Shareholder Control Rights in Bankruptcy: Disassembling the Withering Mirage of Corporate Democracy

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Articles

SHAREHOLDER CONTROL RIGHTS IN BANKRUPTCY:
DISASSEMBLING THE WITHERING MIRAGE OF
CORPORATE DEMOCRACY

THOMAS G. KELCH*

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INTRODUCTION

Uttering the word "democracy" creates an image of a mystical talisman of western cultural power to be unconditionally exalted in all its forms and applications. This ethos is utilized to justify the concept of "corporate democracy" under state law, and to validate its continued vitality when a corporation becomes insolvent and seeks relief under Chapter 11 of the Bankruptcy Code.¹

The symbolism of democracy is used by courts and scholars alike to conclude that the state law "rights" of shareholders—to hold meetings, to vote, to choose a board of directors, and to redefine the course of corporate policy—subsist fundamentally unimpaired in Chapter 11 cases.² This ideal is most frequently


2. While adherence to the definitional scheme of the Bankruptcy Code might impel reference to shareholders as "equity security holders" under 11 U.S.C. § 101(16) (1988), in view of this Article's concentration on the exercise of state law franchise rights of shareholders and the clumsiness of the statutory language, I will generally refer to shareholders by their state law appellation.

3. One scholar has expressed the normative case for corporate democracy in bankruptcy in the following way:

The promotion of corporate democracy is not merely a lofty ideal. Placing this ideal on a pedestal makes it too easy to ignore or discount democratic values when courts face the harsh realities of operating a company in Chapter 11 and satisfying the clamor of creditors who justifiably demand to be paid as much as possible, as soon as possible. Courts should recognize that by promoting corporate democracy, they are maintaining the integrity of state law, which mandates meetings, and federal law, which complements corporate democracy through the proxy rules. In addition, corporate democracy is a necessary adjunct to the investor protection provisions of the Bankruptcy Code. Failing to give due deference to a shareholder meeting request tears at the fabric of the Bankruptcy Code and defeats the reasonable expectations of shareholders.

Mark E. Budnitz, Chapter 11 Business Reorganizations and Shareholder Meetings: Will the Meeting Please Come to Order, or Should the Meeting be Cancelled Altogether?, 58 GEO. WASH. L. REV. 1214, 1256 (1990) (footnote omitted). See also Anna Y. Chou, Corporate Governance in Chapter 11: Electing a New Board, 65 AM. BANKR. L.J. 559, 576 (1991) ("Abrogation of the shareholders' right to elect a board of directors should not be permitted in the absence of a clear congressional mandate. The Code generally contemplates the conduct of business in accordance with state law and prescribes that the bankruptcy court intervene in specific instances only."). This principle of corporate democracy is also frequently stated in nonbankruptcy contexts. See Melvin A. Eisenberg, The Structure of the
raised in response to attempts by besieged debtors in possession at
the threshold of revitalization to obtain injunctions against share-
holder meetings that could potentially interfere with the corporate
rebirth. These proposed meetings are almost invariably intended to
recast the focus of the reorganization effort by replacing present
management with individuals sympathetic to shareholders’ interests.
In this situation, under the banner of corporate democracy, the
courts have fashioned a rigorous standard for the granting of in-
junctions at the request of the debtor in possession’s present man-
agement: the “clear case of abuse” standard.4 Guarded by this
standard, shareholders often win economically unjustified rewards
in the reorganization plan process through exercise of their
franchise rights.5

The purpose of this Article is to question the unquestioned—to
challenge the premises of the accepted view of shareholder rights in
Chapter 11. To accomplish this, the Article first briefly reviews the
history of the rights of shareholders in reorganization cases. This
task is undertaken in Parts I and II. Part III of the Article then ana-
lyzes the standards currently used to evaluate attempts to enjoin
shareholder meetings and the exercise of other state law share-
holder rights. In Part IV, the Article reviews the various creditors’
rights that are preserved or denigrated in bankruptcy, and compares
them to the rights of shareholders similarly preserved or deni-
grated. Through analysis of these two sets of rights, this Article will
demonstrate that preserving shareholders’ rights—to vote, to hold
meetings, to alter the composition of the board of directors, and to
thereby affect the outcome of a Chapter 11 case—is no more, and
probably less, justifiable than permitting creditors with prepetition
claims to exercise their state law rights—to sue the debtor in posses-
sion, or to levy or foreclose on property of the estate during the
course of a Chapter 11 reorganization.6 Finally, in Part V, this Arti-

4. See infra Part III.B.2.
5. See infra notes 303-307, 348-349 and accompanying text.
6. This Article primarily deals with shareholder rights when there is a debtor in
possession. The suggested analysis may, however, be similarly applied if a trustee is
appointed. See 11 U.S.C. § 1104 (1988). This Article is not intended to deal with Chap-
ter 11 governance issues relating to bankrupt partnerships.

Corporation: A Legal Analysis 18-29 (1976) (discussing the principle of “share-
holder democracy” along with other schools of thought regarding the formulation of a
normative model of corporate decision making); Jayne W. Barnard, Shareholder Access to
the Proxy Revisited, 40 Cath. U. L. Rev. 37, 74-103 (1990) (urging limited shareholder
access to proxy lists); Richard M. Buxbaum, The Internal Division of Powers in Corporate
Governance, 73 Cal. L. Rev. 1671, 1672 (1985) (“[E]xisting corporation law is based on
shareholder participation.”).
cle will suggest two approaches for implementing the conclusion that shareholders should not have any greater right than creditors to control the management of a corporation in bankruptcy.

I. History of Reorganization and Shareholder Economic Rights

For a significant portion of the history of bankruptcy law, corporations were not among those entities entitled to relief in bankruptcy; only individuals were endowed with such a privilege. The first federal bankruptcy law, enacted in 1800 and lasting only three years, did not allow voluntary bankruptcy, which was not permitted until the Bankruptcy Act of 1841, a law also effective for only three years. Like earlier state insolvency laws, the 1800 and 1841 Acts provided no relief for corporations and granted individual relief only to merchants and traders. This was largely a result of the focus of bankruptcy law in the early 1800s, which looked to the suppression of dishonest debtors rather than debtor protection. Moneyed, business, and commercial corporations were not within

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7. The term "shareholder economic rights" includes the priority position of shareholders in relation to assets of the debtor corporation's estate and their ability, or inability, to realize on their interests, if any, in the estate in the reorganization process. This portion of the analysis presents several questions concerning the historical nature of the rights of shareholders of a debtor corporation: What interests have shareholders had in the bankrupt estate? What have been the rights of shareholders to realize on these interests? When have shareholders been permitted to retain economic interests in reorganized debtors? The concern here is the distributional share of the estate to which shareholders are entitled, not the rights of shareholders to be heard or to control management of the debtor. This concept of economic rights is basically that of "priority rights," which are discussed more fully below. See infra Part IV. For present purposes, however, I will refer to these rights as "shareholder economic rights."


9. See 1 James Wm. Moore et al., Collier on Bankruptcy ¶0.04, at 7 (14th ed. 1974) [hereinafter Collier].

10. See id.


12. See 1 Collier, supra note 9, ¶0.04.

13. See 1 Remington, supra note 11, §7, at 16 (noting that the 1800 Act was "essentially a law against debtors, framed along the lines of suppressing fraudulent and criminal practices"). But see id. §8, at 17 (noting that, although the 1841 Act, like its predecessor, punished dishonest debtors, it also recognized the "justice" of granting relief to "the honest debtor who aided his creditors in realizing as much as possible from the estate").
the ambit of the bankruptcy laws until the Bankruptcy Act of 1867.\textsuperscript{14}

The first significant opportunity for corporate shareholders to participate in—and profit from—the bankruptcy process arose under the Bankruptcy Act of 1898. Under this Act, creditors could force a corporation into bankruptcy,\textsuperscript{15} the corporation could obtain a discharge,\textsuperscript{16} and shareholders could retain the corporate shell to resurrect the debtor and go on with its business.\textsuperscript{17} The 1898 Act, however, originally contained no provision for the reorganization of corporations.

Corporate reorganization had its primary genesis not in bankruptcy law but in equity receiverships.\textsuperscript{18} Although in equity receiverships there was typically a sale of the corporation's assets, creating a pool for distribution to creditors, there was significant opportunity for intrigue by shareholders, and for conflict among creditors, bondholders, and shareholders.\textsuperscript{19}

One of the main evils of equity receiverships was the frequent ability of shareholders to obtain interests in the reorganized debtor entity, without the creditors receiving full payment.\textsuperscript{20} This result was often accomplished through private pacts between secured creditors and shareholders.\textsuperscript{21} As part of these pacts, the secured creditors obtained the right to foreclose on the assets of the debtor. After such a foreclosure, to enable the secured creditors to continue the debtor's business as a going concern, shareholders were often rewarded in the resulting reorganization plan with an ownership interest in the reorganized debtor, in exchange for their continued operation of the business.\textsuperscript{22} The secured creditors acquiesced in this course because they lacked the expertise to run the debtor's

\begin{enumerate}
\item See Bankruptcy Act of 1867, ch. 176, § 37, 14 Stat. 517, 535 (repealed 1878).
\item See id. § 14a.
\item Donald R. Korobkin, Rehabilitating Values: A Jurisprudence of Bankruptcy, 91 COLUM. L. REV. 717, 747-49 (1990) ("The equity receivership moved beyond corporate liquidation as the exclusive form of corporate bankruptcy and thus away from the concept of the corporation in bankruptcy as merely a pool of assets to be gathered and distributed.").
\item Id. at 749-51 (arguing that the equity receivership was ultimately judged a failure as a "mechanism for realizing the potentialities of the enterprise—of promoting rehabilitation through a fair, open process").
\item See, e.g., Bruce A. Markell, Owners, Auctions and Absolute Priority in Bankruptcy Reorganizations, 44 STAN. L. REV. 69, 74-77 (1991) (discussing the use of equity receiverships for the reorganization of defaulting railroads in the early 1900s).
\item Id. at 76.
\item Id.
business, and because shareholders frequently had the ability and wherewithal to operate the business in a manner that benefited themselves and the secured creditors.23 These arrangements functioned to freeze out unsecured creditors, who were typically not paid in full, while shareholders went on operating the business and realizing future profits of the entity.24 Not surprisingly, these outcomes caused significant disenchantment among unsecured creditors.25

In response to dissatisfaction with reorganization through equity receivership, Section 77B of the Bankruptcy Act evolved in 1934.26 Section 77B did away with the ritual of sale that occurred in equity receiverships, and permitted the court to bind dissenting minorities by confirming a plan of reorganization.27 Again, however, difficulties arose in Section 77B reorganization cases. Among the problems were continued insider control, little effective judicial supervision, no control over proxies, no existing group to advise investors, and a lack of protection for individual investors and

23. The method by which this was accomplished is described by Professor Markell as follows:

Receiverships typically satisfied old debt through a plan of reorganization and a carefully orchestrated foreclosure of the railroad's assets. Plans usually transferred the foreclosed property to a newly created entity and then provided for the new entity to issue debt and equity securities to satisfy the old debt.

Notwithstanding the scarcity of [managerial skills and capital], at least one identifiable group—the stockholders—possessed both resources. Stockholders were often willing to contribute new cash to save their investment. In addition, these same shareholders or their agents were often in a better position to manage operations.

In practice, the new money not only saved an old investment, but the contributions were structured so that the securities received were often worth more than the amount contributed to the reorganization.

Id. at 75-76 (footnotes omitted).

24. See, e.g., Railroad Co. v. Howard, 74 U.S. (7 Wall.) 392, 408, 414-15 (1868) (holding the foreclosure sale of an insolvent railroad to be a fraudulent conveyance where shareholders were to receive 16% of the par value of their stock despite the fact that unsecured creditors' claims were not satisfied).

25. See Markell, supra note 20, at 76-77 (describing attempts by unsecured creditors to set aside foreclosures of corporations' assets on fraudulent conveyance grounds).

26. Act of June 7, 1934, ch. 424, Sec. 77B, 48 Stat. 911, 912 (1934). Section 77B, however, was not the first reorganization provision. The most notable prior provision was Section 77 of the 1898 Bankruptcy Act, a reorganization provision enacted in 1933 for use by railroads. See 11 REMINGTON, supra note 11, § 4345.1, at 16.

