726(a) (setting forth the priority for the distribution of property of the estate to classes of creditors with unsecured claims); *id.* § 726(b) ("Payment on claims [within each priority, including paragraphs 1–10 of section 507(a)] shall be made pro rata among claims."); *id.* § 507(a) (setting forth ten categories of unsecured claims entitled to priority in bankruptcy cases; the effect of priority varies among the chapters of the Code); Czyzewski v. Jevic Holding Corp., 137 S. Ct. 973, 979 (2017) ("Secured creditors are highest on the priority list, for they must receive the proceeds of the collateral that secures their debts. 11 U.S.C. § 725. Special classes of creditors, such as those who hold certain claims for taxes or wages, come next in a listed order. §§ 507, 726(a)(1). Then come low-priority creditors, including general unsecured creditors. § 726(a)(2). The Code places equity holders at the bottom of the priority list. They receive nothing until all previously listed creditors have been paid in full. § 726(a)(6).").

[91] The best examples of this process appear in cases discussing the characterization of a claim, for example, as either a "tax" entitled to administrative priority, or a penalty, which is treated as unsecured. *See, e.g.*, United States v. Reorganized CF&I Fabricators of Utah, Inc., 518 U.S. 213, 226 (1996) (holding 26 U.S.C. § 4971 "must be treated as imposing a penalty, not authorizing a tax" and that, "the 'tax' under §

chapter 11 plan must comply with the absolute priority rule, except in circumstances where the plan proponent secures the consent of affected creditors to deviate from the Code's priority scheme.[92]

In as much as, "[t]he existence of a debt between the parties to an alleged creditor-debtor relation is independent of bankruptcy and precedes it,"[93] the authority of a federal court to override state-created rights in bankruptcy generally, "can be derived only from constitutional and bankruptcy sources."[94] Importantly,

> [p]arties are in a bankruptcy court with their rights and duties already established, except insofar as they subsequently arise during the course of bankruptcy administration or as part of its conduct. Obligations to be satisfied out of the bankrupt's estate thus arise, if at all, out of tort or contract or other relationship created under applicable law.[95]

The scope of a particular creditor's power to exercise certain rights in bankruptcy, which are derivative of the creditor's claim, in the absence of a specific provision of the Code that broadens the creditor's pre-existing rights or creates new substantive rights in favor of the creditor, must be defined by, and limited to, the terms of the underlying obligation which gave rise to the creditor's claim.

Neither section 510(a), nor section 1126(a) grant the bankruptcy court the authority to override the rights created under nonbankruptcy law, which in bankruptcy, become the basis for a particular creditor's claim, thus recognizing the creditor's pre-bankruptcy bundle of legal rights in the bankruptcy case. Specifically, section 1126(a) of the Code grants the right to vote to certain creditors

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4971(a) was not entitled to seventh priority as an 'excise tax' under [11 U.S.C.] § 507(a)(7)(E), but instead is, for bankruptcy purposes, a penalty to be dealt with as an ordinary, unsecured claim"). Cases discussing recharacterization of a claim from "debt" to "equity" are also illustrative of this process. *See, e.g.*, Sender v. Bronze Grp., Ltd. (*In re* Hedged-Investments Assocs.), 380 F.3d 1292, 1298 (10th Cir. 2004) (recharacterization ensures "controlling equity owners of a troubled corporation could jump the line of the bankruptcy process and thwart the company's outside creditors' and investors' priority rights"); *In re* Florida Bay Trading Co., 177 B.R. 374, 383 (Bankr. M.D. Fla. 1994) ("[I]t is important initially to determine whether or not the claim asserted in fact represents a binding legal obligation, a debt, or it is merely nothing more than a capital contribution which is an investment thus does not represent a debt but equity. It is clear that if the loan under consideration is found to be a capital contribution there is no debt created at all. However, if the loan under consideration is a genuine, bona fide loan there is an indebtedness which is presumed to be a valid obligation and absent any other factors it is entitled to be allowed.").

92 7 COLLIER ON BANKRUPTCY ¶ 1129.01 (Richard Levin & Henry J. Sommer eds., 16th ed. 2019) ("Consensual confirmation involves obtaining consent of the debtor's creditors. Under section 1129, however, this consent is by class of creditors, not by the vote of all creditors. Thus, a plan is said to be confirmed consensually if all classes of creditors vote in favor, even if some classes have dissenting creditors. The class consent standard, in turn, is a blended standard: under section 1126, a class of creditors consents if over one-half of the creditors voting on a plan accept the plan, and those creditors hold claims equal to at least two-thirds of the amount of all claims held by those who vote.").

93 Vanston Bondholders Protective Comm. v. Green, 329 U.S. 156, 169 (1946) (Frankfurter, J., concurring).

94 Alfred Hill, *The Erie Doctrine in Bankruptcy*, 66 HARV. L. REV. 1013, 1019 (1953).

95 *Vanston Bondholders Protective Comm.*, 329 U.S. at 169 (Frankfurter, J., concurring).

who are holders of a claim in an impaired class;[96] the plain language of this section suggests that the power to exercise the right to vote springs from the creditor's "legal, equitable, and contractual rights"[97]—the creditor's claim. The claim, in turn, is limited to the terms of the agreement that gave rise to the right to payment under non-bankruptcy law. As we will explain in more detail in the discussion that follows, at the time in the bankruptcy proceeding when the creditor's non-bankruptcy right to payment, which itself consists of a bundle of rights in favor of the creditor, becomes the creditor's bankruptcy claim, the power to exercise bankruptcy rights that are specifically contingent upon the existence of the claim necessarily arises from the claim itself.[98] And such power is, therefore, limited by the substance of the underlying agreement. Effectively, bankruptcy rights, which are specifically contingent upon the terms of the underlying claim, must be limited by the substance of the claim itself; in contrast, bankruptcy rights granted more broadly to, for example, any "party in interest," are not dependent upon the substance of the creditor's claim, but rather upon the creditor having almost any practical interest in the outcome of the issue at bar, and cannot be prospectively waived by agreement.[99]

To illustrate this concept, consider the following: assume for a moment that, as proponents of the section 1126(a) Plain Meaning theory contend, only the creditor that is the true owner of the claim[100] is entitled to vote the claim and, contrary to our theory, the question of who is the "holder" of a claim for the purposes of voting under section 1126(a) is unaffected by the substantive terms of the claim itself (i.e. the bundle of rights theory discussed below). Section 1126(a) provides that the "holder of a claim or interest allowed under section 502 . . . may accept or reject a plan;"[101] however, a holder of a claim in an unimpaired class is "conclusively presumed to have accepted the plan,"[102] and thus cannot vote on the plan. Why is this so? Because the claim, and the "legal, equitable, and contractual rights to which such claim . . . entitles the holder of such claim,"[103] are left unaltered by the plan. Thus, the Code implicitly recognizes that the right to vote arises from, and is defined by the creditor's pre-bankruptcy "legal, equitable, and contractual rights"—the substance of the creditor's claim—and whether those rights are left unaffected by the debtor's plan of reorganization.[104]

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[96] 11 U.S.C. § 1126(a) (2012).
[97] *Id.* § 1124.
[98] *See infra* Part II(B)(3).
[99] *Id.*
[100] *See In re* Southland Corp., 124 B.R. 211, 221 (Bankr. N.D. Tex. 1991) (addressing which parties could vote certain claims, and explaining the difference, in securities practice, between the "record holder" and the "beneficial owner" or "true owner" of the security).
[101] 11 U.S.C. § 1126(a).
[102] *Id.* § 1126(f).
[103] *Id.* § 1124(1).
[104] *See id.*

2. A Creditor's Allowed Claim is a Bundle of Rights and the Right to Vote on the Plan is but One Stick in the Creditor's Bundle

A creditor's "claim" in bankruptcy consists of two separate, yet interdependent, bundles of rights. On one hand, the creditor's claim—the right to payment under applicable non-bankruptcy law—includes the bundle of rights granted to the creditor under the terms and provisions of the agreement that forms the basis for the claim.[105] On the other hand, the creditor has a bundle of bankruptcy rights, which are attached to, and contingent upon the existence of, the creditor's claim.[106] This concept of the "claim" being a bundle of rights is not new; nevertheless, it is often overlooked.

