

4-1-2000

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Alexander F. Watson

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Recommended Citation

Alexander F. Watson, *Left for Dead: The Supreme Court's Treatment of the New Value Exception in Bank of America National Trust & Savings Association v. 203 North LaSalle Street Partnership*, 78 N.C. L. REV. 1190 (2000).

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Left for Dead?: The Supreme Court's Treatment of the New Value Exception in *Bank of America National Trust & Savings Association v. 203 North LaSalle Street Partnership*

When a financially troubled company is forced to file for bankruptcy, it can choose to reorganize the company under Chapter 11 of the Bankruptcy Code.¹ Chapter 11 functions as an alternative to liquidation under Chapter 7² and provides for the reorganization of businesses that are eligible for bankruptcy relief.³ The chapter's primary purpose is to grant relief in situations in which a business's assets have little liquidation value, but the business itself is worth keeping intact.⁴ The policy goals behind Chapter 11 reorganization are twofold.⁵ First, a reorganization should preserve the business as a going concern, allowing jobs to be saved and the business to continue to function.⁶ Second, a reorganization should maximize the property and value available to the shareholders by continuing all profitable activities.⁷

When a debtor decides to file a petition under Chapter 11, the

1. 11 U.S.C. §§ 1101–1174 (1994).

2. 11 U.S.C. §§ 701–766 (1994).

3. See DOUGLAS G. BAIRD, *THE ELEMENTS OF BANKRUPTCY* 230 (1992); GEORGE M. TREISTER ET AL., *FUNDAMENTALS OF BANKRUPTCY LAW* § 9.01, at 419 (4th ed. 1996); Mark A. McDermott, *Bankruptcy Reorganizations: Before and After the Supreme Court's Stillborn Decision in 203 North LaSalle*, *FED. LAW.*, Aug. 1999, at 22, 23 (1999). Reorganization is also available to individuals, but is rarely employed by an individual in the absence of a substantial business operation. See BAIRD, *supra*, at 15.

4. See BAIRD, *supra* note 3, at 56–57. The most frequently cited example is that of a railroad company. See *id.* A railroad's assets, such as rights-of-way, tracks, and bridges, have minimal scrap value. See *id.* A careful reorganization of the railroad, however, may allow it to continue to function and likely would be the most efficient use of its assets. See *id.*

5. See Rafeal Efrat, *Toibb v. Radloff Reconsidered: Reorganization Under Chapter 11 of the Bankruptcy Code by a Consumer Debtor*, 26 *BEVERLY HILLS B.A. J.* 82, 90 (1992).

6. See Lowell P. Bottrell, *The Supreme Court and the "Plain Meaning" of the Bankruptcy Code: A Review of Recent and Pending Supreme Court Decisions*, 69 *N.D. L. REV.* 155, 159 (1993); Dan Deating, *Good Intentions, Bad Economics: Retiree Insurance Benefits in Bankruptcy*, 43 *VAND. L. REV.* 161, 188 (1990); Efrat, *supra* note 5, at 90; Hon. Edith H. Jones, *Chapter 11: A Death Penalty for Debtor and Creditor Interests*, 77 *CORNELL L. REV.* 1088, 1089 (1992); J. Maxwell Tucker, *The Clash of Successor Liability Principles, Reorganization Law, and the Just Demand That Relief Be Afforded Unknown and Unknowable Claimants*, 12 *BANKR. DEV. J.* 1, 7 (1995).

7. See Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 *MICH. L. REV.* 336, 344 (1993); Nathan F. Coco, Note, *An Examination of Successor Liability in the Post-Bankruptcy Context*, 22 *J. CORP. L.* 345, 350 (1997).

Bankruptcy Code invokes an automatic stay that immediately shelters the business's assets.⁸ This stay prevents virtually any act or proceeding against the debtor from being commenced or continued without court approval.⁹ Although a stay is not permanent, it likely will be continued by the court provided the debtor can show a realistic prospect of reorganization.¹⁰ During a stay the debtor negotiates with its creditors in an effort to develop an effective reorganization strategy.¹¹

After negotiating a reorganization strategy, the debtor submits a reorganization plan, which is the blueprint for revitalizing its business.¹² If the plan satisfies the requirements of the Bankruptcy Code, then the court will confirm it, and the debtor will attempt to implement the plan.¹³ The hope is that the debtor's plan will rehabilitate its business, which in turn will allow creditors to realize more from their investments than they would have if the business had been liquidated.¹⁴ The company's owners also benefit from such a plan because reorganization allows them the opportunity to recoup a percentage of their initial investments.¹⁵ Finally, society benefits from a reorganization, because the business continues to provide jobs and products in the marketplace.¹⁶ Overall, a successful reorganization should benefit all involved, especially when compared to the alternative of liquidation.¹⁷

Unfortunately, because the reorganization process does not always function as planned, such efficient results are not always achieved. Although a failing company is allowed to reorganize and

8. See 11 U.S.C. § 362(a) (1994).

9. See *id.*

10. See MARTIN J. BIENENSTOCK, *BANKRUPTCY REORGANIZATION* 7 (1987).

11. See Pat H. Scanlon, *Adequate Protection and Secured Creditors' Strategies After Timbers*, 10 MISS. C. L. REV. 59, 64 (1989).

12. See BAIRD, *supra* note 3, at 231.

13. See *id.*

14. The creditors' ability to realize more from the investment is due to the fact that lenders usually will provide credit to a business based on estimates of the going concern value of the debtor and its assets, rather than its liquidation value. See BIENENSTOCK, *supra* note 10, at 5-6. If the liquidation value is higher than the going concern value, then the parties probably will end up in a Chapter 7 liquidation. See *id.* If the going concern value is higher, however, then the lenders will benefit from this reorganization because the reorganized debtor will be able to pay off more of the lenders' claims than under liquidation. See *id.*

15. See Linda J. Rusch, *The New Value Exception to the Absolute Priority Rule in Chapter 11 Reorganizations: What Should the Rule Be?*, 19 PEPP. L. REV. 1311, 1316 (1992).

16. See *id.*

17. See *id.*

continue its operations, all reorganizations must comply with the guiding principle of Chapter 11—that the rights of creditors transcend the interests of the old equity holders.¹⁸ Simply put, in a reorganization proceeding, the creditors must be paid in full before the debtor's equity holders are allowed to retain any ownership in the reorganized debtor. This idea was recognized by the Supreme Court as early as 1868¹⁹ and became ingrained in reorganization practice in the years that followed.²⁰ Today, the critical notion of protecting creditors' rights in reorganization proceedings is known as the "absolute priority rule" and is firmly established in the Bankruptcy Code.²¹ This rule furthers the objectives of Chapter 11 by preventing unsecured creditors from having their claims usurped by the junior claims of equity holders.²²

The absolute priority rule may not be as absolute as it sounds, however, because of a judicially created exception known as the "new value exception," which originated prior to the 1978 enactment of the Bankruptcy Code.²³ The new value exception allows shareholders to

18. See Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 70 (1991) (explaining the distinct rights of various creditors); George H. Singer, *Supreme Court Clarifies "New Value Exception" to Absolute Priority Rule—Or Does It?*, AM. BANKR. INST. J., Aug. 1999, at 1, 32. Singer explains that "at the core of American corporate law is a fundamental ordering between owners of equity and creditors; creditors must be paid in full in the event of a financial collapse of the business before holders of equity receive any distribution." *Id.* This ordering is a "critical component" of Chapter 11's reorganization provisions. *Id.*

19. See *Railroad Co. v. Howard*, 74 U.S. 392, 414–16 (1868) (refusing to allow a railroad's shareholders to retain their equity in the railroad without fulfilling the claims of unsecured creditors); *infra* note 160 and accompanying text (describing the decision in *Howard*).

20. See *Louisville Trust Co. v. Louisville, New Albany & Chicago Ry.*, 174 U.S. 674, 684 (1899) (describing as the "familiar rule" the notion that the claims of unsecured creditors take precedent over those of shareholders); *Northern Pac. Ry. Co. v. Boyd*, 228 U.S. 482, 506–07 (1913) (stating that the favoring of unsecured creditors was a "fixed principle"); *infra* notes 159–96 and accompanying text (detailing the history of this idea prior to the codification of the Bankruptcy Code in 1978).

21. See 11 U.S.C. § 1129(b)(2)(B)(ii) (1994) ("[T]he holder of any claim or interest that is junior to the claims of such [impaired unsecured] class will not receive or retain under the plan on account of such junior claim or interest any property.").

22. See *id.*

23. The origin of the new value exception is traced to *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939). In dicta, the Court reaffirmed the absolute priority rule while noting that there are circumstances in which prior equity holders may participate in the reorganized debtor. See *id.* at 121; see also *infra* notes 179–87 and accompanying text (discussing the impact of *Los Angeles Lumber*).

While the term generally used is "new value exception," some contend this characterization is incorrect. Rather, they choose to describe it as the new value "corollary." *Bonner Mall Partnership v. U.S. Bancorp Mortgage Co.*, 2 F.3d 899, 906–07 (1993) (noting that the new value principle is basically a description of the limitations of

retain equity in the reorganized debtor in exchange for a capital contribution.²⁴ Unlike the absolute priority rule, however, the new value exception never has been codified.²⁵ This lack of statutory recognition has led to much debate over whether the new value exception survived the codification of the Bankruptcy Code.²⁶ Hanging in the balance is a great deal of bargaining leverage that would shift between lenders and borrowers depending on whether the new value exception is viable.²⁷ Should the exception continue to be recognized, borrowers would be able to retain ownership in reorganized businesses on the basis of capital contributions, allowing them to participate more readily in their reorganized ventures.²⁸ On

the absolute priority rule and therefore should be referred to as a corollary, not by the misleading term "exception"); *In re SM 104 Ltd.*, 160 B.R. 202, 225 (Bankr. S.D. Fla. 1993) (agreeing with the idea that the new value exception "is not an exception at all, but merely a corollary to the absolute priority rule" and upholding the corollary for that reason); John D. Ayer, *Rethinking Absolute Priority After Ahlers*, 87 MICH. L. REV. 963, 999 (1989) (referring to the doctrine as the "new value corollary"); Markell, *supra* note 18, at 73 ("To speak of the new value exception as an exception to absolute priority is thus misleading."). For the sake of consistency in this Note, the term "new value exception" will be used.

24. See *Los Angeles Lumber*, 308 U.S. at 121.

25. The new value exception was accepted under the Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (repealed 1978), but the 1898 Act was repealed by the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended in 11 U.S.C. §§ 101-1329 (1994)). See also Harvey R. Miller & John J. Rapisardi, *Separate and Unequal: The Seventh Circuit Isolates and Neutralizes the Undersecured Creditor in In re 203 N. LaSalle Street Partnership*, 28 U. MEM. L. REV. 667, 681-82 (1998) ("Because the Bankruptcy Act judicially recognized the doctrine but did not codify it under the Bankruptcy Reform Act of 1978 or thereafter, some decisions have held that the new value corollary did not survive the enactment of the Bankruptcy Code."); Singer, *supra* note 18, at 32 ("The existence of an exception or corollary to the rule of absolute priority, while a recognized principle under the Bankruptcy Act, is not expressly codified in the Bankruptcy Code.").

26. See 7 COLLIER ON BANKRUPTCY ¶ 1129.04[4][c], at 1129-102 (Lawrence P. King ed., 15th ed. rev. 1999) (describing the validity of the new value exception as "one of the more hotly contested issues" to have arisen since the adoption of the Bankruptcy Code); McDermott, *supra* note 3, at 23-24 (noting the "considerable controversy" that has long existed over whether § 1129(b) of the Bankruptcy Code contains a new value exception); Singer, *supra* note 18, at 32 (stating that the existence of a new value exception has "generated a firestorm of debate, analysis, commentary and litigation"); J. Ronald Trost et al., *Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification*, SD24 ALI-ABA 401, 409 (1998), available in WL, ALI-ABA database ("The viability of new value plans under the Code has been hotly debated by courts and commentators.").

27. See Brian A. Basil, *The New Value Exception to Absolute Priority in Bankruptcy*, 101 COM. L.J. 290, 291 (1996) (noting the "tremendous implications" that resolution of the new value exception will have on the relative bargaining power of parties in Chapter 11 reorganizations); Richard L. Epling, *The New Value Exception: Is There a Practical, Workable Solution?*, 8 BANKR. DEV. J. 339, 347 (1991) ("The new value exception is an important piece of debtor leverage in a Chapter 11 case.").

