Brooklyn Journal of Corporate, Financial & Commercial Law

Volume 13 | Issue 1 Article 7

10-1-2018

Private Benefits Without Control? Modern Chapter 11 and the Market for Corporate Control

Oscar Couwenberg

Stephen J. Lubben

PRIVATE BENEFITS WITHOUT CONTROL? MODERN CHAPTER 11 AND THE MARKET FOR CORPORATE CONTROL

Oscar Couwenberg[*] *& Stephen J. Lubben*[**]

ABSTRACT

Outside of bankruptcy, a board of directors' decision to take control rights away from existing shareholders and grant them to another is subject to heightened fiduciary duties. As the sale of control represents a kind of end game, shareholders have one last chance to realize the full value for their investment. In such a context, their interests warrant special protection.

A similar sale of control can happen in a chapter 11 procedure when a bankruptcy plan revamps the capital structure of the firm. In such a restructuring of the firm, control rights can be newly created, redefined and redistributed to corporate stakeholders. As bankruptcy always implicates many more stakeholders than only shareholders, a sale of control thus implicates a wider array of control rights owners than a normal control transaction. However, in a chapter 11 procedure, fiduciary duties protecting interests of such owners of control rights do not arise and this creates the potential for agency misdeeds.

We discuss three recent chapter 11 or 15 cases in which the bankruptcy plans led to a restructuring of the capital structures, redistributing control in the process. Our viewpoint is that in such complex restructuring processes, private benefits of control provide incentives to a select group of investors to twist the plan to their advantage. Our three cases show: 1) a lack of openness to other investors who are not part of the plan proposing classes; 2) that plans redistribute control via penny warrants, private placements, and other similar devices, shutting out other shareholders or diluting holdings significantly; and 3) a deal and fee structure that explicitly rewards specific groups and not others.

We conclude that in chapter 11 procedures, a redistribution of benefits is possible to an extent not possible under state corporate law. However, as we discuss only three exemplary cases, caution is warranted at the moment as we cannot provide a full empirical picture of private benefits in chapter 11 and chapter 15 procedures.

INTRODUCTION

Discussions of the market for corporate control start with Henry Manne's assertion that:

---

* Dean Faculty of Spatial Sciences, Professor of Governance and Geography, University of Groningen.

** Harvey Washington Wiley Chair in Corporate Governance & Business Ethics, Seton Hall University School of Law.

> The control of corporations may constitute a valuable asset; that this asset exists independent of any interest in either economies of scale or monopoly profits; that an active market for corporate control exists; and that a great many mergers are probably the result of the successful workings of this special market.[1]

In essence, the existing managers of public corporations must compete against potential acquirers for the right to manage corporate resources; this basic idea is referred to as "the market for corporate control."[2] It is generally argued that a robust market for corporate control performs a critical role in disciplining, monitoring, and replacing underperforming management, which neither shareholders and boards of directors, nor even courts, can replicate easily.[3]

The question then is: what motivates potential acquirers? Two primary motivations are typically surfaced: the acquirers' ability to increase the value of the target and the extraction of private benefits by the acquirers. General increases in the target's value must be shared pro rata, while private benefits need not. Taken to an extreme, private benefits entail everything up to, and including, a full looting of the target company by the acquirers.[4]

We use this Article to consider how well-developed concepts of general corporate law might apply in the specific context of corporate bankruptcy.[5] In particular, we examine three recent bankruptcy cases that illustrate the market for corporate control in the realm of financial distress. In particular, many seem to be able to extract significant private benefits from the insolvency process. We posit that this is the result of the lower efficiency in the market for distressed firms' claims.

I. BANKRUPTCY PROCEDURE: WHERE CONTROL RESIDES?

Corporate control contests belong to the market for corporate control, where control is priced. Given the highly legal nature of these contests, particularly in Delaware, where the relevant law is largely judge-made, the settling of control conflicts often occurs in court rooms with a judicial verdict.[6] The verdict settles the contest and implicates or sets a price for the

1. Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965).
2. *See* Sharon Hannes, *Corporate Stagnation: Discussion and Reform Proposal*, 30 J. CORP. L. 51, 61 (2004).
3. Jonathan R. Macey, *The Politicization of American Corporate Governance*, 1 VA. L. & BUS. REV. 10, 24 (2006).
4. Albert H. Choi, *Concentrated Ownership and Long-Term Shareholder Value*, 8 HARV. BUS. L. REV. 53, 80 (2018).
5. *See* Martin Lipton and Paul K. Rowe, *Pills, Polls, and Professors: A Reply to Professor Gilson*, 27 DEL. J. CORP. L. 1, 2 (2002).
6. Dan Awrey et al., *Resolving the Crisis in U.S. Merger Regulation: A Transatlantic Alternative to the Perpetual Litigation Machine*, 35 YALE J. ON REG. 1, 9–15 (2018).

control transaction.[7] Furthermore, the verdict sets the stage for the future by delineating control rights and implicating the pricing in the market for corporate control.

In bankruptcy, a federal judge must similarly decide on a restructuring plan that encompasses all major financial stakeholders of the bankrupt company.[8] The plan usually calls for a restructuring of the company's activities and assets but also a "realignment" of its financial obligations.[9] This realignment in the reorganization plan re-allocates control over the participants and thus the plan also often becomes the basis for a control contest.[10]

However, this control contest is different from the usual one in the market for corporate control as it plays out in a different venue, that is a federal court applying bankruptcy law to the case at hand. Once a company initiates a chapter 11 bankruptcy procedure as a matter of theory, a double control shift occurs. First, with the start of a bankruptcy procedure, (some) control rights shift from shareholders to creditors.[11] Secondly, although such control rights shift to creditors, a federal court intervenes in the actual exercise of (part of) these rights and the exercise of this rights is primarily a matter of federal bankruptcy law, rather than state contract or corporate law.[12]

This double control shift is theoretical in that it cannot be separated either in time or in procedure. With the advent of a chapter 11 procedure, both happen simultaneously. Nevertheless, it makes sense to think of this as a double shift as it impacts shareholders' rights and how any control contest may play out among shareholders. Moreover, an additional control contest develops between shareholders and creditors as well as among creditors themselves. This latter contest plays out in the federal courtroom when participants vie for the best deal as taken up in the reorganization plan.

From this control angle, any chapter 11 initiation is a fundamental change in a firm's governance set up.[13] But with such fundamental changes, agency problems also arise easily. In corporate law, many legal strategies are geared toward mitigating such agency issues.[14] Once a control perspective is used in

---

7. Kenju Watanabe, *Control Transaction Governance: Collective Action and Asymmetric Information Problems and Ex Post Policing*, 36 NW. J. INT'L L. & BUS. 45, 58 (2016).

8. Michelle M. Harner, *The Search for an Unbiased Fiduciary in Corporate Reorganizations*, 86 NOTRE DAME L. REV. 469, 491–97 (2011).

9. Richard Lieb & Robert J. Feinstein, *LBO Litigation, Financial Projections and the Chapter 11 Plan Process*, 21 SETON HALL L. REV. 598, 615 (1991).

10. *See* Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 YALE L.J. 648, 676 (2010).

11. Stephen J. Lubben, *The "New and Improved" Chapter 11*, 93 KY. L.J. 839, 846–47 (2005).

12. *E.g.*, 11 U.S.C. § 363(b); *see also* Frederick Tung, *Confirmation and Claims Trading*, 90 NW. U. L. REV. 1684, 1730 (1996).

13. This is apart from the fact that such a chapter 11 procedure in itself is a momentous event in a firm's life.

14. Afra Afsharipour, *A Shareholders' Put Option: Counteracting the Acquirer Overpayment Problem*, 96 MINN. L. REV. 1018, 1042 (2012).

the context of financial distress, the bankruptcy procedure actually exacerbates agency issues.