For example, in *Consolidated Rock Products Co. v. DuBois*,[107] the Supreme Court implicitly recognized the concept that a claim is a bundle of rights, and, furthermore, that each individual right within the bundle has value.[108] Thus, the Court held that for a plan to satisfy the absolute priority rule, "[f]ull compensatory provision must be made for the entire bundle of rights which the creditors surrender."[109] According to the Court, these "prior rights" within the bundle of

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[105] *See* Consol. Rock Prod. Co. v. DuBois, 312 U.S. 510, 528–29 (1941) (implicitly recognizing a claim is a bundle of rights; thus, for a plan to satisfy the absolute priority rule, "[f]ull compensatory provision must be made for the entire bundle of rights which the creditors surrender"); *see also* Daniel P. O'Gorman, *Contract Law and Fundamental Legal Conceptions: An Application of Hohfeldian Terminology to Contract Doctrine*, 33 MISS. C. L. REV. 317, 359 (2015) ("Similar to a person's obtaining ownership of a thing, once a contract arises, a bundle of rights, powers, privileges, and immunities, along with their correlatives (duties, liabilities, no-rights, and disabilities), arises between the parties to the contract (and, to a lesser extent, third parties) that are different from the legal interests between the parties prior to contract formation."); Jay Lawrence Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 231 (1989) ("Each prebankruptcy contract represents a bundle of rights belonging to the estate (the obligations of the other party to the contract) and potential claims against the estate (the obligations of the debtor under the contract).").

[106] *See, e.g., In re* LightSquared Inc., 513 B.R. 56, 84 (Bankr. S.D.N.Y. 2014) (holding when determining classifications, the court focuses on the legal nature of the underlying claim because a proof of claim reflects more than just a monetary amount: "it reflects a bundle of rights and remedies that are wielded by the holder of the claim"); *In re* Intermountain Porta Storage, Inc., 74 B.R. 1011, 1017 (D. Colo. 1987) (stating a creditor's right to set off under 11 U.S.C. § 553(b) "is just one component of the bundle of rights a creditor—whether or not his claim is secured—possesses against a debtor"). *Cf. In re* Casco Bay Lines, Inc., 14 B.R. 18, 20 n.2 (B.A.P. 1st Cir. 1981) ("The right to appear and be heard on any issue and the right to appeal are rights associated with the status of a 'party in interest.'"); *In re* Deak & Co., 63 B.R. 422, 423 (Bankr. S.D.N.Y. 1986) ("A party in interest classification provides a party with standing to assert an affirmative bundle of rights and privileges under the Code.").

[107] 312 U.S. 510 (1941).

[108] *See id.* at 527–29.

[109] *Id.* at 528. The Court stated the bondholders were not made whole by the plan due to the following:

> They have received an inferior grade of securities, inferior in the sense that the interest rate has been reduced, a contingent return has been substituted for a fixed one, the maturities have been in part extended and in part eliminated by the substitution of preferred stock, and their former strategic position has been weakened. Those lost rights are of value.

Id. at 527–28.

rights associated with the creditor's claim include, for example, the creditor's right to priority.[110]

Similarly, in *Nobelman v. American Savings Bank*,[111] the Court again recognized that a creditor's claim in bankruptcy consists of a bundle of substantive rights, which necessarily arise from, and are defined by, the instrument that created the creditor's claim.[112] The issue in *Nobelman* was whether the debtor's chapter 13 plan, which proposed bifurcation of the secured creditor's claim into a secured claim and an effectively worthless unsecured claim, modified the "rights" of the secured creditor as a homestead mortgagee in violation of section 1322(b)(2).[113] Section 1322(b)(2) provides that a chapter 13 plan may "modify the rights of holders of secured claims, other than a claim secured only by a security interest in real property that is the debtor's principal residence . . . ."[114] The Court determined that the focus of section 1322(b)(2) was on the modification of the "rights of holders" of claims, and that the secured creditor's "rights" as a mortgagee were not limited to the valuation of its secured claim.[115] Rather, the Court held that the creditor's claim, and the scope of the creditor's rights as the holder of that claim, were defined by the terms of the instrument that created the creditor's claim against the debtor.[116] The Court explained:

> The term "rights" is nowhere defined in the Bankruptcy Code. In the absence of a controlling federal rule, we generally assume that Congress has "left the determination of property rights in the assets of a bankrupt's estate to state law," since such "property interests are created and defined by state law." *Butner v. United States*, 440

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[110] *Id.* 528–29. The Court explained:

> No offer is fair which does not recognize the prior rights of creditors . . . but circumstances may justify an offer of different amounts of the same grade of securities to both creditors and stockholders. Thus it is plain that while creditors may be given inferior grades of securities, their "superior rights" must be recognized. Clearly, those prior rights are not recognized, in cases where stockholders are participating in the plan, if creditors are given only a face amount of inferior securities equal to the face amount of their claims. They must receive, in addition, compensation for the senior rights which they are to surrender. If they receive less than that full compensatory treatment, some of their property rights will be appropriated for the benefit of stockholders without compensation. That is not permissible.

Id. (quoting Kansas City Terminal Ry. Co. v. Cent. Union Tr. Co., 271 U.S. 445, 456 (1926)).

[111] 508 U.S. 324 (1993).

[112] *See id.* at 328–30.

[113] *See id.* at 326–27.

[114] 11 U.S.C. § 1322(b)(2) (2012).

[115] *Nobelman*, 508 U.S. at 328–29.

[116] *Id.* at 331. The Court rejected the debtor's argument that the plan could reduce the fair market value of the collateral without modifying the secured creditor's rights as to other contract terms, and explained that "[t]he bank's contractual rights are contained in a unitary note that applies at once to the bank's overall claim, including both the secured and unsecured component." *Id.* Thus, the plan could not modify the terms of the unsecured component without also modifying the terms of the secured component, which would be "a significant," and impermissible, "modification of a contractual right." *Id.*

> U.S. 48, 54–55, 59 L. Ed. 2d 136, 99 S. Ct. 914 (1979). *See also Barnhill v. Johnson*, 503 U.S. 393, 398, 118 L. Ed. 2d 39, 112 S. Ct. 1386 (1992). Moreover, we have specifically recognized that "the justifications for application of state law are not limited to ownership interests," but "apply with equal force to security interests, including the interest of a mortgagee." *Butner*, *supra*, at 55. The bank's "rights," therefore, are reflected in the relevant mortgage instruments, which are enforceable under Texas law. They include the right to repayment of the principal in monthly installments over a fixed term at specified adjustable rates of interest, the right to retain the lien until the debt is paid off, the right to accelerate the loan upon default and to proceed against petitioners' residence by foreclosure and public sale, and the right to bring an action to recover any deficiency remaining after foreclosure . . . . These are the rights that were "bargained for by the mortgagor and the mortgagee," *Dewsnup v. Timm*, 502 U.S. 410, 417, 112 S. Ct. 773, 116 L. Ed. 2d 903 (1992), and are rights protected from modification by § 1322(b)(2).[117]

Courts have also applied the bundle of rights theory in the claims context to aid in the determination of, for example, whether an entity has a right of subrogation,[118] whether a plan impairs a creditor's claim,[119] whether an assignment includes the right to pursue a particular action against a common debtor,[120] and whether an intercreditor subordination agreement effectively creates a waiver of a debtor's

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[117] *Id.* at 329–30.