27. See Korobkin, supra note 18, at 753; see also Arthur H. Dean, A Review of the Law of Corporate Reorganizations, 26 CORNELL L.Q. 537, 546 (1941) (outlining the advantages and disadvantages of the former Section 77B reorganization scheme).
dissenting parties.28

This dissatisfaction spawned further legislation in the form of Chapters X and XI of the Bankruptcy Act, enacted in 1938 as part of the Chandler Act.29 Chapter X, based primarily on Section 77B,30 was the reorganization vehicle intended for public companies, and was to address the prior problems surrounding shareholder participation in reorganization cases. An important voice in the genesis of Chapter X was that of future Supreme Court Justice William O. Douglas, whose perspective as Commissioner and Chairman of the Securities and Exchange Commission (SEC) led him to view the plight of innocent dissenting investors as a primary sin in prior reorganization law.31 As a result, Chapter X required the appointment of a trustee in cases that presented the greatest likelihood of injury to such investors. Thus, debtors having more than $250,000 in liquidated and noncontingent debt were required to be controlled by a trustee during reorganization.32 Additional safety for investors was provided through the involvement of the SEC, which gave advice and provided detailed review and comment on plans involving corporations with debt in excess of $3 million.33

Despite increased oversight and frequent trustee appointments, it was accepted that control over the corporate entity should continue in the hands of shareholders in Chapter X reorganizations.34 Shareholders remained in control of the election of directors and, thus, over those in control of the debtor—the officers of the corporation.35 This power was, however, subject to judicial scrutiny in

30. See 11 Remington, supra note 11, § 4345.1.
32. 11 U.S.C. § 156 (1976) (repealed 1978); 6 Collier, supra note 9, at 103.
34. 6 Collier, supra note 9, ¶ 8.15, at 1434 ("[Judicial control] should be exercised with due regard to the general proposition that democracy in reorganization demands that stockholders, at least, should be permitted representation by directors of their selection."); 11 Remington, supra note 11, § 4368.1, at 53.
35. See 6 Collier, supra note 9, ¶ 8.15, at 1434.
that court approval of those selections was required.\textsuperscript{36}

Substantively, shareholder interests could be cancelled in a Chapter X reorganization plan under the absolute priority rule.\textsuperscript{37} This rule prohibited shareholders—or other junior classes—from retaining an interest in a reorganized debtor, or obtaining other compensation in a plan of reorganization, when senior classes were not paid in full.\textsuperscript{38} As applied in Chapter X, compliance with the absolute priority rule required that the assets of the estate be valued at the time of plan confirmation.\textsuperscript{39} Unless they contributed "new value," shareholders of an insolvent debtor were not entitled to receive anything under a Chapter X reorganization plan.\textsuperscript{40}

While Chapter X provided a basis for the development of the current treatment of shareholders, the concept of the debtor in possession, which has had substantial impact on present reorganization law and on the control presently exerted by shareholders in reorganizations, was developed in Chapter XI.\textsuperscript{41} Chapter XI allowed for the reorganization of corporate entities other than those covered by Chapter X—primarily nonpublic corporations. Its basic structure was derived from sections 12 and 74 of the 1898 Act, which dealt

\begin{itemize}
\item \textsuperscript{36} See 11 U.S.C. § 191 (1976) (repealed 1978); 6 COLLIER, supra note 9, ¶ 8.15.
\item \textsuperscript{37} See 11 U.S.C. § 216(8) (1976) (repealed 1978); Miller, supra note 17, at 1060-61 ("Chapter X reorganizations were governed by the old "fair and equitable" rule, which required satisfaction of claims on the basis of strict priority . . . ."). The absolute priority rule was recognized long before Chapter X was enacted. See Railroad Co. v. Howard, 74 (7 Wall.) U.S. 392, 410-11 (1868).
\item \textsuperscript{39} See 11 REMINGTON, supra note 11, § 4571 ("Without such valuations the court cannot determine the feasibility of plans or apply the strict liability rule to allotments of securities made by plans.").
\item \textsuperscript{40} See Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106, 122 (1939) ("[T]o accord 'the creditor his full right of priority against the corporate assets' where the debtor is insolvent, the stockholder's participation must be based on a contribution in money or money's worth, reasonably equivalent in view of all circumstances to the participation of the stockholder."). The subject of the absolute priority rule and the so called "new value" exception to this rule have been widely discussed and analyzed in recent scholarly endeavors. See, e.g., Sara A. Austin, New Value Exception: (Wanted) Dead or Alive—Viability of the "New Value" Exception to the Absolute Priority Rule Under Bankruptcy Code § 1129(b)(2), 96 DICK. L. REV. 189 (1992) (discussing whether § 1129(b)(2) of the Bankruptcy Code has eliminated the new value exception to the absolute priority rule); John D. Ayer, Rethinking Absolute Priority After Ahlers, 87 MICH. L. REV. 965 (1989); Lynn M. LoPucki & William C. Whitford, Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies, 139 U. PA. L. REV. 125 (1990) (discussing the history of the absolute priority rule and surveying its use, or non-use, in the bankruptcy reorganization process); Markell, supra note 20, at 90-101 (discussing the absolute priority rule and the new value exception); Raymond T. Nimmer, Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions, 36 EMORY L.J. 1009 (1987).
\item \textsuperscript{41} See 9 REMINGTON, supra note 11, § 3564, at 198.
\end{itemize}
with compositions. At least in theory, the rights of shareholders were to be unaffected by a Chapter XI reorganization plan. As a result, the SEC generally had no involvement in the typical Chapter XI case unless there were "numerous and scattered" shareholders. Thus, issues of shareholder control and related disputes rarely arose in Chapter XI cases.

The reorganization provisions of the Bankruptcy Act survived until the enactment of the Bankruptcy Code in 1978, which effected another substantial revision of reorganization law. Conceptually, Chapter 11 of the Bankruptcy Code is a consolidation of Chapters X and XI of the Bankruptcy Act. Under Chapter 11, a trustee is no longer routinely appointed in large cases, the intimate involvement of the SEC is jettisoned, and the role previously played by the SEC is, to a considerable extent, placed in the new administrative overseer of the bankruptcy process, the United States Trustee. One reason for the decreased role of the SEC was a perception that the abuses that previously plagued minority shareholders no longer existed.

The substantive rights afforded to shareholders in the reorganization process were modified by Chapter 11. Unlike in Chapter X, there is no automatic application of the absolute priority rule to a Chapter 11 plan of reorganization. The rule is only applied when there is a dissenting vote by a class of impaired claims or interests,

42. *See id.* at 199 & n.5. "Compositions" are agreements between a debtor and creditors in which the latter agree to accept less than the whole amount of their claims in complete discharge and satisfaction of their claims.

43. Miller, *supra* note 17, at 1061 (noting that under Chapter XI, "[s]hareholder interests could not be reduced or cancelled unless the debtor corporation proposed it"); 9 *REMINGTON*, *supra* note 11, § 3615.

44. 9 *REMINGTON*, *supra* note 11, § 3615, at 261 (citing SEC v. U.S. Realty & Improv. Co., 310 U.S. 434 (1940)).

45. *See 11 U.S.C.* § 1104(a) (providing for the appointment of a trustee by the court "for cause" or where such appointment is in the interests of creditors or equity security holders); *id.* § 1107 (stating that, in the absence of a court-appointed trustee, the debtor in possession shall have all the rights and powers granted to a trustee under Chapter 11); *id.* §§ 1102, 1103 (1988) (providing for the appointment of creditors' and equity holders' committees to supervise the administration of Chapter 11 cases).

46. *See COMM'N REP.*, *supra* note 31, at 103-56 (recommending that Congress create an agency known as the "United States Bankruptcy Administration," whose principal executive officer would be an Administrator, to perform functions previously delegated to the SEC under Chapter X of the Bankruptcy Act).

47. Mark E. Budnitz, Corporate Governance When a Firm is in Chapter 11 (1991) (presentation to the National Bankruptcy Conference).

or a plan is deemed to be rejected by such a class. Unlike in Chapter X, therefore, valuation of the assets of the estate is not always required for confirmation of a Chapter 11 plan. Valuation occurs only when there is dissent or deemed dissent by a class of claims or interests, and even then only infrequently.

In Chapter 11, as under Chapter X, the procedural rights of shareholders—the right to hold meetings, to vote and to replace the board of directors—remain with the shareholders. There is no requirement, however, that directors chosen by the shareholders be approved by the court, although the court can exercise control over the choice of directors.

One of the major issues in the history of corporate reorganization law has been the appropriate role of shareholders in the reorganization process. There has been substantial controversy over the economic interests that shareholders may retain in the reorganized corporation, resulting in conflicts between shareholders and other classes of claimants, most notably, unsecured creditors. These economic conflicts are played out not only in legislatures and dispassionate courtrooms, but also in vehement battles in boardrooms, in shareholders' meetings, and across conference tables.

II. HISTORY OF SHAREHOLDER PROCEDURAL RIGHTS

Throughout the changes in focus and substance of reorganization law, one constant has remained: the solicitude of the legislature and the courts toward the shareholders' right to control the operation and direction of the corporation by holding shareholder meetings, choosing the board of directors, and otherwise exercising rights of corporate democracy derived from state and federal law. Legislators and judges generally assume, without question, that such rights should be preserved even after the filing of bankruptcy and the insolvency of the corporation. They envision these rights as embodying state and federal policies worthy of protection and thus

49. See id.; see also infra note 61 and accompanying text. For a discussion of the absolute priority rule, see supra notes 37-40 and accompanying text. A plan is deemed to be rejected by a class if the plan does not entitle the holders of claims or interests in that class to receive or retain any property. See 11 U.S.C. § 1126(g).

50. See Miller, supra note 17, at 1087-88 ("Under Chapter 11, there is no court approval of a plan before it is submitted for a vote, and no valuation until and unless the proceedings reach the cramdown stage, or unless it is required in connection with disclosure.").

51. See infra notes 78-199 and accompanying text.

52. See infra note 232 and accompanying text.

53. See infra notes 78-218, 327-350 and accompanying text.
shield them from attack.\textsuperscript{54} Attempts to limit these control rights are met with the retort that there is no evidence of an intent in Congress to change the long-established rules protecting the rights of shareholders in reorganization cases.\textsuperscript{55} This deference to shareholder rights developed early in the case law\textsuperscript{56} and has continued unabated to the present.\textsuperscript{57}

The rights retained by shareholders in Chapter 11 are primarily those created by state law: the right to hold annual and special meetings, to vote for and select a board of directors satisfactory to shareholders, to oust present management, and to vote on or participate in certain corporate actions, such as major asset sales.\textsuperscript{58} This bundle of rights, hereafter referred to as shareholder "control rights," assumes nearly theistic and immutable status in the case law, where exceptions to the continuance of these rights are rarely admitted.\textsuperscript{59} Yet, other than ethereal references to the primacy of these rights under state law and the sometimes-veiled prayer to "democracy," the conceptual logic for this reverence of shareholder rights, if it exists at all, is disguised in the case law.

III. Analysis of Shareholder Control Rights

The primary issues surrounding shareholder control rights in Chapter 11 have their genesis in corporate class conflict. Assume, for example, a large corporate Chapter 11 debtor in possession with

\textsuperscript{54} Cf. Gerber, supra note 31, at 341-47 & n.176 (noting the well-recognized rule that "[u]nless some federal interest requires a different result, there is no reason why [property interests created by state law] should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding").

\textsuperscript{55} Id.

\textsuperscript{56} See, e.g., Graselli Chem. Co. v. Aetna Explosives Co., 252 F. 456, 460-62 (2d Cir. 1918) (sustaining the right of the shareholders to meet and elect a new board of directors while the corporation was in receivership); O'Gara v. New York Cent. R. Co. (In re O'Gara Coal Co.), 260 F. 742, 744-45 (7th Cir. 1919); Van Siclen v. Bush (In re Bush Terminal Co.), 78 F.2d 662, 663-64 (2d Cir. 1935) (protecting the right of a shareholder to examine stockbooks, obtain a list of shareholders, and call a stockholders' meeting while the corporation is in bankruptcy); In re J.P. Linahan, Inc., 111 F.2d 590 (2d Cir. 1940) (recognizing the shareholders' paramount right to control corporate policy during a bankruptcy case).

\textsuperscript{57} See, e.g., In re Central Ice Cream Co., 836 F.2d 1068, 1072 (7th Cir. 1987) (finding that a trustee acted improperly in failing to take into account the interests of shareholders when negotiating the settlement of a claim); Committee of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.), 722 F.2d 1063, 1070 (2d Cir. 1983) (recognizing that protection of investors is a primary goal of the current reorganization provisions).

\textsuperscript{58} See infra notes 78-218, 327-350 and accompanying text.

\textsuperscript{59} For the most extreme statement of these rights, consider Saxon Indus. v. NKFW Partners, 488 A.2d 1298, 1301 (Del. 1984) (describing such rights as "virtually absolute"). See also infra notes 78-218 and accompanying text.
a substantial and active group of shareholders. Through its management team, the debtor negotiates a plan of reorganization with its major creditor constituencies and is expected to present the proposed plan to the bankruptcy court. Shareholders, aware of this plan and its terms, are involved in the negotiating process, but they believe that a plan can be formulated that treats their interests more favorably. This “better” plan, however, would delay payments to creditors, reduce amounts payable to unsecured creditor groups, and provide more favorable treatment for shareholders.

Shareholders in this situation have several alternatives under present law. First, the shareholders could do nothing. They might resign themselves to the potential loss of their entire investment or trust the system to protect any remaining rights they may have. If the potential economic benefit from taking action exceeds its detriment and expense, however, doing nothing will be unacceptable to the shareholders.

Second, shareholders could participate in the plan confirmation process by voting against the plan and objecting to its confirmation by the bankruptcy court.60 If the debtor is insolvent, however, such a strategy would fail to realize any value for shareholders because their rejection of the plan would result in application of the absolute priority rule against them; to the extent that shareholders receive anything under the plan, they are receiving more than they are entitled to under the Bankruptcy Code, and have no right to complain of unfair treatment.61 Even in the unusual, and potentially hard-to-prove, case where the debtor is solvent, the plan may still provide shareholders with more, depending on the value of the estate’s assets, than they are entitled to under the Code.

Third, shareholders can exercise their voting and other control rights in the corporation. These rights may be exercised through a regular annual shareholders’ meeting, if such a meeting is scheduled, or at a special meeting obtained on demand through state law

61. When a class of creditors or interest holders vote against a plan or are deemed to have voted against a plan under 11 U.S.C. § 1126(g), the “cram down” provisions of Chapter 11 determine whether the plan may be confirmed. See id. § 1129(b). Cram down basically requires application of the absolute priority rule to the dissenting class. See supra notes 40, 48-50 and accompanying text. In the case of equity security holders, the plan may be “crammed down” as to such a class—that is, confirmed over their objection—only if the shareholders receive any fixed liquidation preference to which they are entitled, or the redemption price of their stock, or if no class junior to the shareholder class is paid anything under the plan. 11 U.S.C. § 1129(b)(2)(C) (1988).
entitlements. The ultimate goal of this alternative is to elect sympathetic directors committed to a platform advancing the shareholders' interests. Shareholder exercise of these rights frequently results in a delay of the reorganization process which, in turn, causes other groups with a stake in the reorganization process, particularly creditor groups, to feel compelled to make further concessions to the shareholders. For shareholders, this tactic has an advantage over other alternatives in that it promises a potentially significant return without the risk associated with a judicial determination of shareholder entitlements that would result from a confirmation battle. After undertaking this sort of analysis, shareholders often opt for this alternative.