The double control shift incentivizes shareholders and creditors to strategically take positions ex ante and influence renegotiation efforts ex post. Once the firm is in distress, it is no longer solely a conflict between manager and shareholders or between majority and minority shareholders, but instead the conflict involves different classes of creditors competing with each other and the shareholders. This complicates the control situation, but the standard legal strategies used in corporate law are ill-suited to deal with that complexity.

As an example, managerial issuance of shares in the face of a control contest is apt to trigger probing court review, under a variety of theories.[15] In a chapter 11 case, however, the shares can be targeted to a variety of groups, shareholders as well as creditors, making it very hard to pinpoint the firm participant to whom the duty is owed. Protesting against alleged favorable treatment in a federal bankruptcy court is different from litigating against the management or majority shareholder in a state court for breach of a fiduciary duty. The bankruptcy judge looks at this issue as part of a reorganization plan that needs either consent or cramdown, not from the point whether one or some of these groups might be owed a protective duty.[16]

Another example of a fiduciary duty problem is the shifting allegiance of a board in chapter 11 when the equity is underwater.[17] For a board, the creditors or groups of creditors might become much more important to keep the firm afloat, including retaining their jobs, than the duty they owe the shareholders to maximize the value of the estate. Obviously, junior creditor classes might be implicated in this process as well, depending on the financial situation of the firm.[18] Last, but not least, a freezing-out of minority shareholders in a merger deal gives rise to heightened scrutiny in state courts, but with a proposed reorganization plan that freezes out minorities in one or more creditor classes, such a legal check is lacking when that class votes in favor of the plan.[19]

To bring some order to the discussion, we distinguish two types of firms initiating a chapter 11 procedure: one with and one without a controlling shareholder. The presumption is that the board will follow the instructions of a controlling shareholder in the former type, while it will be able to pursue

15. Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713, 723–38 (2009).

16. *See* 11 U.S.C. § 1129.

17. N. Am. Catholic Educ. Programming Found., Inc. v. Gheewalla, 930 A.2d 92, 95 (Del. 2007).

18. Michelle M. Harner, *Disciplining Corporate Boards and Debtholders Through Targeted Proxy Access*, 92 IND. L.J. 227, 236 (2016).

19. *See* David Arthur Skeel, Jr., *The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases*, 78 VA. L. REV. 461, 479 (1992) [hereinafter Skeel, *Nature & Effect of Corporate Voting*].

its own agenda in the latter. As chapter 11 gives the firm the option to hammer out a reorganization plan in the first 120 days of the proceeding, a controlling shareholder may impose his preferences on a plan.[20] In the second type of firm, such an imposition of preferences will come from the board.

Obviously, in both cases, these preferences need to be aligned with the preferences of at least a subset of controlling creditors, as the restructuring plan needs to be accepted by the impaired creditor classes. This brings us to the second distinction: a firm with a group of controlling creditors and a firm with no such group. A controlling group of creditors will be able to impose their preferences on the plan, too.[21] This delivers a matrix of four categories showing the dominant player in a control contest in chapter 11.

Table 1: Contestability of Plans

Type of ownership	**Controlling creditor group**	**Dispersed creditors**
Controlling shareholder:	Contested plan	Shareholder dominated plan
Board control:	Creditor dominated plan	Board dominated plan

In case a controlling shareholder and a controlling creditor group is present, the plan will distribute value over controlling creditor groups and the controlling shareholder, with the board presumably playing a small role. The existence of deviations from the absolute priority rule[22] can be seen as a form of proof that (controlling) shareholders have bargaining power to extract value from creditors even in situations that equity might be underwater.[23]

With unorganized creditors, the plan will be shareholder dominated. The plan will specify a restructuring of (all) financial claims, and it will offer the controlling shareholder a continued stake in the firm. In case a creditor group controls the procedure, together with management, the plan will be dominated by the preferences of creditors with the board acting as an agent

20. 11 U.S.C. § 1121 (2005).

21. Diane Lourdes Dick, *The Chapter 11 Efficiency Fallacy*, 2013 B.Y.U. L. REV. 759, 787 (2013).

22. Pamela Foohey, *Chapter 11 Reorganization and the Fair and Equitable Standard: How the Absolute Priority Rule Applies to All Nonprofit Entities*, 86 ST. JOHN'S L. REV. 31, 34–35 (2012) ("the absolute priority rule provides that only if a debtor pays its creditors in full can owners receive any of the reorganized entity's going concern value. Thus, owners of a company cannot retain ownership of the reorganized company unless each class of creditors consents or is paid in full.").

23. *See* Sreedhar T. Bharath, Venkatesh Panchapagesan & Ingrid M. Werner, *The Changing Nature of Chapter 11* (Fisher College of Bus., Working Paper No. 2008-03-003, 2011), where the authors found a decline in the so-called APR violations compared to the 1980's and 1990's, with such violations occurring in 22% of their cases. Another interpretation is that such deviations are to be expected and are normal in that it capitalizes the option value of out of the money equity. *See* Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930, 1959–61 (2006).

of the creditor group.[24] With no creditor group in control, the board will dominate the restructuring process and set up a plan that echoes the preferences of the board given the requirements needed to attain plan approval.[25]

This discussion abstracts from some very important practical aspects. One is that in situations of dispersed creditors (or non-active creditors), hedge funds or other distressed investors might enter the fray by buying creditor claims in order to gain control and force better terms in the plan. Effectively, it changes the ownership structure to one in which is creditor controlled.[26]

Another is that the ownership situation might be more complex involving multiple groups trying to enforce their preferences on the plan. In those situations, some groups might (eventually) form a coalition in order to become more effective. But it may also be that such a coalition is not viable and then it may be difficult to come to a plan that can carry a deciding vote in chapter 11. A proceeding may then extend over time, be relegated to chapter 7, or settled quickly via an asset sale to prevent inefficient, prolonged bickering over a plan.[27] A drawn-out chapter 11 process, one indicator of a complex bargaining process, may result in increased costs and thus diminished creditors' recoveries.[28]

As the discussion above shows that the locus of control in chapter 11 is important, chapter 11 also adds an interesting twist to any potential contest. Firstly, compared to normal control contests, a chapter 11 procedure often includes more types of claimholders when a proposed plan is put to a vote. For example, under general corporate law, when a controlling shareholder aims to strategically relocate company assets, that shareholder only needs to think about the issue of minority shareholders raising objections to this under state law.[29] In a chapter 11 procedure, such issues not only arise with minority shareholders (if at all, depending on the severity of distress), but will impact other claimholders, resulting in a more complex control contest. However,

24. *See* Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. OF LEGAL ANALYSIS, 511, 511–51 (2009) (detailing a shift to creditor control in chapter 11 cases); *see also* David A. Skeel Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, U. PA. L. REV., 917, 917–51 (2003) (detailing an earlier account detailing the governance shift from managers to creditors in chapter 11).

25. *See* Ayotte & Morrison, *supra* note 23; *see also* Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 154 U. PA. L. REV. 1209, 1209–51 (2006) (arguing that is not management who determines the terms of the plan).

26. *See* Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 YALE L.J. 648, 648–99 (2010) (noting that with today's complexity in capital structures, a breakdown of the bargaining in chapter 11 might be more likely).

27. *See id.*; *see also* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 751–89 (2002).

28. Stephen J. Lubben, *What We "Know" About Chapter 11 Cost Is Wrong*, 17 FORDHAM J. CORP. & FIN. L. 141, 184 (2012).

29. *See, e.g.*, *Kahn v. Lynch Commc'n Sys., Inc.*, 638 A.2d 1110, 1115 (Del. 1994).

the checks and balances under state corporate law are not one-for-one applicable or available in chapter 11.