[118] *See In re* XTI Xonix Techs., Inc., 156 B.R. 821, 827 (Bankr. D. Or. 1993) ("Whether an entity holds a right which falls within the definition of a 'claim' under § 101(5) is determined by state law. This court has found that the use of the term 'right of subrogation' is used by courts rather carelessly to define generally the equitable bundle of rights a guarantor (or surety) holds which aids him in obtaining repayment. For purposes of this opinion it is important that this bundle of rights be separately examined. It consists of the rights of indemnity (or reimbursement), contribution, subrogation and exoneration.").

[119] *See In re* Rogers, 494 B.R. 664, 669 n.8 (Bankr. E.D.N.C. 2013) (holding the creditor's rights, for the purpose of determining whether the plan impaired the claim, included those rights "which were granted to [the secured creditor] under the terms and provisions of the promissory note executed by the debtors and deed of trust encumbering the real property, include *inter alia*: (1) the right to repayment of principal and interest (at a specified adjustable rate) in monthly installments of $1,200.40 over a thirty—year period; (2) the right to retain its lien on the real property until the debt is satisfied; (3) the right to accelerate the amount due upon default and initiate foreclosure proceedings against the real property; and (4) the right to commence a separate action against the debtors to recover any deficiency remaining after a foreclosure sale").

[120] *See* Export-Import Bank of the United States v. United Cal. Disc. Corp., 738 F. Supp. 2d 1047, 1053 (C.D. Cal. 2010) ("UPS assigned to plaintiff the complete bundle of rights that UPS held as a result of Ashford's indebtedness to UPS, including UPS's rights relating to defendant's failure to honor the draft on the UCDC LOCs. Included within the bundle of rights assigned to plaintiff was UPS's right of action against defendant for wrongful dishonor of the UCDC LOCs. *See* Cal. Civ. Code § 954 ('A thing in action, arising out of the violation of a right of property, or out of an obligation, may be transferred by the owner.').").

property rights.[121] The influence of this view is likewise apparent in the context of classification under section 1122, where the focus is on the legal nature of the claim, not on the identity of the claimholders.[122]

Thus, it is well-established in bankruptcy jurisprudence that the rights of a particular creditor in bankruptcy, in the absence of a specific provision of the Code that enlarges those rights or which creates new rights in favor of a specific party, must be defined by, and limited to the terms of the underlying obligation, which forms the basis for the creditor's claim. Therefore, a senior creditor's claim—which necessarily includes all the sticks in the bundle of rights under the terms of the loan agreement and the bundle of rights under the Code which are associated with the existence of the claim—may include a stick from the bundle of rights of another creditor, including the subordinated creditor's right to vote its claim, where that right was negotiated and assigned as consideration for the pre-bankruptcy loan agreement.[123] Consequently, the terms of the loan agreement, which creates the senior creditor's claim, is determinative of whether the senior creditor has a

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[121] *See In re* Three Strokes Ltd., 397 B.R. 804, 808–09 (Bankr. N.D. Tex. 2008). Addressing whether a subordination agreement extinguished certain property rights of the debtor, the bankruptcy court stated, in pertinent part:

> That nuance is the fact that the Debtor and the First Lien Lender are (and have been for more than two years) parties to the Intercreditor Subordination Agreement. The court believes that a legitimate question is presented here as to whether the Intercreditor Subordination Agreement essentially creates a waiver or relinquishment of the Debtor's property rights, *vis-a-vis* the second lien, so that the Debtor really has no meaningful property interests left. In other words, has the Debtor, by contractually subordinating its second lien and significant rights associated therewith, given up what would have ordinarily been a Section 541 property interest? The court thinks not—at least not with the Intercreditor Subordination Agreement, as worded in this case. While the Debtor has clearly subordinated itself to the rights of Conseco, *vis-a-vis* the Arizona Property, and the right to payments on its second lien loan from Citadelle, and while Section 510 of the Bankruptcy Code dictates that the Intercreditor Subordination Agreement is in all ways enforceable in this bankruptcy case (to the same extent enforceable under applicable nonbankruptcy law), this does ***not*** mean that the Debtor has no property right here at all worthy of protection. The subordination agreement certainly dilutes or weakens the Debtor's bundle of rights associated with the second lien. But it does not extinguish the property rights altogether.

Id.

[122] *Compare* Peter E. Meltzer, *Disenfranchising the Dissenting Creditor Through Artificial Classification or Artificial Impairment*, 66 AM. BANKR. L.J. 281, 299 (1992) ("[T]he cases that have permitted separate classification based on differing agendas between unsecured creditors have done so only by focusing on the creditors themselves rather than the nature of their underlying claim. However, as stated in *Collier*: 'the nature of the claim or interest is relevant to classification, not the nature of the identity of the holder of the claim or interest.'"), *with* Fee, *supra* note 30, at 485 ("Assigning the right to vote disrupts class voting by permitting the assignee—with dissimilar interest than the rest of the class—to influence the outcome of the class vote.").

[123] *See* Berman & Lee, *supra* note 9, at 19 ("Since a lender can assign its entire bundle of rights related to a claim, there doesn't seem to be a cogent reason, certainly no public policy reason, why the lender should be prevented from giving up only a portion of its bundle of rights.").

corresponding right to vote on the plan on behalf of a junior creditor.[124] By shifting the focus from sections 510(a) and 1126(a) to the scope of the allowed claim under section 502, and the creditor's rights thereunder, the proposed analysis eliminates the ambiguities inherent in the interpretation and application of section 510(a) and section 1126(a). Specifically, because many subordination agreements are structured in a way such that the subordination agreement between the junior and senior creditor is incorporated into the loan agreement between senior creditor and the debtor,[125] the voting assignment becomes part of the senior creditor's allowed claim. Put another way, the voting assignment becomes one of the sticks in the bundle of rights that is the senior creditor's claim.[126] This is because the individual terms of the negotiated subordination agreement form part of the consideration for

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[124] *See, e.g., In re* Aerosol Packaging, LLC, 362 B.R. 43, 47 (Bankr. N.D. Ga. 2006) (finding a creditor's right to vote based on express terms in the parties' loan agreement).

[125] *See, e.g., id.*; Motion Requesting (1) Determination of Voting Rights and Allowance of Ballot Cast by Blue Ridge Investors, II, L.P. and Brief in Support Thereof, (2) Valuation of Collateral, and (3) Hearing at Ex. A, *In re* Aerosol Packaging, LLC, 362 B.R. 43 (Bankr. N.D. Ga. 2006) (No. 06-67096-MHM), ECF No. 148 [hereinafter Motion for Determination of Voting Rights]. The first paragraph of the "Subordination Agreement" made by Blue Ridge (the "Subordinated Creditor") and Aerosol Packaging (the "Borrower") in favor of Southtrust Bank (the "Lender") states: "The Lender has entered into two Business Loan Agreements, both dated Dec. 5, 2002, one relating to a $2,000,000 line of credit and the other to a $500,000 loan, with the Borrower (said Agreements . . . being collectively referred to as the 'Loan Agreements' . . . ." *Id.* The third paragraph of the Subordination Agreement provides: "It is a condition precedent to the making or advances by the Lender under the Loan Agreements, that the Subordinated Creditor shall have executed and delivered [the Subordination Agreement]." *Id.* Section 7 of the Subordination Agreement ("Subordination Legend; Further Assurances") states that the Subordinated Creditor and the Borrower would endorse "each instrument evidencing Subordinated Debt" with the following legend:

> The indebtedness evidenced by this instrument is subordinated to the prior payment in full of the Obligations (as defined in the Subordination Agreement hereinafter referred to) pursuant to, and to the extent provided in, the Subordination Agreement . . . by the maker hereof and payee named herein in favor of the Lender referred to in such Subordination Agreement.

Id.