28. See Raymond T. Nimmer, *Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions*, 36 EMORY L.J. 1009, 1052-53 (1987) ("[A] rule

the other hand, if the exception is not valid, lenders should have an easier time recovering their money, even over the objections of the shareholders.²⁹

Commentators viewed *Bank of America National Trust & Savings Association v. 203 North LaSalle Street Partnership*³⁰ as an opportunity for the Supreme Court to resolve the question of whether the new value exception continued to exist after the current Bankruptcy Code was adopted.³¹ This Note will seek to show how the Court managed to evade the major issue, while deciding the case on other grounds. First, this Note will review some general principles of bankruptcy law, explore the facts of *Bank of America*, including its lower court history, and discuss the Supreme Court's holding and rationale.³² Next, it will survey the origins of the absolute priority rule and the new value exception, tracing their development over the past century.³³ The Note then will attempt to explain how the bankruptcy community can comply with the *Bank of America* Court's mandate.³⁴ Finally, this Note will offer some thoughts on the future of the new value exception, concluding that the issue remains uncertain.³⁵

Once a debtor has filed for bankruptcy, the next step in a Chapter 11 reorganization is the filing and subsequent confirmation

permitting new capital from prior owners increases their leverage in negotiation. . . . The new [value] theory increases the difficulty for creditors to eliminate ownership, thereby increasing the owner's leverage.").

29. See McDermott, *supra* note 3, at 23 (claiming that restricting the application of the new value exception "shifts the balance of power between debtors and lenders by granting lenders additional leverage in contested reorganization cases").

30. 119 S. Ct. 1411 (1999).

31. See Randolph J. Haines, *The Unwarranted Attack on New Value*, 72 AM. BANKR. L.J. 387, 389 (1998) ("The Supreme Court is now apparently set to resolve the issue."); *id.* at 393 ("[T]he case should provide a clear, unequivocal answer to the question of whether the new value rule survived the adoption of the Code."); McDermott, *supra* note 3, at 25 (noting that, while the Court specifically granted certiorari "to resolve a circuit split on the issue" of the viability of the new value exception, it instead assumed the existence of the exception and decided a separate issue); Thomas J. Salerno et al., *Urgent Message to the Supreme Court: 'Just Do It!'*, 34 No. 6 Bankr. Ct. Dec. (LPR) at 1 (May 25, 1999) (complaining that the case was "supposed, at long last, to resolve the issue"); Singer, *supra* note 18, at 1 (stating that the bankruptcy community had hoped the Court would finally resolve the issue). *But see* Trost et al., *supra* note 26, at 452 (explaining that the Court possibly would choose to address only the narrower issue of the exclusiveness of the opportunity provided to the debtor, rather than delivering a sweeping ruling on the validity of the new value exception).

32. See *infra* notes 36-158.

33. See *infra* notes 159-208.

34. See *infra* notes 209-53.

35. See *infra* notes 254-56.

of a reorganization plan.³⁶ This plan must identify the borrower's creditors, group the creditors into classes based on how their claims are treated under the plan, and describe how each class will be treated and how the plan will be implemented.³⁷ A lender whose claim is secured by an asset of the debtor is deemed to be "undersecured" when the value of the asset is less than the face value of the lender's claim.³⁸ According to the Bankruptcy Code, an undersecured lender is deemed to hold two claims.³⁹ One is a secured claim equal to the value of the debtor's asset. The other is an unsecured claim whose value is the difference between the face amount of the lender's claim and the value of the debtor's asset.⁴⁰

Once the claims are classified and a reorganization plan is proposed, each holder of a claim votes to either accept or reject the plan, and approval is determined on a class-by-class basis.⁴¹ When the voting is completed, a court must certify that the plan meets the thirteen basic requirements outlined in the Bankruptcy Code.⁴² One of these requirements is that any impaired class of creditors,⁴³ namely those whose rights are altered under the plan of reorganization, must vote to accept the plan.⁴⁴

Even if all impaired classes do not vote to accept the plan, however, the debtor may still secure confirmation.⁴⁵ This method of achieving confirmation over the objection of an impaired class of

36. See 11 U.S.C. § 1123(a) (1994).

37. See *id.*

38. McDermott, *supra* note 3, at 23.

39. See 11 U.S.C. § 506(a) (1994).

40. See *id.* For example, in *Bank of America*, the Debtor borrowed \$93 million on a loan secured by 15 floors of an office building. See *Bank of America*, 119 S. Ct. at 1414–15. The bankruptcy judge valued the collateral at \$54.5 million. See *id.* at 1415. Thus, the Bank had a secured claim of \$54.5 million and an unsecured claim of \$38.5 million, the difference between the face value of the loan and the value of the collateral. See *id.* at 1414.

41. See 11 U.S.C. § 1126. A unanimous vote is not required; rather, approval requires only a dual majority vote. See *id.* § 1129(c) ("A class of claims has accepted a plan if such plan has been accepted by creditors . . . that hold at least two-thirds in amount or more than one-half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan.").

42. See *id.* § 1129(a).

43. A class of claims can be impaired under a plan of reorganization "unless, with respect to each claim or interest of such class, the plan . . . leaves unaltered the legal, equitable, and contractual rights to which such claim or interest entitles the holder of such claim or interest." *Id.* § 1124(1).

44. See *id.* § 1129(a)(8). Nonimpaired classes of creditors are not required to vote, as they are "conclusively presumed to have accepted the plan." *Id.* § 1126(f).

45. See *id.* § 1129(a)(10).

creditors is known as a "cramdown."⁴⁶ To effect a cramdown, two conditions must be satisfied.⁴⁷ First, with the exception of 11 U.S.C. § 1129(a)(8), all thirteen elements of § 1129(a) must be fulfilled,⁴⁸ including approval of the plan by at least one impaired class of creditors.⁴⁹ Second, the Code requires that the plan "not discriminate unfairly, and [that it be] fair and equitable, with respect to each class of claims or interests that is impaired under, and has not accepted, the plan."⁵⁰

The phrase "fair and equitable" is the critical language in the requirements for a cramdown.⁵¹ It is this "fair and equitable" requirement that invokes the absolute priority rule.⁵² The Code requires that one of two conditions be met if a plan is to be deemed "fair and equitable" to an impaired class of unsecured claims.⁵³ First, all claims must be paid in full,⁵⁴ such that the members of the class must receive consideration equal to the present value of their entire claim.⁵⁵ If all claims are not paid in full, then the plan must meet the second condition: the absolute priority rule.⁵⁶

As codified by federal statute, the absolute priority rule states that "the holder of any claim or interest that is junior to the claims of such [impaired unsecured] class will not receive or retain under the plan *on account of* such junior claim or interest any property."⁵⁷ Thus, if the impaired unsecured class is not fully compensated as required under the Code, then a junior interest may not receive

46. See BAIRD, *supra* note 3, at 230 (noting that a "cramdown" allows a confirmation of a reorganization plan over objections of creditors, but requires expensive and unreliable valuations).

47. See *id.*

48. See *id.* (citing 11 U.S.C. § 1129(b)(1)).

49. See *id.* (citing 11 U.S.C. § 1129(a)(10)). Because the impaired class of unsecured trade claims accepted the Debtor's plan, the requirement of § 1129(a)(10) that at least one impaired class accept the plan was satisfied. See *Bank of America*, 119 S. Ct. at 1415-16.

50. 11 U.S.C. § 1129(b)(1).

51. See *id.* § 1129(b).

52. See *id.* § 1129(b)(2)(B)(ii); TREISTER ET AL., *supra* note 3, § 9.04(f)(2), at 491. Under the former Bankruptcy Act, a plan of reorganization was required to be "fair and equitable." *Id.* § 9.04(f)(1), at 485. This language was interpreted to embrace the absolute priority rule. See *id.* When drafting the new Bankruptcy Code, Congress omitted the "fair and equitable" standard, deeming it too inflexible and unforgiving to apply to all reorganization plans. See *id.* § 9.04(f)(1), at 487. The "fair and equitable" standard, however, is included in the Code's requirements for a cramdown. See 11 U.S.C. § 1129(b)(2)(B)(ii).

53. See 11 U.S.C. § 1129(b)(2)(B).

54. See *id.* § 1129(b)(2)(B)(i).

55. See TREISTER ET AL., *supra* note 3, § 9.04(f)(2), at 491.

56. See 11 U.S.C. § 1129(b)(2)(B)(ii).

57. *Id.* (emphasis added).

anything.⁵⁸ Congress apparently designed the absolute priority rule so that the only way a class of unsecured creditors could be excluded unwillingly from receiving full compensation is if the reorganization value of the debtor, when distributed in order of seniority, runs out prior to the unsecured claims being fully paid.⁵⁹

The facts of *Bank of America* are relatively uncomplicated. A real estate venture known as 203 North LaSalle Street Partnership ("Debtor" or "Partnership"), owned fifteen floors of a downtown Chicago office building as its principal asset.⁶⁰ The Partnership owed Bank of America ("Bank") ninety-three million dollars on a nonrecourse mortgage secured by its interests in the office building.⁶¹ Once the Debtor defaulted on the loan, the Bank commenced foreclosure proceedings.⁶² The Debtor countered by filing for bankruptcy under Chapter 11 of the Bankruptcy Code, thereby receiving an automatic stay of the foreclosure proceedings.⁶³

After filing for bankruptcy, the Debtor proposed a reorganization plan in the prescribed 180-day period within which it

58. See *id.* § 1129(b)(2)(B).

59. See TREISTER ET AL., *supra* note 3, § 9.04(f)(2), at 491.

60. See *Bank of America*, 119 S. Ct. at 1414.

61. See *id.* A nonrecourse mortgage permits the Bank to look only to the Debtor's collateral for payment in the event of default; the lender has no recourse against the borrower personally. See *id.* at 1414 n.3. Thus, if the Bank chose to foreclose on the office space, it would not have been entitled to recover on anything beyond the value of the collateral. See McDermott, *supra* note 3, at 26. In contrast, under a recourse loan, a guarantor or endorser is secondarily liable if the borrower defaults. See BLACK'S LAW DICTIONARY 1275 (7th ed. 1999). In that case, the borrower would be liable up to the value of the collateral, and the guarantor must come up with the rest.

62. See *Bank of America*, 119 S. Ct. at 1414.

63. See *id.* Once a debtor files for bankruptcy, the Bankruptcy Code provides an automatic stay of any foreclosure proceedings. See 11 U.S.C. § 362(a) (1994); see also *supra* notes 8–11 and accompanying text (discussing the Bankruptcy Code's automatic stay provision).

By filing for bankruptcy, the Debtor was able to postpone almost \$20 million in personal tax liabilities that would arise upon foreclosure by the Bank. See *Bank of America*, 119 S. Ct. at 1414. As the bankruptcy court found, the purpose of the reorganization and new capital contribution was not to allow the Debtor to become solvent; in fact, the bankruptcy court found that the Debtor would never reach solvency. See *In re* 203 N. LaSalle St. Ltd. Partnership, 190 B.R. 567, 588 (Bankr. N.D. Ill. 1995) (mem.), *aff'd sub nom.* Bank of America, Ill. v. 203 N. LaSalle St. Partnership, 195 B.R. 692 (N.D. Ill. 1996) (mem.), *aff'd sub nom.* *In re* 203 N. LaSalle St. Partnership, 126 F.3d 955 (7th Cir. 1997), *rev'd sub nom.* Bank of Am. Nat'l Trust & Savings Ass'n v. 203 N. LaSalle St. Partnership, 119 S. Ct. 1411 (1999). Rather, the Debtor hoped to retain its interest in the partnership because of the tax benefits that would accompany that interest. See *id.* Net operating losses associated with a business are a valuable way to reduce future tax liability, as they can be used to offset future taxable income. See Epling, *supra* note 27, at 339 n.10. If the interest in the partnership was lost, then those net operating losses associated with the partnership would be lost as well. See *id.*

had the exclusive right to do so.⁶⁴ The value of the Debtor's mortgaged property was only \$54.5 million, leaving the Bank with an unsecured claim of \$38.5 million.⁶⁵ Because a portion of the claim was secured and the rest was unsecured, the Bank's claims were classified separately, along with a third class of unsecured trade claims totaling \$90,000.⁶⁶ The Debtor's proposed reorganization plan would pay off the Bank's \$54.5 million secured claim with interest over a period of seven to ten years.⁶⁷ The Bank, however, only would receive approximately sixteen percent of the present value of its unsecured claim of \$38.5 million.⁶⁸ As for the \$90,000 unsecured trade claims, the plan provided for full repayment.⁶⁹ The plan also provided that a \$6.125 million contribution of new capital be made by certain partners of the bankrupt Debtor in exchange for the complete equity interest in the reorganized Debtor.⁷⁰

Under the provisions of the Debtor's plan, therefore, two classes of claims were impaired: the Bank's unsecured claim of \$38.5 million and the trade creditors' claims of \$90,000.⁷¹ Although the class of

64. See *Bank of America*, 119 S. Ct. at 1414. The Bankruptcy Code initially provides a 120-day period of exclusivity during which the debtor alone may file its plan. See 11 U.S.C. § 1121(b) (1994). This period may be extended to 180 days, however, if the debtor files a request for an extension within the allotted 120 days. See *id.* § 1121(c). Here, the Debtor filed for the extension within the initial period, and it was approved. See *In re* 203 N. LaSalle St. Partnership, 126 F.3d 955, 958–59 (7th Cir. 1997), *rev'd sub nom.* *Bank of Am. Nat'l Trust & Savings Ass'n v. 203 North LaSalle St. Partnership*, 119 S. Ct. 1411 (1999).