Secondly, in any impaired creditor class, a one-third minority of creditors may block the acceptance of a proposed plan.[30] Such a voting block delivers contestants the possibility to influence the terms of a plan. In non-bankruptcy control situations, many of these contestants may lack such influence. Such a voting block brings in a strategic element that is not present in non-bankruptcy control situations. Thirdly, the possibility arises to sweeten the offer for a particular class, or a subset of creditors in such a class, to help swing the vote in that class.[31] Fourthly, depending on the terms of any such offer, it may also happen that (small) creditors may free ride on these efforts and can gain without even being active contestants.

While acknowledging the limitations of our simplified analysis, we think it provides a good starting point for consideration of the key issues.

II. PRIVATE BENEFITS, A CONTROL PERSPECTIVE

Private benefits, by their very nature, are elusive. If not, they would be easy to monetize and become incorporated in asset prizes. The fact that they are not, or only imperfectly quantifiable, makes them elusive. But that they are real is not in doubt, as many academic papers have shown.[32]

One approach to study private benefits is to look at the form they take. Their form is in part dependent on the actor involved. For instance, for chief executive officers of large companies, private benefits can be had in the form of excessive compensation, corporate perquisites, corporate loans, the taking of corporate opportunities, transacting with preferred stakeholders, and insider trading. Controlling shareholders may divert value via control transactions (including corporate loans), usurp corporate opportunities, transact on favorable terms and use inside information to their advantage. Apart from these direct benefits, a private benefit may also arise in the form of enjoying control itself as an immaterial benefit or "control happiness."[33]

30. 11 U.S.C. § 1126(c).

31. *See In re* Idearc Inc., 423 B.R. 138, 160 (Bankr. N.D. Tex. 2009), *aff'd*, 662 F.3d 315 (5th Cir. 2011) (stating that the "[c]lassification of substantially similar claims in different classes is permitted for purposes of reorganization only and for reasons independent of debtor's motivation to secure the vote of an impaired, assenting class of claims; similar claims may not be classified differently to gerrymander affirmative votes on the reorganization plan.").

32. *See* Alexander Dyck & Luigi Zingales, *Private Benefits of Control: An International Comparison*, 59 J. FIN. 537, 537–38 (2004) (finding evidence of private benefits for a large sample of controlling block sales in 39 countries); Tatiana Nenova, *The Value of Corporate Voting Rights and Control: A Cross-Country Analysis*, 68 J. FIN. ECON. 325 (2003) (finding that the value of control-block votes is economically significant, varies widely over countries and, among others, legal environment); *see also* Vladimir Atanasov, Bernard Black & Conrad S. Ciccotello, *Law and Tunneling*, 37 J. CORP. L. 1, 1–49 (2011) (discussing ways to transfer value to corporate insiders and how rules may counteract such behavior).

33. *See* Richard M. Hynes, *Taxing Control*, 38 J. CORP. L. 567 (2012–13).

The form and the size of private benefits, and their net cost or net benefit to society, is dependent on many interrelated institutional and path-dependent factors. Ownership regimes, regulatory environment—not limited to securities law, corporation law and even criminal law and regulatory oversight—and the public-private divide in the corporate landscape, all impact the phenomenon of private benefits.[34] For example, a controlling shareholder is often in a position to extract such benefits more easily than in a company lacking such a controlling shareholder, depending of course on disclosure regulations in case companies are publicly quoted.[35]

However, such ownership regimes are also endogenous as they arise due to the economic and political setting in a given country. And to their credit, such ownership regimes may curb managerial agency more effectively than any other legal instrument. Non-controlling shareholders thus face a trade-off of the benefits of effective oversight and controlling shareholder private benefits. All of this is not necessarily static in the life of a company, which over the years may see dramatic changes in its ownership structure, its privately-held status, managerial team and business model. These economic effects may very well change the nature of the game and shift the net balance of such private benefits.

If private benefits are present and of a significant economic magnitude, it is to be expected that they are fought over in control contests. Reasoning the other way around, the fact that such contests arise thus give a clue to the size and the form private benefits take. That is, the presence of private benefits can be a key motivator in a control contest.

III. EXTRACTING PRIVATE BENEFITS IN A BANKRUPTCY CASE

When firms become financially distressed and initiate chapter 11 or other insolvency procedures, the control contest changes due to the double control shift discussed above. The shift includes some new groups in the contest, while others are put off or at least move to a backseat. For example, in many instances senior and secured creditors will become involved as they are crucial to support the reorganization plan, while minority shareholders see their position weaken when their stake is wiped out. In other cases, the senior creditors will be largely immune to the process, as their claims are paid in full. In these cases, the real fights will happen lower in the capital structure.[36]

---

34. *See* Lucian A. Bebchuk & Mark Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, 52 STAN. L. REV. 127 (1999).

35. *See* Ronald J. Gilson & Jeffrey N. Gordon, *Controlling Shareholders*, 152 U. PA. L. REV. 785, 787–89 (2003); *see also* Ronald J. Gilson & Alan Schwartz, *Constraints on Private Benefits of Control: Ex Ante Control Mechanisms versus Ex Post Transaction Review*, 169 J. INSTITUTIONAL & THEORETICAL ECON. 160, 160–83 (2013).

36. Lynn M. LoPucki, *The Myth of the Residual Owner: An Empirical Study*, 82 WASH. U. L.Q. 1341, 1363 (2004).

Where in normal corporate control contests shareholders and management battle over the benefits of control, in bankruptcy that battle suddenly incorporates these other constituents. Chapter 11 also changes the nature of the game, where checks and balances have developed in state law to curb potential expropriation excesses,[37] are instead replaced with rules that were designed to level the playing field between the parties.[38]

But as in normal control contests, controlling positions in chapter 11 allow those having such positions to help or set details of a control deal. But in bankruptcy, private benefits might also be extracted by those without direct control over the debtor, if they nonetheless have control over approval of the debtor's reorganization plan.

For example, while creditors might not have an ability to control the debtor's board or its actions, they might have a blocking position in the capital structure that gives them a veto over the debtor's plan.[39] With such veto power comes the position to extract private benefits. Such benefits may take several typical forms, such as asset relocations, specific rights attached to securities and new securities, but might also include awarding of fees, undervaluation of securities issued under the plan, or extra derivative securities as a form of payment.

Thus, while the private benefits of control can be found in their traditional form in chapter 11, they also can take on new guises. For example, a creditor with a blocking position might be more interested in extracting private benefits in the form of an outsized return on their existing claims, and thus uninterested in more traditional, long-term control over the debtor's operations.

On the other hand, some creditors may lack control themselves, but they may have the ability to unlock others' control. These creditors may extract private benefits as the price for facilitating the other party's control.[40]

---

37. Such checks are, for instance, the design of decision rules in case of conflict of interests, standards as the duty of loyalty, sharing rules as preemptive rights in a share issuance, and exit rights in squeeze outs. *See generally* REINIER KRAAKMAN ET AL., THE ANATOMY OF CORPORATE LAW 145–65, 180–83, 188–92, 226–30 (3rd ed. 2017).

38. Stephen J. Lubben, *Credit Derivatives and the Future of Chapter 11*, 81 AM. BANKR. L.J. 405, 418–20 (2007).

39. In chapter 11, a class of claims has accepted a plan if the plan has been accepted by creditors "that hold at least two-thirds in amount and more than one-half in number of the allowed claims of such class held by creditors . . . that have accepted or rejected such plan." 11 U.S.C. § 1126. Thus, the owners of just over one-third of a bond issue can block acceptance of the plan. Likewise, if the creditor base is relatively concentrated, it may be possible to buy more than half of the claims by number, but representing only a small dollar value. *See In re* Fagerdala USA-Lompoc, Inc., 891 F.3d 848, 855 (9th Cir. 2018) (noting that a secured creditor, owed $4 million, purchased $13,000 in claims, representing about 10% of total value of unsecured claims but more than half of the total number of such claims).