[126] A contract "may consist of several writings" if the writings at issue "clearly indicate that they relate to the same transaction." *In re* Rolfe, 710 F.2d 1, 3 (1st Cir. 1983) (quoting RESTATEMENT (SECOND) OF CONTRACTS § 132); *see also* K.E Res., LTD v. BMO Fin. Corp. (*In re* Century Offshore Mgmt. Corp.), 119 F.3d 409, 414 (6th Cir. 1997) (stating lender was bound by mortgage provisions subordinating its security interest in chapter 11 debtor-well operator's lease proceeds to interests created in operating agreement between debtor and investors, even though lender did not itself sign mortgage, given that lender did sign credit agreement, which was centerpiece of loan transaction, and thus was bound by supporting documents as well). In *In re Rolfe*, the debtors, the president of a certain insolvent corporation and his wife, filed an objection to the claim of a creditor which had executed a corporate note in favor of the debtors' corporation, which was secured, in part, by a mortgage on the debtors' home. 710 F.2d at 2. The First Circuit Court affirmed the bankruptcy court's holding that the debtors received consideration for the granting of the mortgage securing the corporate note, and the mortgage and note together were sufficient to satisfy the statute of frauds. *Id.* at 3. In so holding, the First Circuit panel determined that the consideration for the mortgage of the debtors' home was supplied by the fact that the mortgage security was put up in return for acceptance by the creditor of deferred payments on the corporate debt, and that the purchase agreement, note, and mortgage together supplied all essential terms of the transaction for purposes of the statute of frauds. *Id.* ("[T]he Agreement explicitly refers to the specific Note and Mortgage at issue; the Note makes clear that a home mortgage is held as security for payment; and the Mortgage states that Rolfe's house secures a $70,000 note.").

the obligation between the senior creditor and the debtor.[127] Given the integration of the subordination agreement into the broader loan agreement, upon which the senior creditor's claim is based, it logically follows that the question of whether the senior creditor is the "holder" of the right to vote the junior claim under section 1126(a) should be determined by reference to the substantive provisions of the respective loan agreements that create the claims of the respective senior creditor and junior creditor. Thus, where a senior creditor's "claim" arises from a loan agreement, which includes terms of subordination and assignment of the junior creditor's right to vote the junior claim, such provision must be given effect in bankruptcy because it is a substantive and essential element of the claim itself.[128] This would be true of the subordinated claim, as well, because in most cases where there is a subordination agreement between the senior creditor and junior creditor, the agreement will also be incorporated into the junior creditor's loan agreement—even if it is pre-existing—with the common debtor. By agreeing to the voting assignment provision of the indenture agreement, the junior creditor is selecting the bundle of rights it will have as the holder of its claim in bankruptcy. And this decision, which was negotiated for by the parties, should be recognized in deciding whether the senior creditor or the junior creditor is the holder of the right to vote the junior claim.

Honoring creditors' pre-bankruptcy entitlements is not only consistent with the Code and existing jurisprudence on the substantive rights of creditors in bankruptcy proceedings, it also ensures predictability in restructuring, which is often a remote contingency at the time the creditors enter into the subordination agreement and the corresponding senior loan agreement with the common debtor. It is not disputed that the "right" to vote an associated claim has value insofar as it increases bargaining power, and the value of this right in the context of a subordination agreement is underscored by the fact that a major purpose of subordination is

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[127] This is an important concept when considering the primary purpose of bankruptcy law. To mitigate the potential negative side effect of only being focused on maximizing the going concern surplus—"[i]f the law maximized the going concern value of firms but gave the entire value to the debtor, then creditors would anticipate receiving no value in bankruptcy and charge very high interest rates." Kevin A. Kordana & Eric A. Posner, *A Positive Theory of Chapter 11*, 74 N.Y.U. L. REV. 161, 166 (1999). Bankruptcy law "must also respect credit contracts that establish 'prebankruptcy entitlements.'" *Id.* Kordana and Posner explain:

> Although there is some controversy over this issue, we assume that creditors and debtors should have the power to determine in their prebankruptcy credit contracts the creditors' rights in bankruptcy. Creditors and debtors sometimes prefer low-risk credit, which gives the creditor high priority in bankruptcy and the debtor a low interest rate, and they sometimes prefer high-risk credit, which gives the creditor low priority in bankruptcy and the debtor a high interest rate. These arrangements are obtained through security agreements, debt covenants, and other contracts. Enforcing these arrangements will be referred to as "respecting prebankruptcy entitlements."

Id. (footnote omitted).

[128] Raleigh v. Illinois Dep't of Revenue, 530 U.S. 15, 20–21 ("Do the State's right and the taxpayer's obligation include the burden of proof? Our cases point to an affirmative answer. Given its importance to the outcome of cases, we have long held the burden of proof to be a 'substantive' aspect of a claim.").

security for the senior debt.[129] Thus, it is important to ensure that such bargained for value—as part of the pre-bankruptcy agreements that create and define the respective claims—is not disregarded under the guise of "bankruptcy policy" where the effect would be adjustment of the creditor-creditor relationship, as opposed to the debtor-creditor relationship. The overarching policy of the Bankruptcy Code, and the foundation of the bankruptcy court's jurisdiction, is adjustment of the debtor-creditor relationship, not the creditor-creditor relationship.[130] While it is true that contractual rights may be modified and adjusted in bankruptcy, the circumstances where such modifications are authorized under the Code generally pertain to the debtor-creditor relationship or estate-creditor relationship. On this point, in *Raleigh v. Illinois Dept. of Revenue*,[131] in response to the petitioner's argument that the "Code-mandated priority enjoyed by taxing authorities over other creditors" required "a compensating quality of treatment when it comes to demonstrating validity of claims," the Supreme Court stated that such argument "distorts the legitimate power of a bankruptcy court and begs the question about the relevant principle of equality."[132] The Court explained:

> Bankruptcy courts do indeed have some equitable powers to adjust rights between creditors. *See, e.g.*, § 510(c) (equitable subordination). That is, within the limits of the Code, courts may reorder distributions from the bankruptcy estate, in whole or in part, for the sake of treating legitimate claimants to the estate equitably. But the scope of a bankruptcy court's equitable power must be understood in the light of the principle of bankruptcy law discussed already, that the validity of a claim is generally a function of underlying substantive law. Bankruptcy courts are not authorized in the name of equity to make wholesale substitution of underlying

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[129] David Gray Carlson, *A Theory of Contractual Debt Subordination and Lien Priority*, 38 VAND. L. REV. 975, 999–1000 (1985). Carlson explains, in pertinent part:

> Subordination agreements frequently specify that the senior creditor is to receive bankruptcy dividends if and when bankruptcy occurs. The senior creditor will become the owner of bankruptcy dividends without any further act by the junior creditor. This is just as true when the parties manifest nothing explicitly about bankruptcy dividends. Courts universally have recognized that the non-contingent promise not to receive payment until the senior claims are paid eventually evolves into the double dividend system.

Id. at 999 (footnote omitted).

[130] *See generally* Plank, *supra* note 86 (discussing the constitutional limitations on the power of bankruptcy courts to adjust the debtor-creditor relationship, and in certain circumstances, the creditor-creditor relationship); *see also* Kordana & Posner, *supra* note 127, at 181–82 ("If the only goal of bankruptcy law were to maximize the payouts based on going concern value, we would want to give all the bargaining power to one party. The reason that we do not do this is that the party with all the bargaining power would not respect pre-bankruptcy entitlements.").

[131] 530 U.S. 15 (2000).

[132] *Id.* at 24.