As indicated above, in the event that shareholders choose to try to dislodge present management through exercise of their control rights, they will generally accomplish this through annual or special shareholders' meetings. Typically, however, incumbent management will not have called annual meetings in this situation, perhaps to avoid shareholder modifications of intricate, management-negotiated plans. This, in turn, will force shareholders to attempt to compel annual or special meetings, often against the opposition of creditors. Present management is usually opposed to shareholders engaged in such machinations, believing that the negotiated plan is workable and fair to all parties, including shareholders. Faced with a shareholder insurgency, present management will defend its ground in the bankruptcy court, customarily through efforts to enjoin the proposed shareholder action.

It is upon this canvas that the rights of shareholders to control the corporate Chapter 11 debtor in possession are painted. The

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62. Shareholders are generally entitled to hold annual meetings. See, e.g., Del. Code Ann. tit. 8, § 211(b) (1991); Revised Model Business Corp. Act § 7.01 (1991). Shareholder rights to special meetings are illustrated by the Revised Model Business Corp. Act § 7.02(a)(2) (1991). See also Del. Code Ann. tit. 8, § 211(c) (1991) (providing shareholders with the right to compel a shareholders' meeting through judicial proceedings if one has not been held within 30 days after the designated time for the meeting or within 13 months after the last annual meeting).

63. For a discussion of shareholders' abuse of the right to hold meetings and of the shareholder franchise, as well as extortionist shareholder tactics, see LoPucki & Whitford, supra note 40, at 141-64; discussion infra Part IV.D.

64. Shareholders are not always successful in the use of this alternative and may face the same confirmation battle occurring under the second alternative when faced with intransigent or self-righteous creditor groups willing to challenge the attempts of shareholders to obtain additional rewards. See, e.g., In re Evans Prods. Co., 65 Bankr. 31 (Bankr. S.D. Fla. 1986) (cramming down a zero payment plan against an active, aggressive shareholder group).

65. See infra notes 80-194 and accompanying text.
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battleground is thus set for determination of the rights of shareholders to control the course of the corporate Chapter 11 case. The remainder of this Article will analyze the reaction of the courts to this issue under present law and propose a solution to the dilemmas created by this judicial reaction.

A. Applicability of the Automatic Stay

If we posit a Chapter 11 case in which the shareholders attempt to compel, by judicial proceedings, the holding of a shareholders' meeting for the purpose of ousting present management, it might be assumed that, absent any preconceived prejudice toward permitting such action, the Bankruptcy Code's automatic stay provision, 11 U.S.C. § 362(a), would prevent such activity. It is not irrational, to put the matter mildly, to suppose that such an attempt by the shareholders falls within the prohibitions of the automatic stay.

Turning first to the initial subsection of 11 U.S.C. § 362, one might consider whether the shareholders' efforts are barred because they constitute the "commencement . . . of . . . [an] action or proceeding . . . to recover a claim against the debtor that arose before the commencement of the case under this title." Upon reflection, however, it is apparent that this prohibition does not apply because

66. Section 362(a) states in relevant part that:
[A] petition filed under section 301, 302, or 303 of this title, . . . operates as a stay, applicable to all entities, of
(1) the commencement or continuation, including the issuance or employment of process, of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title, or to recover a claim against the debtor that arose before the commencement of the case under this title;
(2) the enforcement, against the debtor or against property of the estate, of a judgment obtained before the commencement of the case under this title;
(3) any act to obtain possession of property of the estate or of property from the estate or to exercise control over property of the estate;
(4) any act to create, perfect, or enforce any lien against property of the estate;
(5) any act to create, perfect, or enforce against property of the debtor any lien to the extent that such lien secures a claim that arose before the commencement of the case under this title;
(6) any act to collect, assess, or recover a claim against the debtor that arose before the commencement of the case under this title;
(7) the setoff of any debt owing to the debtor that arose before the commencement of the case under this title against any claim against the debtor; and
(8) the commencement or continuation of a proceeding before the United States Tax Court concerning the debtor.

67. Id. § 362(a)(1).
a claim is defined in the Code as a creditor claim, or right to payment, as distinguished from an "interest" held by an equity security holder, or shareholder. This same obstacle lies in asserting that such shareholder action should be barred by 11 U.S.C. § 362(a)(6), which similarly prohibits only acts to collect on a "claim." More fruitful ground is presented by the automatic stay's third subsection, which provides that any entity is prohibited from "any act to ... exercise control over property of the estate." This provision does not suffer from the difficulty of applying only to "claims"; it prohibits conduct of a very broad nature, the exercise of "control" over property of the estate—the presumed goal of the shareholder action.

Shareholder interests may argue that this provision is intended to prohibit only actions of creditors to exercise control over specific property of the estate in which they claim an interest. Indeed, the legislative history of this provision may support this view in that it characterizes the purpose of the subsection as a measure to prevent the dismemberment of the estate by creditor action. Nonetheless, this legislative history refers only to the initial portion of the subsection prohibiting the taking of possession of property of the estate, or property from the estate, not the succeeding, and later-enacted, language forbidding exercise of control over property of the estate. Therefore, it is not clear that this legislative history applies to the "control" language in 11 U.S.C. § 362(a)(3).

Is the diffuse exercise of control over property of the estate conceivably the type of action intended to be prevented by this subsection? In exercising their control rights by calling a special or annual meeting, the shareholders are attempting, indirectly, to gain dominion over property of the estate. Success in this venture will result in the shareholders obtaining a board of sympathetic directors, who will presumably exercise control over corporate affairs in a manner favorable to those shareholders. The exercise of corporate control is not abstract political control, but direct control over assets of the estate. Because a corporation is exclusively an economic entity, whose only purpose is the realization of a return on its assets,

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68. See id. § 101(16).
69. See supra note 66.
control over a corporation can only be exercised through domination of those assets.73 Therefore, an attempt to hold a shareholders' meeting during the pendency of a bankruptcy case is an act to exercise control over assets of the estate, which is theoretically prohibited by 11 U.S.C. § 362(a)(3).74

If this interpretation appears to be contrary to our conception of the bankruptcy process, consider a situation in which a creditor attempts to exercise the same type of control during the pendency of a bankruptcy case—for example, by seeking the appointment of a receiver to control an asset of the corporation. One can hardly deny that this is a violation of the automatic stay.75 Yet, permitting shareholders to exercise their control rights results in the same exercise of control as would occur upon the appointment of a receiver. In fact, the shareholders' exercise of their control rights is even more pervasive and complete than the control of a single asset by a receiver.

Although not illogical, this sort of analysis is inexplicably absent in the case law.76 The right of shareholders to hold meetings for the purpose of ousting present management has not been thoroughly tested under the automatic stay, although at least one court has made a vague suggestion that the stay could potentially be applied.77 Courts have apparently assumed—without substantial argument, and perhaps based on the various normative arguments in...

73. Criticism might be leveled at this argument on the grounds that, if the attempted shareholder control of corporate operations violated the automatic stay, then the exercise of such rights by present management is violative of § 363(a)(3). There is, however, a difference. The acts prohibited by § 362(a)(3) must be acts by persons not in control of property of the estate at the time of the filing of the bankruptcy petition. See H.R. Rep. No. 595, 95th Cong., 1st Sess., 341 (1977), reprinted in 1978 U.S.C.C.A.N. 5963. For example, if a secured creditor were in possession of property of the estate through a pledge, or through prepetition foreclosure, and the debtor no longer had possessory rights in the property, the continued postpetition control of the property by the creditor is not in violation of the automatic stay as an act to obtain control of property of the estate. Such an "act" requires postpetition action. See id. Of course, the debtor in possession might be able to force the creditor to turn over such property under 11 U.S.C. § 542(a) (1988), but this is a different issue.

74. There is some sentiment that the 1984 amendment to § 362 incorporating the "control" language was well-intentioned but overbroad, permitting pervasive, unwarranted application of the stay to actions not originally intended to be within the jurisdiction of the bankruptcy courts. See United States v. Inslaw, Inc., 932 F.2d 1467, 1472-73 (D.C. Cir. 1991), cert. denied, 112 S. Ct. 913 (1992). Nonetheless, until the language is changed, it is open to the proposed interpretation.

75. See 11 U.S.C. § 362(a)(1); supra note 66.
76. See infra cases discussed in notes 79-194.
77. See Manville Corp. v. Equity Sec. Holders Comm. (In re Johns-Manville Corp.), 52 Bankr. 879, 887 (Bankr. S.D.N.Y. 1985) (suggesting that the use of control rights to gain leverage over other constituencies, who are subject to § 362 but who enjoy priority in the Code's distributional scheme, is inappropriate), aff'd, 60 B.R. 842 (Bankr. S.D.N.Y.
favor of the free and democratic exercise of shareholder control rights in nonbankruptcy contexts—that the automatic stay does not apply to shareholder control rights. Having avoided this issue, the case law focuses on the next level of analysis, whether the debtor in possession has the right to prohibit the exercise of shareholder control rights through injunctive relief.

B. The Standard for Imposition of an Injunction Restricting Exercise of Shareholder Control Rights

1. Development of the Clear-Case-of-Abuse Standard.—Faced with a request by present management for injunctive relief to permit them to remain in control of a debtor in possession during an insolvency case, and thus to deny shareholders the right to oust them at a shareholders’ meeting, the courts have applied one primary standard for determining whether such injunctive relief should be granted:78 the “clear case of abuse” test. This test was created in In re J.P. Linahan, Inc.,79 in the context of a Chapter X reorganization, but, not surprisingly, it has theoretical antecedents in equity receivership cases.

Although not cited by the Linahan court, one of the most famous early cases dealing with shareholder control rights in a reorganization case is Graselli Chemical Co. v. Aetna Explosives Co.80 In Graselli, equity receivers had been appointed to control and operate the business of a presumably solvent explosives manufacturer.81 Certain common stockholders of the corporation believed that preferred shareholders intended to propose a debt readjustment plan for the receivership that treated the common stockholders unfairly.82 The preferred shareholders intended to accomplish this result by exercising temporarily available voting rights at a meeting of

1986), rev’d, 801 F.2d 60 (2d Cir. 1986). See discussion infra notes 123-161 and accompanying text.

78. It is important to note that the power to restrain shareholder action is not necessarily restricted to the bankruptcy or insolvency context. Even absent insolvency, courts have the power to restrain shareholders from exercising control rights where their acts would constitute waste, or the like. Davidson v. American Blower Co., 243 F. 167, 170-71 (2d Cir. 1917) (enjoining majority shareholders from voting their stock where the result would be waste of corporate property and restraint of competition in the industry).

79. 111 F.2d 590 (2d Cir. 1940).
80. 252 F. 456 (2d Cir. 1918).
81. Id. at 457.
82. Id. at 459.
shareholders. The receivers of the corporation requested an injunction against the preferred shareholders' proposed action.

The Court of Appeals for the Second Circuit affirmed a lower court order enjoining the preferred shareholder action. In reaching this conclusion, the court relied on the theory that, while a corporation is in receivership, the board of directors' power to conduct the affairs of the corporation is suspended, and the power of the shareholders to exercise otherwise existing rights may be similarly restrained. Without enunciating the standard it applied in granting the injunction, the court declared that its general equity power gave it the ability to prevent an action potentially injurious to common stockholders, even where that harm would arise from the valid exercise of voting rights by another class of security holders.

In O'Gara v. New York Central Railroad Co. (In re O'Gara Coal Co.), decided one year after Graselli, the Seventh Circuit was quick to note that while courts may, in some circumstances, limit the shareholders' exercise of their state law rights of control over a corporation in bankruptcy, the shareholders ordinarily retain these rights in the absence of explicit court orders to the contrary. In O'Gara, the primary shareholder challenged the ability of the board of directors to consent to a composition plan in a bankruptcy case on the basis that after the filing of a bankruptcy petition and the appointment of a trustee, the board had no authority to act on behalf of the corporation. To this contention, the court responded:

The provisions in the Bankruptcy Act providing for a composition clearly indicate that the Congress did not intend to deny to corporations the right to protect their own

83. The preferred shareholders would have had voting rights because of a default in the payment of dividends. Id. at 458.
84. Id.
85. Id. at 462.
86. The court stated:

The order appointing the receivers placed the corporation in the custody and control of the court. It placed the receivers under the admonition, direction, and guidance of the court. . . . The appointment of the receiver supersedes the power of the directors to carry on the business of the corporation, and the receivers take possession of the corporation, its books, its records, and assets. . . . The court's power to take from the directors their right to direct can also, while in control, restrain action by the stockholders, when it deems it for the best interests of all concerned to do so.

Id. at 459.
87. Id.
88. 260 F. 742 (7th Cir. 1919).
89. Id. at 744-45.
90. Id. at 744.
interest, including the right to elect directors. To give the bankrupt companies the right to propose compositions is inconsistent with a denial of the right of stockholders and directors to maintain the corporate existence and to take action necessary to the submission of such proposals. Nor does the right of the court to control the affairs of the company, as was done in [Graselli] deny to the stockholders the right to act in case the court fails or refuses to exercise its supervisory power.91

The equitable power of the court to limit the exercise of shareholder control rights was thus found to be limited. This limitation on the power of the courts to interfere with the exercise of control rights is also illustrated by Van Siclen v. Bush (In re Bush Terminal Co.),92 a case involving a stockholder's request to examine the stockbook of a corporation seeking reorganization under Section 77B of the former Bankruptcy Act.93 The stockholder's purpose in seeking the stockbook was to call a shareholders' meeting. The lower court denied the stockholder's application for the right to review the stockbook,94 but the Second Circuit reversed, noting the extraordinary character of the relief it had approved in Graselli.95 It was only in the rare case, the court warned, that such power to limit shareholder rights should be exercised.96 In analyzing the application of Graselli to the facts before it, the Bush Terminal court stated that:

A court of equity or bankruptcy may enjoin any action which would tend to defeat or impair its jurisdiction. . . . This power in the court is extraordinary and should be exercised only where the harm, likely to flow from the stockholders' action, is more real than here, and disproportionate to the good obtainable. . . . If the right of stockholders to elect a board of directors should not be carefully guarded and protected, the statute giving the debtor a right to be heard or to propose a plan of reorganization could not truly be exercised, for the board of directors is the representative of the stockholders.97

91. Id. at 744-45 (citations omitted).
92. 78 F.2d 662 (2d Cir. 1935).
93. Id. at 663. See supra notes 26-28 and accompanying text.
94. See Bush Terminal, 78 F.2d at 663.
95. Id. at 664-65.
96. Id. at 665.
97. Id. (citation omitted).
Bush Terminal, therefore, added to the Graselli analysis a new standard for determining whether an injunction will be granted to prohibit shareholder exercise of control rights. This standard requires a balancing of the harm that would result from permitting the shareholder action against the benefits attainable through exercise of shareholder rights. If the balance favors allowing the proposed shareholder action, injunctive relief will be denied; if the balance shows substantial potential injury to the rights of interested parties, injunctive relief will be granted.