40. Imagine a creditor class where the two largest creditors hold 25% and 10%, respectively. The second-largest creditor holds the key to the largest creditor's exercise of control. *See supra* note 35 and accompanying text.

Creditors can also leverage their power in the insolvency process to create a coalition with management. For example, a bondholder group might offer to release management from potential state law liability in exchange for special treatment in the reorganization plan.

The permutations are almost endless. But the primary point is that private benefits and control rights are substantially more complex in the context of financial distress, as compared with traditional corporate governance.

IV. THREE CASE STUDIES

To give the prior section some concreteness, in this section of the paper we examine three recent chapter 11 and 15 cases where parties extracted preferential treatment—that is, private benefits—during the course of the case. The three cases are *Peabody Energy Corp.*, *Seadrill Ltd.*, and *CGG SA*.

Note that in this Article we have no intention to provide a full empirical picture of private benefits in chapter 11 procedures. Ours is much more mundane in that we only provide evidence that private benefits can be present and impact a reorganization procedure. Whether this is ubiquitous or only occasionally happening in chapter 11 or chapter 15 remains for future work. Also, our case studies are explicitly not intended to cover all cells in the table above. But our three cases cover the important category of controlling creditor groups. Although creditors were dispersed in the 1980's leading to then major comments that management (i.e., the "debtor") was in control in chapter 11 procedures, in the 1990's large secured creditors (re)took control.[41] Our paper begins to show that the current dynamic in large corporate reorganization cases may be changing yet again, to a new, more complex balance of power.

A. PEABODY ENERGY CORP.

In a March 15, 2017 editorial, the *St. Louis Post-Dispatch* described this case:

> Beginning Thursday, a novel concept will be tested in federal bankruptcy court in St. Louis: Will a judge approve a reorganization plan tailored by a company's executives, in league with hedge funds that own most of its debt, that greatly benefits the executives and hedge funds while leaving smaller, non-institutional creditors holding the bag?[42]

Assuming we accept this framing of the case, the answer turned out to be "yes."

41. Harner, *Disciplining Corporate Boards and Debtholders Through Targeted Proxy Access*, *supra* note 18, at 236; Skeel, *Nature & Effect of Corporate Voting*, *supra* note 19, at 479–80; 11 U.S.C. § 1121 (2005).

42. *EDITORIAL: Judge must decide if Peabody's tilted bankruptcy exit plan is fair*, ST. LOUIS POST-DISPATCH (Mar. 14, 2017), https://www.stltoday.com/opinion/editorial/editorial-judge-must-decide-if-peabody-s-tilted-bankruptcy-exit/article_963f1d44-c251-5def-af05-a769ffd2f8b3.html.

When it filed for bankruptcy in April 2016, Peabody Energy was the largest coal mining company in the United States. The basic problem it faced was the rapid adoption of natural gas in place of coal in the power generation industry, a change driven both by environmental and simple price concerns.[43] Namely, domestically produced natural gas was and is far cheaper than coal.[44]

But that all changed with the unexpected election of Donald Trump in November of that year. Trump had pledged to revitalize the American coal industry, although he was notably short on specifics with regard to that pledge.[45] It was suddenly possible that the largely bankrupt American coal industry might have more value than previously thought.[46]

The company's chapter 11 plan ultimately turned on the sale of $1.5 billion in new equity, made up of $750 million in new preferred shares and $750 million in common shares. The preferred shares were convertible into common shares at the option of the holder, or automatically if the common stock traded above certain levels after the confirmation of the plan.[47]

Until conversion, the preferred shares carried an 8.5% dividend, payable in further preferred shares. That is, every six months preferred shareholders would receive $31.88 million in new preferred shares which were also entitled to dividends and eligible for conversion into common shares.

Moreover, the holders were guaranteed to receive a dividend for at least three years—a "makewhole" provision, more often seen in debt instruments, provided that if a mandatory conversion happened within the first 36 months after the plan, the preferred shareholders would benefit from a conversion price calculated "as if" they had received 36 months of dividends.[48]

---

43. Reid Wilson, *Coal Industry Mired in Decline Despite Trump Pledges*, THE HILL (Mar. 4, 2018), https://thehill.com/homenews/state-watch/376522-coal-industry-mired-in-decline-despite-trump-pledges.

44. John W. Miller & Matt Jarzemsky, *Peabody Energy Files for Chapter 11 Bankruptcy Protection*, WALL ST. J. (Apr. 14, 2016), https://www.wsj.com/articles/peabody-energy-files-for-chapter-11-protection-from-creditors-1460533760.

45. Timothy Gardner, *Donald Trump vowed to revive the coal industry but figures show its future is as bleak as ever*, INDEPENDENT (Nov. 13, 2017), https://www.independent.co.uk/news/world/americas/donald-trump-us-coal-industry-bleak-future-hiring-growth-prospects-energy-environment-rick-perry-epa-a8051886.html.

46. Jennifer A. Dlouhy et al., *Trump Promised to Bring Back Coal. It's Declining Again*, BLOOMBERG ECON.(Aug. 21, 2018), https://www.bloomberg.com/news/articles/2018-08-21/trump-promised-to-bring-back-coal-it-s-declining-again ("Although domestic consumption continues to erode, American coal production rebounded during Trump's first year in office, mostly driven by increased exports.").

47. Debtors' Motion For An Order (I) Approving (A) Private Placement Agreement And (B) Backstop Commitment Agreement; (II) Authorizing Debtors To Enter Into (A) Plan Support Agreement, (B) Private Placement Agreement And (C) Backstop Commitment Agreement; (III) Approving (A) Rights Offering, (B) Related Procedures And (C) Payment Of Related Expenses And (IV) Granting Related Relief, 28–29, *In Re* Peabody Energy Corp., Case No. 16-42529-399 (Bankr. E.D. Mo. 2017) [hereinafter Private Placement Motion].

48. *Id.* at 29.

The preferred shares had full voting rights before conversion, meaning that the shares were ultimately just like common shares for all governance purposes. Yet they also benefited from the generous dividend and the downside protection offered by the liquidation priority before conversion.

The sale of the common shares was open to all bondholders, whereas the preferred shares were only available to bondholders that were also qualified institutional investors under the securities laws. This split was the source of much public criticism—including the aforementioned *St. Louis Post-Dispatch* editorial—inasmuch as it left retail bondholders and shareholders (who were "wiped out" under the plan) out in the cold.

Equally controversial were provisions that set aside almost a quarter of the new preferred stock for a group of bondholders comprised of:

- PointState Capital LP;
- Contrarian Capital Management L.L.C.;
- Panning Capital Management, LP;
- the South Dakota Investment Council;
- Elliott Management Corporation;
- Discovery Capital Management; and
- Aurelius Capital Master Ltd. (and ACP Master, Ltd., an entity controlled by Aurelius).

These seven parties held 39% of the debtor's second lien notes and 40% of the senior unsecured notes.[49]

While other bondholders could purchase the remaining preferred shares upon signing up to a plan support agreement, these early supporters of the plan had the exclusive right to buy 22.5% of the shares.

Less noticed were the other ways in which these same bondholders also received additional compensation for agreeing to purchase any of the preferred or common shares that other bondholders declined to take. In particular, these bondholders were entitled to receive $120 million in cash, $35.5 million per month from April 3, 2017 until the plan's effective date (with proration for partial months) and warrants for 2.5% of the reorganized debtor's common stock. In addition, the debtor agreed to pay these bondholders' professional expenses, without the need for fee application in the bankruptcy court.

In exchange, these bondholders agreed to support the debtor's plan, and reject all other plans. The debtor's Private Placement Motion repeatedly stressed that the special rights and payments made to these bondholders were "not on account on any claim held by any of the purchasing noteholders and . . . , thus, separate and apart from any distribution rights a creditor may possess under the Plan."[50]

49. *Id.* at 4.
50. *Id.* at 16, 28.

