THE YALE LAW JOURNAL

VINCENT S.J. BUCCOLA

Unwritten Law and the Odd Ones Out

The Unwritten Law of Corporate Reorganizations

BY DOUGLAS G. BAIRD

CAMBRIDGE UNIVERSITY PRESS, 2022

ABSTRACT. To understand the logic of corporate reorganization, one should start not with the Bankruptcy Code, nor with Supreme Court precedents, but with the lawyers, judges, and financiers for whom corporate distress is life. That is the premise of Douglas G. Baird's new book, *The Unwritten Law of Corporate Reorganizations*. Reorganizers comprise a more or less cohesive subculture oriented around the value of preserving going concerns. Having mastered the art of ignoring or interpreting away "written law" inconsistent with their core commitments, it is the reorganizers themselves who set the terms of engagement. With characteristic subtlety, Baird leverages this insight to account for—almost to celebrate—a variety of persistent norms and tensions of reorganization practice not attributable to statute or judicial precedent.

This Book Review develops a pathology seemingly inherent in the world Baird so artfully draws. It explains why bankruptcy courts in such a world can be expected to validate innovative but legally dubious transactions that divert value from so-called legacy creditors and toward incumbent managers and their allies. The upshot is that, under rule by reorganizers, one should expect the law to become increasingly biased against creditors poorly positioned to make new investments in the reorganizing business. And in fact, such a bias helps to explain many of the most contentious developments in the last twenty years of Chapter 11 practice, from critical vendor payments and roll-ups to rights-offering backstop fees. Whether anything useful can be done about the pathology is another question. Potential reforms, to the extent they have bite, risk squandering what are real advantages of expertise. In any case, Baird's account of unwritten law yields a framework for making sense of an otherwise puzzling and troubling tendency of bankruptcy law.

AUTHOR. Associate Professor, The Wharton School of the University of Pennsylvania. For helpful criticism and guidance, I thank Douglas Baird, Allison Buccola, Steve Buccola, Tony Casey, Matt Caulfield, Jared Ellias, Adam Levitin, Stephen Lubben, Josh Macey, David Skeel, and participants at a workshop at Wharton.

REVIEW CONTENTS

INTRODUCTION 1561

I. IDENTIFYING REORGANIZATION CULTURE 1564

II. ASSESSING REORGANIZATION CULTURE 1572
- A. How Reorganization Culture Undercuts Legacy Creditors 1573
- B. Why the Treatment of Legacy Creditors Matters and What (If Anything) Can Be Done About It 1579

CONCLUSION 1582

INTRODUCTION

In the spring of 1916, Paul Cravath, namesake of the storied law firm and one of the nation's leading railroad lawyers, addressed the New York bar on the topic of corporate reorganization. A recent decision of the Supreme Court threatened to unsettle what had become a lucrative practice on Wall Street.[1] Many in the audience were no doubt eager to hear the great man's account of the state of play. Cravath began, however, with a striking caveat. He did not have much to say about reorganization in general, he warned. To treat the subject in a systematic fashion would be as hopeless as "for a poet to tell how to write poetry."[2] It was not that Cravath thought he lacked the necessary analytic or expressive powers of abstraction. He was not a modest man. Rather he thought the systematic approach ill-suited to the field. "One cannot formulate many rules or refer to many precedents which will serve as a guide to the reorganizer," he explained.[3] Circumstances were too various. The most a savvy audience could wish for was what Cravath called "a series of practical suggestions based upon experience."[4]

The folly of imagining reorganization law to be a set of articulable rules is no mere prefatory warning, but the organizing theme of Douglas G. Baird's new book, *The Unwritten Law of Corporate Reorganizations*.[5] To the uninitiated, it might seem a doubtful thesis. Cravath preceded the era of codification. In his day, the freewheeling courts of equity superintended reorganization.[6] Variability was to be expected. Now, though, a century later, title 11 of the United States Code runs more than 300 small-print, dual-column pages. The Federal Rules of Bankruptcy Procedure run another 150 pages, and the volumes of judicial guidance grow apace. One might have supposed that the excess verbiage available to the modern bar would have made reorganization more explicable. Hardly so.

---

1. N. Pac. Ry. v. Boyd, 228 U.S. 482 (1913).
2. Paul D. Cravath, The Reorganization of Corporations; Bondholders' and Stockholders' Protective Committees; Reorganization Committees; and the Voluntary Recapitalization of Corporations, Lecture Before the Association of the Bar of the City of New York (Mar. 1 & 8, 1916), *in* SOME LEGAL PHASES OF CORPORATE FINANCING, REORGANIZATION AND REGULATION 153, 153 (1917) (quoting Adrian H. Joline).
3. *Id.*
4. *Id.*
5. DOUGLAS G. BAIRD, THE UNWRITTEN LAW OF CORPORATE REORGANIZATIONS (2022).
6. For an overview of the theory and practice of equity receivership, see Charles Thomas Payne, *The General Administration of Equity Receiverships of Corporations*, 31 YALE L.J. 685 (1922).

As Baird tells it, much of what matters most in corporate reorganization still is not in print. An intelligent generalist who read only the orthodox legal materials, however assiduously, would find even standard practice baffling.[7] The book's unifying insight explains why: reorganizers have created a world in which ordinary assumptions about the relationship between text and custom are inverted. In the world of corporate reorganization, ostensibly binding statutes, rules, and judicial opinions embellish practical norms rather than the other way around. What is essential to reorganization law, then, is not the Bankruptcy Code, much less any distributional principles it frames, but rather the commitments of the lawyers and judges who specialize in distress.[8] Baird withholds judgment of the world he conjures, but it is fair to say that he emphasizes its virtues.

My principal aim in this Book Review is to draw out the dark side of Baird's account of "unwritten law." The nub of the problem is that it can be expected to subordinate the interests of so-called legacy creditors to the interests of incumbent managers and their allies. I argue that the values of what I will call "reorganization culture" are apt to yield a process of norm development biased against creditors who cannot offer new investment. What is more, such a bias in fact describes the history of innovation in Chapter 11, and I suggest that Baird's account goes a long way toward explaining a troubling and otherwise puzzling tendency. Exposing the dark side of unwritten law does not resolve any important normative questions. But I hope it will illuminate the law as it stands, as well as the stakes of meaningful reform.

The Book Review has two parts. Part I lays out the normative logic of the world Baird so vividly illustrates. Baird identifies a surprising variety of persistent, unwritten norms widely shared by reorganizers and indicates their importance to practice.[9] He likewise shows that many written rules have less bite than commentators often suppose.[10] But the relationship between written and unwritten law, as such, remains implicit. By making the schema explicit, I hope both to open the door to critical appraisal and to help the casual reader see how the book's elements hang together—to see why, for example, a conceptual analysis of absolute priority[11] belongs in the same work as a commentary on the plight of national merchandisers in the late nineteenth century.[12]

7. BAIRD, *supra* note 5, at ix-x (describing statutes and precedent as "unhelpful" for answering "basic questions" about reorganization practice).

8. *Id* at x (describing bankruptcy law as governed by "a coherent set of unwritten principles").

9. *E.g.*, *id.* at 15, 60, 85, 90, 118, 143.

10. *E.g.*, *id.* at 151, 166, 170, 174.

11. *Id.* at 92-93.

12. *Id.* at 46-47.