65. See *Bank of America*, 119 S. Ct. at 1415. Under § 1111(b), a nonrecourse secured creditor who is undersecured is treated in Chapter 11 as if it had recourse. See 11 U.S.C. § 1111(b)(1)(A) ("A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of this title the same as if the holder of such claim had recourse against the debtor on account of such claim, whether or not such holder has such recourse."); *Bank of America*, 119 S. Ct. at 1414 n.6 (stating the same).

66. See 11 U.S.C. § 1122(a); *Bank of America*, 119 S. Ct. at 1414–15.

67. See *Bank of America*, 119 S. Ct. at 1415.

68. See *id.*

69. See *id.*

70. See *id.* Partners in the bankrupt Debtor were given the opportunity to contribute new capital to the reorganized debtor. See *id.* In return for that new capital, the old equity holders were to receive an equity interest in the reorganized debtor. See *id.* This opportunity was made available exclusively to equity holders in the bankrupt Partnership; thus, the reorganized debtor would be comprised only of those former partners who made equity contributions. See *id.* Over 60% of the partnership would change hands under the plan. No third parties—in other words, anyone who did not hold an equity share in the bankrupt partnership—would have been permitted to contribute or to receive an interest in the reorganized debtor. See *id.* at 1415 n.11.

71. See *id.* at 1415–16. A class is unimpaired if it retains all prepetition legal, equitable, and contractual rights against the debtor. See 11 U.S.C. § 1124(1). Thus, the Bank's claim was impaired because it stood to receive only 16% of the present value of its claim, and the trade creditors' claim was impaired because they would receive no interest

trade creditors voted to approve the plan, the Bank rejected the plan,⁷² thus preventing consensual confirmation of the plan as required under Chapter 11.⁷³ The Debtor then sought to enforce the plan over the objections of a dissenting class through a cramdown.⁷⁴

The Bank's objection to the reorganization plan focused on the absolute priority rule.⁷⁵ The Bank claimed that the Debtor's plan violated the rule because the equity holders of the bankrupt Partnership who contributed to the reorganized Debtor and whose claims were junior to those of the creditors would receive property even though the Bank's unsecured claim was not fully paid.⁷⁶ This arrangement was an apparent violation of the absolute priority rule: the claims of equity holders were junior to those of the Bank, but those junior claimants were to receive property, namely an interest in the reorganized Debtor, without all senior claims being satisfied completely.⁷⁷ Nevertheless, the bankruptcy court confirmed the plan,⁷⁸ as did the district court on appeal.⁷⁹

The United States Court of Appeals for the Seventh Circuit upheld the lower courts' approval of the plan.⁸⁰ In doing so, the Seventh Circuit noted the ambiguity in the phrase "on account of" as used in the statute codifying the absolute priority rule.⁸¹ It read this language to permit a "new value" corollary to the absolute priority

under the Debtor's proposal. See *Bank of America*, 119 S. Ct. at 1415–16.

72. See *Bank of America*, 119 S. Ct. at 1415.

73. See 11 U.S.C. § 1129(a)(8) (requiring that the reorganization plan be accepted by each class of impaired creditors).

74. See *Bank of America*, 119 S. Ct. at 1415.

75. See *id.*

76. See Brief for the Petitioner at 8, *Bank of America*, 119 S. Ct. 1411 (1999) (No. 97-1418).

77. See *id.*

78. See *In re 203 N. LaSalle St. Ltd. Partnership*, 190 B.R. 567, 594 (Bankr. N.D. Ill. 1995) (mem.), *aff'd sub nom.* *Bank of America, Ill. v. 203 N. LaSalle St. Partnership*, 195 B.R. 692 (N.D. Ill. 1996) (mem.), *aff'd sub nom. In re 203 N. LaSalle St. Ltd. Partnership*, 126 F.3d 955 (7th Cir. 1997), *rev'd sub nom.* *Bank of Am. Nat'l Trust & Savings Ass'n v. 203 North LaSalle St. Partnership*, 119 S. Ct. 1411 (1999).

79. See *Bank of America*, 195 B.R. at 716, *aff'd sub nom. In re 203 N. LaSalle St. Ltd. Partnership*, 126 F.3d 955 (7th Cir. 1997), *rev'd sub nom. Bank of Am. Nat'l Trust & Savings Ass'n v. 203 North LaSalle St. Partnership*, 119 S. Ct. 1411 (1999). Congress has granted jurisdiction over bankruptcy claims to United States district courts. See 28 U.S.C. § 1334 (1994). The district courts, pursuant to 28 U.S.C. § 157(a) (1994), will then refer these matters to the bankruptcy courts, which are described as a "unit" of the district court. *Id.* § 151. Final bankruptcy court orders are then appealable to the district courts. See *id.* § 158(a). From there, the courts of appeals have jurisdiction. See *id.* § 158(d).

80. See *In re 203 N. LaSalle St. Partnership*, 126 F.3d at 970, *rev'd sub nom. Bank of Am. Nat'l Trust & Savings Ass'n v. 203 North LaSalle St. Partnership*, 119 S. Ct. 1411 (1999).

81. See *id.* at 964.

rule.⁸² Although the absolute priority rule states that a junior claimant cannot receive any property if all senior claimants have not been fully paid, the new value theory would hold otherwise.⁸³ As recognized under pre-1978 practice, the theory holds that by contributing new capital to a reorganized debtor, a party with a junior claim may receive or retain property even when all senior claims have not been satisfied.⁸⁴

The court of appeals based its decision on its reading of the statutory absolute priority rule,⁸⁵ interpreting the language to mean that a junior claimant could receive property if it was not received "on account of" the junior claim or interest.⁸⁶ Specifically, the Seventh Circuit held that the junior claimants could retain their interests in the property if they made a contribution of new value to the reorganized Debtor.⁸⁷ In such a situation, the junior claimants would not be receiving property "on account of" their positions as prior equity holders but rather "on account of" their contributions of new capital.⁸⁸ In light of a split among the circuits concerning the viability of the new value exception,⁸⁹ the Supreme Court granted

82. *Id.* at 965.

83. *See id.* at 963.

84. *See id.*

85. *See* 11 U.S.C. § 1129(b)(2)(B)(ii) (1994).

86. *See In re 203 N. LaSalle St. Partnership*, 126 F.3d at 964.

87. *See id.* at 966-67.

88. *See id.* at 966. In dissent, Judge Kanne argued that the plain language of the absolute priority rule "fails to even hint" at a new value corollary. *Id.* at 970 (Kanne, J., dissenting). According to Judge Kanne, the majority incorrectly inserted the words "solely or primarily" before "on account of" in the statute. *See id.* at 972 (Kanne, J., dissenting). Thus, the statute would read "'the holder of any claim or interest that is junior to the claims of such class will not receive or retain under the plan SOLELY or PRIMARILY on account of such junior claim or interest any property.'" *Id.* (Kanne, J., dissenting). Judge Kanne felt this interpretation was an inappropriate deviation from the "otherwise firm rule" of absolute priority. *See id.* (Kanne, J., dissenting).

The dissent also argued that, assuming the statute was ambiguous, legislative history was inconclusive and did not support the new value exception. *See id.* at 973 (Kanne, J., dissenting). Furthermore, because the Bankruptcy Code "so fundamentally altered" pre-Code practice and procedures, following pre-Code practice might be adverse to the intentions of Congress. *Id.* at 974 (Kanne, J., dissenting). In Judge Kanne's view, the Debtor's plan gave the old equity holders the exclusive right to retain their ownership in the reorganized debtor because of their status as former equity holders. *See id.* at 973 (Kanne, J., dissenting). Judge Kanne therefore would follow the plain meaning of the statute and prohibit such a plan. *See id.* (Kanne, J., dissenting).

89. The Seventh and Ninth Circuits have recognized the existence of the new value exception, while the Second and Fourth Circuits, although not explicitly rejecting the new value exception, have rejected new value plans similar to those approved in other circuits. *Compare id.* at 965 (recognizing the existence of the new value exception), *and Bonner Mall Partnership v. U.S. Bancorp Mortgage Co.*, 2 F.3d 899, 918 (9th Cir. 1993) (confirming a reorganization plan based on the new value exception), *with Coltex Loop*

certiorari.⁹⁰

In an opinion by Justice Souter, the Court held that pre-bankruptcy equity holders who wish to contribute new capital in return for equity in the reorganized entity may not do so over the objection of a senior class of impaired creditors if: (1) the prior equity holders have an *exclusive* opportunity to contribute new capital; and (2) no alternative plans are considered.⁹¹ Although the majority rejected the reorganization scheme in this case, it explicitly stated that it would not pass judgment on the validity of the new value exception.⁹² Despite its rather limited holding, the Court engaged in a comprehensive analysis of the language and history of the absolute priority rule as codified in § 1129(b)(2)(B)(ii).⁹³

The Court began by discussing the legislative history behind the codification of the absolute priority rule.⁹⁴ Consistent with the uncertainty surrounding the new value exception, the Court found that the legislative history on the rule was open to interpretation.⁹⁵ Both the Bank and the Debtor, for example, interpreted Congress's attempt in 1973 to overhaul the Bankruptcy Act of 1898 as support for their arguments.⁹⁶ While it was debating the merits of a new bankruptcy act in 1973, Congress, amidst widespread disapproval,

Central Three Partners, L.P. v. BT/SAP Pool C Assocs., L.P., 138 F.3d 39, 44–45 (2d Cir. 1998) (disapproving a plan similar to the proposed plan in *Bank of America*, but not explicitly rejecting the new value exception), and *Travelers Ins. Co. v. Bryson Properties*, XVIII, 961 F.2d 496, 504 (4th Cir. 1992) (rejecting a plan that gave old shareholders the exclusive opportunity to retain their equity, while not rejecting the new value exception per se).

90. See *Bank of America Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. Partnership*, 523 U.S. 1106 (1998).

91. See *Bank of America*, 119 S. Ct. at 1424. Chief Justice Rehnquist and Justices O'Connor, Kennedy, Ginsburg, and Breyer joined Justice Souter in the majority decision. See *id.* at 1413. Justice Thomas, joined by Justice Scalia, concurred only in the judgment, see *id.* at 1424–26 (Thomas, J., concurring), while Justice Stevens dissented. See *id.* at 1426–30 (Stevens, J. dissenting).

92. See *id.* at 1417 (“We do not decide whether the statute includes a new value corollary or exception . . .”).

93. See *id.* at 1417–22.

94. See *id.* at 1417–19.

95. See *id.*

96. See Brief for the Petitioner at 26, *Bank of America*, 119 S. Ct. 1411 (1999) (No. 97-1418) (“The legislative history, in fact, reinforces the clear import of the statutory text: there is no new value exception to the absolute priority rule.”); *id.* at 32 (“The legislative history shows that Congress intended to codify the absolute priority rule without a new value exception.”); Brief for Respondent at 37–38, *Bank of America* (No. 97-1418) (“Congress understood the new value principle to be part of the absolute priority rule codified in the [old Bankruptcy Act] . . . and intended to make no change to that ‘black-letter’ principle when it carried the ‘fair and equitable’ requirement forward into Chapter 11 of the Code.”).

rejected a proposal from the bankruptcy commission intended to reform the absolute priority rule.⁹⁷ The commission's proposal would have permitted prior equity holders to participate in a reorganized debtor based on a contribution of "continued management ... essential to business" or other participation beyond "money or money's worth."⁹⁸

The Bank, like many opponents of the new value exception, treated Congress's rejection of the measure as an explicit disavowal of the new value exception.⁹⁹ The Debtor and other supporters of the new value exception took the opposite view, interpreting these same circumstances to be evidence that Congress was aware of the new value exception and that its rejection of this expansion of the traditional concept of new value was merely an endorsement of the exception.¹⁰⁰

The Court, although not assessing the validity of either side's argument, appeared to side with the Debtor. It characterized Congress's rejection of the proposal as "equivocal," recognizing that the rejection of this proposed modification to the absolute priority rule was ambiguous at best.¹⁰¹ Additionally, the Court acknowledged that the proposed new value rule was a broadened version of the traditional model,¹⁰² seemingly agreeing with the Debtor that the rejection of the 1973 proposal was not the same as an outright rejection of the new value exception as most see it. Most importantly, the Court noted that "this history does nothing to disparage the possibility apparent in the statutory text, that the absolute priority rule now on the books as subsection (b)(2)(B)(ii) may carry a new

97. See *Bank of America*, 119 S. Ct. at 1418.

98. *Id.* (citing H.R. DOC. NO. 93-137, pt. 1, at 258-59 (1973)). This proposal would have greatly expanded the new value exception by allowing nonmonetary contributions of new value. See *id.* Even when the new value exception is upheld, it is limited to money or money's worth. See *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203 (1987).