B. SEADRILL LTD.

Seadrill Limited, a Bermuda exempted company with its headquarters in London, and 85 of its direct and indirect subsidiaries, filed chapter 11 petitions in Texas on September 12, 2017. As described in its "first day" papers:

> Seadrill Limited was formed on May 10, 2005 as a Bermuda exempted company. John Fredriksen, who holds a number of interests in the offshore space through Hemen [Holding Ltd.] and other investment vehicles, has served as chairman of Seadrill Limited's board of directors since its inception. At the time of its formation, Seadrill acquired a fleet of three jack-up rigs pursuant to a purchase and subscription agreement with entities affiliated with Hemen. Today, Hemen owns an approximately 24-percent ownership interest in Seadrill Limited. During the years following its formation, Seadrill capitalized on strong demand for offshore drilling equipment and services, driven by a favorable oil pricing environment, by actively expanding its fleet, geographic footprint, and technical capabilities through both strategic acquisitions and organic growth. By the end of 2013, Seadrill had grown into one of the world's premier offshore drilling contractors.[51]

Oil prices peaked in mid-2014 at more than $115 per barrel before declining to less than $30 per barrel by early 2016.[52] As a result, oil companies reduced their drilling, thus their need for drilling supplies. Offshore drilling, being more expensive than "onshore" drilling, was one of the first areas to experience cutbacks.[53]

Seadrill's initial proposed reorganization plan was centered on a deal presented by Hemen and Centerbridge Credit Partners L.P., the holder of about 10% of Seadrill's unsecured bonds. Premised on the notion that "the value of the Debtors' estates does not support a significant recovery for holders of Unsecured Bonds under a chapter 11 plan,"[54] the plan proceeded to give Hemen (the controlling shareholder) and select bondholders, including Centerbridge, an 84% equity stake in the reorganized debtor, millions of very high-yielding bonds and lucrative fees.

---

51. Declaration of Mark Morris, Chief Financial Officer of Seadrill Limited, In Support Of Chapter 11 Petitions And First Day Motions, 16, *In re Seadrill Ltd.*, Case No. 17-60079 (Bankr. S.D. Tex. 2017).

52. *Commodities: ICE Brent Crude Oil Front Month*, FIN. TIMES, https://markets.ft.com/data/commodities/tearsheet/summary?c=Brent+Crude+Oil (last visited Oct. 29, 2018).

53. Holly Ellyatt, *OPEC To Mop Up On Oil; non-OPEC supply falls*, CNBC (Oct. 12, 2015), https://www.cnbc.com/2015/10/12/opec-strategy-working-as-non-opec-supply-falls.html.

54. *Id.* at 47.

Other bondholders would receive 15% of the company's new equity. The existing shareholders (including Hemen) would get 2%, if the unsecured creditor accept the plan.[55] Otherwise the old equity would be extinguished.

Centerbridge and the other plan supporters own 40% of the unsecured bond debt.These select bondholders (and controlling shareholder) obtained their favored treatment through their commitment to support the issuance of $860 million in new secured notes, as well as the $200 million in new equity. It is perhaps important to note in connection with our discussion of this new financing that the debtor, upon filing for bankruptcy, explained that it did not need a conventional DIP loan because it had more than $1 billion in cash on hand.[56]

The buyers of the new secured notes would be entitled to their pro rata share of 57.5% or approximately $115 million of the new equity.[57] The notes have a seven-year term and will carry an interest rate of 12%—with 8% paid "in kind" as further notes and 4% paid in cash.[58] Eligible unsecured creditors—those who qualify as institutional investors and who vote to accept the plan—can buy up to 10% (or $85 million) of these notes,[59] but otherwise the notes are to be allocated as follows:

- Hemen Investments Limited and Centerbridge will purchase $462,442,000;
- ARCM Master Fund III Ltd ("ARCM") will purchase $15 million;
- Fintech Investments Ltd ("Fintech") will purchase $25 million; and
- Aristeia Capital LLC, GLG Partners Inc., Saba Capital Management, LP and Whitebox Advisors LLC, together (hereinafter, the "Funds"), will purchase $357,558,000.[60]

ARCM and Fintech, who were apparently not noteholders before the bankruptcy, would purchase their stakes regardless of the outcome of the offering to the unsecured creditors. The others will have their stakes reduced

55. Peg Brickley, *Seadrill Sets a Fast Pace for Bankruptcy Turnaround*, WALL ST. J. (Sept. 13, 2017), https://www.wsj.com/articles/seadrill-sets-a-fast-pace-for-bankruptcy-turnaround-1505346101.

56. *Id.* ("With about $1 billion in cash already in its coffers, Seadrill won't need chapter 11 financing to continue business as usual, Seadrill lawyer Anup Sathy said Wednesday at the London-based company's debut in the U.S. Bankruptcy Court for the Southern District of Texas.").

57. Restructuring Support Agreement, Ex. A, at 91, *In Re Seadrill Ltd.*, Seadrill Disclosure Statement, at 2 (page 2 of the annexed document entitled "Restructuring Term Sheet").

58. Disclosure Statement Relating to The First Amended Joint Chapter 11 Plan of Reorganization Of Seadrill Limited And Its Debtor Affiliates Pursuant To Chapter 11 Of The Bankruptcy Code, 30, *In Re Seadrill Ltd.*, Case No. 17-60079 (Bankr. S.D. Tex. 2017) [hereinafter Seadrill Disclosure Statement].

59. Notes Rights Offering Procedures, Ex. E2, *In Re Seadrill Ltd.*, Seadrill Disclosure Statement, at 1.

60. Restructuring Support Agreement, Ex. B, at 324, *In Re Seadrill Ltd.*, Seadrill Disclosure Statement, at 3 (page 3 of the annexed document entitled "New Secured Notes Term Sheet").

pro rata by the amount of notes purchased. These others—Hemen Investments, Centerbridge, and the Funds (collectively, the "Plan Proponents")—are being paid a fee of up to $43 million.

All of the note purchasers, including the Plan Proponents, would also receive $8.6 million as a "closing fee" upon purchase of the notes. And the Plan Proponents also benefit from the predictable payment of their professional fees.

Beyond the equity granted to the new noteholders, mentioned above, Hemen Investments and Centerbridge would pay $150 million for 18.75% of the new common stock and the Funds would pay $50 million for 6.25%.[61] Once again, the Plan Proponents were to be paid various fees for buying their shares.

First, there is a $10 million "equity purchaser fee." Next, if the stock is not listed on the Oslo Stock Exchange within 90 days of plan confirmation, a ticking fee begins at $100,000 per month.

And then the structuring fees. Hemen Investments would receive an additional 5% of the debtor's new equity, and the Funds will receive a relatively modest 0.5% of the equity as well.

Fredriksen would end up owning a lot more than his current 24% stake when the dust settles, if the plan is approved. The plan does include a ninety-day "go shop" provision, allowing for some consideration of alternative plans, and Barclay's PLC and a group of bondholders have each proposed alternative plans.

That was the original plan, but facing strong opposition from various outside groups, Seadrill postponed a planned hearing on the original plan to allow further negotiations with these parties.[62] Press reports noted that Fredriksen had been making some effort to buy the dissenting bondholders' positions.[63]

Then, in late February, the *Wall Street Journal* reported that many dissenting groups had signed on to a revised plan:

> Creditors left on the sidelines, including Barclays Capital and a cadre of unsecured bondholders, protested, complaining that Centerbridge and Mr. Fredriksen had unfairly put together a sweetheart deal for themselves and a few supporters.
>
> The official committee representing all unsecured creditors agreed, and started getting ready to sue.

61. Restructuring Support Agreement, Ex. B at 91, *In Re Seadrill Ltd.*, Seadrill Disclosure Statement, at 91 (page 2 of the annexed document entitled "Restructuring Term Sheet").