Although this early case law is rather vague concerning the standard to be applied in determining whether to grant an injunction, it does reveal a tendency that continues to the present day—injunctive relief against the exercise of shareholder rights is granted rarely, in only extraordinary cases.

It was within this conceptual framework that the court in In re J.P. Linahan, Inc. fashioned the "clear case of abuse" test. In Linahan, a Chapter X case, the majority shareholder of the debtor corporation requested that the court permit an annual meeting of shareholders during the pendency of the case; at the same time, the shareholder sent out a notice of a special meeting of shareholders for the purpose of attempting to obtain a vote to dismiss the case. Because it was clear that the shareholder’s ultimate motive was to convert the case from one under Chapter X to one under Chapter XI, the petitioning creditors requested an injunction to block the special meeting. The lower court granted this relief and prohibited the special meeting, while simultaneously denying the shareholder’s request for an annual meeting.

The Second Circuit reversed, stating that:

As to such matters the right of the majority of stockholders to be represented by directors of their own choice and thus to control corporate policy is paramount and will not be disturbed unless a clear case of abuse is made out.

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98. See Budnitz, supra note 3, at 1251-53 (discussing the two-prong balancing test set forth in Bush Terminal).
99. For one early, but post-Linahan, case denying shareholders an affirmative injunction, see Bailey v. Proctor, 160 F.2d 78 (1st Cir. 1947) (affirming the district court’s refusal to call a special shareholder meeting in an equity receivership case), cert. denied, 331 U.S. 834 (1947).
100. 111 F.2d 590 (2d Cir. 1940).
101. Id. at 591.
102. Id. See supra text accompanying notes 29-44.
103. Linahan, 111 F.2d at 591.
104. See id.
This has been the rule all along in equity receivership, in ordinary bankruptcy and in proceedings for reorganization under former section 77B of the Bankruptcy Act, where the corporate property was in control of receivers or trustees. . . . The controversy [in the present case] had to do with the type of reorganization to which the corporation should submit. On an issue of that kind the stockholders are entitled to elect directors who will abide by their wishes, provided of course the directors chosen are not persons who will injure the honest and efficient management of the corporate property.¹⁰⁵

Thus the Linahan court reached the conclusion that the lower court erred in divesting shareholders of their control rights. The court acknowledged that, while it had the power to approve or disapprove the appointment of officers or directors of the debtor, this power did not extend beyond determining that the debtor was properly managed and did not, in the typical case, call for restraining the exercise of shareholder rights.¹⁰⁶ Certain rights and certain fundamental determinations, such as the appropriate chapter of the Bankruptcy Act under which to proceed, were left unimpaired in the hands of the shareholders.¹⁰⁷ The Linahan court made it clear, however, that its decision did not impair the jurisdiction of the court to control management of the debtor, because regardless of the shareholders’ actions, the debtor remained before the reorganization court and subject to its authority.¹⁰⁸

Although the court in Linahan stated that the standard it enunciated arose out of prior case law, there is no explicit statement of the clear-case-of-abuse standard in the cases the court cited for this proposition.¹⁰⁹ Moreover, having stated the standard, the court left its elucidation to subsequent case law. One could argue, however, that the court intended to follow the previous balancing standard,
due to its reference to *Bush Terminal* and other prior cases that can be characterized as conforming to such a standard.¹¹⁰

Since *Linahan*, the clear-case-of-abuse test has developed as the primary analytic tool in determining whether a proposed action by shareholders will be enjoined in bankruptcy. Stating the words "clear case of abuse," however, fails to invoke content. It is only through analysis of subsequent case law, which has followed and developed the clear-case-of-abuse test,¹¹¹ that one can potentially make sense of this standard for the granting of injunctive relief.¹¹²

2. Content of the Clear-Case-of-Abuse Test.—Judicial reluctance to enjoin shareholder control rights, as evidenced by the very few cases allowing injunctive relief as well as the stringent nature of the test for obtaining such relief, is frequently justified by a supposed lack of jurisdiction in the court to interfere with the exercise of such rights.¹¹³ It is not apparent, however, what is meant by the conclusory statement that it is beyond the court's jurisdiction to enjoin the exercise of these rights. No particular statutory provision is in-

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¹¹⁰ See *supra* notes 92-98, *infra* note 184 and accompanying text.

¹¹¹ See, e.g., *In re* Gaslight Club, Inc., 782 F.2d 767 (7th Cir. 1986) (recognizing the applicability of the clear-case-of-abuse test in reviewing the bankruptcy court's appointment of a "responsible officer" to replace the board of directors and officers chosen by the shareholders); *In re* Potter Instrument Co., 593 F.2d 470, 475 (2d Cir. 1979) (denying shareholders' petition for a special meeting to elect new directors during the pendency of a Chapter XI case); Resolution Trust Corp. v. Allied Stores Corp. (*In re* Federated Dep't Stores, Inc.), 133 B.R. 886, 892-95 (S.D. Ohio 1991) (upholding the extinguishment of preferred shareholders' right to vote their shares and elect directors to the debtor's board of directors). See also *infra* notes 115-181 and accompanying text. The test has also been the subject of scholarly comment. See *Budnitz, supra* note 3, at 1246-51.

¹¹² There is something curious about this standard. It is easy to forget that it is a standard for the issuance of a preliminary injunction. The requirements for a preliminary injunction are well known: a showing of irreparable harm, of the lack of an adequate legal remedy, and of likelihood of success on the merits. *See, e.g.*, Reynolds v. International Amateur Athletic Fed'n, 112 S. Ct. 2512 (1992) ("The dispositive questions . . . are, first, whether applicant has established a probability of success on the merits, and second, whether the availability of a damages remedy precludes a finding of irreparable harm."). This standard may be stated with slight variation by other courts. *See, e.g.*, State Dep't of Health & Mental Hygiene v. Baltimore County, 281 Md. 548, 554, 383 A.2d 51, 55 (1977) ("[A] proper exercise of discretion [in granting or refusing a writ of injunction] requires the court to consider four factors: likelihood of success on the merits; the 'balance of convenience'; irreparable injury . . .; and, where appropriate, the public interest."). It is not entirely clear why the same standard is not applied in shareholder meeting cases. See *infra* notes 195-199 and accompanying text.

voked to justify this result.\textsuperscript{114} Perhaps there is an intuitive feeling that it is beyond the power of a bankruptcy or other federal court to rule on purely state corporate law issues when there is no obvious federal interest or reason for interference.\textsuperscript{115} Whatever the basis, the notion is wrong, at least at its edges. It is beyond denial, for instance, that the rights of shareholders to exercise control rights can be judicially limited when there is a threat to the existence of the corporation or to its reorganization.\textsuperscript{116}

Underlying the concern expressed over the rights of shareholders in bankruptcy is undoubtedly a conviction that there are strong state and federal policies supporting the free exercise of the shareholder franchise. At the state level, the source of this policy is state corporate law forming and fostering shareholders' voting rights.\textsuperscript{117} As a federal matter, the sources of the policy are the securities laws\textsuperscript{118} and 28 U.S.C. § 959, which requires trustees and debtors in possession to comply with applicable state laws during the course of bankruptcy cases.\textsuperscript{119}

Whether explicit or implicit, these policies, to some extent, all have their basis in some conception of "corporate democracy," and through this concept shareholder control rights are generally protected notwithstanding the filing of a petition in bankruptcy.\textsuperscript{120} In fact, one court has taken the extreme position that these rights are "virtually absolute" and are unaffected by the insolvency of a

\textsuperscript{114} See cases cited supra note 113.
\textsuperscript{115} This view may have been a premonition of Justice Brennan's opinion in Northern Pipeline Construction Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982), in which the Court held that Congress's delegation of the adjudication of state-created "private rights" to the non-Article III bankruptcy courts was unconstitutional. \textit{Id.} at 71-72.
\textsuperscript{116} See infra notes 122-218 and accompanying text; supra notes 78-113 and accompanying text.
\textsuperscript{119} 28 U.S.C. § 959(b) (1988) states, in relevant part:

\[ \text{[A] trustee . . . appointed in any case pending in any court of the United States, including a debtor in possession, shall manage and operate the property in his possession as such trustee . . . according to the requirements of the valid laws of the State in which such property is situated, in the same manner that the owner or possessor thereof would be bound to do if in possession thereof.} \]
\textit{Id.}
\textsuperscript{120} Haugh v. Industries, Inc. (\textit{In re} Public Serv. Holding Corp.), 141 F.2d 425, 426 (2d Cir. 1944) ("[T]he mere pendency of a petition for reorganization under the Bankruptcy Act does not deprive stockholders of the debtor of the right to hold an annual meeting.").
While the policy basis of the clear-case-of-abuse standard is relatively clear, the elements and focus of the test are less lucid. A general theme in the case law appears to be that the rights of shareholders are to be intruded upon only when there is peril to the orderly administration of the corporation’s estate. This type of analysis is illustrated by the decisions of the bankruptcy court, district court, and the court of appeals in Manville Corp. v. Equity Security Holders (In re Johns-Manville Corp.), a massive and complicated Chapter 11 case dealing primarily with substantial potential future tort claims. In Johns-Manville, the debtor corporation requested an injunction preventing a proposed meeting of shareholders during the pendency of its Chapter 11 case. At the time of the request, most of the interested parties in the case had consented to a proposed plan of reorganization. The shareholders’ committee and certain individual shareholders did not, however, have the same enthusiasm for the plan, due to its dilution of the interests of equity security holders.

In its original consideration of the debtor’s request for an injunction, the bankruptcy court referred to and applied the clear-case-of-abuse test. The court first noted that the shareholders’ right to conduct a shareholders’ meeting is not absolute, but is limited by the clear-abuse test, which the court characterized as limiting the rights of shareholders to meetings when “other considerations”

121. Saxon Indus. v. NKFW Partners, 488 A.2d 1298, 1300, 1302 (Del. 1984). See also Resolution Trust Corp. v. Allied Stores Corp. (In re Federated Dep’t Stores, Inc.), 133 B.R. 886, 892 (S.D. Ohio 1991) (“[T]here is a strong preponderance toward the free exercise by shareholders of all available rights . . . .”).


123. Manville Corp. v. Equity Sec. Holders Comm. (In re Johns-Manville Corp.), 801 F.2d 60 (2d Cir. 1986); Manville Corp. v. Equity Sec. Holders Comm. (In re Johns-Manville Corp.), 66 B.R. 517 (Bankr. S.D.N.Y. 1986); Manville Corp. v. Equity Sec. Holders Comm. (In re Johns-Manville Corp.), 60 B.R. 842 (S.D.N.Y. 1986), rev’d, 801 F.2d 60 (2d Cir. 1986); Manville Corp. v. Equity Sec. Holders Comm. (In re Johns-Manville Corp.), 52 B.R. 879 (Bankr. S.D.N.Y. 1985), rev’d, 801 F.2d 60 (2d Cir. 1986). The detailed analysis of the Johns-Manville cases does not imply that other cases are without significance. These cases are reviewed because the process and permutations of the appeals in Johns-Manville so well portray the strengths and weaknesses of the clear-case-of-abuse test.


125. Id. at 531.

126. Id.

require boundaries on such a meeting.\textsuperscript{128} Application of the test thus entails a search for “other considerations” that compel en-joining a shareholders’ meeting.

The other considerations reviewed by the court fall within two categories. The first category, the shareholders’ motivation in desiring a meeting, was described by the bankruptcy court as follows:

[The Equity Committee’s] present conceded objective is to strengthen its bargaining position and provide additional leverage. At this juncture the effort comes at the expense of an orderly reorganization and the interests of all parties. Simply, the Equity Committee is using the [state action to compel a shareholders’ meeting] to enhance and elevate its role over those other constituencies who are statutorily stayed from dealing with Manville in a non Chapter 11 setting [due to the automatic stay] and who enjoy a higher position in the distribution scheme of bankruptcy.\textsuperscript{129}

The foundation of this portion of the analysis was that shareholders cannot be permitted to use the guise of a shareholders’ meeting to subvert the statutory distribution scheme established by the Bankruptcy Code as expressed in the absolute priority rule.\textsuperscript{130} While the mere request for a meeting did not imply such a motive, this motive was admitted by the Equity Security Holders’ Committee.

The second category of considerations that the Johns-Manville bankruptcy court found to be a basis for granting an injunction was shareholder interference with the administration of the estate and, more specifically, shareholder interference with the reorganization plan favored by the debtor’s existing management. This hindrance to reorganization was exemplified by the waste of resources attendant to the proposed action by the shareholders. The court elaborated on this point as follows:

There is no reason for this Court to countenance the waste of this estate’s resources and therebyjeopardize the reorganization process.

At this time in the Manville proceedings, any shareholder meeting and ensuing proxy fight has the potential to derail

\textsuperscript{128} Id.
\textsuperscript{129} Id. at 887.
the entire Manville reorganization with devastating consequences or at least to delay or halt plan negotiations.