99. See Brief for the Petitioner at 27, *Bank of America* (No. 97-1418); see also *In re* 203 N. LaSalle St. Partnership, 126 F.3d 955, 974-76 (7th Cir. 1997) (Kanne, J., dissenting) (arguing that the legislative history fails to provide any evidence that the new value exception survived the enactment of the Bankruptcy Code), *rev'd sub nom.* *Bank of Am. Nat'l Trust & Savings Ass'n v. 203 North LaSalle St. Partnership*, 119 S. Ct. 1411 (1999); *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1361-62 (7th Cir. 1990) (noting that the statutory language and legislative history suggest that the new value exception did not survive).

100. See, e.g., *In re Snyder*, 967 F.2d 1126, 1130 (7th Cir. 1992) ("Rather than rejecting the new value exception wholesale, Congress 'only rejected the Commission's proposed relaxation of the rule's requirements.' " (quoting Markell, *supra* note 18, at 103)).

101. *Bank of America*, 119 S. Ct. at 1418-19.

102. See *id.*

value corollary.”¹⁰³ While not explicitly rejecting the Bank’s legislative history arguments, this statement certainly left the door open for the Court to recognize the new value exception.

Turning from a legislative history to a textual analysis, the Court then examined the meaning of the phrase “on account of”¹⁰⁴ by considering three possible meanings for the phrase.¹⁰⁵ The first, endorsed by the Debtor, was that “on account of” means “in exchange for” or “in satisfaction of.”¹⁰⁶ The Debtor argued that this interpretation would resolve any new value problems,¹⁰⁷ thus permitting the recognition of a new value exception. The old equity holders’ stakes in the reorganized Debtor could then be considered “in exchange for” the new capital contributions and not “in exchange for” their old equity interests.¹⁰⁸

The Court rejected the “in exchange for” interpretation for both textual and practical reasons.¹⁰⁹ An examination of the statutory language proved unfavorable for the Debtor’s preferred interpretation because the absolute priority rule governs the retention of property as well as its receipt.¹¹⁰ Thus, a junior claimant is not only prohibited from receiving property on account of its prior interest, but also may not retain property on account of its prior interest.¹¹¹ The Court explained that if “in exchange for” is the proper meaning for “on account of,” then Congress would have used the awkward terminology of “‘retain[ing]’ property in exchange for the same property interest.”¹¹² The Court found it highly unlikely that Congress would use such convoluted language.¹¹³ In addition, Congress used the phrase “in exchange for” in another area of the Bankruptcy Code,¹¹⁴ so the Court reasoned that Congress would have employed that specific terminology if that was its intent.¹¹⁵ From a

103. *Id.*

104. *See id.* at 1419–22.

105. *See id.* at 1419.

106. *Id.*; *See* Brief for Respondent at 12–16, *Bank of America*, 119 S. Ct. 1411 (1999) (No. 97-1418).

107. *See Bank of America*, 119 S. Ct. at 1419.

108. *See id.*

109. *See id.* at 1420.

110. *See* 11 U.S.C. § 1129(b)(2)(B)(ii) (1994).

111. *See id.*

112. *Bank of America*, 119 S. Ct. at 1420.

113. *See id.*

114. *See id.*; *see also* 11 U.S.C. § 1123(a)(5)(J) (providing that “a plan shall provide adequate means for implementation, such as issuance of securities of the debtor . . . for cash, for property, for existing securities, or in exchange for claims or interests, or for any other appropriate purpose”).

115. *See Bank of America*, 119 S. Ct. at 1420.

practical standpoint, the Court viewed the "in exchange for" interpretation as too "manipulable" and ultimately dismissed the Debtor's preferred explanation as "beset with troubles."¹¹⁶

The Court then turned to what it felt was a more common usage of the phrase "on account of."¹¹⁷ According to the Court, viewing the Code's language as meaning "because of" is a more sensible approach because that is how the language is used in numerous other sections of the Code.¹¹⁸ The phrase "because of" itself has multiple meanings, however. For example, consider the hypothetical situation of a junior claimant who received property under a reorganization plan for three reasons: (1) claimant was under forty years old; (2) he was married; and (3) he was a prior equity holder. If the phrase "because of" is used in applying the absolute priority rule, two possible scenarios could occur. First, the phrase could take on a direct and absolute level of causation, as advocated by the Debtor.¹¹⁹ In that case, the junior claimant would only violate the absolute priority rule when he received property directly and solely because of his prior interest. With a direct level of causation, this junior claimant would be allowed to retain his property, as he did not receive it solely because of his prior interest, but also because of his age and marital status.

Alternatively, "because of" could be used in a less direct manner, implying a "but for" level of causation. In this interpretation, which is more in line with the Bank's view,¹²⁰ the junior claimant would violate the absolute priority rule when his status as a prior equity holder had any bearing whatsoever on his receiving property. To determine whether the absolute priority rule was violated, one would ask "but for the junior claimant's position as a prior equity holder, would he

116. *Id.* at 1419-20.

117. *See id.* at 1420.

118. *See id.* For other provisions of the Code using this language, see, for example, 11 U.S.C. § 1111(b)(1)(A) ("A claim secured by a lien on property of the estate shall be allowed or disallowed under section 502 of the title the same as if the holder of such claim had recourse against the debtor on account of such claim."), *id.* § 522(d)(10)(E) ("[A] payment under a stock bonus, pension, profit sharing, annuity, or similar plan or contract on account of illness, disability, death, age, or length of service . . ."), *id.* § 547(b)(2) ("[T]he trustee may avoid any transfer of an interest of the debtor in property . . . for or on account of an antecedent debt owed by the debtor before such transfer was made . . ."), *id.* § 547(c)(4)(B) ("[T]o the extent that . . . such creditor gave new value to or for the benefit of the debtor . . . on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor . . .").

119. *See* Brief for Respondent at 19-21, *Bank of America*, 119 S. Ct. 1411 (1999) (No. 97-1418).

120. While the Bank did not push for "but for" causation in its strictest sense, its position was much closer to a "but for" level than it was to the Debtor's direct causation. *See* Brief for the Petitioner at 21-23, *Bank of America* (No. 97-1418).

receive any property?" Here, even though the junior claimant receives property based on three conditions, he would not have received any property unless he was a prior equity holder because that was one of the three requirements. Using a "but for" level of causation, the junior claimant would not be allowed to retain the property.

Thus, the Court was faced with determining the appropriate level of causation for the phrase "because of."¹²¹ In an amicus brief, the United States Government argued in favor of the "but for" approach, asserting that any degree of causation should invalidate a plan in which a prior interest ends up with equity, a rigid position the Court described as "starchy."¹²² Following the Solicitor General's interpretation would result in a complete prohibition on equity holders retaining any property over an objecting class of unpaid senior creditors.¹²³ The Court explained that such an approach likely did not reflect Congress's intent, as Congress could have accomplished the same objective by eliminating the phrase "on account of" entirely.¹²⁴

The final proposed meaning also involved the phrase "because of," but uses a more direct level of causation.¹²⁵ Under this theory, between the prior interest and property received would exist only if the new contribution is less than what would have been paid by another party without a prior interest.¹²⁶ Thus, the contribution would be invalidated only if it "failed to provide the greatest possible addition to the bankruptcy estate."¹²⁷ Causation of this type would certainly be more conducive to new value proposals than would the Solicitor General's view because this direct causation would

121. See *Bank of America*, 119 S. Ct. at 1420. In *Bonner Mall Partnership v. U.S. Bancorp Mortgage Co.*, 2 F.3d 899 (9th Cir. 1993), the Ninth Circuit recognized the importance of determining the level of causation. See *id.* at 909 ("[T]he answer to the meaning of the phrase 'on account of' lies in the level of causation Congress had in mind when it prohibited old equity owners from receiving property 'on account of' their prior interests.").

122. *Bank of America*, 119 S. Ct. at 1420.

123. See Brief for the United States as Amicus Curiae Supporting Petitioner at 10-16, *Bank of America*, 119 S. Ct. 1411 (1999) (No. 97-1418); Brief for Respondent at 15-16, *Bank of America*, 119 S. Ct. 1411 (1999) (No. 97-1418). This argument has been delivered on two other occasions by previous Solicitors General. See Brief for United States as Amicus Curiae at 15-20, *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) (No. 86-958); Brief for the United States as Amicus Curiae Supporting Petitioner at 15-25, *U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership*, 2 F.3d 899 (9th Cir.1993) (No. 93-714).

124. See *Bank of America*, 119 S. Ct. at 1421.

125. See *id.*

126. See *id.*

127. *Id.*

invalidate only the most blatant proposal in which old equity retains its interest due to its position as a prior interest holder.¹²⁸

Because the Debtor's plan would fail on any level of causation, the Court found it unnecessary to choose among the three meanings.¹²⁹ The Court explained that the plan's fatal flaw was "its provision for vesting equity in the reorganized business in the Debtor's partners without extending an opportunity to anyone else either to compete for that equity or to propose a competing reorganization plan."¹³⁰ Thus, the exclusivity of the reorganization plan raised the Court's ire.

The Court was particularly troubled by two issues related to the plan's exclusivity. First, the Court was concerned by the method used by the old shareholders to freeze out all others from proposing competing bids.¹³¹ Under § 1121(b), the Debtor had a 120-day period of exclusivity (which was extended to 180 days) during which it was the only party who could propose a plan of reorganization.¹³² The Debtor took advantage of this situation, however, and proposed a plan under which members of the Debtor had the sole right to *retain equity* in the reorganized Debtor.¹³³ According to the Court, this plan amounted to the Debtor's exercise of an exclusive option to retain interest in the new firm.¹³⁴ Such an option has value and should itself be treated as property.¹³⁵ If treated as property, the option would constitute property received "on account of" an old equity interest and would violate the absolute priority rule.¹³⁶

The Court's second concern involving the exclusivity of the Debtor's plan was rooted in the underlying policies of Chapter 11. Exclusivity prevents the market from placing an appropriate value on

128. See Brief for Respondent at 19–21, *Bank of America* (No. 97-1418).

129. See *Bank of America*, 119 S. Ct. at 1422.

130. *Id.*

131. See *id.*

132. See *supra* note 64 and accompanying text (describing the statutory provisions behind the 120-day period of exclusivity).

133. See *Bank of America*, 119 S. Ct. at 1422.

134. See *id.*

135. See *id.*; cf. *Coltex Loop Central Three Partners, L.P. v. BT/SAP Pool C Assocs., L.P.*, 138 F.3d 39, 43 (2d Cir. 1998) ("[T]he *exclusive* right to retain the debtor's property upon making a capital contribution is itself property."); *Travelers Ins. Co. v. Bryson Properties, XVIII*, 961 F.2d 496, 504 (4th Cir. 1992) (stating that the exclusive right to contribute capital in return for retaining equity is property under 11 U.S.C. § 1129(b)(2)(B)(ii) (1994) "received or retained on account of a prior interest"); *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1360 (7th Cir. 1990) (asserting that an option to purchase stock is property under § 1129(b)(2)(B)(ii)).

136. See 11 U.S.C. § 1129(b)(2)(B)(ii).

the firm.¹³⁷ By making this opportunity available exclusively to those with a prior interest, the reorganization plan ensured that there would be no way of knowing whether the amount contributed as new capital was the maximum amount that could be raised in the market.¹³⁸ Consequently, the determination of whether the former equity holders paid the full price was left to the bankruptcy judge, whose valuation expertise was inferior to the market's.¹³⁹ Ensuring that the market is the mechanism that determines the value of the firm would help to preserve businesses as going concerns and to maximize the property available to creditors, as old shareholders would be forced to pay at least as high a price as anyone else would pay.¹⁴⁰ According

137. See *Bank of America*, 119 S. Ct. at 1423.

138. See *id.* at 1423.

139. See *id.*; see also BAIRD, *supra* note 3, at 250 (noting that shareholders, who possess greater information about a company than even the most diligent bankruptcy judge, will be in a better position to value their firm); cf. Markell, *supra* note 18, at 73 ("Reorganization practice illustrates that the presence of competing bidders for a debtor, whether they are owners or not, tends to increase creditor dividends.").

140. The Court stated that a "less absolute" reading of the "on account of" language in the statute would reconcile the two main policies of Chapter 11: preserving the going concern and maximizing the property available to satisfy creditors. See *Bank of America*, 119 S. Ct. at 1421; see also Toibb v. Radloff, 501 U.S. 157, 163 (1991) (reciting the underlying objectives of a Chapter 11 reorganization). The *Bank of America* Court outlined this interpretation of "on account of," stating that the requisite causation "would presumably occur" when old equity retains property at a price that "failed to provide the greatest possible addition to the bankruptcy estate, and it would always come at a price too low when the equity holders obtained or preserved an ownership interest for less than someone else would have paid." *Bank of America*, 119 S. Ct. at 1421.