62. *UPDATE 1-Seadrill postpones court hearing for restructuring talks*, REUTERS, Jan. 25, 2018, https://www.reuters.com/article/seadrill-bankruptcy/update-1-seadrill-postpones-court-hearing-for-restructuring-talks-idUSL8N1PK6IW.

63. *Id.*

> On Monday, Seadrill unveiled settlements that will stop the legal threats and bring support for the chapter 11 turnaround plan to at least 70% of unsecured bondholders, up from the 40% level of support the original plan enjoyed. . . .
>
> Seadrill estimates general unsecured creditors are being offered debt investment rights worth at least $239 million, as well as equity rights worth at least $136 million, in the revised plan, court papers say. As a result, some unsecured creditors could recover as much as 47% of what they are owed, a 15-point improvement from the original plan, court papers say. . . .
>
> Some things didn't change in the revised turnaround plan. As in the original plan, top-ranking banks will stretch out the maturity on their loans, giving Seadrill a longer period of time to recover from the energy-market turmoil. Seadrill shareholders that fought a losing battle for better treatment will get a 2% stake in the reorganized company, less than half of what Mr. Fredriksen's investment company, Hemen Holding, will collect as a "fee" for going along with the restructuring.
>
> Mr. Fredriksen, who had negotiated an immunity deal that shielded him from lawsuits over his handling of the company's affairs as part of the original turnaround strategy, will continue to be protected from litigation under the revised plan.[64]

C. CGG SA

CGG's products and services use seismic imaging to help the oil and gas industries explore and develop reserves.[65] As with Seadrill, it has been dramatically affected by recent market declines and changes in the oil industry. CGG's consolidated EBITDA had fallen from a high of $1.139 billion in 2013 to $273.6 million in 2016.[66]

In mid-June 2017, CGG filed a French safeguard ("sauvegarde") proceeding and a complementary chapter 15 in New York.[67] An intermediate U.S. holding company and some dozen affiliates (some incorporated outside the U.S.) also filed chapter 11 cases.[68] The New York chapter 15 and 11 cases were run in concert with the French proceedings, and the reorganization plan only revamped investment debt and shareholders, leaving trade creditors and employees untouched.

---

64. Brickley, *supra* note 55.
65. Company Profile: CGG SA (GEPH.PA), REUTERS, https://www.reuters.com/finance/stocks/companyProfile/CGG (last visited Oct. 29, 2018).
66. Disclosure Statement For Joint Chapter 11 Plan Of Reorganization, at 19, CGG Holding (U.S.) Inc. And Certain Affiliates, Case No. 17-11637 (Bankr. S.D.N.Y. 2017).
67. Patrick Fitzgerald, *France's CGG files for bankruptcy protection*, MARKETWATCH (June 15, 2017), https://www.marketwatch.com/story/frances-cgg-files-for-bankruptcy-protection-2017-06-15.
68. *Cf.* Oscar Couwenberg & Stephen J. Lubben, *Corporate Bankruptcy Tourists*, 70 BUS. LAW. 719 (2015) [hereinafter Couwenberg & Lubben, *Corporate Bankruptcy Tourists*].

The plan involved swapping high-yield and convertible bonds into new CGG shares and extending maturities on about $800 million of secured debt by five years to 2023. CGG sold $125 million of new stock and $375 million of new high-yield debt as part of the plan.

The plan was presaged by a lockup agreement signed in early June, and subject to French law.[69] Key parties to the agreement included an ad hoc committee of secured lenders, who held collectively 53.8% of the group's secured debt, an ad hoc committee of senior noteholders, who collectively held 52.4% of the CGG senior notes, and DNCA Finance and DNCA Invest (together "DNCA"),[70] which held 5.5% of the senior notes and 20.7% of CGG's convertible bonds. In addition, CGG entered into a restructuring support agreement with DNCA in connection with its holding of 7.9% of the debtor's shares.

Table 2: CGG: Ad Hoc Noteholders Committee (with holdings)

Alden Global Capital, LLC	7.86%
Attestor Capital LLP	7.66%
Aurelius Capital Management, LP	7.99%
Boussard & Gavaudan Asset Management, LP	11.27%
Contrarian Capital Management, L.L.C.	10.69%
Third Point LLC	6.93%

As with the other plans we have examined, this plan called for new money to be raised, namely $500 million split between a $125 million right issue to existing shareholders, backstopped by DNCA and senior noteholders (in their case, by way of set-off of their notes against the obligation to buy shares), and a $375 million issue of new second lien senior notes combined with penny warrants to "eligible" senior noteholders, backstopped by the ad hoc committee of senior noteholders.[71] These penny warrants allowed for the purchase of shares in the reorganized company at a price of €0.01 per share.[72]

69. Notice Of Filing (I) Revised Joint Chapter 11 Plan Of Reorganization Of CGG Holding (U.S.) Inc. And Certain Affiliates; (II) Revised Disclosure Statement For Joint Chapter 11 Plan Of Reorganization Of CGG Holding (U.S.) Inc. And Certain Affiliates; (III) Exhibits To Disclosure Statement For Joint Chapter 11 Plan Of Reorganization Of CGG Holding (U.S.) Inc. And Certain Affiliates; (IV) Revised Solicitation Materials; (V) Revised Order Approving The Disclosure Statement For Joint Chapter 11 Plan Of Reorganization Of CGG Holding (U.S.) INC. And Certain Affiliates; And (VI) Related Materials, Exhibit D-3 at 59, CGG Holding (U.S.) Inc. And Certain Affiliates, Case No. 17-11637 (Bankr. S.D.N.Y. 2017) [hereinafter CGG Notice]; *see* Couwenberg & Lubben, *Corporate Bankruptcy Tourists*, *supra* note 68, at 352.

70. The last two were Luxembourg-based fund managers.

71. CGG Notice, Exhibit D-1 at 48 (English translation of safeguard plan at page 46; Exhibit D-1 at page 48).

72. *Id.* at 51.

The new second lien notes had a six-year term, callable at par after three years,[73] and a floating cash coupon of at least 5%,[74] combined with a pay in kind coupon of 8.5% in new notes.[75] The associated warrants gave the new noteholders the right to buy 16% of the reorganized company's equity.[76] The eligible senior noteholders were only permitted to subscribe to this new debt offering if they signed the lockup agreement, which committed them to support the plan and make no moves (in either France or the U.S.) to disrupt its confirmation by the courts.[77]

The inevitable fees and other rewards accompanied these backstop agreements. Any noteholder who agreed to buy the new senior notes received a 7% commitment fee. The ad hoc committee received an additional 3% backstop fee for standing behind the notes, plus warrants equal to 1.5% of the reorganized company's equity. The ad hoc committee of senior noteholders received further penny warrants equal to 1% of the reorganized company's shares as what we might call a "global coordination fee."[78] DNCA received $8 million for its partial backstop of the equity rights.[79] Everyone had their professional fees and expenses taken care of as well.[80]

The convertible bondholders complained bitterly of their treatment. Under the overall plan (that is, the chapter 11 plan combined with the safeguard plan) both the senior and convertible debt were being equitized. But only the senior noteholders had access to the offering of new notes. The convertible debtholders also complained that the new money provided by the plan was insufficient to ensure the debtor's continued viability, further undermining the value of the equity they were receiving.

The plans were approved in New York and Paris and were implemented in late February 2018.

V. PRIVATE BENEFITS IN BANKRUPTCY

When looking at these three cases, some commonalities and specifics come to the fore but before discussing these, we first review the three cases how to interpret them as control contests.