The Manville reorganization comes within the purview of [Delaware corporate law allowing a court to enter appropriate orders to carry out a reorganization plan]. Manville has made great strides in formulating and negotiating a plan of reorganization which is well on its way to being confirmed. A plan has been filed and the protagonists with the exception of the Equity Committee have acknowledged to the court that remaining hurdles are not insurmountable. . . . The holding of a shareholders' meeting at this juncture will seriously jeopardize any attempt at successfully reorganizing Manville.¹³¹

This aspect of the analysis concentrates on the promotion of successful reorganization and the orderly resolution of disputes in the plan process. It is for the court, not a unilateral act of the shareholders, to determine whether the plan meets with the requirements mandated by the Bankruptcy Code. In this connection, the Johns-Manville court noted that a fragile consensus of groups other than shareholders had been reached and might be upset if a shareholders' meeting were permitted.¹³² The court also considered the eventuality that unsatisfactory management installed through a shareholders' meeting, as well as a possible inability to reconstitute a consensus, could potentially destroy an effective reorganization if the immediate plan proposal was not brought to fruition.¹³³

The decision was appealed to the district court.¹³⁴ There, the court engaged in the same sort of analysis as the lower court, concluding that the bankruptcy court correctly analyzed the request for injunctive relief under the clear-case-of-abuse standard.¹³⁵ While it noted that the standard is void of lucid precepts for analysis,¹³⁶ the district court followed the evaluation of the bankruptcy court, noting two bases for finding a clear case of abuse: (1) jeopardy to the reorganization efforts resulting from the shareholders' meeting,¹³⁷

¹³¹ Johns-Manville, 52 B.R. at 888-89.
¹³² Id. at 889.
¹³³ Id. at 888.
¹³⁵ Id. at 850-54.
¹³⁶ Id. at 850 ("Although this rule is settled, clearcut standards regulating the manner of its application are generally lacking. In particular, the precise circumstances that will make out a showing of 'clear case of abuse' have yet to be precisely delineated.").
¹³⁷ Id. at 851-52.
and (2) improper motivation on the part of the shareholders.\textsuperscript{138} The combination of complex issues of massive future tort liability\textsuperscript{139} and the fragile consensus for dealing with these claims caused the reorganization efforts, in the view of the district court, to be subject to unusual pressure and potential destruction by a shareholder meeting.\textsuperscript{140} Without citation to authority, the court also noted that the shareholders' motivation, either to torpedo the reorganization plan or to gain bargaining advantage through the use of a shareholders' meeting, lent further support to its decision to enjoin the proposed shareholder action.\textsuperscript{141}

It was in this context that the \textit{Johns-Manville} case was presented to the Court of Appeals for the Second Circuit,\textsuperscript{142} which reversed and remanded the case for further consideration under the principles it enunciated.\textsuperscript{143} These principles were not, however, an abandonment of the clear-case-of-abuse test but, rather, an attempt to elucidate the standard. The court began its analysis by reintroducing the time-worn doctrine that the right of shareholders to meet, and thereby retain dominion over the board of directors, remains intact after the filing of a Chapter 11 case,\textsuperscript{144} and that it is only in the exceptional case that courts may use their equitable power to enjoin the exercise of these prerogatives.\textsuperscript{145}

The Second Circuit went on to criticize the lower courts' analyses, beginning by derogating the idea that the motives of shareholders in deciding to pursue a shareholders' meeting are a proper basis for granting an injunction.\textsuperscript{146} The development of bargaining power through the shareholder-meeting process, the court reasoned, was a legitimate and acceptable reason for pursuing such ac-
tion. The court stated that in this way, the right of the shareholders to be heard in the reorganization case is realized. The Second Circuit further reasoned that it is only when shareholders are willing to jeopardize the corporation's rehabilitation altogether in their quest to gain more leverage that their motivation rises to the level justifying an injunction.

In attempting to articulate a standard for applying the clear-case-of-abuse concept, the court stated that such abuse exists only if "rehabilitation will be seriously threatened, rather than merely delayed, if [the debtor's] present plan is not submitted for confirmation now." Thus, it is only where shareholders wish to "Kamikaze" the debtor—that is, commit economic suicide and sound the "death knell" of reorganization efforts—that injunctive relief will be granted. The Second Circuit further expanded this concept, not-

147. *Johns-Manville*, 801 F.2d at 65 ("[T]he shareholders' mere intention to exercise bargaining power—whether by actually replacing the directors or by 'bargaining away' their chip without replacing the board... cannot without more constitute clear abuse.").

148. See *id.* at 64-65. The court acknowledged that there are many other ways shareholders can be heard in a Chapter 11 case. *Id.* at 66. Indeed, there was a committee of equity security holders appointed in *Johns-Manville*. In a Chapter 11 case, such a committee is treated as a party in interest, entitled to be heard. *Id.* § 1109(b). See also *In re Meister Brau*, Inc., 355 F. Supp. 515, 517 (N.D. Ill. 1972); *In re Federated Dep't Stores*, Inc., No. 1-90-00130, 1991 Bankr. LEXIS 743, at *6 (Bankr. S.D. Ohio, May 31, 1991), aff'd, 133 B.R. 886 (S.D. Ohio 1991); *In re Texaco*, Inc., No. 1-90-00130, 1991 Bankr. LEXIS 743, at *6 (Bankr. S.D.N.Y. 1988). Nonetheless, the *Johns-Manville* appellate court viewed the other methods of shareholder participation and voicing disapproval, such as requesting appointment of a trustee, to be ineffective substitutes for participation in the negotiation of the plan to be presented by the debtor. *Johns-Manville*, 801 F.2d at 66. This notion that protecting shareholders' rights to participate in the reorganization plan requires that respect be shown for their control rights even in bankruptcy is not a view held exclusively by the *Johns-Manville* court. See, e.g., *Van Siclen v. Bush* (*In re Bush Terminal Co.*), 78 F.2d 662 (2d Cir. 1935).

Curiously, the Second Circuit in *Johns-Manville* ignored the fact that the shareholders were initially invited to participate in the plan process, but were later "cut out" of the negotiations that led to the final plan. *Johns-Manville*, 801 F.2d at 62-63. Moreover, there was nothing inhibiting the equity security holders from requesting permission to propose an independent plan. See 11 U.S.C. § 1121 (1988). Undoubtedly, however, such a plan would have had little possibility of success with the other interest groups as long as the competing plan was viable.

149. *Johns-Manville*, 801 F.2d at 65. In this case, the motivation itself becomes the real threat to the reorganization that is required for injunctive relief.

150. *Id.* at 66.

151. This "death knell" language, quoted by the *Johns-Manville* court, is taken from *In re Potter Instrument Co.*, Inc., 593 F.2d 470 (2d Cir. 1979), in which the Second Circuit found that the clear-case-of-abuse standard was met upon a showing that the shareholders' meeting to elect new directors "might result in unsatisfactory management and would probably jeopardize both [the debtor's] rehabilitation and the rights of creditors and stockholders—sounding the 'death knell' to the debtor as well as the [stockholder] himself." *Id.* at 475.
ing that on remand the lower court "should analyze the real risks to rehabilitation posed by permitting the Equity Committee to call a meeting of shareholders for the purpose of compelling reconsideration of [the debtor's] presently proposed plan."\(^{152}\) Evaluating the record under these standards, the court could not find facts that reached the levels of threat and risk required for injunctive relief.\(^{153}\)

The *Johns-Manville* court did not end its analysis with shareholder motives, however, but went on to add a new element to its clear-case-of-abuse test: a showing of the irreparable harm normally required for injunctive relief.\(^ {154}\) While the case law might have led one to believe that the preliminary-injunction-relief standard lay forgotten and abandoned in the context of shareholders' meetings, the Second Circuit agreed with the shareholders' committee, and concluded that to obtain injunctive relief the traditional showing of irreparable harm was required *in addition to* a showing of a clear case of abuse.\(^ {155}\) In reaching this conclusion, the court acknowledged that although the clear-case-of-abuse and irreparable-harm standards may often overlap, as the case law in this area seems to have implicitly assumed, this overlap does not excuse a failure to apply the traditional test for injunctive relief:

Moreover, as the Equity Committee argues, a finding of clear abuse must be supplemented by a finding of irreparable injury before an injunction may issue. The bankruptcy court seemed to assume that the two inquiries coalesce; after finding clear abuse, it concluded without further analysis that an injunction was necessary to prevent irreparable harm to the reorganization. . . .

Although the inquiries into clear abuse and irreparable injury will likely yield the same result in most if not all cases, an articulated analysis of irreparable injury would achieve a better focus and assist the reviewing court.\(^ {156}\)

The *Johns-Manville* court's view of the clear-case-of-abuse standard teaches several things. First, the test is meant to be objective rather than subjective. The motivations of shareholders are irrelevant to the inquiry unless the motive is destruction of reorganization efforts, in which event the objective standard is met.\(^ {157}\) Second, at

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152. *Johns-Manville*, 801 F.2d at 69.
153. *Id.*
154. *See supra* note 112.
155. *Johns-Manville*, 801 F.2d at 68.
156. *Id.* (citations omitted).
157. *See supra* note 149 and accompanying text.
least in the view of the Second Circuit, the standard requires a finding of palpable danger to the debtor’s potential reorganization before injunctive relief may be granted.\textsuperscript{158} Possible danger or delay are insufficient, and suspect proof cannot alone form the basis for relief. It is only by confronting and meeting the uncompromising burden of displaying the debtor’s incapacity to reorganize if the present plan is thwarted that an interested party can obtain an injunction against shareholder action under the clear-case-of-abuse standard. Third, the clear-abuse standard is not a replacement for the irreparable-harm standard, but is a separate test, used in conjunction with irreparable-harm to determine whether an injunction may issue in shareholder franchise cases.\textsuperscript{159} Thus, a two-step analysis is required: the clear-abuse test must first be met; if it is, the irreparable-harm standard must also be satisfied before relief may be granted.

On remand, the bankruptcy court in the \textit{Johns-Manville} case meticulously evaluated the facts surrounding the debtor’s request for injunctive relief, and again found a clear case of abuse, as well as the newly required irreparable harm under the standards enunciated by the Second Circuit.\textsuperscript{160} In reaching this conclusion, the bankruptcy court found that the following illustrative factors posed a serious threat to the debtor’s reorganization:

(1) \textit{Destruction of the consensus}: The court determined that a shareholders’ meeting for the purpose of electing a new board to remove the proposed plan from consideration would likely unravel the established consensus among the interested parties beyond restoration.\textsuperscript{161}

(2) \textit{Exclusivity termination}: The end of consensus was considered likely to result in termination of the exclusive period\textsuperscript{162} for the debtor to file and obtain acceptance of a plan.\textsuperscript{163}

(3) \textit{Liquidation}: Removing the plan from consideration would also have a significant likelihood of causing parties to refrain from further attempts at reorganization. In turn, this significantly in-

\begin{itemize}
\item \textsuperscript{158} See supra notes 150-152 and accompanying text.
\item \textsuperscript{159} See supra notes 154-156 and accompanying text.
\item \textsuperscript{160} Manville Corp. v. Equity Sec. Holders Comm. (\textit{In re Johns-Manville Corp.}), 66 B.R. 517, 534-42 (Bankr. S.D.N.Y. 1986).
\item \textsuperscript{161} Id. at 536-37.
\item \textsuperscript{162} Where a trustee has not been appointed, the Bankruptcy Code provides for an exclusive period of 120 days after the order for relief in which only the debtor may file a plan. See 11 U.S.C. § 1121 (1988).
\item \textsuperscript{163} \textit{Johns-Manville}, 66 B.R. at 537.
\end{itemize}
creased the possibility of liquidation, 164 which would ultimately re-
sult in a substantial loss in value for all constituencies.

(4) Appointment of a trustee: Termination of present prospects for
a consensual plan might also result in pressure for the appointment
of a trustee, more completely divesting shareholders of control and
threatening the value of the assets of the estate. 165

(5) Management immobilization: Evidence showed that there was
little possibility that new management would be able to rebuild a
consensus, due to the transfigured negotiating postures that would
emerge after a management change. 166 Moreover, even if new man-
agement were able to restore consensus, the value of the debtor's
business would be likely to decline during the inevitable delay. 167

Having established the presence of these factors and an ab-
sence of any mitigating facts, the court concluded that a clear case of
abuse had been made out. 168 Not ignoring the final step of the pro-
cess, the court further determined that, because of the same factors,
the proposed shareholders' meeting would also cause irreparable
harm to the debtor's estate. 169

The Johns-Manville cases represent perhaps the best exposition
of the operation of the clear-case-of-abuse test available. The analy-
sis contained in these cases is not, however, universally accepted.
There are other formulations of the test, other issues that have been
raised in the context of the test, and other permutations of fact that
have led courts to apply wholly different tests. 170 Yet, the true sub-
stance of the test, as in so many others used to resolve troublesome
issues with multifarious policy implications, is judicial discretion, 171
which allows inconsistent results and often takes into consideration
factors other than those enumerated in Johns-Manville.

Not surprisingly, for example, protection of the rights of credi-
tors has been considered as a factor in decisions involving injunc-
tions against the exercise of shareholder rights. 172 Even the Second

164. Id. at 537-38.
165. Id. at 538-39.
166. Id. at 539 ("There has been substantial and this court finds persuasive, credible
testimony that the current negotiating postures of the parties will change significantly in
the face of a new plan of reorganization. For some this will mean a return to positions
held two years ago.").
167. Id. at 540.
168. Id. at 541.
169. Id.
170. See, e.g., infra text accompanying notes 172, 176-195.
171. See In re Public Serv. Holding Corp., 141 F.2d 425, 426 (2d Cir. 1944) (per
curiam).
172. See In re Gaslight Club, Inc., 782 F.2d 767, 770 (7th Cir. 1986).
Circuit admitted that, when the debtor is insolvent, injunctive relief might be permitted without the kind of showing required in the *Johns-Manville* case, because the shareholders then lack a true economic interest in the corporation and its assets. 173 Without true economic interests, the shareholders should have no right to control the debtor's estate. Even this, however, is by no means a universal view. Another prominent case, *Saxon Industries v. NKFW Partners*, 174 determined that the insolvency of the debtor should not, by itself, destroy shareholders' control rights. 175

The clear-abuse test has also been held to be inapplicable when the asserted shareholder rights have not vested prior to the filing of the petition in bankruptcy. In *Resolution Trust Corp. v. Allied Stores Corp. (In re Federated Department Stores)*, 176 the district court affirmed a bankruptcy court order altering postpetition shareholder voting rights without a showing of clear abuse by finding that the rights were purely prepetition contractual rights within the court's discretion to alter. 177 Preferred shareholders' rights to vote—arising contractually upon nonpayment of dividends for a specified period of time—had vested postpetition. 178 The court theorized that the voting rights, having vested postpetition, were subject to alteration by the court, whereas the voting rights of common shareholders, which vested prepetition, could not be so altered. 179 Focusing on the con-

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173. The court stated: "We note that if Manville were determined to be insolvent, so that the shareholders lacked equity in the corporation, denial of the right to call a meeting would likely be proper, because the shareholders would no longer be real parties in interest." Manville Corp. v. Equity Sec. Holders Comm. (In re Johns-Manville Corp.), 801 F.2d 60, 65 n.6 (2d Cir. 1986).