Adopting such a heightened level of causation as the threshold for rejecting a reorganization plan would further these two policies of Chapter 11. The infusion of new capital and the advantages of continuous ownership help to satisfy the goal of preserving the company as a going concern. Property available to creditors also would be maximized because, by definition, the old shareholders would be forced to pay more than someone else would pay. Thus, the problems that could arise from the recognition of a new value exception do not seem relevant under this level of causation. Because the old shareholders are forced to pay fair market value to retain their equity in the reorganized company, it is not likely that these old shareholders will be able to take unfair advantage of the debtor's senior creditors. Although the Court appeared to lean towards this policy-oriented level of causation, it stopped short of expressly adopting it. See *id.* at 1422.

Adopting this policy-based interpretation of "on account of" would solve a problem inherent in new value cases that arises after the bankruptcy judge places a value on a firm. Although a bankruptcy judge may be excellent at valuing firms, his estimate likely will not be as accurate as the shareholders', who have a stake in the business and are kept constantly apprised of the firm's value. See BAIRD, *supra* note 3, at 250. Because of the shareholders' advantage in valuation expertise, a reorganization process that includes a new value exception is subject to be taken advantage of by the old shareholders. Baird demonstrates this with an analysis of the decision making process of debtors who have just learned the value of their bankrupt firm. Suppose the bankruptcy judge values the firm at one million dollars. If the true value of the firm is less than one million dollars, then the shareholders will not propose to retain any equity in the firm, as they would not pay more

to the Court, if a market valuation was used, exclusivity would serve no legitimate purpose.¹⁴¹ Prior equity holders would not need the protection of exclusivity if they paid the highest price available.¹⁴² If the prior equity holder does not pay the best price, then there is no reason to confer exclusive retention of equity upon him.¹⁴³ Because the reorganization plan in *Bank of America* granted the old shareholders the exclusive right, free from any market valuation, to contribute new capital in return for equity in the reorganized Debtor, the old shareholders were receiving property—namely, the exclusive right to purchase equity—“on account of” their prior interest and over the objection of an unpaid senior creditor.¹⁴⁴ This exclusivity was the defect that caused the Debtor’s plan to violate the absolute priority rule.¹⁴⁵

Although the majority of the Court refused to take a stand on the existence of the new value exception, the remaining Justices argued that a definitive pronouncement should be made as to the viability of the exception. In a concurring opinion, Justice Thomas stated that there was undoubtedly some degree of causation implied in the phrase “on account of” as used in the absolute priority rule.¹⁴⁶ Additionally, Justice Thomas contended, it was just as clear that the old equity holders received at least two forms of property under the plan: (1) the exclusive option to retain their equity; and (2) the equity in the reorganized Debtor.¹⁴⁷ Therefore, he reasoned, at a minimum, the exclusive option was obtained “on account of” the old equity

than the firm is worth. If the firm is worth more than one million dollars, however, the shareholders certainly will offer that sum as new value and hope to retain an interest in the undervalued firm. In that case, the shareholders would be using their superior information about the firm’s value to exploit any unpaid senior creditors. *See id.*, at 250–51. The policy-oriented level of causation described by the Court would resolve this issue, because the price paid by the old shareholders would be the maximum that any party would pay. The creditors’ interests are again protected, and all parties would likely benefit from the reorganization. *See id.*

141. *See Bank of America*, 119 S. Ct. at 1422–23. As the Court explained, “[I]f the price to be paid for the equity is the best obtainable, old equity does not need the protection of exclusiveness (unless to trump an equal offer from someone else); if it is not the best, there is no apparent reason for giving old equity a bargain.” *Id.* Thus, the Court noted that there was no reason for the Debtor’s plan to invoke exclusivity “unless the very purpose of the whole transaction is, at least in part, to do old equity a favor.” *Id.*

142. *See id.*

143. *See id.*

144. *See id.* at 1423. *But see infra* notes 153–58 and accompanying text (discussing Justice Stevens’s dissent, which characterized the exclusive opportunity as a function of the procedural aspects of the Bankruptcy Code).

145. *See Bank of America*, 119 S. Ct. at 1424.

146. *See id.* at 1424 (Thomas, J., concurring).

147. *See id.* (Thomas, J., concurring).

interest, so the plan should not be confirmed.¹⁴⁸ Viewing the new value exception as originating in nonbinding dicta that had never been employed by the Court, Justice Thomas urged the Court to definitively pronounce the new value exception dead and explained that the majority opinion “only thickens the fog.”¹⁴⁹

In dissent, Justice Stevens also implored the Court to resolve any new value questions, but would have affirmed both the Debtor’s plan and the court of appeals’ interpretation of the absolute priority rule.¹⁵⁰ According to Justice Stevens, the new value exception stands for the idea that a junior claimant may only receive equity in a reorganized debtor if the claimant’s new capital contribution does not come at a bargain price.¹⁵¹ Therefore, if the new value contribution is equivalent to or of greater value than the junior claimant’s interest in the reorganized firm, the new equity is “on account of” the new contribution and not “on account of” the claimant’s prior interest.¹⁵²

Justice Stevens’s dissent also criticized the majority’s complaint that the “exclusive opportunity” obtained by the old equity holders was the fatal flaw in the reorganization plan.¹⁵³ He argued that this opportunity was not an unfair advantage gained by the old shareholders, but rather a function of three procedural aspects of the Bankruptcy Code¹⁵⁴: (1) the statutorily mandated period of exclusivity during which only the debtor may propose a reorganization plan; (2) the refusal by the bankruptcy judge to allow the bank to file a competing plan; and (3) the inability of the judge to approve multiple plans.¹⁵⁵ Because he saw no reason to doubt the bankruptcy judge’s valuation of the Debtor¹⁵⁶ and found the supposed “exclusive opportunity” to be a product of the Bankruptcy Code,¹⁵⁷ Justice Stevens would have approved the Debtor’s plan.¹⁵⁸

148. *See id.* at 1425 (Thomas, J., concurring).

149. *Id.* (Thomas, J., concurring). Justice Thomas chastised the majority for its “unnecessary speculation” in discussing the United States’ argument, as well as the majority’s comments advocating a market test for determining the firm’s value. *See id.* at 1424–25 (Thomas, J., concurring). He also criticized the majority’s reliance on legislative history and pre-Bankruptcy Code practice in resolving current questions of interpreting the Code. *See id.* at 1425–26 (Thomas, J., concurring).

150. *See id.* at 1427 (Stevens, J., dissenting).

151. *See id.* (Stevens, J., dissenting).

152. *See id.* (Stevens, J., dissenting).

153. *See id.* at 1428 (Stevens, J., dissenting).

154. *See id.* at 1429–30 (Stevens, J., dissenting).

155. *See id.* (Stevens, J., dissenting); *see also supra* note 64 and accompanying text (discussing the statutory exclusivity period found in 11 U.S.C. § 1121 (1994)).

156. *See Bank of America*, 119 S. Ct. at 1427–28 (Stevens, J., dissenting).

157. *See id.* at 1429–30 (Stevens, J., dissenting).

158. *Id.* at 1430 (Stevens, J., dissenting).

A review of the background law leading up to *Bank of America* provides insight to the Court's struggle with the new value exception. Prior to the codification of the Bankruptcy Code in 1978, a line of cases appeared to allow debtors some leeway in their efforts to participate in the reorganized company.¹⁵⁹ *Northern Pacific Railway Co. v. Boyd* was one of the first cases to allude to this possibility.¹⁶⁰

159. See *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 121 (1939) (stating in dicta that old equity holders may, when necessary, retain their equity in the reorganized firm in exchange for a capital contribution); *Kansas City Terminal R.R. Co. v. Central Union Trust Co.*, 271 U.S. 445, 446 (1926) (noting that prior equity holders may retain their interests in the reorganized company when their contribution is fundamental to the success of the new firm, provided the priority of creditors over stockholders is not impaired); *Northern Pac. Ry. Co. v. Boyd*, 228 U.S. 482, 508 (1913) (stating that prior equity holders may obtain an interest in the reorganized debtor if they make a fair offer to unsecured creditors).

160. 228 U.S. 482 (1913). Two cases preceding *Boyd* developed the concept of absolute priority. In *Railroad Co. v. Howard*, 74 U.S. 392 (1868), Chicago & Rock Island Co. offered to purchase a failing railroad for \$5.5 million. See *id.* at 393. Although this price was less than the \$7 million owed to secured creditors, it was greater than the railroad was supposedly worth. See *id.* In an effort to avoid paying the unsecured creditors, Rock Island met with the secured creditors and the shareholders and arranged a complicated transaction involving the creation of a third-party corporation that would purchase the railroad at a foreclosure sale. See *id.* at 394-95. This third-party corporation would then merge with Rock Island, giving Rock Island full title in the railroad. See *id.* The proceeds from the sale would then be distributed to the secured creditors (84% of the proceeds) and the shareholders of the failing railroad (16%). See *id.* at 396-97. The railroad's unsecured creditors sued, claiming that this transaction was basically a prearranged sale and the proceeds distributed to the shareholders actually belonged to the railroad, which would mean the unsecured creditors had access to those proceeds over the shareholders. See *id.* at 403. The secured creditors and shareholders disagreed, claiming that the price paid for the railroad was less than the amount of secured claims, so there was nothing left over for the unsecured claimants. See *id.* at 398. The shareholders then argued that the money received by the secured creditors was theirs alone, and they could give it away to the shareholders, anyone else they chose, or keep it for themselves. See *id.* at 398-99. The Court sided with the unsecured claimants, holding that "[e]quity regards the property of a corporation as held in trust for the payment of the debts of the corporation" and that "stockholders are not entitled to any share . . . until all the debts of the corporation are paid." *Id.* at 409-10. No inside group would be allowed to deprive the unsecured creditors of their rightful positions to the benefit of the shareholders. See *id.* at 414-16.

Following *Howard*, the Court reiterated its position on the rights of unsecured creditors in *Louisville Trust Co. v. Louisville, New Albany & Chicago Railway*. 174 U.S. 674 (1899). In *Louisville Trust*, a friendly creditor of New Albany entered into a foreclosure sale agreement with the railroad that would provide compensation for secured creditors and shareholders, but not unsecured creditors. See *id.* at 676-80. The railroad entered into this transaction in hopes of avoiding large liability for its guarantee of another railroad's bonds. See *id.* at 675-76. Unsecured creditors brought suit, claiming the sale was fraudulent in that it provided for shareholders without providing for unsecured creditors. See *id.* at 679-80. The Court agreed, stating that any foreclosure that attempts to preserve the rights of prior equity must first satisfy the rights of its creditors. See *id.* at 683-84. After repeating the "familiar rule" that the equity's interest is subordinate to the

Boyd was an unsecured creditor of a failing railroad that underwent a reorganization.¹⁶¹ The secured creditors of the railroad were also the railroad's shareholders.¹⁶² In the reorganization, the secured creditors and shareholders structured the plan in a way that allowed them to retain ownership and exclude the unsecured creditors.¹⁶³ Thus, while there was a change in ownership, the new ownership group was made up of substantially the same investors as the previous group.¹⁶⁴ Because the reorganization plan voided his interests, Boyd challenged the plan.

The Court invalidated the transaction on the basis that the exclusion of the unsecured creditors was improper.¹⁶⁵ The Court stated that if the reorganization did not provide for all creditors, then any creditor that was not provided for "could assert his superior rights" against the interests of the old shareholders.¹⁶⁶ This statement simply restated the absolute priority rule, which the Court noted was a "fixed principle" that it was obligated to follow.¹⁶⁷ The Court hinted, however, that a new value concept may be a part of the absolute priority rule. In doing so, the Court noted that, the objection of an unsecured creditor notwithstanding, prior equity holders may be allowed to claim ownership in the reorganized debtor if the equity holder makes a "fair offer" to the unsecured creditor.¹⁶⁸ The Court noted that this "fair offer" need not be cash and ruled that income bonds or preferred stock, provided they are issued on "equitable terms," would be sufficient to preserve the creditor's interests.¹⁶⁹ *Boyd's* holding, while affirming the absolute priority rule, also left room for future cases to address the concept of new value.¹⁷⁰

rights of creditors, the Court held that "any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation." *Id.* at 684.

161. *See Boyd*, 228 U.S. at 501; *Northern Pac. Ry Co. v. Boyd*, 177 F. 804, 808 (9th Cir. 1910).

162. *See Boyd*, 228 U.S. at 506.

163. *See id.*

164. *See id.* at 506-07.

165. *See id.* at 508.

166. *Id.* at 504.

167. *Id.* at 506-07.

168. *Id.* at 508.