73. CGG Notice, Exhibit D-3 at 91.

74. The floating rate was set at LIBOR plus 4%, with a minimum total rate of 5. CGG Notice, Exhibit D-1 at 51.

75. CGG Notice, Exhibit D-3 at 91.

76. *Id.*

77. CGG Notice, Exhibit D-3, at 78.

78. *Id*. at 81–82 ("As compensation for their global coordinator role in the context of the Restructuring, members of the Ad Hoc Senior Noteholder Committee will receive free Coordination Warrants").

79. CGG Notice, Exhibit D-1, at 47.

80. CGG Notice, Exhibit D-3, at 30.

Peabody's reorganization plan was structured around a coalition of seven institutional bondholders and the management of the company.[81] The plan provided these creditors a position as new (preferred) shareholders in the reorganized company. The plan would, over time, give these preferred shareholders approximately a 12.5% stake of the company, effectively making them a minority and potentially a controlling shareholder.[82] The deal was sweetened by extra warrants, diluting the common shares in favor of this small group and a side payment of $120 million in total for the time the plan was outstanding. Other claimholders were not awarded such a fee.

The seven creditors promised to back the plan and veto all others. Given their position as second lien notes holders and senior unsecured notes holders they have a blocking minority in their respective classes. Management is awarded a stock bonus under the plan to 10% of new stock issued in the restructuring process. Peabody fits into table 1 where a coalition of management and creditors set the details of the plan. The private benefits center on the rights issue at discounted prices targeted to specific (creditor) groups, a side payment, sweetening warrants. For this, the coalition offered to (partially) backstop the financing deal, back the plan under the risk that the coal market would not revive.

With Seadrill's original plan, it is a controlling shareholder, Fredrikson, and a small group of select bondholders (notably Centerbridge) who devised the reorganization plan. The plan, even as revised, leaves Fredrikson, via the Hemen Holding company, together with Centerbridge as controlling shareholder of the company. As in Peabody, a rights issue played an important role here as well to restructure the ownership of the company.

Next to that the plan proponents are awarded various (cash and common stock) fees for their commitment. The cash part of these fees run into approximately $61 million, while the equity part might be valued at $44 million.[83] The documents filed with the bankruptcy court also show substantial fees for legal and financial advisory services. The instruments for private benefits center on the structuring of the rights issue, the setting of the terms to bring in new equity and the various fees. Again, in return, the controlling group members promise to back the plan and veto others.

Special treatment is provided in exchange for the new financing, but does the debtor really need the new financing? It proclaimed it was flush with cash on the first day of the case. If we suspect that the new financing is simply a

81. Tracy Rucinski & Tom Hals, *Hedge funds to reap big stock gains from bankruptcy of coal miner Peabody*, REUTERS, Mar. 15, 2017, https://www.reuters.com/article/us-peabody-energy-bankruptcy/hedge-funds-to-reap-big-stock-gains-from-bankruptcy-of-coal-miner-peabody-idUSKBN16M33L.

82. If the preferred shares are all taken up by the institutional bondholders, and assuming the stock dividend is paid out as planned, this implies a stake of 56% in the new equity issue. As 22.5% is reserved for this group of seven creditors, this implies a stake of 12.5%.

83. In the plan, Hemen and Centerbridge receive 25% of new equity for $200 million. Based upon this, the equity structuring fee of 5% for Hemen implies a value of $40 million.

vehicle for providing disparate treatment to bondholders (and non-insider shareholders), this too is a story about control rights.

CGG's reorganization plan covers two jurisdictions, France and the United States. It details a rights issue, a swap of debt into equity, warrants and various fee arrangements. In this way, it looks similar to the two other cases.

In the CGG case, a group of bondholders and one large (minority) shareholder (DNCA) accepts a lock up arrangement, guaranteeing the approval of the reorganization plan. Later in the procedure it is especially the class of convertible bondholders that objects. The rights issue of $125 million is targeted to the existing shareholders, backstopped by DNCA. When subscribing to the new senior notes investors are forced to accept the lock up agreement, while the ad hoc committee of bondholders backstopped the issue (for a fee). The notes receive a cash coupon of at least 5% and an 8.5% in-kind coupon. The latter coupon increases the debt with approximately $32 million per year. However, in one respect, CGG's plan differs from the other two cases: it is more open to outside investors, although it is backstopped by the ad hoc committee of bondholders. Furthermore, the fee structure includes the use of penny warrants for those bondholders agreeing to the lock up. The amount of penny warrants that is offered to this group implies a total of 18.5% of the reorganized equity. All cash fees amount to approximately $19 million.

The lockup agreement is subject to French law, meaning that even if the terms are objectionable to the American bankruptcy judge, he will have a hard time unwinding it. Even terms that are unenforceable in the United States—as violating public policy or the Bankruptcy Code—might well be enforceable in France or other jurisdictions. Indeed, it is notable that the agreement provided for specific performance—meaning that a French court might bind a dissenting creditor to an American bankruptcy plan.[84]

Overall, we see the frequent use of new financing as the basis for providing different treatment to existing stakeholders. Typically, this differing treatment is paired with a commitment to support a specific plan. As commentators have recently noted, "Even when the same deal terms are being offered to all creditors, a tactically minded ad hoc committee may take advantage of information asymmetry to put themselves in a better position when compared with the wider creditors community."[85]

In many respects, this represents the move of a technique common to European restructurings to American proceedings. For example, in English schemes of arrangement, it is common to provide those who quickly commit

84. *See generally* Kenneth Ayotte, Anthony J. Casey, & David A. Skeel, Jr., *Bankruptcy on the Side*, 112 NW. U. L. REV. 255 (2017).

85. Yushan Ng & Helen Ward, *The Role and Purpose of an Ad Hoc Committee from the Perspective of Creditors*, GLOBAL RESTRUCTURING REV. (Nov. 26, 2017), https://globalrestructuringreview.com/print_article/grr/chapter/1151044/the-role-and-purpose-of-an-ad-hoc-committee-from-the-perspective-of-creditors?print=true.

to support the scheme with an extra fee.[86] Historically in the United States, differing treatment of creditors within a single class was disfavored, but there is sufficient play in the provisions of chapter 11 to allow this move so long as the disparate treatment at least has the veneer of being for "something else." That is, while the creditors in a class must all receive the same payments, some creditors within the class might receive additional payments if the plan proponent can point to some additional rights those creditors possess, or additional value these creditors bring to the table.

Although not expressly mentioned in the cases, in essence this is also a revival of the old American bankruptcy chestnut known as the "New Value Exception."[87] Both historically and as a matter of current law, senior creditors are prohibited from "gifting" part of their recovery to junior creditors, particularly if doing so will create recoveries that violate the so-called absolute priority rule.[88] That is, a senior creditor is not permitted to give part of its recovery to shareholders, if unsecured creditors remain unpaid.

Under the New Value Exception, however, junior claimants are allowed to participate in exchange for providing new funds.[89] This became quite common in railroad reorganization cases in the late Nineteenth century, where shareholders typically "bought in" to the reorganized company.[90] As seen in our three cases, it is being used again to provide the basis for some creditors to recover more than others within the same class, through the host of fees and other benefits paid to creditors supporting the plan.

In control contests outside of bankruptcy, the issuance of substantial amounts of new shares would be controlled by fiduciary duties and, in extreme cases, by joint decision-making processes.[91] The state-law governance structure mitigates the problems first identified by Berle and Means, and protects small, unorganized shareholders from managerial or controlling shareholder abuse.[92] But such structures only protect shareholders and do not extend to the other parts of the capital structure, all of which are in play during a reorganization case.

Furthermore, it is difficult to identify who any such duty of loyalty would protect, given the varied nature of creditor claims. Stating that the duty runs to the corporation simply obscures the problem, because the distribution of

86. For more on schemes, *see* Susan Block-Lieb, *Reaching to Restructure Across Borders (Without Over-Reaching), Even After Brexit*, 92 AM. BANKR. L.J. 1, 12 (2018).