> law controlling the validity of creditors' entitlements, *but* are limited to what the Bankruptcy Code itself provides.[133]

If pre-bankruptcy negotiated voting assignments are not enforced, the junior creditor is given bargaining power that it would not otherwise be entitled based on the junior creditor's decision to give that power as consideration to induce the senior creditor to loan additional funds to the common debtor.[134] Such approach, if taken, would effectively enlarge the junior creditor's rights in contravention of the underlying agreement, which brought the junior creditor's claim into existence in the first instance without any support for doing so under the express provisions of the Code.[135] It might be argued that enforcing the voting assignment has the same effect, i.e. enforcement of the voting assignment gives the senior all the bargaining power to disregard the junior creditor's pre-bankruptcy entitlements; however, this argument is undermined by the fact that the junior creditor's pre-bankruptcy entitlement is contingent upon the senior creditor's right to be paid in full before any distribution is made to the junior creditor. Thus, the effect of the senior creditor voting the junior creditor's claim does not disregard the junior creditor's pre-bankruptcy entitlement. Additionally, enforcement of voting assignment provisions facilitates the goal of efficient reorganization because it incentivizes the debtor to avoid delay and to propose a confirmable plan within the exclusivity period, which maximizes the going concern value by avoiding costs of extended bankruptcy litigation and administration.[136]

Lastly, it is well established that other analogous federal statutory rights may be prospectively waived by contract and that such waivers will be enforced by federal courts where the waiver is unambiguous and was knowingly and voluntarily agreed to by the parties.[137] For example, federal courts have consistently enforced

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[133] *Id.* at 24–25 (emphasis added).

[134] *See* Cohn, *supra* note 30, at 293–94 (1982).

[135] *See In re* Itemlab, Inc., 197 F. Supp. 194, 198 (E.D.N.Y. 1961) ("Since the vote attached to the claim is the only means of determining how and when the claim shall be enforced and the terms of payment, it would follow that the person entitled to collect the claim should be the person entitled to vote the claim; otherwise the result would be anomalous and would repose in the inferior creditor the power to use his vote to determine how the superior creditor shall collect a claim in which the inferior creditor no longer has an interest."); Fee, *supra* note 30, at 479 (noting before the enactment of the Bankruptcy Code in 1978, notwithstanding the absence of any provision in the former Act equivalent to § 510(a), "courts uniformly enforced subordination agreements" based on the reasoning that "a creditor should not be allowed to bargain for a particular treatment prepetition and then flagrantly disregard such arrangement once in bankruptcy" because that would result in the junior creditor receiving "a windfall by getting both the benefit of the bargained for contractual arrangement and the ability to alter that arrangement in bankruptcy if it saw fit").

[136] *See* Kordana & Posner, *supra* note 127, at 182 (noting the tension between the respect for prebankruptcy entitlements and the division of bargaining power that reflects those entitlements on one hand, and maximization of going concern value on the other, which concentrates bargaining power in one party—usually the debtor via the exclusivity period).

[137] *See, e.g.*, Pierce v. Atchinson, Topeka & Santa Fe Ry. Co., 65 F.3d 562, 570 (7th Cir. 1995) ("Employees may waive their federal ADEA rights in private settlements with their employers, provided that their consent to a release is both knowing, and voluntary.").

contractual waivers of the statutory right of removal under 28 U.S.C. § 1141(a)[138] and/or waivers of the right to select the venue in which a dispute will be heard under 28 U.S.C. § 1404(a),[139] which are both unquestionably valuable federal statutory rights akin to the right to vote on a chapter 11 plan under 11 U.S.C. § 1126(a).[140] It is common for contracting parties to agree to a forum-selection clause. Such clauses operate as a prospective waiver of the federal statutory right of removal and/or the federal statutory right to select the venue where future claims—ones that may or may not arise—will be litigated.

In his concurring opinion in *Stewart Organization, Inc. v. Ricoh Corp.*,[141] Justice Kennedy observed that "enforcement of valid forum-selection clauses, bargained for by the parties, protects their legitimate expectations and furthers vital interests of the justice system[,]"[142] such as "to spare litigants unnecessary costs . . . [and] to relieve courts of time-consuming motions"[143]—interests which are substantially similar to the bankruptcy policy of ensuring timely and efficient reorganization.[144] Other courts have, consistent with Justice Kennedy's concurring opinion in *Stewart Organization, Inc.*, emphasized the bargained-for value inherent in forum-selection clauses. For example, in *Yakin v. Tyler Hill Corp.*,[145] a panel of the Second Circuit Court of Appeals enforced an unambiguous forum selection clause under which the defendant waived its right to remove the case from the state court to the federal district court.[146] In reaching its decision, the panel applied the well-settled rule that "[p]arties are free to bind themselves to forum selection clauses that trump what would otherwise be a right to remove cases to federal

[138] *See* 28 U.S.C. § 1441(a) (2012) ("[A]ny civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendant or the defendants, to the district court of the United States for the district and division embracing the place where such action is pending."); *see also* Cogdell v. Wyeth, 366 F.3d 1245, 1248 (11th Cir. 2004) (stating there are three prerequisites for removal jurisdiction: (1) that the case originated in state court; (2) that the defendant remove the case to the appropriate federal district court; and (3) that the federal district court have original jurisdiction over the matter).

[139] 28 U.S.C. § 1404(a) ("For the convenience of parties and witnesses, in the interest of justice, a district court may transfer any civil action to any other district or division where it might have been brought or to any district or division to which all parties have consented.").

[140] *See* 11 U.S.C. § 1126(a) (2012). In comparing the aforementioned federal statutory rights with the right to vote on a chapter 11 plan, it is important to distinguish between the jurisdictional aspect of these rules and the aspect of the rules which grant power to parties to take certain actions. For the purposes of our analogy, the focus is on the enforcement of prospective waivers of those rights which arise out of, or are predicated upon, a jurisdiction-invoking claim—in civil cases, the cause of action; in bankruptcy, the creditor's claim.

[141] 487 U.S. 22, 33 (1988) (Kennedy, J., concurring).

[142] *Id.* at 33.

[143] *Id.*

[144] The federal statutory rights which may be prospectively waived under a negotiated forum selection clause are, in many respects, analogous to the right to vote on a chapter 11 plan under 11 U.S.C. § 1126(a). Similar to the prerequisites for removal, the right to vote only arises if: (1) the party holds an allowed claim, which is the basis of the bankruptcy court's jurisdiction to grant relief to that party; and (2) the claim is impaired under the plan.

[145] 566 F.3d 72 (2d Cir. 2009).

[146] *See id.* at 76–77.

courts."[147] Similarly, in *Varabiev v. Bank Leumile Israel (Switzerland)*,[148] the district court rejected the plaintiff's argument that the forum selection clause negotiated between the parties should not be enforced, and explained:

> A potential plaintiff's ability to choose a forum in which to bring her claim is part of the bundle of rights under her ownership when she enters contract negotiations, and the transfer of that right to the other party is a valuable consideration, in return for which the potential defendant offers valuable consideration of its own.[149]

A pre-bankruptcy assignment by the junior creditor of its right to vote as consideration to induce the senior lender to enter into the contemplated loan agreement with the common debtor is substantially similar to a prospective waiver of the federal statutory rights discussed above. The effect of considering the voting assignment as a substantive part of the senior creditor's claim, and thus giving the senior creditor status as the "holder" of the subordinated claim for the purposes of voting, is to protect the bargained for expectations of the parties and to ensure an efficient reorganization in accordance with those expectations, while also respecting the pre-bankruptcy entitlements of the parties.

3. Enforcement of Voting Assignment Provisions Neither Precludes the Junior Creditor from Participating in the Administration of the Bankruptcy Estate, Nor Does It Leave the Junior Creditor Without Remedies to Protect Its Interest

A common refrain of proponents of either the narrow theory of enforcement or the 1126(a) plain meaning theory of enforcement is that enforcement of voting assignment provisions will effectively preclude the junior creditor from exercising its right to participate in the administration of the debtor's bankruptcy estate, which leaves the junior creditor without any remedy to protect its interest in the estate.[150]

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147 *Id.* at 76 (citing Philips v. Audio Active Ltd., 494 F.3d 378, 386 (2d Cir. 2007) ("[C]ontracting parties may . . . agree in advance on a forum where any and all of their disputes must be brought . . . .")).