169. *Id.*

170. The four dissenting justices in *Boyd* fully embraced a new value exception. *See id.* at 511-13 (Lurton, J., dissenting). Justice Lurton argued that the absolute priority rule should not be absolute, but rather should be applied only after a fact-based inquiry into the circumstances in each case. *See id.* at 511 (Lurton, J., dissenting). This inquiry should focus on how the shareholders' participation affects the creditors. *See id.* (Lurton, J.,

The Court again recognized the possibility that old equity may retain ownership in *Kansas City Terminal Railroad Co. v. Central Union Trust Co.*¹⁷¹ *Kansas City Terminal* involved a challenge by a group of unsecured creditors to a reorganization plan that allowed stockholders of the insolvent company to retain equity interests even though unsecured creditors were not fully paid.¹⁷² The Court followed the path taken by *Boyd*, acknowledging the need for "rigid adherence" to the absolute priority rule. It did admit, however, that this "rigid adherence" does not "require the impossible" and demand that all unsecured claims be fully paid in cash before old equity can retain ownership.¹⁷³ According to the Court, when necessary, unsecured creditors may be protected through other arrangements that recognize their preferred status to the old shareholders and allow the unsecured creditors to avail themselves of their right of absolute priority.¹⁷⁴ Thus, the Court seemed to allow prior equity holders to maintain an interest in a reorganized company when the reorganized firm is in dire need of additional funds, and such funds are not likely to be received unless the old stockholders are allowed to contribute and retain their interests.¹⁷⁵ The essential nature of contributions from old equity, combined with the understanding that these contributions are unlikely to come unless the contributors are allowed to retain their equity interests, led the Court to adopt a holding that reaffirmed the absolute priority rule while still being receptive to contributions of new value.¹⁷⁶

Eight years after the Court's decision in *Kansas City Terminal*, Congress amended the 1898 Bankruptcy Act¹⁷⁷ to require that proposed reorganization plans be "fair and equitable" with respect to each creditor before the plan could be confirmed.¹⁷⁸ The Court soon

dissenting). Here, Justice Lurton felt that the \$11 million contribution made by the shareholders was essential to the success of the reorganization and that it would actually benefit the creditors. *See id.* at 513 (Lurton, J., dissenting).

171. 271 U.S. 445 (1926).

172. *See id.* at 451. The plan compensated both unsecured creditors and shareholders with new securities in the reorganized debtor. *See id.* While shareholders were forced to pay for their securities, the securities were of equal grade. *See id.* at 452. The plan drew the ire of unsecured creditors because the shareholders were receiving property, while the unsecured creditors had not been fully compensated for their claims. *See id.*

173. *Id.* at 454.

174. *See id.* at 454-55.

175. *See id.* at 455.

176. *See id.* at 455-56.

177. Act of June 7, 1934, ch. 424, § 77(B), 48 Stat. 911, 912 (repealed 1978).

178. Act of August 27, 1935, ch. 774, § 77(e)(1), 49 Stat. 911, 918 (repealed 1938). In 1938, just four years after it was enacted, Congress enacted the Chandler Act Amendments to the Bankruptcy Act, replacing § 77(B) with Chapter X. *See* Chandler Act

had an opportunity to interpret the “fair and equitable” standard in *Case v. Los Angeles Lumber Products Co.*¹⁷⁹ In *Los Angeles Lumber*, the old equity holders proposed a plan in which they would offer their managerial ability, familiarity with the business, and community standing as consideration in exchange for equity in the reorganized company.¹⁸⁰ The Court rejected this plan as inconsistent with the statute’s “fair and equitable” standard, explaining that management’s proposed contributions were intangible and “reflect[ed] merely vague hopes or possibilities.”¹⁸¹ The Court, however, fell short of creating a blanket prohibition on the efforts of old equity holders to retain their shares of a reorganized debtor.

Justice Douglas, writing for the Court, stated that there are “circumstances under which stockholders may participate in a plan of reorganization of an insolvent debtor.”¹⁸² Relying on *Kansas City Terminal*, he recognized that there are situations in which new capital is vital to the reorganization efforts and the old shareholders may be the only ones willing to provide it.¹⁸³ Accordingly, Justice Douglas noted, “[w]here that necessity exists and the old stockholders make a fresh contribution and receive in return a participation reasonably equivalent to their contribution, no objection can be made.”¹⁸⁴ Such contributions must be in “money or in money’s worth,” and the participation of the stockholders must be “reasonably equivalent” to their capital contributions.¹⁸⁵ The Court’s framework for allowing old shareholders to retain equity in the reorganized firm became known

of 1938, ch. 575, §§ 101–276, 52 Stat. 840, 883–905 (repealed 1978). Because the debtor in *Los Angeles Lumber* filed its reorganization plan under § 77(B), however, the Court decided the matter under that section. See *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 108–09 (1939); see also *infra* notes 188–96 and accompanying text (describing the ramifications of Chapter X in regards to absolute priority cases).

179. 308 U.S. 106 (1939).

180. See *id.* at 112–13.

181. *Id.* at 122–23.

182. *Id.* at 121.

183. See *id.* Justice Douglas’s reliance on *Kansas City Terminal* may have been misplaced, however. See BAIRD, *supra* note 3, at 249. In *Kansas City Terminal*, the bankrupt firm was worth less than what the most senior creditor was owed. See 271 U.S. 445, 450–51 (1926). The senior creditor hoped to freeze out the general creditors, while allowing the old shareholders to retain their positions in the reorganized firm. See *id.* at 451. While *Los Angeles Lumber* involved a group of shareholders attempting to impose themselves on unwilling creditors, *Kansas City Terminal* involved a group of senior creditors seeking to exclude their junior counterparts. See BAIRD, *supra* note 3, at 249. The three-party scenario in *Kansas City Terminal* may not stand for the concept that old equity holders may remain in place over the objection of its creditors. See *id.*

184. *Los Angeles Lumber*, 308 U.S. at 121.

185. *Id.* at 122.

as the "new value exception" to the absolute priority rule.¹⁸⁶ Despite acknowledging the necessity of new value, the Court rejected the debtor's plan because the shareholders' contributions were not "of money's worth."¹⁸⁷

Several decisions in the 1940s reaffirmed the holding of *Los Angeles Lumber*,¹⁸⁸ but there was not a great deal of activity involving new value in the decades that followed.¹⁸⁹ This inactivity was largely due to the congressional replacement of section 77(B) of the Bankruptcy Act, the section under which *Los Angeles Lumber* was filed, with Chapter X.¹⁹⁰ The new amendment changed reorganization practice in two major ways. First, it gave the Securities and Exchange Commission (SEC) the duty to review and to give an opinion on virtually all corporate reorganizations.¹⁹¹ Second, it required the appointment of a disinterested trustee, rather than the interested debtor, to develop reorganization plans.¹⁹² The appointment of the disinterested trustee, along with SEC oversight, ensured that shareholder participation in reorganizations would be minimal.¹⁹³ These burdens made Chapter XI a much more attractive

186. TREISTER ET AL., *supra* note 3, § 9.04(f)(2), at 491.

187. *Los Angeles Lumber*, 308 U.S. at 121-22 ("[T]he stockholder's participation must be based on a contribution in money or in money's worth, reasonably equivalent in view of all the circumstances to the participation of the stockholder.").

188. See *Group of Institutional Investors v. Chicago, Milwaukee, St. Paul & Pac. R.R.*, 318 U.S. 523, 542 (1943) (noting that the fair and equitable standard set forth in *Los Angeles Lumber* was correctly applied); *Marine Harbor Properties, Inc. v. Manufacturers Trust Co.*, 317 U.S. 78, 85 (1942) (holding that a reorganization plan that allows old equity to participate in the reorganized debtor without making a new capital contribution is not "fair and equitable" as defined in *Los Angeles Lumber*); *Consolidated Rock Prods. Co. v. DuBois*, 312 U.S. 510, 527 (1941) (acknowledging *Los Angeles Lumber* as the standard for determining what is "fair and equitable"); Markell, *supra* note 18, at 85 (acknowledging that the *Los Angeles Lumber* interpretation of "fair and equitable" was soon approved by several Supreme Court decisions).

189. See 7 COLLIER ON BANKRUPTCY, *supra* note 26, ¶ 1129.04[4][c], at 1129-106 (noting the decline in the number of likely candidates for application of new value principles); Markell, *supra* note 18, at 87 (describing the lack of challenges to the absolute priority rule from *Los Angeles Lumber* until a 1970s congressional review of the bankruptcy laws).

190. See Chandler Act of 1938, ch. 575, §§ 101-276, 52 Stat. 883-905 (repealed 1978).

191. See *id.* §§ 172-173, 52 Stat. at 890-91 (stating that a judge must, when debts are over \$3 million, and may, when debts are under \$3 million, send a report to the SEC for review before approving a reorganization plan).

192. See *id.* § 156, 52 Stat. at 888 (directing the court to appoint an independent trustee if the debt exceeds \$250,000).

193. See Walter W. Miller, Jr., *Bankruptcy's New Value Exception: No Longer a Necessity*, 77 B.U. L. Rev. 975, 1000-01 (1997) (asserting that the requirements of Chapter X meant that shareholder participation to the detriment of creditors only occurred in "cases of true necessity").

alternative for those filing a reorganization plan.¹⁹⁴ Because the new burdens did not apply under Chapter XI, however, Congress removed the “fair and equitable” requirement from Chapter XI in 1952. The removal meant that the absolute priority rule no longer applied to Chapter XI reorganizations.¹⁹⁵ The reluctance of most debtors to file under Chapter X, combined with the removal of the absolute priority rule from Chapter XI, meant that *Los Angeles Lumber* had few challengers until Congress chose to rewrite the bankruptcy laws in the early 1970s.¹⁹⁶

Congress began revising the legislation in the 1970s, culminating with the passage of the Bankruptcy Code in 1978.¹⁹⁷ The fair and equitable standard used to invoke the absolute priority rule was inserted into the Code, but only as a prerequisite for a cramdown and not as a general requirement for consensual confirmations.¹⁹⁸ Although the idea of a new value exception to the absolute priority rule had been present since *Los Angeles Lumber*, the final statute did not contain any reference to such an exception.¹⁹⁹

The Supreme Court had an occasion to resolve this uncertainty in the 1988 case *Norwest Bank Worthington v. Ahlers*.²⁰⁰ In *Ahlers*, the debtors, who were farmers, proposed a reorganization plan in which they would retain their interest in the farm in return for their future labor, experience, and expertise.²⁰¹ The Eighth Circuit approved this plan, viewing the proposed contribution as “new value” permitted under the new value exception.²⁰² The Supreme Court reversed, deciding that “sweat equity” did not constitute “money or

194. See 7 COLLIER ON BANKRUPTCY, *supra* note 26, ¶ 1129.04[4][c], at 1129-106 (“Although Chapter X retained the fair and equitable requirement, it mandated the appointment of a disinterested trustee. This factor at least partially explains the preference, from 1938 to the Code’s adoption in 1978, for filing under Chapter XI rather than under Chapter X.”).

195. See Pub. L. No. 82-456, § 35, 66 Stat. 420, 433 (1953); 7 COLLIER ON BANKRUPTCY, *supra* note 26, ¶ 1129.04[4][c], at 1129-106; Markell, *supra* note 18, at 87, 92 n.152.

196. See Markell, *supra* note 18, at 87. In fact, before the Code’s adoption in 1978, no reported case adopted the new value dicta from *Los Angeles Lumber*. See 7 COLLIER ON BANKRUPTCY, *supra* note 26, ¶ 1129.04[4][c], at 1129-106.

197. See 11 U.S.C. §§ 101-1329 (1994).

198. See *id.* § 1129(b)(1).

199. James J. White, *Absolute Priority and New Value*, 8 T.M. COOLEY L. REV. 1, 6 (1991).

200. 485 U.S. 197 (1988).

201. See *id.* at 199.

202. *In re Ahlers*, 794 F.2d 388, 402-03 (8th Cir. 1986), *rev’d sub nom.* Northwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988).

money's worth" as required by *Los Angeles Lumber*.²⁰³ The Court, however, refused to rule on the existence of the new value exception. Rather, it stated that even if a new value exception had survived the enactment of the Bankruptcy Code, the debtor's proposed contribution did not fall within the new value requirements.²⁰⁴

The Court's refusal to take a position on the existence of the new value exception caused significant division among lower courts.²⁰⁵ The circuits were split on the question, with the Seventh and Ninth

203. *Ahlers*, 485 U.S. at 204.

204. *See id.* at 203-04 n.3 ("Thus, our decision today should not be taken as any comment on the continuing vitality of the . . . [new value] exception.").