87. *See generally* Walter W. Miller, Jr., *Bankruptcy's New Value Exception: No Longer A Necessity*, 77 B.U. L. REV. 975, 975 (1997).

88. *In re* DBSD N. Am., Inc., 634 F.3d 79, 97–99 (2d Cir. 2011).

89. S.W. O'Donnell, *Toward A Better Understanding of New Value*, 108 PENN ST. L. REV. 703, 709–10 (2004).

90. Sarah Pei Woo, *Regulatory Bankruptcy: How Bank Regulation Causes Fire Sales*, 99 GEO. L.J. 1615, 1652 (2011).

91. For example, the certificate of incorporation of a Delaware corporation can only be amended with the affirmative votes of both the board and the shareholders. 8 Del. C. § 242 (West 2014).

92. *See generally* William W. Bratton, *Berle and Means Reconsidered at the Century's Turn*, 26 J. CORP. L. 737 (2001).

value in the restructuring is to specific creditor classes. Enforcement of a fiduciary duty to the corporation is impossible without a full valuation of those distributions.[93]

It is noteworthy that in all three cases we study, a coalition of creditors together with either a controlling shareholder or the board are effectively calling the shots. It points to, but does not provide definitive proof, that in coalition led cases extra attention is needed for the terms of the offer.

The general structure of these sort of cases does tend to be somewhat coercive, in that even a creditor who does not support the plan is compelled to do so in order to obtain a "full" recovery. If the creditor believes that most creditors will not be bothered to raise objections to the structure, then they too will not risk a fruitless objection that will cost some part of their recovery.[94] Through a kind of prisoner's dilemma, it becomes possible to stampede creditors into supporting a plan that many oppose.

The presence of this coercion also makes it difficult to rely on the voting mechanism to signal "good" reorganization plans. In many cases the plan might be supported by sizeable majorities of creditors, but if such support is the price of obtaining a full recovery in the case, courts will receive an unreliable signal about creditors' true sentiments.

The use of lockup and restructuring support agreements, or RSAs, also shows an effort to move key aspects of the restructuring deal out of the purview of the court.[95] Instead, parties are left to their fate in the rough and trouble world of private contracting. In this context, stories are repeatedly told of options to sign lockups or RSAs that expire in mere days, or similar offers extended for seemingly longer periods of time, but during a holiday.

One last important observation that follows from the three cases is that reorganization plans are increasingly utilizing complex distributional approaches. Payment in kind dividends, mixed PIK and cash interest rates, warrants, contingent fees, variable interest rates, and the like make it difficult to understand precisely what controlling parties are receiving in any particular case. Intentional complexity may be useful to plan proponents who wish to leave the value of plan distributions somewhat opaque.

Given this, we doubt that Douglas Baird's recent suggestion that bankruptcy courts can police these concerns through the existing requirements that plans be both "fair and equitable" and proposed in "good faith" will go far enough.[96] First, both of these requirements reside within chapter 11, but as one of our case studies show, the problem of appropriation of private benefits extends into the transnational cases as well. Indeed,

93. Oscar Couwenberg & Stephen J. Lubben, *Solving Creditor Problems in the Twilight Zone: Superfluous Law and Inadequate Private Solutions*, 34 INT'L REV. L. & ECON. 61, 75 (2013).

94. Ronald J. Gilson & Reinier Kraakman, *Delaware's Intermediate Standard for Defensive Tactics: Is There Substance to Proportionality Review?*, 44 BUS. LAW. 247, 262–63 (1989).

95. *See* Douglas G. Baird, *Bankruptcy's Quiet Revolution*, 91 AM. BANKR. L.J. 593, 604 (2017).

96. *Id.*

increased policing of these issues in chapter 11 might well encourage the use of UK schemes, combined with chapter 15, as a readily available substitute.[97]

More importantly, the "fair and equitable" concept is focused on the vertical relationship among creditors under the absolute priority rule, whereas our case studies show that horizontal misappropriation is an issue as well. All three of our cases feature senior creditors, but they were paid in full and largely disappeared from the scene. The issue is a group of select creditors conspiring with either management or controlling shareholders to disenfranchise their fellow creditors.

* * *

A reorganization plan is a control transaction in that it revamps not only capital structure but also ownership structure. Under state corporate law, such a transaction would be subject to intense scrutiny.[98] But in bankruptcy, the preference for consensual deals and swift resolution of financial distress may work against such probing examination of control shifts.

To be sure, many of the investors in question likely can hold their own. But we might wonder what it is doing to the bankruptcy system as a whole. And not all cases involve sophisticated investors. The many retail bond and shareholders in Peabody Energy can attest to that.

More broadly, we see that while bankruptcy is nominally founded on the principal of equality being equity, the market for corporate control as practiced in distress provides for something far less noble. Indeed, we might worry that it is becoming more like a gladiator contest than anything involving equity.

When reflecting on our cases discussed above some salient features emerge. Firstly, remarkable is the lack of openness to other investors in the various rights offerings. Only specific classes or groups are invited to participate. This would seem to be in tension with raising funding on the most efficient basis, which again suggests something else may be going on.

Secondly, shareholdings are redistributed via penny warrants, private placements, and other similar devices, shutting out other shareholders or diluting their holdings significantly. Such tricks would be much more difficult to employ in a normal control contest.

Thirdly, part and parcel of the deal seem to be a (cash) fee structure that explicitly rewards specific groups and not others. In chapter 11, a redistribution of benefits has thus become possible to stakeholders that would very probably not be possible in normal control contests. It might even provide an incentive to start using chapter 11 for being more permissible with respect to the forms and sizes of private benefits. Given the rules in chapter

97. Couwenberg & Lubben, *Corporate Bankruptcy Tourists*, *supra* note 68, at 725.
98. Mary Siegel, *Going Private: Three Doctrines Gone Astray*, 4 N.Y.U. J.L. & BUS. 399, 450 (2008).

11 and the centrality of the reorganization plan, it makes sense—if one wants to curb private benefits—to think about instruments to contain private benefits.

Finally, given these findings one may expect we close with a rallying call for legislative action. But, actually, for the moment, caution is warranted as we cannot provide in this Article a full empirical picture of private benefits in chapter 11 and chapter 15 procedures. Also, if one thinks about the intervention options available, one should doubt whether swift action now is the best solution.

As stated above creditors may start organizing countervailing power. News stories about redistributional tactics and studies such as these, may help in setting in motion a more contested chapter 11 arena, furthering private strategies to contain such tactics. Next, a second line of defense may be to rely on bankruptcy judges to become more attuned to such tactics and find legal remedies to further transparency, inclusiveness and contain asymmetric benefits.[99] Only the last line of defense may be to look at Congress for legislative action. However, devising rules for chapter 11 ordering transparency, inclusiveness and symmetrical treatment may be too elusive to write into law. Formally we already have many of these concepts in the law—for example, payments must be disclosed—but we might doubt whether the strict letter of the law is followed more than the broader intent.

CONCLUSION

Outside of bankruptcy, the board's decision to take control rights away from existing shareholders and grant them to another is subject to heightened fiduciary duties.[100] The thinking is that the sale of control represents a kind of end game in which shareholders have one last chance to realize full value for their investment. In such a context, their interests warrant special protection.

Enforcing such duties in the heady, complex and fast-moving worlds of chapters 11 or 15 would be more than a bit challenging. But the lack of such effective fiduciary duties does highlight the potential for misdeeds in a context at least as vital as the sale of control outside of bankruptcy.

Whether the chapter 11 of 1978 can keep up the chapter 11 of 2018 is a fundamental and unanswered question.

99. *Cf.* Jill E. Fisch, *Governance by Contract: The Implications for Corporate Bylaws*, 106 CAL. L. REV. 373, 404 (2018).

100. *E.g.*, Paramount Commc'ns Inc. v. QVC Network Inc., 637 A.2d 34 (Del. 1994).