That logic of unwritten law begins and ends with an insular and self-propagating subculture comprising the investors, bankers, and especially lawyers (including judges) who specialize in corporate distress. On Baird's telling, the values of reorganization culture antedate modern bankruptcy legislation. Its values, like the values of any culture, are complex, multidimensional, and contested. They are therefore impossible to state definitively: they are not only unwritten, but unwriteable.[13]

Although the culture is ultimately irreducible, it is oriented unmistakably toward a forward-looking commercial imperative. In a world rife with asymmetric information and holdup threats, the law on the ground must protect the ability of professionals to coalesce around deals that preserve enterprise value.[14] Fidelity to statute, rule, and appellate decision is secondary. Textual authorities that leave the bargaining environment intact are folded into practice, even when they modify substantially the terms of the deals likely to be struck. But an ostensible authority that gets in the way of value-conserving bargains altogether may be read implausibly narrowly (to neuter its charge) or ignored outright. The primacy of unwritten law does not, then, mean that the Bankruptcy Code is irrelevant. It means only that, as Baird has put it elsewhere, the way the Code operates in practice "cannot be easily reconciled with conventional understandings of how statutes are supposed to work."[15] Reorganization culture acts as a Procrustean bed, stretching or deforming written law as needed to make it fit with reorganizers' core commitments.

Part II links the culture's normative structure to a generic problem in reorganization practice: bankruptcy law encourages and validates practical innovations that tend to subordinate claims of right brought by legacy creditors. The odd ones out, so to speak, are not only well-known "marks" such as pensioners and tort and environmental claimants, whose interests are always "on the table" in reorganization talks, but all creditors poorly situated to provide new investment: landlords whose property is no longer useful to the business, vendors whose goods and services are easily replaced, financial creditors unable to pro-

13. The norms of the culture are nevertheless relatively stable. Baird does not spend much time exploring the reasons for continuity. Stable norms might reflect timeless wisdom. Alternatively, they might reflect a kind of "capture" of rulemaking by a concentrated interest (namely, reorganization professionals themselves). In any case, a process of acculturation plays at least a superficial role in transmission from one cohort to another. Junior initiates learn by immersion and imitation. They study the canon and pay attention to what giants of the field have to say.

14. *See, e.g.*, BAIRD, *supra* note 5, at 117.

15. Douglas G. Baird, *The Fraudulent Conveyance Origins of Chapter 11: An Essay on the Unwritten Law of Corporate Reorganizations*, 36 EMORY BANKR. DEV. J. 699, 699 (2020).

vide new capital. Commentators have long debated the propriety of various techniques in Chapter 11 by which the interests of legacy creditors, seemingly safeguarded by Bankruptcy Code protections, can be undermined.[16] But the literature has not generally understood the problem as such, even less its connection to reorganization law's peculiar normative structure.

The problem comes down to motive and opportunity. Incumbent managers will always have reason to shortchange legacy creditors, whatever the legal system. From a forward-looking perspective, legacy creditors are mere rentiers. Their investments are sunk. They cannot contribute to prospective surplus. Consequently, it is in the interest of a debtor's managers to distribute as little value as possible to them and as much as possible to allies and investors whose new or continued support might help the business thrive. One of the functions of reorganization statutes is to police this motive, and the Bankruptcy Code in particular does so in a variety of ways.[17] Reorganization culture, by undermining relevant features of the written law, gives managers and their allies opportunity. Ironically, the blame lies with reorganizers' desire to achieve commercially sensible results in specific cases. This desire explains not only reorganization culture's insistence on contextual or case-specific norms, but also the poor treatment of legacy creditors, for incumbent managers will always be the masters of local context.

To notice a perverse tendency of unwritten law is not, of course, sufficient to condemn it. For that a better alternative is needed. *The Unwritten Law* is largely interested in the charm and stout good sense of reorganization culture. It is worth remembering as well, however, that there are drawbacks to a world in which the law consists of "a series of practical suggestions based upon experience."

I. IDENTIFYING REORGANIZATION CULTURE

The Unwritten Law could be profitably read as a collection of independent essays. Each of the book's eight chapters covers an important moment, theme, or transition in the history of corporate reorganization. They feature everything from a busted land deal in post-Revolution New York to a critical discussion of

16. The risk to "outsider" creditors caused by excessive debtor flexibility is emerging as a theme in research. *See, e.g.*, Stephen J. Lubben, Protecting Ma and Pa: Bond Workouts and the Trust Indenture Act in the 21st Century (2021) (unpublished manuscript) (on file with author); Adam J. Levitin, *Purdue's Poison Pill: The Breakdown of Chapter 11's Checks and Balances*, 100 TEX. L. REV. (forthcoming 2022), https://ssrn.com/abstract=3851339 [https://perma.cc/S94S-NLD2].

17. *See infra* notes 56-61 and accompanying text.

single-asset real-estate bankruptcies in the 1970s,[18] from a eulogistic portrait of the great Victor Morawetz to gentle mockery of William O. Douglas.[19] Although notionally history—the events covered range from 1600 to the present and proceed roughly in chronological order—*The Unwritten Law* is more like a meditation on continuity and change.[20]

Readers who have dipped a toe into the world of commercial-law scholarship in the last four decades will have no problem recognizing Baird's inimitable style—a unique combination of a historian's facility with concrete detail, an economist's eye for abstract analysis, and the storytelling instincts of an English major. One chapter forays into the early Republican system of merchant credit, showing how American courts wielded the old principles of fraudulent and preferential transfer to protect disfavored creditors and, by extension, the liquidity of budding secondary-debt markets.[21] Another keys into the dynamics of one of the most important of all the railroad reorganizations—that of the Atchison, Topeka & Santa Fe.[22] A third addresses problems that an increasingly national retail market at the tail of the nineteenth century posed for the institutions of impersonal credit, describing how the members of a new trade organization, the National Association of Credit Men, influenced important provisions of the Bankruptcy Act of 1898.[23] There is plenty to chew on without the reader giving a thought to the idea that holds the book's constitutive essays together.

As much as its chapters can be enjoyed individually, however, one can appreciate the book's central message—about the primacy of uncodified principle—only by considering the work as a coherent whole. *The Unwritten Law* is not structured as a linear argument. It does not set out and then defend a clearly articulated thesis. Instead, Baird proceeds in almost curatorial fashion, allowing a gestalt to emerge from the choice and arrangement of topics, anecdotes, and asides. The reader who wants to grasp the big idea must read the component elements in light of one another.

When Baird deploys explicit argumentation, it is usually to contest received wisdom about the status of particular norms rather than to defend a unique vi-

---

18. BAIRD, *supra* note 5, at 6-21 (describing the busted land deal); *id.* at 158-160 (discussing single-asset real-estate bankruptcies).

19. *Id.* at 30-45 (Victor Morawetz); *id.* at 95-101 (William O. Douglas).

20. Readers looking for a wide-gauge story of the development of American bankruptcy law would still do best to consult DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA (2001).

21. BAIRD, *supra* note 5, at 1-21.

22. *Id.* at 22-45.

23. *Id.* at 46-62.

sion of the significance of codification itself. In some instances, this means identifying or otherwise raising the status of principles that lack any legislative basis to speak of. Baird thus draws attention to conventional norms about such matters as disclosure obligations,[24] the treatment of "side payments,"[25] and the permissible objectives of parties to a reorganization proceeding.[26] In other instances, he impugns the status of written rules usually thought important to Chapter 11. Some such rules are overrated because they are, in Baird's view, redundant. The Code's explicit assignment to bankruptcy judges of a power to "designate," or disregard, the votes of improperly motivated investors is one example.[27] In Baird's view, the written rule, an artifact of a major New Deal statutory overhaul, reflects what was already a common practice rooted in unwritten bargaining norms.[28] More intriguingly, Baird points to a number of textually assured rules that lawyers and judges simply ignore.[29] The bar on vote solicitation is just one example. Section 1125(b), which prohibits plan proponents from lining up support before the bankruptcy judge has blessed disclosure documents,[30] was meant to be a key part of Chapter 11 infrastructure. Yet debtors routinely seem to violate the rule when they propose plan-support agreements, and no one cares.[31]

Baird's arguments succeed in more or less striking ways.[32] And they have a cumulative effect. They suggest that convention in general might receive too little attention and written law in general too much. It is a point to be heeded. But none of the individual bits explicitly identifies the significance of a norm's being written, or how unwritten norms interact with statutory mandates or judicial opinion. They do not describe the normative structure of reorganization law. That the reader must put together.