205. A number of courts explicitly or implicitly approved the new value exception. *See In re Homestead Partners, Ltd.*, 197 B.R. 706, 710-15 (Bankr. N.D. Ga. 1996); *In re Haas*, 195 B.R. 933, 939 (Bankr. S.D. Ala. 1996), *rev'd on other grounds*, 162 F.3d 1087 (11th Cir. 1998); *In re Gramercy Twins Assocs.*, 187 B.R. 112, 126 (Bankr. S.D.N.Y. 1995); *In re Beaver Office Products, Inc.*, 185 B.R. 537, 541 (Bankr. N.D. Ohio 1995); *In re Trevarrow Lanes, Inc.*, 183 B.R. 475, 494, (Bankr. E.D. Mich. 1995); *State St. Bank v. Elmwood, Inc.*, 182 B.R. 845, 852 (D. Nev. 1995); *In re Rocha*, 179 B.R. 305, 307 (Bankr. M.D. Fla. 1995); *In re 8315 Fourth Ave. Corp.*, 172 B.R. 725, 737 (Bankr. E.D.N.Y. 1994); *In re Dean*, 166 B.R. 949, 955 (Bankr. D. N.M. 1994); *In re Short*, 173 B.R. 946, 949 (Bankr. E.D. Okla. 1994); *In re Baseline-Dobson Ctr. Real Estate Ltd.*, 193 B.R. 284, 289 (Bankr. D. Ariz. 1994); *Coones v. Mutual Life Ins. Co. of New York*, 168 B.R. 247, 252 (D. Wyo. 1994); *In re SM 104 Ltd.*, 160 B.R. 202, 225 (Bankr. S.D. Fla. 1993); *FGH Realty Credit Corp. v. Newark Airport/Hotel Ltd.*, 155 B.R. 93, 101 n.8 (D.N.J. 1993); *In re Eitemiller*, 149 B.R. 626, 630 (Bankr. D. Idaho 1993); *In re Ropt Ltd. Partnership*, 152 B.R. 406, 412 (Bankr. D. Mass. 1993); *In re F.A.B. Indus.*, 147 B.R. 763, 769 (C.D. Cal. 1992); *In re Sovereign Group 1985-27, Ltd.*, 142 B.R. 702, 706 (E.D. Pa. 1992); 7 COLLIER ON BANKRUPTCY, *supra* note 26, ¶ 1129.04[4][c], at 1129-103 & n.149.

A few courts also rejected the new value exception. *See In re Ribs Auto Sales, Inc.*, 140 B.R. 390, 395 (Bankr. E.D. Va. 1992); *Piedmont Assocs. v. CIGNA Property & Cas. Ins. Co.*, 132 B.R. 75, 79 (N.D. Ga. 1991); *In re Embassy Enters. of St. Cloud*, 125 B.R. 552, 554 (Bankr. D. Minn. 1991); *In re Drimmel*, 108 B.R. 284, 288 (Bankr. D. Kan. 1989), *aff'd*, 135 B.R. 410, 415 (D. Kan. 1991); *In re Winters*, 99 B.R. 658, 663 (Bankr. W.D. Pa. 1989); 7 COLLIER ON BANKRUPTCY, *supra* note 26, ¶ 1129.04[4][c], at 1129-103 & n.149.

Finally, there were also courts that expressed uncertainty over whether the new value exception exists. *See In re BMW Group I, Ltd.*, 168 B.R. 731, 734 (Bankr. W.D. Okla. 1994); *In re D&W Realty Corp.*, 156 B.R. 140, 145 (Bankr. S.D.N.Y. 1993), *rev'd on other grounds*, 165 B.R. 127 (S.D.N.Y. 1994); *In re Miami Ctr. Assocs.*, 144 B.R. 937, 942 (Bankr. S.D. Fla. 1992); *In re Holiday Assocs. Partnership*, 139 B.R. 711, 716 (Bankr. S.D. Iowa 1992); *In re 495 Cent. Park Ave. Corp.*, 136 B.R. 626, 632 (Bankr. S.D.N.Y. 1992); *In re Modern Steel Treating Co.*, 130 B.R. 60, 64 (Bankr. N.D. Ill. 1991); *In re Executive House Assocs.*, 99 B.R. 266, 281 (Bankr. E.D. Pa. 1989); *In re Perdido Motel Group, Inc.*, 101 B.R. 289, 292 n.4 (Bankr. N.D. Ala. 1989); *In re Chandler*, 98 B.R. 516, 518 (Bankr. D. Mont. 1988); *In re Food City, Inc.*, 94 B.R. 91, 94 n.7 (Bankr. W.D. Tex. 1988); *In re Atlanta West VI*, 91 B.R. 620, 627 (Bankr. N.D. Ga. 1988); *In re Maropa Marine Sales Serv. & Storage, Inc.*, 90 B.R. 544, 545 (Bankr. S.D. Fla. 1988); *In re Rudy Debruycker Ranch, Inc.*, 84 B.R. 187, 189 (Bankr. D. Mont. 1988); 7 COLLIER ON BANKRUPTCY, *supra* note 26, ¶ 1129.04[4][c], at 1129-103 & n.150.

Circuits permitting a new value exception,²⁰⁶ and the Second and Fourth Circuits rejecting plans involving new value, though not expressly repudiating the exception.²⁰⁷ The Supreme Court granted certiorari for *Bank of America* in order to resolve the circuit split.²⁰⁸

Observers of bankruptcy practice welcomed the Court's decision to hear *Bank of America* as a sign that it would finally determine whether a new value exception to the absolute priority rule exists.²⁰⁹ The Court, however, failed to deliver what many hoped would be a

206. Both the Seventh and Ninth Circuits have explicitly upheld the new value exception. In *Bonner Mall Partnership v. U.S. Bancorp Mortgage Co.*, the Ninth Circuit focused on the idea that the new value exception is not really an exception, but is in fact a corollary of the absolute priority rule. 2 F.3d 899, 906-07 (9th Cir. 1993); *see also supra* note 23 and accompanying text (describing the new value doctrine as a corollary rather than an exception). Although the Ninth Circuit discussed a myriad of reasons as to why new value is viable, the key issue was whether the contribution from old equity satisfied the five requirements of new value. According to the *Bonner Mall* court, new value must be: (1) new; (2) substantial; (3) in money or money's worth; (4) necessary for a successful reorganization; and (5) reasonably equivalent to the value or interest received. *See Bonner Mall Partnership*, 2 F.3d at 908-09. In the view of the Ninth Circuit, these five requirements will, if applied properly, ensure that a new value plan will not violate the absolute priority rule and should benefit the creditors as well. *See id.* at 916. The Ninth Circuit rejected the Fourth Circuit's claim that granting shareholders the exclusive opportunity to contribute new value and retain their interests violates the absolute priority rule. *See id.* at 910-11; *see supra* notes 80-88 and accompanying text (discussing the Seventh Circuit's approval of the new value exception in *In re 203 N. LaSalle St. Partnership*, 126 F.3d 955 (7th Cir. 1997), *rev'd sub nom.* *Bank of Am. Nat'l Trust & Savings Ass'n v. 203 North LaSalle St. Partnership*, 119 S. Ct. 1411 (1999)).

207. Both *Travelers Insurance Company v. Bryson Properties*, XVIII, 961 F.2d 496, 504 (4th Cir. 1992) and *Coltex Loop Central Three Partners, L.P. v. BT/SAP Pool C Assocs., L.P.*, 138 F.3d 39, 44 (2nd Cir. 1998), held that the absolute priority rule prohibits confirmation of new value plans during the exclusivity period. Each case focused on bankruptcy plans' provisions for granting the debtors the exclusive rights to retain their interests by contributing new value to reorganized debtors. *See Bryson*, 961 F.2d at 404; *Coltex Loop*, 138 F.3d at 44. In *Coltex Loop*, the Second Circuit expressly followed the plain meaning approach used in *Bryson*. *See Coltex Loop*, 138 F.3d at 42. The similarities between the Second Circuit's *Coltex Loop* opinion and the Fourth Circuit's *Bryson* opinion are no coincidence; the same judge authored both opinions. Judge Jane A. Restani, a judge for the United States Court of International Trade, sat by designation in both cases. *See id.*, 138 F.3d at 40; *Bryson*, 961 F.2d at 498.

208. *See Bank of America*, 119 S. Ct. at 1416. Most of the other circuits have failed to take a definitive stand on the validity of the new value exception. *See Unruh v. Rushville State Bank*, 987 F.2d 1506, 1510 (10th Cir. 1993); *John Hancock Mutual Life Ins. Co. v. Route 37 Bus. Park Assocs.*, 987 F.2d 154, 162 n.12 (3d Cir. 1993); *In re Lumber Exchange Bldg. Ltd. Partnership*, 968 F.2d 647, 650 (8th Cir. 1992); *In re Greystone III Joint Venture*, 948 F.2d 134, 142 (5th Cir. 1991), *modified*, 948 F.2d 142 (5th Cir. 1992) (*per curiam*); *Anderson v. Farm Credit Bank of St. Paul*, 913 F.2d 530, 532-33 (8th Cir. 1990); *In re Blankemeyer*, 861 F.2d 192, 194 (8th Cir. 1988) (*per curiam*); 7 COLLIER ON BANKRUPTCY, *supra* note 26, ¶ 1129.04[4][c], at 1129-102 & n.148.

209. *See supra* note 31 and accompanying text (noting that many commentators expected the Court to rule definitively on the existence of the new value exception).

resolution to this debate.²¹⁰ The majority ignored the wishes of Justices Thomas, Scalia, and Stevens to take a definite stand on the issue and instead remained content to straddle the fence, just as in *Ahlers*.²¹¹ Nevertheless, the fact that the Court refused to provide a conclusive answer does not mean that the decision in *Bank of America* was uninformative.

The Court's major qualm with the Debtor's plan was the exclusive opportunity it gave members of the bankrupt Partnership to retain their interests in exchange for contributions of new value.²¹² Two aspects of this exclusivity concerned the Court. First, the Court viewed the partners' exclusive opportunity to make a capital contribution as exercising an option to retain its interest in the reorganized Debtor.²¹³ This exclusivity infringed upon the absolute priority rule, as the exclusive option was property received "on account of" their prior interests.²¹⁴ The Court's second concern was the negative impact that exclusivity would have on determining the proper value of the firm.²¹⁵ Because a true market valuation could not be ascertained, there would be no way of knowing whether the price paid by old equity to retain their interests was the best possible price attainable.²¹⁶ For a new value plan to have any chance at being confirmed, it must appease the Court's worries over these two issues.

210. Some commentators were openly critical of the Court for sidestepping what they viewed as the crucial issue. See McDermott, *supra* note 3, at 26 (calling the Court's decision a "major disappointment" for its failure to resolve the new value controversy, as well as for the lack of guidance as to how to conduct a market valuation); *id.* at 27 (stating that the Court's unwillingness to resolve this issue "demonstrates just how far out of touch the Court can be with the realities of everyday practitioners"); Judith Greenstone Miller & John C. Murray, *The "New Value" Exception: Myth or Reality After Bank of America National Trust & Savings Association v. 203 N. LaSalle Street Partnership?*, 104 COM. L.J. 147, 149-50 (1999) ("It is, therefore, unfortunate that the Court, when faced with the opportunity to resolve the issue, failed to finally end the debate . . ."); Salerno et al., *supra* note 31, at 1 (commenting that the Court managed to "dodge the issue" and stating that "[t]he Supreme Court's decision is as satisfying as watching the *Star Wars* prequel on a Sony Watchman with no sound").

211. See *supra* note 92 and accompanying text (discussing the Court's claim that it was not expressing any opinion as to the validity of the new value exception); *supra* notes 146-58 and accompanying text (reviewing the concurrence of Justices Thomas and the dissent of Justice Stevens, each stating a definitive resolution to this question); *supra* notes 200-04 and accompanying text (explaining the Court's views in *Ahlers*).

212. See *Bank of America*, 119 S. Ct. at 1422 ("[The Debtor's plan] is doomed . . . by its provision for vesting equity in the reorganized business in the Debtor's partners without extending an opportunity to anyone else either to compete for that equity or to propose a competing reorganization plan.").

213. See *id.*

214. See *id.*

215. See *id.* at 1423.

216. See *id.*

The first hurdle should be the easier of the two to overcome. *Bank of America* demonstrates that exclusivity may no longer remain a part of a new value proposal.²¹⁷ For a plan that is part of an attempted cramdown to survive the Court's scrutiny, the plan must be proposed outside the 120-day exclusivity period provided by § 1121(b).²¹⁸ Consequently, others would have an opportunity to submit competing plans, and any new value plan that is approved should be approved based on its superiority to the other proposals and not "on account of" a prior interest. The only way that a nonconsensual new value plan proposed during the period of exclusivity would have any chance of being confirmed is if the plan provided some degree of market testing that would demonstrate the validity of the price.²¹⁹ This requirement poses more difficulty for those attempting to craft a potentially successful new value plan.²²⁰

Because the Court's ruling appears to impose a market measure requirement on new value cramdowns, scholars have been discussing many approaches for satisfying this prerequisite.²²¹ Of these suggestions, three seem to make the most sense. One of the most popular proposals is to hold an auction or engage in some sort of bidding process for the equity in the reorganized debtor.²²² This idea was mentioned by the Court in *Bank of America*, but only in declaring that the Court was not passing judgment on that type of plan.²²³ The theory behind the auction proposal is that it effectively deals with the valuation problem inherent to exclusive new value

217. See *id.* at 1422–24.

218. See Salerno et al., *supra* note 31, at 1 ("[A]ny debtor that wishes to avail itself of a 'new value' cramdown plan must kiss exclusivity good-bye."); *supra* note 64 and accompanying text (discussing the Code's exclusivity period in which the debtor alone may propose a plan of reorganization).