175. *Id.* at 1300. This view also has support in the scholarly literature. Professor Gerber contends that because the absolute priority rule has been relaxed under the Bankruptcy Code, *see supra* text accompanying notes 48-50, Congress must have desired participation by shareholders even when there is no equity in the corporation. *See* Gerber, *supra* note 31, at 353-54 ("By 'soften[ing] the regime of Chapter X and favor[ing] consensual compositions at the expense of the [absolute priority rule],' Chapter 11 gives stockholders an interest in a case even though they may appear to lack an economic interest in the company." (footnote omitted)). Nonetheless, this conclusion does not clearly follow from the premise. Congress may have simply been trying to promote consensual plans by permitting other classes to confer benefits on shareholders when they so choose, and may not have been focusing on issues of corporate governance or shareholder influence.


177. *Id.* at 892-93 ("[T]he abrogation of unexercised shareholders rights during reorganization proceedings can be an appropriate action on the part of the Bankruptcy Court." (citing Manville Corp. v. Equity Sec. Holders Comm. (In re Johns-Manville Corp.), 52 B.R. 879, 879 (Bankr. S.D.N.Y. 1985), rev'd, 801 F.2d 60 (2d Cir. 1986))).

178. *Id.* at 892.

179. *Id.* at 892-93. Could this principle also be applied to the rights of common
tractual nature of the rights, the Federated court divined a power in the bankruptcy court to alter these rights to aid in the reorganization of a debtor.

The Federated decision thus relies on two principles: first, and most questionable, that shareholder rights may be subject to modification to the extent they are "contractual"; second, that the courts should not universally apply the clear-case-of-abuse standard to issues surrounding shareholder control rights.

3. Other Standards for Injunctive Relief Concerning Shareholder Control Rights.—The clear-case-of-abuse standard, while widely followed, does not monopolize the law on enjoining assertion of shareholder control rights in bankruptcy. Several other tests exist. One of these other tests has been identified in a detailed analysis by Professor Mark Budnitz. After recognizing the clear-abuse standard, which he contends is properly applied to permit injunctive relief where the shareholders intend action that would destroy prospects for reorganization, Budnitz discusses what he categorizes as a "balancing test" used in case law in this area and presents arguments for adoption of a particular type of balancing test, which is discussed in detail below. The traditional balancing test upon which Budnitz elaborates—which can be viewed as more than one test due to the use of differing factors in the "balance" by different courts—evolved from case law prior to evolution of the clear-abuse test. Under balancing standards, courts have generally deter-

shareholders to hold a regular annual meeting while the debtor is in bankruptcy? If the right to an annual meeting did not arise until after the filing of the bankruptcy petition, could the court, under Federated, claim the ability to prohibit such a meeting on the basis that the right "vested" postpetition? Perhaps not, because the right to hold annual meetings is ordinarily statutory, not contractual as were the rights of the preferred shareholders in Federated. See supra note 62.

180. Federated, 133 B.R. at 891.
182. See Budnitz, supra note 3, at 1251-55.
183. Id. at 1250.
184. Id. at 1255-56. See discussion infra Part III.B.4.
185. See, e.g., Van Siclen v. Bush (In re Bush Terminal Co.), 78 F.2d 662, 665 (2d Cir. 1935) (holding that injunctions should be issued only when the harm likely to flow from shareholder action is "disproportionate to the good obtainable"); Graselli Chem. Co. v. Aetna Explosives Co., 252 F. 456, 461-62 (2d Cir. 1918) (enjoining the vote of preferred
mined whether injunctive relief is necessary by offsetting the benefits of allowing a shareholder meeting against the potential harm to reorganization efforts that could result from such a meeting.\footnote{186} Net benefit in this analysis results in denial of the request for an injunction; net harm results in granting injunctive relief. The factors reviewed and the results obtained in the use of balancing tests have varied in different courts. Some courts have required the perceived harm to be "real" and to be disproportionate to any "good" obtainable.\footnote{187} Here the focus is on the circumstances of the particular case and evidence presented on the impact of a shareholder meeting. Another balancing equation was supplied by \textit{Saxon Industries v. NKFW Partners},\footnote{188} where the factors placed on the balancing scale are the competing interests of state and federal law, the latter being embodied in the Bankruptcy Code.\footnote{189} In performing this ratiocination, the court in \textit{Saxon Industries} accorded principal consideration to the interests of state law and protection of shareholder control rights. This resulted in favorable consideration of a request by shareholders to compel an annual shareholders' meeting.\footnote{190}

Several issues surrounding balancing tests should be noted. While the clear-abuse test is probably a "majority" rule, a significant number of recent cases can be fit into Budnitz's balancing test definition.\footnote{191} Moreover, this balancing-test branch of the law may be seen as creating an even stricter standard for granting injunctions shareholders when the result of that vote would be detrimental to the interests of the common stockholders).

\footnote{186. Budnitz, \textit{supra} note 3, at 1251-55.}
\footnote{187. \textit{Id.} at 1251, 1252.}
\footnote{188. 488 A.2d 1298 (Del. 1984).}
\footnote{189. \textit{Id.} at 1302-03. Framing the issue as one involving essentially two competing sets of policy concerns, those of state corporate law and those of federal bankruptcy law, is a theme also identified in the scholarly literature. \textit{See} Budnitz, \textit{supra} note 3, at 1253-54; Gerber, \textit{supra} note 31, at 341-56.}
\footnote{190. In reaching this result, the \textit{Saxon Industries} court concluded that: Certainly an appropriate balance must be struck between the Bankruptcy Code and our General Corporation Law. But given the strong Delaware policy behind the free exercise of a stockholder's right to elect directors, and the absence of that focus in the pending bankruptcy proceedings, the scales necessarily tip in favor of the former. \textit{Saxon Indus.}, 488 A.2d at 1302-03.}
\footnote{191. \textit{See}, e.g., \textit{Minter v. Directors of Concrete Prods., Inc. (In re Concrete Prods., Inc.), 110 B.R. 997 (Bankr. S.D. Ga. 1989}) (paying lip service to the clear-abuse standard, but granting an injunction based on the more traditional grounds of probable success at trial and the threat of irreparable injury outweighing the potential damage from an injunction); \textit{LTV Corp. v. Miller (In re Chateaugay Corp.), 109 B.R. 613 (S.D.N.Y. 1990}) (issuing an injunction in order to preserve the integrity of the reorganization process), \textit{appeal dismissed}, 924 F.2d 480 (2d Cir. 1991).}
limiting shareholder rights than the clear-case-of-abuse test. For example, the court in *Saxon Industries* began its analysis by stating that the right to shareholders' meetings is nearly absolute, thus making injunctive relief extremely difficult to obtain. For a court to deny state law rights to shareholders, a showing of real, imminent, and tangible harm to the reorganization process must be made under the *Saxon Industries* balancing test. This showing requires evidence of an effort to "smash" the reorganization efforts of the debtor. To the extent that one can call the balancing cases a modern trend, it is possible to predict that efforts to prevent shareholder access to control rights in bankruptcy will fall increasingly to shareholder franchise entitlements.

A more infrequently used test to determine whether injunctive relief should be granted is the test one would expect to be applied, the ordinary standard for granting or denying injunctive relief. This standard requires the well-known showings of irreparable harm and a likelihood of success on the merits of the claim.

It is remarkable that the ordinary injunction standard is so infrequently used. While it is sometimes used in corporate governance disputes as a supplement to the clear-abuse test, as in the *John-Manville* case, it is typically ignored in the corporate governance area and is replaced by arcane tests for injunction, such as the clear-case-of-abuse standard or the various balancing tests. Historical anomaly is perhaps an appropriate characterization of this phenomenon, but more likely there is a hidden doctrinal basis for the special standards. This doctrinal basis must evolve from the normative value placed on the concept of corporate democracy and the corporate franchise.

193. See id. at 1301-03.
194. Id. at 1301. This "smashing" standard arose out of language in *In re Potter Instrument Co.*, 593 F.2d 470, 474 (1979).
196. See supra notes 154-156 and accompanying text.
197. The clear-abuse and balancing tests are "arcane" if our inclination is to assume that the granting of injunctions should follow ordinary and accepted standards in all substantive areas of the law.
198. The basis for these standards is "hidden" in that the case law does not provide an explanation for the distinction between the corporate governance area and other precincts of the law, where the test for injunctive relief is the irreparable-harm standard.
199. See infra notes 327-350 and accompanying text.
4. Synthesis.—Uncertainty confronts counsel, clients and commentators in attempting to rationalize the authorities concerning shareholder control rights in bankruptcy. To which standard shall we turn? At least three exist: the clear-case-of-abuse standard, the balancing tests, and the ordinary temporary injunction standard.

Assuming a court makes a decision concerning the standard to be applied, the content of the standard adds further mystification to the process. If the clear-abuse standard is applied, what level of inquiry into this abuse is appropriate? What are the factors to be reviewed? Is some possibility of abuse sufficient to allow relief, or does the standard require a likelihood of corporate suicide? The confusion in this process has not gone unnoticed in the case law or the scholarly literature. Of the clear-case-of-abuse test, the district court in *Johns-Manville* noted, "[a]lthough this rule is settled, clear-cut standards regulating the manner of its application are generally lacking. In particular, the precise circumstances that will make out a showing of 'clear case of abuse' have yet to be precisely delineated."\(^{200}\) While the Second Circuit attempted such a delineation of factors in the same case, the uncertainty has not dissipated, as the literature exemplifies.\(^{201}\)

Opting to follow the modern trend, with its stringent balancing tests, does not relieve the confusion. Here we need perhaps even more guidance in divining the factors to place on the balancing scale and in measuring their relative weights.\(^{202}\) A balancing test is more open-ended; with the clear-abuse test, one is at least certain that real danger to reorganization is required for injunctive relief, whereas this is not logically required in a balancing test—although in practice such a showing has been required.\(^{203}\) Although balancing-test cases have produced results similar to clear-abuse cases, such results are not logically ordained. Potential uncertainty is thus multiplied under such a test.

The ordinary preliminary injunction standard has the advantage of familiarity and a volume of precedent not available under the unique corporate governance tests. Nonetheless, even with the traditional preliminary injunction standard, we again confront the

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202. *See supra* notes 123-161 and accompanying text.
dilemma of ascertaining what factors to analyze and how much weight to give to them in drawing conclusions.

In all of this, the problem is the unbridled discretion residing in the arbiter. Without guidelines for decision and the weighing of factors, it is impossible to predict results in specific cases.\(^2\) This lack of direction breeds litigation by giving parties license to request and oppose relief in cases in which a more definite standard would preclude such adventures.

The need for predictability, as well as the failure of these tests to give expression to bankruptcy policy, led Professor Budnitz to propose a new standard for determining the appropriateness of injunctive relief in Chapter 11 corporate governance disputes.\(^3\) The proposed test is actually a balancing test, where the good to be gained by a shareholder meeting is balanced against the harm to the reorganization process. The distinction between this balancing test and those previously applied by the courts, however, is that Budnitz would require courts "to explain the weight that is given to each factor, to justify that allocation, and to show how it results in one side outweighing the other."\(^4\) In addition to requiring explicit enunciation of the emphasis to be accorded each factor, Budnitz listed factors to be considered on both sides of the equation.

On the benefit side, the following factors are to be considered:

1. Corporate democracy values.\(^5\)
2. Efficiency: Here the assumption is that shareholders will choose the management team best able to operate the business and avoid the miscalculations of the past that caused the debtor's bankruptcy.\(^6\) This assumption may, however, be challenged on a

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\(^2\) A response to this criticism is that too much emphasis can be placed on certainty and predictability; flexibility is one of the policies to be considered in granting injunctive relief, and criticism of the inherent flexibility of these standards is an attack on the injunctive remedy itself. But one of the chief jurisprudential foundations of the law is predictability, a normative quality absent in the hodgepodge of authority on injunctive relief in corporate governance disputes. "Flexibility" without bounds is anarchy. Thus, predictability is a recognized legal normative value. RONALD DWORKIN, LAW'S EMPIRE 146-47 (1986) (discussing the need for a balance between predictability and flexibility in the law); RICHARD A. POSNER, THE PROBLEMS OF JURISPRUDENCE (1990) (containing a detailed discussion of a "prediction" theory of the law); Alan R. Palmiter, Restructing the Corporate Fiduciary Model: A Director's Duty of Independence, 67 TEX. L. REV. 1351, 1461 (1989) ("The ultimate test of any legal thesis is its usefulness in explaining and guiding behavior.").

\(^3\) See Budnitz, supra note 3.

\(^4\) Id. at 1256.

\(^5\) Id. at 1256-57.

\(^6\) Id. at 1257-58.
number of grounds, not the least of which is that shareholders have parochial interests not likely to be aligned with the interests of creditors.\footnote{209} Further, the expectation that shareholders will choose efficient and competent management must be tempered by the realization that the present "bad" management was itself chosen by shareholders.