---

24. *Id.* at 139-41.

25. *Id.* at 143-48.

26. *Id.* at 81 (suggesting that voting creditors "have to put on blinders with respect to their outside interests").

27. 11 U.S.C. § 1126(e) (2018).

28. BAIRD, *supra* note 5, at 85.

29. Bankruptcy professionals' capacity to ignore or implausibly interpret written law extends beyond the Code to case law. In a companion essay, Baird draws attention to a couple of remarkable instances. *In re Lionel Corp.*, 722 F.2d 1063 (2d Cir. 1983), and *In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004), are two of the most well-known appellate decisions construing the Bankruptcy Code, but, as Baird points out, they are also typically cited for almost exactly the opposite of what they say. *See* Baird, *supra* note 15, at 699 n.1.

30. 11 U.S.C. § 1125(b) (2018).

31. *See, e.g.*, *In re* Indianapolis Downs, LLC, 486 B.R. 286, 293-97 (Bankr. D. Del. 2013) (construing the term "solicitation" narrowly to permit creditors to enter into plan-support agreements).

32. The treatment of the so-called "best interests of creditors" test is, in my opinion, the most remarkable. *See* BAIRD, *supra* note 5, at 56-61.

On reflection, two central ideas underlie Baird's vision of the field. First, the values of specialist professionals take precedence over statutory dictates or appellate court opinions. The lawyers and bankers who specialize in corporate distress are few in number and spend most of their waking hours together. They comprise a legal and financial subculture, an informal network that defines, propagates, and reinforces shared (if idiosyncratic) understandings about how things should be. Distinctive habits of mind are not uncommon among working colleagues. What is remarkable about reorganizers, then, including those on the bench, is a willingness and ability to prefer shared values over ostensibly authoritative legal texts—that is, to ignore inconvenient law or interpret it away. It is not that reorganizers reject written rules as such, or disdain legislative or judicial power in general. Not at all. They honor orthodox legal materials—just not at the expense of important shared values.[33]

Second, the most fundamental of these values are concerned with maintaining a future-oriented bargaining environment. Reorganizers are committed to a system of norms that will lead parties, including those with conflicting financial

33. It would be a mistake, however, to read Baird as intervening in a debate over statutory interpretation. One might be tempted to understand him to be claiming that reorganizers prefer purposivist or pluralist over textual approaches to interpretation. Such a reading would put *The Unwritten Law* in conversation with a strand of bankruptcy scholarship now some thirty years old. *See, e.g.*, Charles Jordan Tabb & Robert M. Lawless, *Of Commas, Gerunds and Conjunctions: The Bankruptcy Jurisprudence of the Rehnquist Court*, 42 SYRACUSE L. REV. 823, 827-28 (1991); Daniel J. Bussel, *Textualism's Failures: A Study of Overruled Bankruptcy Decisions*, 53 VAND. L. REV. 887, 889 (2000). One theme in the literature is the contrast between the Supreme Court, where textualism is supposed to reign, and the bankruptcy courts, where pragmatism is said to dominate. *See* Megan McDermott, *Justice Scalia's Bankruptcy Jurisprudence: The Right Judicial Philosophy for the Modern Bankruptcy Code?*, 2017 UTAH L. REV. 939, 959; Robert K. Rasmussen, *A Study of the Costs and Benefits of Textualism: The Supreme Court's Bankruptcy Cases*, 71 WASH. U. L.Q. 535, 593 (1993); Robert M. Lawless, *Legisprudence Through a Bankruptcy Lens: A Study in the Supreme Court's Bankruptcy Cases*, 47 SYRACUSE L. REV. 1, 48 (1996). That line of thought is consistent with the book, even if Baird himself has cast doubt on whether "textualism" adequately specifies the way the Court seems to approach bankruptcy cases. *See* Douglas G. Baird & Anthony J. Casey, *Bankruptcy Step Zero*, 2012 SUP. CT. REV. 203, 230 (arguing that the Court tends to incline toward interpretations that limit the range of discretion afforded to bankruptcy judges); *cf.* Alan Schwartz, *The New Textualism and the Rule of Law Subtext in the Supreme Court's Bankruptcy Jurisprudence*, 45 N.Y.L. SCH. L. REV. 149, 153 (2001) (reaching a similar conclusion).

But the book is best read in a different register. Baird's thesis is that a set of understandings having little or nothing to do with the Bankruptcy Code, and long predating it, is key to grasping the fault lines of reorganization practice. Reorganizers at times deploy the rhetoric of interpretation to protect their values from legislative meddling. But their concern is not principally to elucidate meaning. By contrast, when a Code provision does not threaten important reorganization values, all of the ordinary variations in interpretive method are apt to appear.

interests, to settle on a value-preserving path forward at relatively low cost.[34] Distress specialists enter the fray long after a business's principal capital investments have been sunk. They see a crisis, and they want to save as much of the enterprise as they can. They are not especially concerned with the effects today's deal might have on another company's capital costs tomorrow. Most reorganizers do not believe that the optimal rate of rescue failure is greater than zero. What they want from the law is a normative environment in which sophisticated players have incentives to put their cards on the table and the flexibility to produce a deal most can live with.[35]

The outline of Baird's vision is best captured in the book's extensive treatment of the absolute priority rule. A fixture of bankruptcy law for the better part of a century, absolute priority stands for the proposition that a plan of reorganization must pay senior claims in full if, over objection, it proposes to assign anything at all on account of junior claims.[36] Many smart people consider absolute priority to be *the* foundation of corporate bankruptcy law.[37] Yet it is very much a written rule and very much concerned with distributional rather than procedural values. Superficially, its status might thus seem to challenge Baird's emphasis on unwritten norms. On inspection, however, it is his Exhibit A.

On Baird's account, the absolute priority rule hardly matters to the success or failure of reorganization law. Two lines of thought support this view. First, in most instances the distributional norm does not bear on the ability of professionals to reach commercially sensible deals. Baird does not deny absolute priority's thoroughgoing influence on the content of plans of reorganization. Indeed, he himself recently described the rule as "the organizing principle of the modern law of corporate reorganizations."[38] But that is not the same as saying the rule is necessary or useful or even especially relevant to what reorganizers care about. Absolute priority rarely impedes effective bargaining, but the same is true of a variety of alternatives. *The Unwritten Law* cites, in particular, the competing principle of relative priority, which prevailed in the railroad receiverships of the

34. *See, e.g.*, BAIRD, *supra* note 5, at 126.

35. *Id.*

36. The Supreme Court first made a version of the absolute priority rule law in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 117 (1939). A variation is now codified at 11 U.S.C. § 1129(b) (2018).

37. *See, e.g.*, Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 VA. L. REV. 1235, 1243 (2013) ("The Bankruptcy Code's core principle is that distribution conforms to predetermined statutory and contractual priorities, with creditor equality within each priority class."). For a notable, contrary view, see generally Stephen J. Lubben, *The Overstated Absolute Priority Rule*, 21 FORDHAM J. CORP. & FIN. L. 581, 584-85 (2017).