219. See Salerno et al., *supra* note 31, at 1 (describing as "facially unconfirmable" any new plan filed during the exclusivity window "unless it provides for a mechanism to have 'competing bids' for the equity in the reorganized debtor, or otherwise allow the 'market' to test whether the debtor/plan proponent is paying the highest value for the equity"); Singer, *supra* note 18, at 33, 47 (arguing that any new value plan filed during the exclusivity period would be "patently unconfirmable . . . unless a mechanism is in place that allows for competing bids for the equity in the reorganized venture or otherwise provides a valuation of the interest retained or acquired through a 'market test'").

220. See McDermott, *supra* note 3, at 26 (lamenting the Court's refusal to offer any insight as to how market valuation should be undertaken).

221. See *infra* notes 222–53 and accompanying text (describing several proposals to satisfy the Court's market measure requirement).

222. See Epling, *supra* note 27, at 337; Trost et al., *supra* note 26, at 480–82.

223. See *Bank of America*, 119 S. Ct. at 1424 ("Whether a market test would require an opportunity to offer competing plans or would be satisfied by a right to bid for the same interest sought by old equity, is a question we do not decide here.").

proposals.²²⁴

Presumably, an auction could work in one of two ways. The debtor could instigate a true auction process through which it would announce and conduct a bidding process over a stated period of time, likely under the watch of a bankruptcy judge. Alternatively, it may be sufficient for the debtor merely to state that its plan is open to competing bidders. By waiving exclusivity, each option would appear to appeal to the Court's concerns. In any given case, an auction process would make the validity of the new value exception immaterial.²²⁵ If the auction process was staged, then the winner would receive the interest in the reorganized debtor not "on account of" any prior interest, but rather "on account of" its superior bid.²²⁶ An auction process could resolve the problem without having to await a definitive resolution on the new value exception, which the Supreme Court appears reluctant to provide.

While the auction process may be the obvious choice to determine market value, it is also the most uncertain. Many attributes of the bidding process would be left for a court to determine, making an auction a potentially costly experiment. For example, an issue remains as to whether there must be an actual auction or merely a proposal to accept competing bids.²²⁷ In addition, it is unclear whether the bidding process would be limited to creditors or would be open to third parties as well.²²⁸

These issues have been confronted in recent years by lower

224. Richard Epling effectively summarized the valuation issue that concerns the Court:

[An auction process] attempts to deal with the problem that habitually occurs if the court is required to place a value on the new equity—such a valuation is a guess compounded by an estimate at best. The value of most equity positions on the date of confirmation usually is zero, and anyone willing to pay one dollar in cash for the new stock arguably has extended "new value." However, the fallacy in this line of reasoning lies in misunderstanding what is being purchased. The object of the bidder is not the value of the stock *today*, but the upside potential of the stock as the reorganized debtor's business prospects improve over time. Thus, any value which may be assigned by a court is speculative, just as any bid for the stock is speculative. The way to avoid this trap is to let the interested parties assign the market value by allowing them to bid against each other for the new equity.

Epling, *supra* note 27, at 337.

225. See Trost et al., *supra* note 26, at 481.

226. See *id.*

227. See Bruce H. White & William L. Medford, *Conducting Equity Auctions Under LaSalle—The Fog Thickens*, AM. BANKR. INST. J., Oct. 18, 1999, at 20, 32.

228. See *id.*

courts. In *In re Bjolmes Realty Trust*,²²⁹ a Massachusetts bankruptcy court held that an auction must be staged if a creditor who is a likely purchaser of the equity interests objects to a reorganization plan.²³⁰ In *Bjolmes*, the auction involved a two-phased offer, first to creditors and then to third parties.²³¹ By contrast, *In re Ropt Limited Partnership*²³² held that debtors must give notice of their intentions to file a new value plan, and an auction is required only if the creditors object to this plan.²³³ Thus, prior case law does not provide a solution to these remaining issues. Other practical concerns of the auction process involve how to ensure that all parties have equal information,²³⁴ whether the process can be kept fair to all parties,²³⁵ and whether an auction would conflict with other non-bankruptcy laws, such as securities regulations.²³⁶ Thus, the auction process carries with it many uncertainties and risks.

One alternative to the initiation of a bidding process would be the termination of the exclusivity period,²³⁷ which could be done either at the time a new value plan is filed or following the failure of

229. 134 B.R. 1000 (Bankr. D. Mass. 1991).

230. See *id.* at 1010. This *Bjolmes*-type auction concept was advocated in *In re Homestead Partners, Ltd.*, 197 B.R. 706, 719 (Bankr. N.D. Ga. 1996).

231. See *Bjolmes*, 134 B.R. at 1010.

232. 152 B.R. 406 (Bankr. D. Mass. 1993).

233. See *id.* at 412.

234. See Carla E. Craig, *Court's Ruling on 'New Value' Exception Leaves Questions for Continued Debate*, N.Y. L.J., May 12, 1999, at 1.

235. One commentator proposes a system whereby the parties involved in the auction retain equal subscription rights to use at their discretion. See Epling, *supra* note 27, at 341-46. Shares of the debtor would be offered to creditors at a price established by the old shareholders. See *id.* at 343. All creditors would be allowed to subscribe to this offer along with the old shareholders. See *id.* at 345. The shares would be limited to the amount of insolvency, but no higher. See *id.* at 343. If the offer is fully subscribed, the creditors' claims will be paid off at 100%. See *id.* This system is designed to ensure that a fair price is paid for the interest in the reorganized debtor. See *id.* at 341-42.

236. Because an auction would involve a sale of equity interests, the sale could collide with the Securities Act of 1933. See 15 U.S.C. § 77(e) (1994); White & Medford, *supra* note 227, at 31. The securities regulations could impose extraordinarily costly registration requirements, and failure to comply with the rules could lead to severe civil and criminal liability. See *id.* The private placement exception exempts certain equity sale transactions from these requirements if they do not involve a public offering. See 15 U.S.C. § 77(d)(2); White & Medford, *supra* note 227, at 31. Transactions that involve substantial disclosure are often exempt from the registration requirements, as the requirements are designed to ensure significant disclosure. See *United States v. Lindo*, 18 F.3d 353, 358 (6th Cir. 1994); *Ackerberg v. Johnson*, 892 F.2d 1328, 1336-37 (8th Cir. 1989); White & Medford, *supra* note 227, at 31. Thus, with the extensive disclosure requirements inherent in Chapter 11, it appears that this sort of equity sale may not be subject to the extra securities regulation requirements. See *In re Homestead Partners, Ltd.*, 197 B.R. at 718.

237. See *supra* note 64 and accompanying text (describing the 120-day exclusivity period found in 11 U.S.C. § 1121(b) (1994)).

an attempted consensual confirmation of a new value plan.²³⁸ The termination of exclusivity should also yield a market-protected price.²³⁹ While the old equity holders are free to value the reorganized debtor as they choose, the possibility of competing plans should encourage a proper valuation from the debtor.²⁴⁰ This proposal was adopted by the National Bankruptcy Review Commission in a 1997 recommendation to Congress.²⁴¹

Like an auction, this proposal has its flaws. Factors such as the high cost of preparing and confirming a plan,²⁴² as well as the potential for competitors to employ facially neutral plans with built-in business advantages,²⁴³ could chill the bidding process. If these disincentives prove strong enough, they could decrease the effectiveness of the market test to the point where it is no longer a beneficial alternative.²⁴⁴ Another problem with termination is a practical one that occurs once exclusivity is terminated and the debtors and creditors have been given the opportunity to propose competing plans. The available plans are usually incredibly diverse, making it extremely difficult to compare the merits of each plan and select which one is most beneficial for all involved.²⁴⁵ The uniqueness of the proposals would make it harder for courts to evaluate and choose among the plans.²⁴⁶

The third and final proposal for easing the Court's concerns over market valuation is likely the most practical of the three. Instead of organizing an auction process or revising the Bankruptcy Code to provide for a termination of exclusivity, it may be possible for the debtor wishing to propose a new value plan to waive the period of exclusivity, thereby immediately opening bidding for competing plans.²⁴⁷ A debtor simply could make a motion to the court that the

238. See Trost et al., *supra* note 26, at 482. A consensual confirmation occurs when each class of creditors accepts the reorganization plan. See 11 U.S.C. § 1129 (a)(8) (1994).

239. See Trost et al., *supra* note 26, at 482-82.

240. See Epling, *supra* note 27, at 338.

241. See NATIONAL BANKRUPTCY REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS, § 2.4.15, at 545-67 (1997). The NBRC's proposal would have codified the new value exception, but would have automatically terminated exclusivity if the debtor sought to confirm a nonconsensual new value plan. See *id.* Congress has not shown any willingness to adopt this proposal, however. See Singer, *supra* note 18, at 32.

242. See 7 COLLIER ON BANKRUPTCY, *supra* note 26, ¶ 1129.04[4][c], at 1129-122.

243. See *id.*

244. See *id.*

245. See Epling, *supra* note 27, at 347-48 (describing the difficulty in choosing between competing plans at this stage).

246. See *id.*

247. See Salerno et al., *supra* note 31, at 1; Singer, *supra* note 18, at 47.

debtor plans to waive the statutory period of exclusivity.²⁴⁸ This waiver could be done in conjunction with an auction process²⁴⁹ or possibly as part of a standard confirmation.²⁵⁰ Of course, waiving exclusivity is not without its pitfalls. As with early termination of the exclusivity period, waiving exclusivity could also produce an abundance of disparate plans, a result that could further cloud the reorganization process.²⁵¹ Nevertheless, because the waiver would end the period of exclusivity and open the process for competing bids, such a proposal would appear to have the Court's blessing.²⁵²

These proposals, while not without their faults, seem to provide what the Court in *Bank of America* was looking for: some measure of market protection to ensure that the price paid by old equity to retain their interest in a new value plan is the best price possible. Numerous other proposals are available to debtors, most of which would accomplish the same objective.²⁵³ The key will be to find the method that provides sufficient market protection for all phases of the procedure and avoids any appearances of exclusivity.

The Court's discussion regarding the need for a market test left the bankruptcy community with a feeling of uncertainty, especially considering its lack of guidance as to how such a test should be

248. See Singer, *supra* note 18, at 47.

249. See *id.*

250. See *id.*

251. See *supra* note 245–46 and accompanying text (describing the problems that diversity of plans could cause under a termination of exclusivity proposal).

252. Alternatively, the debtor may choose to allow the 120-day exclusivity period to run its course and then file its plan on the next day. See Singer, *supra* note 18, at 46. This alternative permits the debtor to not show its cards early in the process, while presumably still allowing market forces to operate properly, because the plan will be proposed outside the period of exclusivity. See *id.* Such a plan may draw suspicion from the courts, which could view this as an attempt to evade the market requirements.

253. See Epling, *supra* note 27, at 340. Two proposals that Professor Epling mentions as proposed efforts to implement a market test are revaluations and clawbacks. See *id.* Revaluations re-examine the value of the business several years after the plan to see how it turned out and what adjustments need to be made, if any; clawbacks permit junior creditors to retain “clawback rights” so that they may return with their claim if the company is performing well in the years following the reorganization. See *id.*; see also McDermott, *supra* note 3, at 27–28 (suggesting that a lender request to have the court terminate the automatic stay, which would allow the lender to test the debtor's proposed plan against the market by advertising a foreclosure sale); *id.* at 28 (proposing that the lender make a motion asking the bankruptcy judge to compel an auction of the debtor's property under 11 U.S.C. § 363); Singer, *supra* note 18, at 46–47 (suggesting that the debtor place unspecified provisions in its plan prior to confirmation, which would subject future participation to a market test); Trost et al., *supra* note 26, at 486–87 (advocating a “liberalization” of new value standards as applied to closely held corporations because the new value exception was designed to apply to large publicly held companies and not to their closely held counterparts).

implemented. Nevertheless, more litigation likely will follow to determine what will placate the Court's demand for a market test.²⁵⁴ In any event, *Bank of America* means that any new value plan proposed within the exclusivity period that fails to include some feature that promotes a market valuation has no chance of being confirmed.²⁵⁵ Beyond these conclusions, little can be said with any degree of certainty about the future of new value.

Despite efforts to formulate a plan that will satisfy the Court's market test requirement, it must be remembered that even if a completely market-friendly new value plan is filed, there are no guarantees that the Supreme Court will uphold it. While the Court stated that a new value plan that provided the equity holders with exclusive opportunities could not be confirmed without some degree of market protection,²⁵⁶ it never declared that a new value plan without exclusivity and with market protection would be confirmed. While one may assume that confirmation of a market-protected new value plan is a mere formality, nothing with such a curious history as the new value exception should be taken for granted.

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254. See 7 COLLIER ON BANKRUPTCY, *supra* note 26, ¶ 1129.04[4][c], at 1129-123; PRACTISING LAW INST., UNDERSTANDING THE BASICS OF BANKRUPTCY AND REORGANIZATION 1055 (1999); Miller & Murray, *supra* note 210, at 150.

255. See *supra* notes 218-19 and accompanying text (stating that any new value plan proposed during the period of exclusivity that does not provide any market protection will not be confirmed).

256. See *Bank of America*, 119 S. Ct. at 1424.