(3) Maintenance of otherwise applicable state and bankruptcy law governing the relationship between management and shareholders. In this context, the focus is upon state law duties of care to which the directors are subject, as well as the special fiduciary duties to which the directors are subject under bankruptcy law.\footnote{210}

In analyzing these factors, Budnitz recommended the use of a rebuttable presumption buttressing any request for a shareholders' meeting;\footnote{211} thus, a request for an injunction is presumptively to be denied.

On the harm side, Budnitz identified the following factors:

(1) Timing of the meeting: A request for a meeting near the time of plan confirmation is more likely to be harmful to reorganization efforts than an earlier request.\footnote{212}

(2) Evidence of abuse: The court should consider evidence of abusive behavior in the shareholder-director relationship.\footnote{213} This factor refers to the "kamikaze" or "smashing" activity that might be engaged in by shareholders.\footnote{214}

(3) Costs associated with a meeting must be considered a harm factor, though a weak one.\footnote{215}

(4) Delay must also be a subject of deliberation. Again, however, this is a weak factor,\footnote{216} not accorded the weight of the first two harm factors, undoubtedly because of the normative value of share-
holder meetings, which should not ordinarily be compromised for mere considerations of delay or cost.

In deciding an issue of shareholder control rights, Professor Budnitz argued that the motives of shareholders should not be considered.\(^\text{217}\) In reaching the same conclusion on this issue as the Second Circuit did in *Johns-Manville*, \(^\text{218}\) Budnitz reasoned that the shareholders' motives should be considered only when their goal is abuse of the reorganization process through destruction of the debtor.\(^\text{219}\) The shareholders' conduct in this situation would fall within the substantive standard for injunctive relief, without consideration of motive. Inherent in this view is that "posturing" by the shareholders in requesting a meeting, as opposed to purely destructive activity, is a healthy and appropriate part of the reorganization process.

Professor Budnitz's analysis provides a framework for addressing the problems with existing standards for injunctive relief, but it does so from the less-than-neutral perspective of deference to shareholders' rights, which is so prevalent in the case law. His analysis also suffers in certain respects from problems identical to those of existing standards: while it provides for clear expression of the factors to be considered in the analysis, and asks courts to *identify* the weight they give to these factors, it does not *prescribe* for the courts the weight that should be given to the various factors. Although efficiency and corporate democracy values are clearly to be considered under Budnitz's standard, we do not know what weight to ascribe to them in relation to other values. Again, this approach allows for the exercise of extraordinary discretion, with a resulting lack of predictability and precision in individual cases. Thus, while application of this new standard constitutes a major step, it suffers from many of the same uncertainties inherent in the flexible standards typically used in determining the appropriateness of injunctive relief.

5. *Other Impacts of Bankruptcy on Shareholder Rights*—To fully comprehend and analyze shareholder control rights in Chapter 11, it is necessary to determine whether, apart from any limits placed on the right to hold meetings and exercise voting rights, bankruptcy otherwise impacts shareholder entitlements under state and federal law. To the extent that such impacts exist, they may provide insight

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217. *See id.* at 1262-63.
218. *See supra* note 146 and accompanying text.
into the proper treatment of control rights. A cursory review of the Bankruptcy Code reveals a number of provisions that affect the ordinary exercise of shareholder rights, in both enabling and prohibitory fashions.220

The first among these enabling provisions is 11 U.S.C. § 1102, which gives shareholders the right to have committees of equity security holders.221 Unlike unsecured creditors' committees, however, committees of equity security holders are not routinely appointed. Equity committees are only appointed upon the showing of a need "to assure adequate representation of... equity security holders."222 The question in considering appointment of an equity security holders' committee is whether, without a committee, shareholders are or can be adequately heard in the case. In deciding whether "adequate representation" requires a committee, the court will look at the size of the case, the diversity of the groups involved, the existence of conflicting claims needing resolution in the plan, and the costs of a committee.223 In deciding whether to appoint committees, bankruptcy courts have significant discretion.224 If a committee is appointed, shareholders will have their views represented at the expense of the estate without the need to exercise control rights. These committees have, indeed, been successful in protecting and asserting the rights of shareholders.225

Other enabling-type rights given to shareholders and others are the ability to request reduction of the debtor's exclusive period to file and obtain acceptance of a plan of reorganization, and the ability to oppose the extension of that period.226 In the event the exclusive period is reduced or otherwise ends, other parties in interest, including shareholders, have the right to propose a plan of reorganiz-

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220. By "enabling" is meant provisions of the Bankruptcy Code granting shareholders rights that otherwise do not exist under applicable state or federal law. "Prohibitory" provisions are those that limit the rights of shareholders.

221. 11 U.S.C. § 1102(a)(2) (1988) states that: "On request of a party in interest, the court may order the appointment of additional committees of creditors or of equity security holders if necessary to assure adequate representation of creditors or of equity security holders. The United States trustee shall appoint any such committee." Subsection (b)(2) provides that an equity security holders' committee shall ordinarily consist of the seven largest equity security holders of the relevant class who are willing to serve. Id. § 1102(b)(2).

222. Id. § 1102(a)(2).


224. Id. at 948.

225. See Budnitz, supra note 3 at 1263, 1264. See also In re Evans Prods., Inc., 58 B.R. 572 (Bankr. S.D. Fla. 1985).

zation,227 thereby potentially determining the course of the reorganization or otherwise having a substantial impact on the case.

A provision of the Bankruptcy Code that has both enabling and prohibitory aspects is the one that permits parties in interest,228 including shareholders,229 to request the appointment of a trustee by the bankruptcy court. In the prohibitory sense, the provision can be used by persons other than shareholders to oust management approved by shareholders, if management acts in a fashion constituting "cause" for the appointment of a trustee.230 In the enabling sense, 11 U.S.C. § 1104 can be used by shareholders to oust present management if it does not act in a fashion conforming to shareholders' desires, as long as there are adequate grounds for the appointment.231

A similar power not specified in the statute, but having the same enabling and prohibitory elements, is the power of the court to appoint a "responsible person" other than a trustee to operate the business of the debtor during a Chapter 11 case.232 While the source of this power is unclear, it appears to be an accepted method of judicial control over corporate governance.233 Yet another of these mixed enabling and prohibitory provisions is the one allowing the court to limit the ability of a debtor in possession to operate the business.234 These provisions may act to expand or contract the

227. Id. § 1121(c).
228. Id. § 1104(a).
230. The grounds for appointment of a trustee are set forth in 11 U.S.C. § 1104(a)(1), which states that a trustee may be appointed "for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause . . . ." Id.
231. See id.
232. In re Gaslight Club, Inc., 782 F.2d 767, 770-72 (7th Cir. 1986) (denying the majority shareholder of the debtor the right to renege on his consent to the court's appointment of a responsible officer to replace him); In re UNR Indus., 30 B.R. 609, 609 (Bankr. N.D. Ill. 1983); In re FSC Corp., 38 B.R. 346 (Bankr. W.D. Pa. 1983) (upholding the authority of the court-appointed "Responsible Officer" to conduct the affairs of the debtor corporation). Cf. In re Lifeguard Indus., 37 B.R. 3, 17-18 (Bankr. S.D. Ohio 1983) (denying the majority shareholder's motion to confirm the appointment of a new board of directors, whom the court believed to be unable to competently manage the corporation, and thus leaving a "responsible officer" in place to operate the corporation).
233. See cases cited supra note 232; see also Kelch, supra note 210, at 1328 & n.23.
234. 11 U.S.C. § 1108 (1988) ("Unless the court, on request of a party in interest and
power of the shareholders, depending on whether they side with those in control of the debtor in possession.

A number of purely prohibitory restrictions in the Bankruptcy Code and elsewhere place bounds on the free exercise of control rights. The state law right of shareholders to vote on major sales of assets does not exist in bankruptcy. Sales of assets outside the ordinary course of business are governed by section 363 of the Bankruptcy Code, not by state law requiring shareholder approval of such sales. Thus, shareholder veto power over such sales does not exist in bankruptcy. Similarly, contrary to what one might assume considering state law, shareholders are not entitled to vote on a plan of reorganization prior to its proposal by management. These voting rights are, in the bankruptcy context, controlled by the Bankruptcy Code, which gives shareholders, like creditors, the right to vote on a plan of reorganization after it is proposed by management or another party in interest. This vote is conducted under and regulated by bankruptcy law, not state law. Even state laws recognize that, in reorganization cases, state-law shareholder rights may be appropriately altered.

Thus, there are a number of provisions in the Bankruptcy Code and state law that in one manner or another enhance or limit the rights of shareholders of a corporation in bankruptcy to assert their rights after notice and a hearing, orders otherwise, the trustee may operate the debtor's business.

235. See, e.g., CAL. CORP. CODE § 1001(a) (West 1990); DEL. CORP. LAW CODE ANN. tit. 8, § 271(a) (1991); MODEL REVISED BUSINESS CORP. ACT § 12.02(b)(2) (1991).
236. 11 U.S.C. § 363(b)(1) (1988) ("The trustee, after notice and a hearing, may use, sell, or lease, other than in the ordinary course of business, property of the estate.").
237. Sportservice Corp. v. Northern Ill. Dev. Corp. (In re Northern Ill. Dev. Corp.), 324 F.2d 104, 106-07 (7th Cir. 1963) (holding that shareholders have no right to vote on a plan providing for the sale of property when the debtor's estate is insolvent), cert. denied, 376 U.S. 938 (1964); In re Searles Castle Enters., 12 B.R. 127, 129 (Bankr. D. Mass. 1981) (denying shareholders the right to vote on a proposed sale of assets once an order for relief is entered in a Chapter 11 case), aff'd, 17 B.R. 440 (Bankr. 1st Cir. 1982); Mills v. Tiffany's, Inc., 198 A. 185 (Conn. 1938).
238. 11 U.S.C. 1126(a) (1988) (providing that a holder of an interest has the right to accept or reject a proposed plan of reorganization). Section 1126(d) provides that a class of interests accepts the plan if the holders of at least two-thirds in amount of the allowed interests of the class vote in favor of the plan. ld. § 1126(d). Nonetheless, the plan may be approved in the absence of consent by the shareholders if the "cram down" standards of Section 1129(b) are met. See 11 U.S.C. § 1129(b); supra text accompanying notes 48-49.
240. See, e.g., DEL. CODE ANN. tit. 8, § 303(a) (1991) (allowing a Delaware corporation to put into effect a court-confirmed plan of reorganization without further action by its directors or stockholders).
state-law prerogatives and otherwise protect their interests. In some ways, such as by the right to be heard on all issues in the bankruptcy case, the rights of shareholders are accentuated by these provisions. In other aspects, such as by case law allowing appointment of responsible persons to run the corporation notwithstanding the views of shareholders, the rights of shareholders are limited. In any event, the ability and resolve of Congress and the courts to regulate the power of shareholders in Chapter 11 has been exercised in many instances and cannot be denied.

IV. A Critical Analysis of Shareholder Control Rights Over the Debtor in Possession

The deficiencies of present doctrine on shareholder control rights in Chapter 11 are evident from the foregoing discussion. Insufficient certainty and overbroad discretion couple to create blunt tools of analysis. Nor can tinkering with the present mechanism provide solutions. The fundamental imperfections of the clear-abuse standard and its cousins cannot be sufficiently cleansed to reach a lustre worthy of resurrection.\textsuperscript{241} Chipping at the outer shell of the dogma surrounding shareholder control of the Chapter 11 debtor in possession yields no answer. Blasphemous as it may be, a more searching lens must be utilized to pierce deeper into the democracy-based policy concerns of cultivated doctrine, to reach its nucleus, and to peel away the prejudice created by the historic and normative luggage with which travel in this precinct has been burdened.

To cast aside this prejudice, the following path is submitted: First, analyze the rights protected and sacrificed for the primary non-owner players in the bankruptcy process—the creditors. In this regard, the following should be explored: (1) to what protection are creditors entitled, and (2) what rights must be sacrificed? Second, after these entitlements and sacrifices are categorized, apply this same analysis to the rights of shareholders to determine if a fresh resolution to the shareholder-control dilemma can be formulated in this way.

A. Creditor Rights Protected in Bankruptcy

What are the creditors' rights and entitlements left unaffected by the bankruptcy process? It is state law that controls the determination of property rights in bankruptcy absent an overriding federal

\textsuperscript{241} See supra notes 200-204 and accompanying text.
However, the property rights defined by state law are not left entirely intact in the bankruptcy process. In various ways, they are limited or enhanced in bankruptcy. For instance, the automatic stay inhibits the exercise of certain rights. Liens may be created in a manner priming those that under state law would otherwise have priority. Security interests may be avoided if not properly perfected.

A fundamental core of rights, however, remains free from modification by bankruptcy law. This is recognized in the “adequate protection” requirements sprinkled throughout the Bankruptcy Code. What is the basis for the distinction between rights that may be lost in bankruptcy and those that are inviolate?

A logical starting point for this analysis is *United Savings Ass'n v. Timbers of Inwood Forest Associates*, in which the Supreme Court delineated the precise nature of the rights protected in bankruptcy in the “adequate protection” context. The question in *Timbers* was what “interest in property” was subject to the adequate protection requirement of 11 U.S.C. § 362(d). An undersecured creditor argued in *Timbers* that its “interest in property” entitled to adequate protection included the right to immediately foreclose on its collateral and reinvest the money received. The result of such a view is that to be adequately protected, undersecured creditors would be entitled to interest on their secured claims. The Supreme Court, after a detailed analysis of a number of sections of the Bankruptcy Code, concluded that the interest in property entitled to “adequate protection” is only the value of the creditor’s interest in the collateral, not the right to immediately foreclose on the property and re-

243. Where there is a strong federal policy, “property” rights may be more broadly defined by federal law than would be the case under state law:

   Of course, where the bankrupt law deals with property rights which are regulated by the state law, the federal courts in bankruptcy will follow the state courts; but when the language of Congress indicates a policy requiring a broader construction of the statute than the state decisions would give it, federal courts can not be concluded by them.