38. Douglas G. Baird, *Priority Matters: Absolute Priority, Relative Priority, and Costs of Bankruptcy*, 165 U. PA. L. REV. 785, 786 (2017).

late nineteenth and early twentieth centuries.[39] As a matter of first principle, the choice between absolute and relative priority is not easy; there are theoretical marks for and against each.[40] For Baird's purposes, though, the theoretical winner is not important. What is important is that both principles have proved workable. Reorganizers need *a* distributional rule, a focal point on which to anchor negotiations, but the rule's content may not matter to them in most instances.[41]

Second, reorganizers find ways to dodge the rule in the unusual cases where strict adherence to absolute priority might actually threaten a value-preserving deal. The specific means of evasion change—the disapproval of appellate courts spurs innovation in the bankruptcy courts—but the basic logic is at least 150 years old.[42] There is a senior creditor with a lien on all of a company's productive assets. The amount of the creditor's claim exceeds the value of the business. Junior creditors are thus out of the money. The company's future cash flows are worth more than whatever the assets might fetch in a liquidation, such that the senior creditor would prefer to keep the business alive. The difficulty is that the company's shareholders—also, of course, out of the money—say that they will leverage procedural rights to delay a resolution, or walk away from managerial roles in a disorderly fashion, unless they get a piece of the action. The senior creditor begrudgingly agrees to "gift" them equity in the reorganized business.

Bankruptcy judges have long been willing to confirm gifting plans even though they plainly violate the absolute priority rule (because creditors with intermediate claims are not paid in full).[43] From a reorganizer's perspective, gifting is too useful a tool to dispense with just because the Bankruptcy Code says it is

---

39. Relative priority has long occupied Baird's attention. *See, e.g.*, Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930 (2006); Douglas G. Baird & Robert K. Rasmussen, *Control Rights, Priority Rights, and the Conceptual Foundations of Corporate Reorganizations*, 87 VA. L. REV. 921 (2001); Douglas G. Baird & Robert K. Rasmussen, Boyd*'s Legacy and Blackstone's Ghost*, 1999 SUP. CT. REV. 393.

40. BAIRD, *supra* note 5, at 91-107. The argument draws on Baird, *supra* note 38. For competing perspectives on the subject, see Jonathan M. Seymour & Steven L. Schwarcz, *Corporate Restructuring Under Relative and Absolute Priority Default Rules: A Comparative Assessment*, 2021 ILL. L. REV. 1, 3-4; Barry E. Adler & George Triantis, *Debt Priority and Options in Bankruptcy: A Policy Intervention*, 91 AM. BANKR. L.J. 563, 563-65 (2017); and ADAM J. LEVITIN, BUSINESS BANKRUPTCY: FINANCIAL RESTRUCTURING AND MODERN COMMERCIAL MARKETS 791-97 (2d ed. 2019).

41. BAIRD, *supra* note 5, at 129 ("In the end, what matters most is whether the rules of corporate reorganization—written or unwritten—allow parties to negotiate with each other once the reorganization begins.").

42. *See id.* at 16-17 (discussing Chi., Rock Island & Pac. R.R. Co. v. Howard, 74 U.S. 392 (1868)).

43. *See, e.g.*, *In re* World Health Alts., Inc., 344 B.R. 291, 297-300 (Bankr. D. Del. 2006).

illegal.[44] The counterfactual world, in which holdout behavior by out-of-the-money creditors could delay, tax, or even kill sensible deals, is intolerable. So, when important courts of appeals held nonconsensual gifting plans unconfirmable,[45] reorganizers did not simply lie down. They devised formally differentiated transactions that mimicked the economics of the forbidden plans. In the much-discussed *In re ICL Holding Co.*, for example, secured creditors procured bankruptcy-court approval of a priority-skipping disposition simply by making sure that the funds to be gifted were routed around, rather than through, the debtor's accounts.[46] The priority-skipping "structured dismissal" at issue in the Supreme Court's last major corporate bankruptcy case, *Czyzewski v. Jevic Holding Corp.*,[47] is but another example of reorganizers' seemingly boundless capacity to evade absolute priority when they think it commercially expedient to do so.[48] In sum, as Baird would predict, reorganization culture honors the Bankruptcy Code's priority rule insofar as it does not degrade the bargaining environment, but no further.

* * *

Baird's picture is appealing as a descriptive matter because it makes sense of a number of otherwise-puzzling features of corporate reorganization practice.

---

44. To be clear, reorganizers do not accept all priority-skipping transactions. Baird divines a line between what he calls "innocuous 'tips,'" which are acceptable, and "forbidden 'gifts,'" which are not. BAIRD, *supra* note 5, at 145. The distinction is contextual and so, as Baird acknowledges, contestable in any given case. *Id.* at 144-48. Both involve the payment from one creditor (or from the debtor's assets) to another to secure the latter's cooperation in the bankruptcy proceeding. Tips are side payments meant to induce a party with procedural or other holdup power to get out of the way of a sensible disposition. Gifts, by contrast, are side payments designed to suppress information that might benefit third parties—to mask, that is, what is in effect a plan to squeeze intervening creditors out of value that by rights should be theirs. Thus, the classic priority-skipping transfer I describe in the text—from concededly undersecured senior creditors to junior investors who could make themselves a nuisance—is compatible with the norms of reorganization culture, while similar transfers in other scenarios may be more troubling.

45. *See, e.g.*, *In re* DBSD N. Am., Inc., 634 F.3d 79 (2d Cir. 2011); *In re* Armstrong World Indus., Inc., 432 F.3d 507 (3d Cir. 2005).

46. The Third Circuit affirmed in an opinion by Judge Ambro, a prominent bankruptcy lawyer before his appointment to the bench. *In re* ICL Holding Co., 802 F.3d 547, 547 (3d Cir. 2015). For illumination of this point, see Douglas G. Baird, Anthony J. Casey & Randal C. Picker, *The Bankruptcy Partition*, 166 U. PA. L. REV. 1675, 1698-1700 (2018).

47. 137 S. Ct. 973, 979 (2017).

48. *See* Vincent S.J. Buccola, *The Janus Faces of Reorganization Law*, 44 J. CORP. L. 1, 2-5 (2018). Each element of the priority-skipping structured dismissal is seemingly independently permissible under the Code, but the obvious and intended effect of combining them as it does is to circumvent absolute priority. The Supreme Court eventually held the transaction too cute by half. *See Jevic*, 137 S. Ct. at 986.

Especially illuminating is the acceptance by bankruptcy lawyers of what are arguably the three most important innovations of the last quarter century: the preplan going-concern sale and the use of debtor-in-possession (DIP) financing and restructuring support agreements (RSAs) to, in effect, legislate debtor-specific bankruptcy procedures. It is hard to understand how they so rapidly became settled options without a notion of the primacy of unwritten, deal-focused cultural norms.