148 No. 03 Civ. 3063(SAS), 2004 WL 936804 (S.D.N.Y. Apr. 30, 2004).

149 *Id.* at *3 (citing Carnival Cruise Lines v. Shute, 499 U.S. 585, 594 (1991) (stating it "stands to reason that passengers who purchase tickets containing a forum clause . . . benefit in the form of reduced fares reflecting the savings the cruise line enjoys by limiting the fora in which it may be sued"); *see also* Roby v. Corp. of Lloyd's, 996 F.2d 1353, 1363 (2d Cir. 1993) ("[T]he [Supreme] Court has noted that contracts entered into freely generally should be enforced because the financial effect of forum selection and choice of law clauses *likely will be reflected in the value of the contract as a whole*.") (emphasis added).

150 *See In re* 203 N. LaSalle St. P'ship, 246 B.R. 325, 332 (Bankr. N.D. Ill. 2000) ("Congress may well have determined to protect [the potential for subordinated claim to receive a distribution] by allowing the subordinated claim to be voted. This result assures that the holder of a subordinated claim has a potential role in the negotiation and confirmation of a plan, a role that would be eliminated by enforcing contractual transfers of Chapter 11 voting rights."); Fee, *supra* note 30, at 485 ("[A]ssigning the right to vote may deprive a subordinated creditor of the protection of the absolute priority rule provided in § 1129(b) by allowing equity holders to retain their interests when the subordinated creditor is not being fully paid and would otherwise be a dissenting class as a result of voting against the plan.").

This argument, however, is based on a fundamental misconception that the junior creditor's right to vote its claim is the only way for the junior creditor to protect its interest, and that the right to vote is the only thing that prevents disenfranchisement of the junior creditor by the senior creditor and, for example, equityholders. In furtherance of this argument, the proponents of the Non-Enforcement Theories point to the fact that many subordination agreements purport to waive or assign other bankruptcy "rights" of the junior creditor, such as the right to object to the confirmation of a plan[151] or the right to seek appointment of a trustee or examiner.[152] From this, proponents of the Non-Enforcement Theories argue that if the voting assignment is enforced and the junior creditor is not allowed to vote its own claim, the junior creditor is left without remedy to protect its interest.[153] What these arguments fail to consider is the substantive difference between those rights under the Code that are contingent upon and attached to a certain claim, and those rights granted to a "party in interest." This is an important distinction.

Rights granted to a "party in interest" (e.g., the "right" to object to a chapter 11 plan)[154] are distinguishable from those rights that are specifically contingent upon the existence of a claim, such as the right of the "holder" of a claim to vote. This is because rights granted to a "holder" of a claim are, for the reasons previously discussed, necessarily defined by the terms and scope of the agreement that gives rise to the claim, such that the creditor's standing in the proceeding is based upon the substance of the claim itself. In contrast, the provisions of the Code which grant certain rights to a "party in interest"[155] are interpreted broadly as conferring standing to those parties that are or will be affected by the resolution of the issue at bar to be heard and to take certain actions to protect their interest.[156] The term "party in

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151 *See* 11 U.S.C. § 1128(b) (2012) ("A party in interest may object to confirmation of a plan.").

152 *See id.* § 1104.

153 *See, e.g.*, Cohn, *supra* note 30, at 316 ("Unrestricted voting of subordinated claims by senior creditors robs the subordinated claimants of the opportunity to decline to assent, without providing any other protection for their interest.").

154 11 U.S.C. § 1128; *see also infra* note 155 and accompanying text.

155 There are a number of provisions which grant rights to a "party in interest"—as opposed to, for example, specifically a creditor or holder—to take action in the case. 11 U.S.C. § 362(c)(3) ("on the motion of a party in interest for continuation of the automatic stay and upon notice and a hearing, the court may extend the stay in particular cases as to any or all creditors . . ."); *id.* § 362(d) ("On request of a party in interest and after notice and a hearing, the court shall grant relief from the stay provided under subsection (a) of this section."); *id.* § 502(a) (a claim is deemed allowed, "unless a party in interest" objects); *id.* § 1104 (providing various rights regarding the appointment of a trustee to a "party in interest"); *id.* § 1105 (the court may terminate the service of the trustee upon request of a party in interest prior to the confirmation of a plan); *id.* § 1109(b) (a party in interest (creditor, equity security holder, etc.) has the right to be heard on any issue in a chapter 11 case); *id.* § 1112(b) (a party in interest may request conversion of the case); *id.* § 1121(c) (any party in interest may file a plan if certain prerequisites are met); *id.* § 1128 (party in interest may object to the confirmation of the plan). *Cf. id.* § 363(c)(2)(A) (a trustee cannot use, sell, or lease cash collateral unless "each entity that has an interest in such cash collateral consents"); *id.* § 1125 (provisions related to the disclosure statement specifically address the plan proponent's obligations of disclosure to "holders of claims or interests"); *id.* § 1126 (the holder of an allowed claim or interest may accept or reject the plan).

156 One treatise on bankruptcy explains:

interest" is not defined in the Bankruptcy Code or the Federal Rules of Bankruptcy Procedure. The term has been described as "an expandable concept depending on the particular factual context in which it is applied."[157] In various contexts, a "party in interest" has been held to be one who has a pecuniary interest that will be directly and adversely affected by an order of the bankruptcy court,[158] anyone who has a practical stake in the outcome of a case,[159] and those who will be impacted in any significant way in the case.[160] In other contexts, it is an established principle that standing generally cannot be waived by agreement, particularly where there is no alternative forum available to the prospective litigant to vindicate its interest.[161]

> Numerous Code provisions contemplate requests by a "party in interest" for relief. These provisions give rise to standing issues in contested matters. Courts have noted that the Code and the Bankruptcy Rules contain some 46 references to "party in interest." The requests by a "party in interest" that give rise to contested matters include, among other things, safeguarding trade secrets or confidential research, development, or commercial information; relief from the automatic stay; demanding adequate protection for an interest in property that the debtor proposes to use, sell or lease; compelling the trustee to assume or reject executory contracts or unexpired leases; modifying the amount of any deposit or other security necessary to obtain service for a utility; objecting to a claim; the appointment of additional committees of creditors or other equity security holders in a Chapter 11 case; seeking a trustee or an examiner in a Chapter 11 case; terminating the appointment of a Chapter 11 trustee; object to confirmation of a plan; converting a case under Chapter 11 to a case under Chapter 7 or dismissing a Chapter 11 case.

Standing of Parties in Interest to Appear and Be Heard, 1 BANKR. LITIG. § 6:33 (2018) (footnotes omitted).

157 *In re* River Bend–Oxford Assocs., 114 B.R. 111, 115 (Bankr. D. Md. 1990) (distinguishing between who is a "real party in interest" for the purposes of relief from stay and stating real party in interest "differs from the concepts of capacity and standing, although standing may closely resemble real party in interest in many instances . . . . A real party in interest determination thus serves an essentially different and more narrow purpose than the determination of a party in interest in a non-adversary context of determining who may be sufficiently impacted by a reorganization proceeding to be entitled to some representation or voice in the process.") (internal citation omitted).

158 *See In re* Lona, 393 B.R. 1, 3 (Bankr. N.D. Cal. 2008) (citing Fondiller v. Robertson (*In re* Fondiller), 707 F.2d 441, 442–43 (9th Cir. 1983)) ("[C]ourts have held that standing in a bankruptcy context requires an 'aggrieved person' who is directly and adversely affected pecuniary by an order of the bankruptcy court."); Kapp v. Naturelle, Inc., 611 F.2d 703, 706 (8th Cir. 1979) ("The term 'party in interest' is not defined in the [Bankruptcy] Act. Courts construing the provision have reasoned that the interest must be a pecuniary interest in the estate to be distributed.").

159 *See In re* Amatex Corp., 755 F.2d 1034, 1041–44 (3d Cir. 1985) ("Whether or not future claimants have claims in the technical bankruptcy sense that can be affected by a reorganization plan, such individuals clearly have a practical stake in the outcome of the proceedings.").