One can, to be sure, cite capacious statutory language into which each of these innovations can be shoehorned. But the construction one needs to give the Bankruptcy Code to do so fits, at best, uncomfortably with the text's context. It is at least odd that a provision meant to allow shrinking companies to get rid of surplus equipment would be used to justify the sale, outside the terms of a plan of reorganization, of one-third of all large companies that enter Chapter 11.[49] It is easy to imagine a world in which the bankruptcy courts had rejected the Section 363 going-concern sale and the overelaborate DIP loan agreement or RSA, for want of explicit textual permission. *The Unwritten Law* helps one see, however, why such a counterfactual is fantasy under anything like present conditions.[50]

Baird's account has the additional virtue of a plausible supporting mechanism. The book suggests two features of the institutional landscape that could explain the origin and persistence of reorganization culture's influence.[51] First, the judges who most directly police reorganization are drawn from a pool of (mostly very successful) bankruptcy lawyers. These are individuals who have spent careers negotiating and arguing within the culture's parameters, in the culture's language. The culture's basic presuppositions are unlikely to trouble them deeply. When they don robes, they understand what the lawyers who will appear before them expect, and their status within the professional milieu depends on delivering it. Second, appeals are few and far between. The final-order rule and doctrines such as equitable mootness limit the opportunities for judges from outside reorganization culture to intervene.[52] Some generalist judges might wish

---

49. *See* Vincent S.J. Buccola, *Bankruptcy's Cathedral: Property Rules, Liability Rules, and Distress*, 114 NW. U. L. REV. 705, 733 n.119 (2019) (collecting studies pegging the frequency of cases resulting in a going-concern sale between one-fifth and two-thirds of all large cases).

50. *See infra* notes 86-89 and accompanying text (discussing the New Deal).

51. The discussion is not a major part of the book. The entire discussion of mechanism fits on a page. BAIRD, *supra* note 5, at 151.

52. *See, e.g.*, Nuverra Env't Sols., Inc. v. Hargreaves (*In re* Nuverra Env't Sols., Inc.), 834 F. App'x 729, 736 (3d Cir. Jan. 6, 2021) (Krause, J., concurring). For more on the limitations of judicial review of bankruptcy court decisions, see Troy A. McKenzie, *Judicial Independence, Autonomy, and the Bankruptcy Courts*, 62 STAN. L. REV. 747, 772-91 (2010); and Levitin, *supra* note 16 (manuscript at 45-52).

to see written law bind practice more tightly,[53] but their interventions are sporadic enough that reorganization lawyers can safely discount their agenda.

To these I would add the observation that unwritten law works well for insiders. The values of reorganization culture, although not fully articulable, can be grasped sufficiently well that specialists can form reasoned expectations about how disputes might be resolved. At the same time, the esoteric quality of the practice raises an entry barrier. Few lawyers know their way around a Chapter 11 case. It takes years of diligence and acculturation to figure out what is going on in a large-scale corporate reorganization. The primacy of unwritten law keeps it that way.

II. ASSESSING REORGANIZATION CULTURE

Whether one should be thrilled about rule by reorganizers is a harder question and not one *The Unwritten Law* seeks to resolve. Baird himself seems to be temperamentally sanguine about the world he describes. His heroes are not hard to spot. They are the "sophisticated professionals," like Victor Morawetz and Ronald Trost, who interpret and sustain reorganization culture.[54] But the book takes no explicit stance on the desirability of what it reveals. Baird's project is to explain reorganization practice, not to judge it, and he leaves comparative institutional analysis to the reader.

To jumpstart such an analysis, I want to sketch one important cost of unwritten law that is implicit but submerged in the book. Reorganization culture should be expected to—and I think does—yield practices that tend to undercompensate legacy creditors. Modern Chapter 11 features a range of devices of dubious validity under the written law that a distressed business's incumbent managers and their allies (including, for example, private equity sponsors) can use to disadvantage legacy creditors. The devices are individually well-known. Many have already been the subject of extensive academic debate. My aim is to connect them and suggest that such devices follow predictably from the kind of reorganization culture Baird describes.

Identifying a perverse feature of unwritten law does not imply an easy fix. After all, a hallmark of reorganization culture is its resistance to incremental reform—at least statutory reform—and wholesale displacement of the status quo, even if politically feasible, would create problems of its own. But attending to

53. *See* Baird & Casey, *supra* note 33, at 227; *see also* Schwartz, *supra* note 33, at 153 ("[T]he Court's goal is to find interpretations of the Bankruptcy Code that restrict the lower courts to the making of the most ministerial judgments that text and circumstances permit.").

54. BAIRD, *supra* note 5, at 118, 137, 161, 165.

the dynamics that subordinate legacy creditors may at least shed light on the kinds of changes worth considering.

A. How Reorganization Culture Undercuts Legacy Creditors

One thing that most companies in reorganization have in common is a need for new investment. A frequent cause of bankruptcy is, after all, the money running out—or fear that it soon will. To reverse the effects of what is often a period of austerity in the run-up to a Chapter 11, and to build a balance sheet that skilled employees, specialized vendors, clients, and landlords can trust, distressed businesses need capital.

The managers empowered to run reorganizations can seek investment from two generic sources: from those who have an existing claim on or interest in the company (i.e., current investors) or from everyone else (i.e., the market). Suppose a business in Chapter 11 seeks to arrange a loan upon emergence from bankruptcy. At first approximation, current investors and arm's length financiers should think the same way about the opportunity to fund the loan. The company's risk profile is what it is, whoever the lender might be. This is not to say the types are identically situated. Current investors will tend to know the business better, for example, so might face smaller diligence costs. But the difference is at the level of detail. At first approximation, current investors and arm's length lenders are apt to demand the same expected return on the loan—namely, the risk-adjusted return they could find in the next-best opportunity available in the market.

But despite the approximate equivalence of potential lenders, a reorganization's proponents may have a strong preference. The incumbents maximize the value of their own stakes by sourcing the loan from current investors to the extent that what by rights should go to the company's legacy creditors can be used to pay part of the loan's cost.

The trick is to see that current investors can be paid in two ways. Suppose a reorganizing company wants a $1 million loan, and the market rate for such a loan is 5%. Setting aside amortization and other irrelevant complications, an arm's length lender will demand $50,000 annually in interest. That is just what a 5% rate means. A current investor, however, may accept less—$40,000, say—even though its opportunity cost of making the loan is the same. It receives interest on the loan, as the arm's length lender does, as well as compensation on account of its pre-reorganization claim. In theory, the amount of each payment stream is independent of the other. But in practice they are intimately connected. The investor cares about its blended return, not the amount attributed to either addend. It will accept a dollar less in interest on its loan if it receives a dollar

more on its claim.[55] The proponents of reorganization can thus minimize the company's future interest expense if they can goose the investor-lender's recovery on its claim. The problem is that the incremental value must come from somewhere.

Legacy creditors are the obvious source. By definition, legacy creditors are not positioned to make new investments in the company. The enterprise cannot use anything that an old bond buyer, a retired employee, or a vendor in a defunct supply chain has to offer. Their investments—in virtue of which they are entitled to a share in the reorganization—are sunk. From a forward-looking perspective, whatever legacy investors receive is a rent, a tax on the business. Incumbent managers would thus choose, if they could, to split the value of the reorganized business entirely between themselves and creditors from whom they seek new investment.