160 *See In re* Johns–Manville Corp., 36 B.R. 743, 754 (Bankr. S.D.N.Y. 1984) (holding the concept of "party in interest" gives a court latitude to "insure fair representation" of a party who is significantly impacted by a chapter 11 case).

161 *See* Cmty. First Bank v. Nat'l Credit Union Admin., 41 F.3d 1050, 1053 (6th Cir. 1994) ("Standing is not an affirmative defense that must be raised at risk of forfeiture. Instead, it is a qualifying hurdle that plaintiffs must satisfy even if raised *sua sponte* by the court.") (emphasis in original); *In re* NASDAQ Mkt.-Makers Antitrust Litig., 176 F.R.D. 99, 103 (S.D.N.Y. 1997) ("Standing is a jurisdictional matter which must be resolved by the court; parties cannot either waive or confer standing by agreement."). *Cf.* Richardson v. Sugg, 448 F.3d 1046, 1055 (8th Cir. 2006) (explaining *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) stands for the proposition "employees may make the individual decision to contract away a right to have a federal court hear a civil rights claim in favor of an arbitration forum," and

This would almost certainly be the case with waivers of those bankruptcy rights which a party in interest is granted standing to enforce because, due to the bankruptcy discharge, the bankruptcy forum is the only forum where those interests can be vindicated. It logically follows that standing to assert those rights that are granted to a "party in interest" under the Code cannot be prospectively waived by agreement. Therefore, to the extent that courts and scholars, in analyzing the enforceability of voting assignments along with other "ancillary bankruptcy rights"[162] (such as seeking the appointment of a trustee or examiner, objecting to plan confirmation, or seeking designation of a vote), have lumped such rights together in order to give effect to their argument that the junior creditor often forfeits all of its rights to voice any opposition to the plan or to participate in a meaningful way in the reorganization proceedings, these analyses are fundamentally flawed in that they fail to distinguish between rights afforded to a "party in interest," which cannot be prospectively waived, and rights associated with the

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emphasizing by entering such an agreement, "a party *does not forgo the substantive rights afforded by the statute;* it only submits to their resolution in an *arbitral*, *rather than a judicial*, *forum*") (emphasis in original) (quoting *Gilmer*, 500 U.S. at 26).

[162] Berman and Lee explained that "ancillary bankruptcy rights" of the subordinated lender can impact various events in reorganization proceedings such as:

> [W]hether a subordinated lender can oppose DIP financing proposed or supported by senior lenders, whether a subordinated lender can propose alternative DIP financing in opposition to that proposed by senior lenders, what form that DIP financing might take, the right to seek adequate protection for their subordinated lien on the common collateral owned by the debtor, and the right to seek relief from the automatic stay in the absence of that adequate protection being provided. Ancillary bankruptcy rights also include those that impact the intermediate course of the reorganization proceeding as, absent the enforceability of an intercreditor provision to the contrary, a subordinated lender would have the right to oppose a § 363 lease or sale of assets to which the senior lenders consent, to seek the appointment of a trustee or an examiner, or the outright dismissal of the case. Ancillary bankruptcy rights can have a huge impact on the final stages of the reorganization by addressing who gets to vote the subordinated lender's claim, whether the subordinated lender can propose an alternative plan at all, especially one that seeks to cram down the senior debt, whether the subordinate lender can object to a disclosure statement presented in connection with a plan supported by the senior lenders, and whether the subordinated lender can object to the confirmation of that plan.

Berman & Lee, *supra* note 9, at 14. Similarly, in *In re Hart*, the bankruptcy court considered the effect of the subordination agreement on the rights of a secured creditor; specifically, the secured creditor's right to seek adequate protection or relief from the automatic stay. *In re* Hart Ski Mfg. Co., Inc., 5 B.R. 734, 736 (Bankr. D. Minn. 1980). The court placed these rights, which are specifically granted by the Code to secured creditors, on the same footing as other rights which are more broadly granted by the Code. *Id.* The court generally referred to these rights as "bankruptcy rights," which the court eventually determined were outside the scope of the subordination agreement. *Id.* This analytical approach to section 510(a) is problematic in that secured creditors have certain protected constitutional rights. *See* Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 594–95 (1935); Wright v. Vinton Branch of the Mountain Tr. Bank, 300 U.S. 440, 458–61 (1937). Therefore, certain provisions of the Code specifically grant secured creditors the right to take certain action with respect to their secured claim. Unsecured creditors, however, do not enjoy these additional protections under the Code. The bankruptcy court in *In re Hart* did not address this important distinction.

enforcement of a claim, which are limited by the substance of the claim itself. The selective and discerning decisions by Congress throughout the Code to give standing to any "party in interest" renders the provisions where Congress specifically chose to condition standing upon the existence of claim even more important. The decision by Congress to preserve the right of a party in interest to object to the confirmation of the plan[163] or to request designation of a vote,[164] while conversely limiting other rights such as the right to vote to specifically the "holder" of a claim, suggests that Congress contemplated situations where the "holder" of a claim for the purpose of voting may have different motivations from a "party in interest," whose pecuniary interest will be affected by the decision of other creditors to vote for or against a plan. It also underscores the importance of the substantive aspects of the underlying claim. Conversely, this distinction would not be implicated if, for example, a party whose claim is left unimpaired by the plan nevertheless seeks to object to confirmation of the plan. In such circumstances, because the plan leaves the legal interest unaltered, the party whose claim is unimpaired would not suffer any pecuniary effect and, therefore, that party would not have standing to object to confirmation.[165]

For example, in cases where a junior creditor desires to use the threat of valuation to gain bargaining leverage, the junior creditor would have standing to object to the confirmation of the plan notwithstanding the voting assignment by virtue of its rights as a party in interest under section 1128 and section 1129(a)(7)(A)(ii).[166] Additionally, in circumstances where the only purpose of the senior creditor's vote on the subordinated claim is to permit a class of equityholders to retain their interest in the reorganized debtor in violation of the absolute priority rule,[167] under section 1126(e)[168] the junior creditor, as a party in interest, would

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[163] *See* 11 U.S.C. § 1128 (2012). As envisioned, the junior creditor would have standing as a party in interest to object to the confirmation of a plan on the grounds that the junior creditor, on account of its right to payment, would not "receive or retain under the plan" the liquidation value of its claim under 11 U.S.C. § 1129(a)(7)(A).

[164] *See id.* § 1126(e) ("On request of a party in interest, and after notice and a hearing, the court may designate any entity whose acceptance or rejection of such plan was not in good faith, or was not solicited or procured in good faith or in accordance with the provisions of this title.").

[165] *See In re* SW Boston Hotel Venture, LLC, 460 B.R. 38, 62 (Bankr. D. Mass. 2011) (holding the objecting secured creditor did not have standing to assert the absolute priority rule as a secured creditor because it did not show that it would "sustain any harm from the Plan's provisions respecting treatment of unsecured creditors"); *In re* Orlando Inv., L.P., 103 B.R. 593, 596 (Bankr. D. Mass. 2011) ("[C]reditors whose rights are unimpaired under the plan, and who therefore have no right to vote on the plan, *see* 11 U.S.C. §§ 1124, 1126(f), have been held to possess no right to object to confirmation.").

[166] 11 U.S.C. §§ 1128, 1129(a)(7)(A)(ii).