The Bankruptcy Code is supposed to check that ambition. The Code announces a number of rules designed to prevent incumbents from splitting value as they would like to do. The system of classified voting that underpins consensual plan confirmation is part of the story.[56] But voting is a highly imperfect bulwark insofar as a bankruptcy judge can, with some additional process, confirm a plan over even substantial dissent.[57] A handful of imperatives are meant to provide stronger protection: the absolute priority rule,[58] to prevent managers loyal to prepetition equity interests from squeezing out legacy unsecured and junior-lien creditors; the bar on "discriminat[ing] unfairly,"[59] to prevent incumbents from using separate classification to deliver disfavored creditors idiosyncratically poor treatment; and the requirement that each claim in a class be treated identically,[60] to prevent incumbents from gerrymandering consent. The evident logic of these rules is to establish most-favored-nation rights for the kinds of creditors who can be expected to lack influence. Incumbents have wide latitude to devise

55. The dynamics around debtor-in-possession (DIP) financing are very different. Distributions are not directly addressed at the time a DIP loan is negotiated. So there is no horse trade to be made. Indeed, the DIP loan is frequently used as a means to exclude from the bankruptcy option set outcomes the incumbent and senior lenders disfavor. *See* Kenneth Ayotte & Jared A. Ellias, *Bankruptcy Process for Sale*, 39 YALE J. ON REGUL. 1, 3-7, 14-16 (2022) (documenting the use of so-called milestones). And DIP loans appear to pay above-market rather than below-market interest rates. *See* B. Espen Eckbo, Kai Li & Wei Wang, *Rent Extraction by Super-Priority Lenders* 2 (Eur. Corp. Governance Inst., Working Paper No. 794, 2021), https://ssrn.com/abstract_id=3384389 [https://perma.cc/MQ8E-77JQ].

56. *See* 11 U.S.C. § 1129(a)(8) (2018).

57. *See id.* § 1129(b)(1).

58. *Id.* § 1129(b)(2).

59. *Id.* § 1129(b)(1).

60. *Id.* § 1123(a)(4).

a plan of reorganization matched to their company's unique circumstances, but legacy creditors can insist that their prepetition claims not be disfavored on account of their inability or unwillingness to invest in the postpetition business.

It should be no surprise, therefore, that incumbent managers often hope to evade the obstacles the Code throws up to block them. A major theme in the history of Chapter 11 practice – maybe the dominant theme – is the development and then rapid acceptance of evasive techniques. My observation here is that common knowledge of the way unwritten law functions has been an important ingredient in that process. More specifically, I want to suggest that a variety of legally dubious maneuvers capable of shortchanging legacy creditors grow out of an interaction between incumbents' control of the agenda, their superior knowledge of company prospects, and the basic commitments of reorganization culture.

The mechanism turns on incumbents' ability to use agenda control to frame a binary choice between, on one hand, approval of a legally dubious transaction that they propose and, on the other, a world in which substantial enterprise value would be lost. Agenda control is the power to decide when the court and investors will consider a set of alternatives as much as it is the power to decide which alternatives they will consider. Because the Bankruptcy Code grants substantial agenda control to a debtor's managers, they can often time a proposal so that its rejection will lead to, or appear to lead to, an unacceptable outcome – at the limit, the piecemeal liquidation of a viable business.[61] If information were evenly distributed, creditors harmed by such a proposal might be able to show that the counterfactual is not as dire as the incumbents represent, or else that the binary is an artifact of the incumbents' design. In most cases, though, information is highly asymmetric. With enough time, it might be possible to sort out what is what. But by design there is no time to lose. Common knowledge of incumbents' superior information thus often makes it difficult to contest their definition of the choice set, especially on short notice.

Framing such a binary is only useful, however, because incumbents intuit the values of reorganization culture. They are able to set up what is, in effect, a sequentially staged game of chicken. They advertise that their steering column is broken and count on the court – and even reluctant fellow professionals – to

61. Formally, agenda control is vested in the debtor's managers. The law empowers them to choose the time and place of a bankruptcy, and gives them exclusive power to manage the business's assets – including to propose extraordinary transactions – and exclusive right (for a time) to propose a plan of reorganization. *See id.* §§ 301, 1107, 1121(b). Practically, though, managers are often sharply constrained in their exercise of agenda control by their need for cash. Senior lenders use cash collateral or loan agreements to influence the timing and substance of managers' proposals. But where powerful senior lenders do gain a measure of control over the agenda, it is useful to think of them as part of an incumbent coalition.

swerve.[62] In a world in which written law is held sacred, the tactic would be useless. A reputation for fidelity to the Code would work as a precommitment device that could dissuade incumbents from playing in the first instance. But that is not the world of unwritten law. Incumbents may believe, with Baird, that the bankruptcy judge will be predisposed to preserve value rather than cling to the precepts of legality. The bankruptcy judge might not like it. She might bless a legally dubious transaction while declaring it an exceptional case. But agenda control and information asymmetries mean there is no way to ground any particular case's exceptional nature. Such is the power of incumbency; debtors in future cases can recreate the circumstances of the exception, and soon the exception becomes the rule. The generic transaction becomes an option for incumbents to deploy as they wish.

The history of the Section 363 going-concern sale provides an instructive example of something like this dynamic in action. The Bankruptcy Code explicitly allows a debtor to sell itself under the terms of a plan of reorganization.[63] To do so still requires, however, that the plan garner every class's approval or satisfy the conditions of cramdown.[64] The procedural burden of plan confirmation led incumbents to begin trying to sell major assets, and eventually entire businesses, under the Code's grant of authority to debtor management, during the pendency of the case, to "use, sell, or lease . . . property" outside the ordinary course of business.[65] The first courts to confront incumbents' assertion of a broad sale power hesitated on the ground that such a right would seem to run around the

62. It is fair to ask why the lawyers who represent legacy creditors would acquiesce in legally questionable devices that harm their clients. There are at least two observationally equivalent possibilities, and I suspect they work in tandem. One is more robustly *cultural*. Everyone internalizes to some extent the basic commitments of the trade. Many lawyers who occasionally represent legacy creditors spend much of their time representing debtors or ad hoc creditor groups on the other side of the divide. Even those whose practices focus on legacy creditors, namely lawyers specializing in unsecured creditors' committee work, spend their lives in a normative world where value-preserving deals mark out success. The other possibility sounds in rational expectations about judicial behavior. The lawyers who represent legacy creditors might form private interpretations of the law consistent with their clients' interests. Nevertheless, if they believe that the bankruptcy judges who oversee complex reorganization cases adhere to the primacy of value-preserving deals, then their own public actions—the arguments they make, the vigor of their argumentation, and so on—are likely to conform to those norms, at least on the margin. This is especially true for lawyers who wish to preserve their credibility over a long career.

63. 11 U.S.C. § 1123(b)(4) (2018) ("[A] plan may . . . provide for the sale of all or substantially all of the property of the estate, and the distribution of the proceeds of such sale among holders of claims or interests.").

64. *Id.* § 1129(a)(8), (b)(1).

65. *Id.* § 363(b)(1).

Code.[66] They settled, however, on a view that large-scale asset sales were justifiable in the right circumstances. In an oft-cited opinion, the Second Circuit famously demanded that managers wishing to sell important assets under Section 363 show a "good business reason" for doing so.[67]

Incumbent managers and the senior secured lenders who often stand to benefit most directly from a quick going-concern sale soon discovered incantations that would prove irresistible to the courts.[68] With a little help from retained bankers, they could opine that the market value of the business would diminish sharply over time. It would not be easy to prove otherwise. Relatedly, sale proponents could feign or overstate the stringency of time limits on the availability of bankruptcy financing. Since senior lenders are usually best situated to provide such financing, their representations are hard to second guess. The legal check on incumbents' discretion practically evaporated.

I do not mean to say that going-concern sales are in fact illegal or even unattractive. The text and history of Section 363 supply a plausible legal justification of contemporary practice, and sales have many virtues. Proponents might not usually or even often be snowing the bankruptcy courts. But the process by which Section 363 became an option in the hands of incumbent managers is telling. And there is evidence that incumbents use the option of a sale to protect the interests of senior secured lenders at the expense of legacy creditors.[69]

The Section 363 sale is by no means the only example of the phenomenon. A variety of standard maneuvers allow managers to juice the returns of continuing

---

66. *See, e.g.*, *In re* Baldwin United Corp., 43 B.R. 888, 905 (Bankr. S.D. Ohio 1984) (recognizing "tension" between Section 363 and "the disclosure and voting rights found in Chapter 11"); *In re* White Motor Credit Corp., 14 B.R. 584, 587-90 (Bankr. N.D. Ohio 1981) (holding that the use of Section 363 to sell substantially all of a debtor's assets would "side-step[ ] the procedural and substantive provisions of Chapter 11 itself").

67. Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1071 (2d Cir. 1983).

68. *See, e.g.*, Melissa B. Jacoby & Edward J. Janger, *Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy*, 123 YALE L.J. 862, 866 (2014) (observing that "[p]leas for quick 363 sales frequently feature the melting ice cube argument").

69. *See, e.g.*, Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 533 (2009) (finding that debtors are much more likely to sell their business rather than reorganize when senior secured creditors are modestly oversecured than when they are either undersecured or significantly oversecured); Mark Jenkins & David C. Smith, Creditor Conflict and the Efficiency of Corporate Reorganization (May 29, 2014) (unpublished manuscript at 33), http://ssrn.com/abstract=2444700 [https://perma.cc/US7L-LFLQ] (finding that fire sales are most common when asset values are close to the face value of secured debt).

investors relative to similarly situated legacy creditors. Critical vendor payments[70] and debt roll-ups,[71] for example, are by now well-known. Innovations becoming prominent more recently include commitment payments for select RSA signatories,[72] rights offerings practicably exercisable only by favored investors,[73] and the payment of generous fees to backstop new-money offerings.[74] The priority-skipping structured dismissal fit the pattern until the Supreme Court condemned it in *Jevic*.[75] Each of these maneuvers allows a debtor to direct value to favored investors from whom new or renewed investment is sought, in a manner that is at least in tension with codified distributional norms.

The tendency of reorganization practice to undercompensate legacy creditors operates at the margin, of course. It is not as though incumbents can do whatever they want. Managers usually have superior information about financing and operational possibilities, but they do not have a monopoly on information; not every assertion they might wish to peddle will be believed. Likewise, managers have agenda control, but it is not absolute; an outsider treated poorly enough by a proposed transaction can make its objection credible by putting together a competing proposal. And while reorganizers may emphasize future-oriented value preservation, it by no means exhausts their normative imagination; respect

70. *See, e.g.*, *In re* Kmart Corp., 359 F.3d 866 *passim* (7th Cir. 2004).

71. *See, e.g.*, Frederick Tung, *Financing Failure: Bankruptcy Lending, Credit Market Conditions, and the Financial Crisis*, 37 YALE J. ON REGUL. 651, 668-72, 695-702 (2020).

72. *See, e.g.*, David A. Skeel, Jr., *Distorted Choice in Corporate Bankruptcy*, 130 YALE L.J. 366, 384-88 (2020); Edward J. Janger & Adam J. Levitin, *The Proceduralist Inversion—A Response to Skeel*, 130 YALE L.J.F. 335, 341-49 (2020).

73. *See, e.g.*, Marti P. Murray, *Assessing the Reasonableness of Rights Offerings: Raising Exit Financing in a Chapter 11 Proceeding*, 32 AIRA J. 35, 36 (2019).

74. *See, e.g.*, Ad Hoc Comm. of Non-Consenting Creditors v. Peabody Energy Corp. (*In re* Peabody Energy Corp.), 933 F.3d 918, 921-23 (8th Cir. 2019). For discussion of the way Peabody was able to direct value to preferred creditors, and the case's relationship to broader trends in Chapter 11, see Oscar Couwenberg & Stephen J. Lubben, *Private Benefits Without Control? Modern Chapter 11 and the Market for Corporate Control*, 13 BROOK. J. CORP. FIN. & COM. L. 145, 154-56 (2018).

75. *See, e.g.*, Bruce Grohsgal, *How Absolute Is the Absolute Priority Rule in Bankruptcy? The Case for Structured Dismissals*, 8 WM. & MARY BUS. L. REV. 439, 454-56 (2017).

for past investment matters, too,[76] and may exert a countervailing force in practice, even if fidelity to the Code is not the dominant reason.[77] Still, insofar as going-concern preservation is the dominant value in reorganization culture, asymmetric pressure on the law should be expected.

B. *Why the Treatment of Legacy Creditors Matters and What (If Anything) Can Be Done About It*

There are rule-of-law as well as economic reasons to think the tendency of unwritten law to undercompensate legacy creditors is a mark against it. The rule-of-law concern is too evident, and yet upon examination too elusive, to merit extensive discussion here. I will say only that it is not unreasonable to think that valid legislation about investors' entitlements should supersede the preferences of lawyers who have sworn an oath to administer the law. Needless to say, the obviousness of the concern does not discount its importance.

Economic concerns can be divided into two types. First, undercompensation of legacy creditors will in many cases effect a distortive wealth transfer. It may not be immediately obvious that this should be so. After all, investors might price their likely fate at the time of initial investment. If a potential investor knows at the time of investment that managers will try to divert value from it if the business should become distressed, and if it can reasonably estimate the probability and significance of distress, it can compensate itself by demanding a higher price, greater security, or whatever.[78] Some kinds of creditors probably do just that, at least in a long-run equilibrium sense. The prices of junior unsecured bonds, for example, probably reflect a reasonable estimate of the holders' uselessness to a

76. The surest way to preserve value—and at the least administrative cost—would be to zero out all creditors immediately after a petition is filed. The effect it would have on credit markets is, however, too obviously pernicious for anyone to advocate it. Distributional concerns must, then, contribute somehow to reorganizers' ideal of a healthy bargaining environment, and certainly Baird never suggests otherwise. *Cf.* David Skeel, *Unwritten Rules and the New Contract Paradigm*, 36 EMORY BANKR. DEVS. J. 739, 744-46 (2020) (suggesting that distributional norms set a baseline against which "tips" and "bribes" have meaning); Richard Levin, *A Response to Professor Baird's Essay on Unwritten Law: Writing Some Unwritten Law*, 36 EMORY BANKR. DEVS. J. 729, 729-30 (2020) (suggesting coequality of process and substance norms).

77. Baird has noted that Judge Shannon, who presided in the *Jevic* bankruptcy, reports being pleased with the Supreme Court's decision because he "likes the idea that his hands are tied going forward." *See* Douglas Baird, Harry A. Bigelow Distinguished Serv. Prof. of L., Univ. of Chi., Remarks at Corporate Bankruptcy Panel: The Fraudulent Conveyance Origins of Chapter 11, *in* 36 EMORY BANKR. DEVS. J. 671, 687 (2020).

78. Imperfectly, to be sure, because ex ante price hikes are an imperfect substitute for efficient ex post governance.

reorganizing management team. But many kinds of creditors are poorly positioned to adjust. Some may have a hard time guessing whether their continued investment will be valuable to the business in a hypothetical future distress scenario, or may find adjustment ungainly. Involuntary creditors, such as tax and tort claimants, have no "prices" to adjust, even if in some sense their shabby treatment in a reorganization is entirely predictable.[79]

Second, and probably more important, deadweight losses associated with incumbents' efforts to frame their preferred, binary universe should be expected to increase capital costs. To create the appearance that a legally questionable transaction is the only way to escape disaster, incumbents may resort to a variety of wasteful tactics. They may decline to investigate the full range of alternatives available (for fear that one will be superior and the act of exploration will create a record). They may conceal information and shade internal analysis away from plausible alternatives. And they may delay reckoning with reality in a manner which in fact limits options. One of the best ways to make a business appear fragile is to make it actually fragile.