[167] In arguing that enforcement of voting rights assignments allows the plan proponent to circumvent the absolute priority rule by depriving the subordinated creditor of its right to invoke the absolute priority rule, one commentator suggests the following hypothetical:

> Senior Creditor and Subordinated Creditor are unsecured creditors of the Corporation and are parties to a Subordination Agreement. The Subordinated Creditor agrees to subordinate its priority and right to payment and assign its voting rights in the event the Corporation files bankruptcy. When the Corporation ultimately files chapter 11 it designates two classes of unsecured creditors and one class for the equity holders: Class

have standing to seek designation of the senior creditor's vote on the grounds that it was cast in bad faith.[169] The House Report accompanying section 1126 states the following regarding subsection (e):

> Subsection (e) permits the court to designate for any class of claims or interests any person that has, with respect to that class, a conflict of interest that is of such nature as would justify exclusion of that person's claim or interest from the amounts and number specified in subsection (c) or (d). A person might have such a conflict, for example, where he held a claim or interest in more than one class. Exclusion from one class for voting purposes would not require his exclusion from the other class as well. The result is to overrule cases such as *Aladdin Hotel Corp. v. Bloom*, 200 F.2d 627 (8th Cir. 1953), which, though not in the bankruptcy context, would appear to count votes for a reorganization plan motivated by an attempt to squeeze out a minority of a class. In that case, the conflict of interest of those voting for the plan was clear, but the court permitted the votes.[170]

> I consists of the Senior Creditor; Class II consists of the Subordinated Creditor; and Class III consists of the shareholders. The Corporation's chapter 11 plan proposes to pay 98% of the Class I claim, 2% of the Class II claim, and allow shareholders in Class III to retain their equity interests.
>
> Disregarding the Subordination Agreement, Class I and Class II are entitled to vote on the plan because both classes are impaired. Class II would likely vote to reject the plan because Class I is almost being paid in full and equity is retaining its interest while Class II is only receiving a 2% distribution. Assuming Class II rejected the plan, the Corporation must either renegotiate with Class II, or attempt to cramdown Class II. The latter option, however, is not available to the Corporation because it violates the absolute priority rule. Class III cannot retain its equity interest while a dissenting senior class is not receiving the full value of its claim. Consequently, the Corporation must either pay Class II in full, or not permit Class III—a class junior to Class II—to retain any property under the plan on account of its interests.
>
> Alternatively, enforcing the Subordination Agreement and permitting the Senior Creditor to vote would prevent the Subordinated Creditor from invoking the absolute priority rule and allow the Corporation to favor equity interest holders. Under these facts, it is reasonable to assume the Senior Creditor would vote to accept the plan on behalf of the Subordinated Creditor because its claim is almost being paid in full, it can receive payment immediately upon the plan's confirmation (or the effective date of the plan), and it can avoid a potentially lengthy confirmation process. And with the Senior Creditor voting to accept the plan on behalf of the Subordinated Creditor, the court can confirm the plan without considering whether the plan is fair and equitable to Class II because all impaired classes have accepted the plan. To the Subordinated Creditor's dismay, it is bound to a 2% distribution while a junior class—the equity interest holders—retains their interests under the plan.

Fee, *supra* note 30, at 496–97 (footnotes omitted).

[168] *See supra* note 164 and accompanying text.

[169] *See* Am. United Mut. Life Ins. Co. v. City of Avon Park, 311 U.S. 138, 146–48 (1940), *discussed in* KENNETH N. KLEE, BANKRUPTCY AND THE SUPREME COURT at 84 nn. 777, 778 (LexisNexis 2008).

[170] H.R. REP. NO. 95-595, at 410–11 (1977).

Cases have generally recognized two types of bad faith: "(1) where a claimholder attempts to extort a personal advantage not available to other creditors, or (2) where the claimholder has an 'ulterior motive.'"[171] Thus, the next logical question is under what circumstances a junior creditor could successfully invoke the provisions of 1126(e) to have the senior creditor's vote on behalf of the junior creditor's claim designated. No case has specifically considered application of section 1126(e) in the context of a junior creditor seeking designation in circumstances where the senior creditor voted the junior claim pursuant to a voting assignment. In the claims trading context, however, courts have applied section 1126(e) and designated the vote of the purchaser of a junior claim where the junior claim was purchased solely for the purpose of frustrating the debtor's reorganization, or to enable a subordinate class of equityholders to retain their interests at the expense of what would have been (but for the purchase of a two-thirds majority of the claims) a dissenting class of junior claimholders.[172]

In *In re Allegheny Int'l, Inc.*, a senior creditor acquired a blocking position and defeated the debtor's plan.[173] The senior creditor's interest was to "take over and control the debtor."[174] The debtor sought to designate the senior creditor's vote on the acquired claim.[175] The court determined that the senior creditor purchased the claims in bad faith where the creditor purchased the blocking position "in aid of an interest other than an interest as a creditor"[176] for the sole purpose of frustrating the debtor's reorganization.[177] In support of its conclusion, the court cited a case interpreting a provision of the former Bankruptcy Act analogous to section 1126(e), in which the court explained:

> The mere fact that a purchase of creditors' interests is for . . . securing the approval or rejection of a plan does not of itself amount to "bad faith." When that purchase is in aid of an interest other than an interest as a creditor, such purchases may amount to "bad faith" under section 203 of the Bankruptcy Act.[178]

Applying this reasoning, the *Allegheny* court held:

> The overriding fact that causes this court to reach this conclusion is that Japonica chose to buy claims which gave it unique control over

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[171] *In re* Quigley Co., Inc., 437 B.R. 102, 130 (Bankr. S.D.N.Y. 2010) (quoting *In re* DBSD N. Am., Inc., 421 B.R. 133, 138 (Bankr. S.D.N.Y. 2009)).
[172] *See, e.g.*, Dish Network Corp. v. DBSD N. Am., Inc. (*In re* DBSD N. Am., Inc.), 634 F.3d 79, 103–05 (2d Cir. 2011).
[173] *In re* Allegheny Int'l, Inc., 118 B.R. 282, 289 (Bankr. W.D. Pa. 1990).
[174] *Id.*
[175] *Id.* at 287–88.
[176] *Id.* at 289 (quoting *In re* P-R Holding Corp., 147 F.2d 895, 897 (2d Cir. 1945)).
[177] *Id.*
[178] *Id.* (quoting *In re* P-R Holding Corp., 147 F.2d at 897).

> the debtor and the process. With one minor exception, Japonica purchased its claims—and became a creditor—after the debtor's disclosure statement was approved. Japonica knew what it was getting into when it purchased its claims. Japonica is a voluntary claimant. If Japonica was unsatisfied by the proposed distribution, it had the option of not becoming a creditor. Japonica could have proposed its plan without buying these claims.[179]

Therefore, as illustrated above, while enforcement of voting assignment provisions will limit the remedies that are available to a junior creditor to protect its interest in the reorganization proceedings, junior creditors will, nevertheless, have remedies available notwithstanding the senior creditor voting the subordinated claim. In practice, this will mean that, in most cases, administration of the bankruptcy estate will be consistent with the bargained for pre-bankruptcy entitlements of the parties, which give predictability to the markets while also ensuring efficiency in reorganization proceedings.

CONCLUSION

In conclusion, adoption of the proposed bundle of rights theory of enforcement of chapter 11 voting assignments is the most efficient solution to the issue of voting assignments. The proposed theory ensures that creditors' entitlements outside of bankruptcy, particularly the bargained-for rights that come into existence by virtue of the underlying instrument, are maintained while also balancing those rights with bankruptcy considerations. By integrating consideration of the scope of the allowed claim under section 502 into the analysis of the enforceability of voting assignments, our theory ensures that due consideration is given both to the Supreme Court's existing bankruptcy jurisprudence, as well as bankruptcy policy.

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[179] *Id. But cf. In re* Marble Cliff Crossing Apartments, LLC, 485 B.R. 849, 854 (Bankr. S.D. Ohio 2013) (refusing to disregard votes cast by a particular creditor in accepting impaired class and refusing to deem that creditor insider per 11 U.S.C. §§ 101(31), 1126(e), 1129(a)(10) despite another creditor's claim that votes were motivated by promised relationship with debtor and did not represent independent exercise of business judgment on part of voting creditor because evidence did not support moving creditor's claim).