That acts of self-sabotage are effectively unobservable does not make them unreal. Bankruptcy judges have proved alert enough to potential problems to set up guardrails meant to deter egregious abuse. Disclosure rules are common. Incumbents proposing an extraordinary transaction are routinely required to disclose facts that might prompt disfavored creditors to inquire into the reasons for the transaction as well as alternatives to it. In the Bankruptcy Court for the District of Delaware, for example, the proponents of a Section 363 sale must call attention to matters such as the buyer's insider status,[80] agreements between the buyer and management,[81] and arrangements to insulate the buyer from competing bidders.[82] But objectionable behavior is in its nature difficult to detect. Opportunities in business are often latent, and managers know them best. It is easy enough to paper a transaction in a way that ignores what only ever existed as possibility. Only at the macro level does the pattern become clear. Incumbents encounter too many "perfect storms"—unless, that is, some percentage of them have purposefully sailed for the eye of the hurricane.

To outline the costs of unwritten law does not, of course, settle any questions about how the institutions of corporate reorganization ought to work. One has

---

79. *See* Vincent S.J. Buccola & Joshua C. Macey, *Claim Durability and Bankruptcy's Tort Problem*, 38 YALE J. ON REGUL. 766, 767-69 (2021); *see also* Joshua Macey & Jackson Salovaara, *Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law*, 71 STAN. L. REV. 879, 906-07 (2019) (describing coal companies' use of bankruptcy to avoid environmental and pension liabilities).

80. Del. Bankr. L.R. 6004-1(b)(iv)(A).

81. *Id.* at 6004(b)(iv)(B).

82. *Id.* at 6004(b)(iv)(D).

to know what alternative is on offer. But the usefulness of at least the most obvious direct interventions is uncertain.

If an objectionable trajectory of innovation is a predictable, even inevitable, consequence of rule by reorganizers, irrespective of what the written law might say, then simple statutory fixes are unlikely to change dynamics in the long term. The story of anti-executive bonus amendments introduced to the Code in 2005 illustrates just how difficult practice is to alter. After news of some arguably egregious bankruptcy retention bonuses sparked public controversy, Congress banned a common device in Chapter 11 practice, the so-called Key Employee Retention Plan.[83] The idea of the legislation was that executives of floundering businesses should not be paid large sums just to stick around. Rather than take the hint, however, companies simply began offering retention bonuses on the eve of Chapter 11 or structuring bonuses as thinly veiled *incentive* payments—work-arounds to which bankruptcy judges readily acceded.[84]

To the extent incremental changes could tie bankruptcy practice more closely to the Code, they probably need to alter the environment in which reorganizers find themselves rather than target objectionable practices directly. The values of reorganization culture dominate practice because the professionals who administer large-scale reorganizations, including the bankruptcy judges, are few in number, come from similar milieus, and face limited discipline from appellate courts. Interventions aimed either at decentralizing practice or enhancing appellate review could thus dampen the tendency to wink at written law. In a new article, Adam J. Levitin proposes assigning large Chapter 11 cases to a broader group of bankruptcy judges—in particular to judges whose practice background is not in large-scale corporate counseling—and establishing a form of appellate review free from the constraints of equitable mootness or similar doctrines.[85] Whatever one thinks of the letter of the proposals as he frames them, they suggest the shape incremental reform would have to take to have a chance of making a lasting impact.

To achieve enduring change might, however, require targeting reorganization professionals themselves. That was tried once. In 1938, at the behest of William Douglas and other New Deal reformers, Congress amended the Bankruptcy Act to create Chapter X, a new reorganization procedure for large businesses.[86] This new chapter did not only alter the rules of corporate bankruptcy previously

83. The directive was a small part of a large set of changes wrought by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C., 12 U.S.C., 15 U.S.C., 18 U.S.C., and 28 U.S.C.).

84. Jared A. Ellias, *Regulating Bankruptcy Bonuses*, 92 S. CAL. L. REV. 653, 656-57 (2019).

85. Levitin, *supra* note 16, at 73-77.

86. Bankruptcy Act of 1938, ch. 575, 52 Stat. 840.

in effect. It also ousted from the bankruptcy process incumbent managers and virtually anyone with ties to reorganization culture, in particular the Wall Street banks and law firms that had first developed and then maintained the norms Douglas so despised.[87] Indeed, Baird's account of reorganization culture helps explain this otherwise curious aspect of the New Deal agenda. Douglas had been a reorganizer, with the Cravath firm, at the start of his career.[88] Perhaps he had an inkling that altering bankruptcy's substantive and procedural rules would not change as much on the ground as a naïf might expect. In any event, Chapter X was by most accounts a disaster.[89] The machinery of large-scale corporate reorganization virtually ceased to turn. The advantages of subculture, of tacit understandings, may just be too valuable to give up even if there are associated costs.[90]

CONCLUSION

With *The Unwritten Law*, Baird has developed a surprising yet eminently useful heuristic for interpreting the world of corporate reorganization. On his telling, the core of that world is not the Bankruptcy Code, as most will have assumed, nor a distributional principle (absolute priority) enshrined in the Code, nor even a series of judicial decisions elaborating the Code. The core is instead a body of relatively stable norms shared by the lawyers and financiers who spend their lives reorganizing businesses. Because their work product is rarely subject to review by outsiders (i.e., generalist judges), the reorganizers can, and often do, subordinate ostensible legal authority to their own shared understandings of how things should be. To grasp the values of reorganization culture is therefore a first step toward making sense of reorganization itself.

Although it is not perhaps Baird's chief aim to do so, the book also reveals the foundations of much contemporary debate about Chapter 11. Many of the

87. *See* Stephen J. Lubben, *Fairness and Flexibility: Understanding Corporate Bankruptcy's Arc*, 23 U. PA. J. BUS. L. 132, 135-36 (2020) (describing the interval from 1938 to 1978 as a period in which distributional "fairness" outweighed functional "flexibility" as the predominant value in corporate bankruptcy); Skeel, *supra* note 76, at 740 ("Rather than simply introducing more vigilant judicial oversight of the restructuring process, for instance, the New Deal reformers seem to me to have sought and temporarily achieved a sharp break from prior practice.").

88. *See* David A. Skeel, Jr., *Vern Countryman and the Path of Progressive (and Populist) Bankruptcy Scholarship*, 113 HARV. L. REV. 1075, 1087-91 (2000).

89. For discussion of some of Chapter X's failings, see SKEEL, *supra* note 20, at 160-76.

90. One promising reform tactic stops short of dismantling reorganization culture. Unsocial motives to push a legally dubious practice will unwind if the elements of the practice capable of preserving going-concern value can be decoupled from the elements relating to distribution. Melissa B. Jacoby and Edward J. Janger's "ice cube bond" is an example. *See* Jacoby & Janger, *supra* note 68, at 926-28. But we should recognize that in many cases the distributional effects of a practice drive its potential to preserve value, and so cannot be decoupled from it.

most controversial innovations in practice can be used to, if they do not inevitably, divert value from legacy creditors to incumbents and investors who promise new support to the enterprise. To notice the primacy of unwritten law in the world of corporate reorganization is to see why that pattern should be expected. Reorganizers' commitment to value preservation will tend to sanction maneuvers not obviously allowed under written law, by which the proponents of a reorganization can direct wealth to themselves and other favored investors at the expense of creditors who cannot offer new firm-specific investments. Reorganization culture need not be ideal to be laudable—beware the Nirvana fallacy!—but it is worth at least acknowledging its capacity for shabby treatment of the odd ones out.