   Board of Trade v. Johnson, 264 U.S. 1, 10 (1924).
244. 11 U.S.C. § 362(a) (1988); see supra text accompanying notes 66-77.
246. Id. § 544(a).
247. See id. §§ 361, 362(d), 363(e).
249. Id. at 370-71. This concept had been articulated in Crocker Nat'l Bank v. American Mariner Indus. (In re American Mariner Indus.), 734 F.2d 426 (9th Cir. 1984).
250. American Mariner, 734 F.2d at 435.
invest the proceeds.\textsuperscript{251} Thus, in the context of the undersecured creditor—and presumably that of the fully secured creditor as well—what is preserved and protected by the bankruptcy law, and specifically its adequate-protection requirement, is the substantive manifestation of the creditor's state-law-created property right—the money's worth of the property that is security for the claim, not the intangible potential of presently realizing a sum of money, through foreclosure or other enforcement, and reinvesting it. The real value of the creditor's right, of course, depends on the creditor's priority position in the property—again, as determined by state law.\textsuperscript{252}

That state law entitlements control the fundamental property rights of creditors in bankruptcy is also exemplified by the way unsecured creditors are treated. Though modified for policy reasons in certain cases, the priority scheme under state law is preserved in bankruptcy.\textsuperscript{253} Secured creditors are paid first;\textsuperscript{254} unsecured creditors, though their rights are modified by special priorities given to a few preferred creditors,\textsuperscript{255} are paid second;\textsuperscript{256} and the owners of the entity are last in priority.\textsuperscript{257} Thus, the priority rights set under state law continue to control in the context of bankruptcy.

What is an appropriate characterization of these rights defined by state law and federally protected so that they may ultimately be realized under bankruptcy law? They are not properly called "property" rights, because property rights include more than the entitlements protected under the \textit{Timbers} case and the priority rules applicable to creditors. For example, the right to immediately foreclose that was held not to be protected in \textit{Timbers} is a right that one would likely categorize as a "property" right under state law. Thus, bankruptcy law does not protect the entire field of property rights, but only some subset of it.

\textsuperscript{251} \textit{Timbers}, 484 U.S. at 370-76.


\textsuperscript{253} See 11 U.S.C. §§ 503, 507, 724, 726 (1988). These sections set forth the priorities followed in bankruptcy. Section 724 prescribes the order of distribution to secured creditors where there are tax liens. \textit{Id.} § 724. Sections 724 and 726 are not technically applicable in a Chapter 11 case, but their essence filters into Chapter 11 through the requirement that creditors receive at least as much in a Chapter 11 case as they would in a case under chapter 7 of the Bankruptcy Code. \textit{See id.} § 1129(a)(7); infra text accompanying note 265.

\textsuperscript{254} 11 U.S.C. § 724(b)(1).

\textsuperscript{255} \textit{Id.} §§ 726(a)(1), 507.

\textsuperscript{256} \textit{Id.} § 726(a)(2).

\textsuperscript{257} \textit{Id.} § 726(a)(6).
This subset of rights will be referred to as "priority rights," which include the following entitlements protected by bankruptcy law: (1) For secured creditors, their interest in the property of the debtor in its palpable form, that is, not their intangible procedural rights to realize on tangible property, but the tangible property itself;\(^2\) (2) for unsecured creditors, the right to a definite priority position with respect to distribution of the assets of the estate. The latter is not a specifically enforceable right in any property, but the expectancy of certain treatment in the event of the insolvency of a debtor. That expectancy is the right to be paid after payment of secured claims, but before the owners of the corporation.\(^2\)

These priority rights are the real economic value of a creditor’s interest in the assets of an insolvent debtor, excluding the time value of that interest.\(^2\) The view that priority rights are the primary values protected in bankruptcy is one that has substantial support in the statutes and elsewhere. For example, the Code provides that a creditor’s claim is:

\[
\text{[A]} \text{ secured claim to the extent of the value of such creditor’s interest in the estate’s interest in such property, or to the extent of the amount subject to setoff, as the case may be, and is an unsecured claim to the extent that the value of such creditor’s interest or the amount so subject to setoff is less than the amount of such allowed claim.}\]

Again, the principle announced is that bankruptcy protects the money value of the creditor’s interest in estate property itself—the tangible or intangible subject matter of the creditor’s interest—not the procedural right, although potentially of value, to realize on it.\(^2\)

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\(^2\) See Westbrook, supra note 181, at 257-63. Westbrook identifies “interests in the thing itself” as property rights not alterable by rejection of an executory contract. Id. at 260-61. Due to differences in context and meaning, the present analysis will be done under the rubric of priority rights.

\(^2\) This priority right is reflected in the Code’s absolute priority rule. 11 U.S.C. § 1129(b). See supra notes 37-40, 49-50, 61 and accompanying text.

\(^2\) One could say that priority rights are the rights of creditors in a universe without time or action. Time is absent due to the lack of an entitlement to interest, except in the case of fully secured creditors; “action” is absent because creditors are prevented from asserting their procedural rights. See infra Part IV.B.


\(^2\) See United Sav. Ass’n v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 372 (1988) ("[T]he creditor’s ‘interest in property’ [under § 506(a)] obviously means his security interest without taking account of his right to immediate possession of the collateral on default.").
In giving examples of adequate protection, the Code further supports the view that it is the value of the subject matter of the creditor's interest that is protected in bankruptcy. Each of the suggested alternative methods of providing adequate protection, consistently with *Timbers*, refers to compensation for a decline in value of the palpable subject matter of the creditor's interest.

The minimum rights of creditors in a Chapter 11 plan are described in 11 U.S.C. § 1129(a)(7), which requires that all creditors in a Chapter 11 case are to be paid at least what they would receive in a chapter 7 liquidation case. This provision preserves in Chapter 11 the priority positions that otherwise exist in liquidation cases, thereby defining the value of creditor priority rights and ensuring their protection in Chapter 11.

The confirmation provisions of 11 U.S.C. § 1129 further reveal that what is immutable in a creditor's claim is its tangible value and priority position. That section's "cram down" provisions highlight the preservation of priority rights. Under 11 U.S.C. § 1129(b)(2)(A), secured claims are entitled to one of three types of treatment. They must: retain their liens and receive deferred cash payments equal to the allowed amount of their secured claims; have the property in which they have an interest sold, and receive payment from the sale, or deferred cash payments equal to the allowed amount of their secured claims; or receive the "indubitable equivalent" of their interest in the estate's property. As a practical matter, this allows a plan proponent to rewrite a secured loan to the debtor, as long as the ultimate value realized by the secured creditor, over whatever term is provided in the plan, is equal to the present value of the underlying collateral. Thus, a loan due at the time of the bankruptcy filing can theoretically be converted to a twenty-year loan with an appropriate interest rate to compensate for the extended term. All of the standards set forth in 11 U.S.C. § 1129(b)(2)(A) are examples of methods for the realization of the

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264. The methods of adequate protection noted in § 361 are periodic cash payments, additional or replacement liens, and provision of the "indubitable equivalent" of the creditor's interest in the estate's property. *Id.*
265. *Id.* § 1129(a)(7).
266. "Cram down" occurs in a Chapter 11 case when there is a dissenting class of impaired claims or a "deemed" dissenting class. *Id.* § 1129(b)(1). The cram down provisions are applied to determine whether a plan may be confirmed notwithstanding the failure of a class to accept it. *Id.* Under Section 1129(b)(1), a plan will be confirmed despite objection if it is "fair and equitable" to an objecting class. *Id.*
267. *Id.* § 1129(b)(2)(A) (outlining the requirements for a "fair and equitable" plan).
268. *Id.*
money's worth of the secured creditor's interest in the debtor's property.

The priority rights of unsecured creditors are protected by 11 U.S.C. § 1129(b)(2)(B). Under this subsection, a dissenting class of unsecured creditors must receive full payment before a junior class receives any compensation on account of its claims or interests.269 Thus, the priority position of a dissenting class of unsecured creditors is considered inviolate.

Further evidence of this safeguarding of priority rights can be found in the Code's automatic stay provisions.270 Priority rights are "substantive"—that is, they are the value of the property itself. The right to realize on tangible value at any particular moment, however, can be characterized as a procedural right—the right to use mechanisms to realize substantive money value. Through this distinction, it becomes apparent that the automatic stay does not affect the priority rights of a creditor. It does not alter the value of the property or priority right itself; it does not take away any substantive property right or value. What the automatic stay operates on are the procedural rights to foreclose and to create and perfect liens; in short, the rights to employ the mechanisms provided by applicable law to realize upon priority rights. This principle—that the automatic stay is a procedural tool—is recognized both in the case law271 and in the legislative history of the Bankruptcy Code.272

As a statutory injunction, the automatic stay operates similarly to other injunctions restraining acts against another's property. Such injunctions have been held to affect only procedural rights, not substantive ones.273 An injunction preventing exercise of rights to enforce a lien does not impair the lien, but only suspends the right

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269. Id. § 1129(b)(2)(B). There is a much debated exception to this precept, the "new value" exception, which some argue allows shareholders to retain an interest in the reorganized debtor if they contribute new capital to the corporation. See supra note 40 and accompanying text.


to enforce it.\textsuperscript{274} Only the remedy is affected by the stay, not the interest in the property itself.

This view is consonant, in certain respects, with economic theories of the nature and purpose of bankruptcy law. Simply stated, it is the typical premise of such theories that the purpose of bankruptcy law is to protect state law entitlements of creditors—that is, the property and priority rights established by state law.\textsuperscript{275} It is not the purpose of bankruptcy law to change the relationships created under state law, as some would posit, but to preserve and maximize them in the context of insolvency.\textsuperscript{276} The automatic stay is one of the mechanisms used to prevent state law entitlements of creditors from being torn asunder by piecemeal dismemberment of the debtor upon insolvency.\textsuperscript{277}

Conforming views can be found in several influential articles on executory contracts.\textsuperscript{278} Those writings emphasize that the executory-contract provisions of the Bankruptcy Code\textsuperscript{279} are not intended to alter state-law-created property rights.\textsuperscript{280} The fact that a contract has not been performed does not give the debtor new rights to avoid or alter property interests established by state law. Section 365 of the Bankruptcy Code creates the right to reject a contract,\textsuperscript{281} with state-law-created property rights of the parties otherwise in-

\textsuperscript{274} \textit{Id.} ("The injunction . . . in no way impairs the lien, or disturbs the preferred rank of the pledgees. It does no more than suspend the enforcement of the lien by a sale of the collateral pending further action.").


\textsuperscript{276} \textit{See, e.g.}, \textit{Jackson & Scott, supra note 275} at 155-56, 160-62 ("The cornerstone of the creditors’ bargain is the normative claim that prebankruptcy entitlements should be impaired in bankruptcy only when necessary to maximize net asset distributions to the creditors as a group and never to accomplish purely distributional goals.").

\textsuperscript{277} \textit{See Jackson, The Logic and Limits of Bankruptcy Law, supra note 275, at 157; Jackson, Bankruptcy, Non-Bankruptcy Entitlements, supra note 275, at 860-68.}

\textsuperscript{278} \textit{See supra note 181.}


\textsuperscript{280} \textit{See, e.g., Andrew, A Reply to Professor Westbrook, supra note 181, at 2.}

\textsuperscript{281} 11 U.S.C. § 365(a) (1988) (providing that with certain exceptions, "the trustee, subject to the court’s approval, may assume or reject any executory contract or unexpired lease of the debtor").
Bankruptcy thus preserves the substantive value of property rights created in executory contracts, though it may affect the method of enforcing of these rights and the value of the ongoing relationship with the debtor.

B. Creditor Rights Affected by Bankruptcy

In contrast to the above-described priority rights are the remaining rights of creditors, best characterized as "procedural rights," which are subject to modification by the Bankruptcy Code, and are limited by the automatic stay and other relevant statutory provisions. The term "procedural rights" refers to the means and mechanisms for realizing the substantive priority rights of the creditor. They include self-help foreclosure rights, rights to judicial remedies including judgment and levy of execution, and the other creditor remedies provided by law and agreement. These procedural rights are limited by the automatic stay and such provisions as may be incorporated into plans of reorganization that modify and regulate the ability of creditors to immediately realize on their priority rights.

It is not the substantive economic value of creditors' rights that is affected by bankruptcy law, but the means of effectuation of these rights that are subject to prohibition. For secured creditors, these means are the right to foreclose. For unsecured creditors, they are the right to become, through a race to the courthouse, secured creditors, by obtaining tangible interests in property of the debtor. Not only are these procedural rights suspended during bankruptcy, but delay of their enforcement is not ordinarily compensable.

The proponent of a plan of reorganization can rewrite the terms of secured and unsecured debt, notwithstanding that the creditor could, absent bankruptcy, exercise its procedural rights to prevent such action. The debtor in possession is said to be able to

282. See supra note 280.
283. See supra notes 271-274 and accompanying text.
284. See supra notes 243-282 and accompanying text.
285. See supra notes 271-274 and accompanying text.
286. The suspension is subject, of course, to 11 U.S.C. § 362(d) (1988), which grants the right to relief from stay in appropriate circumstances.
287. See supra notes 248-251 and accompanying text. United Sav. Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 365 (1988), represents a clear statement of the principle that it is within the ambit of the bankruptcy law to affect these procedural rights without compensation. The lost right to immediate foreclosure, as to an undersecured creditor, is not compensable in bankruptcy. Id. at 370-76.
“impair” the rights of creditors in a plan of reorganization.\textsuperscript{288} This allows the debtor to alter the state-law procedural rights of a creditor in a reorganization plan.\textsuperscript{289} On the other hand, the priority rights of the creditor will remain unaltered; the creditor remains entitled to the value of its priority position in the assets of the estate.\textsuperscript{290} The ultimate right to payment of the value represented by priority rights is not impaired; only the procedural ability to demand that payment is affected.

C. Application of Priority Rights and Procedural Rights Analysis to Shareholder Control Rights

Application of these principles to the control rights of shareholders in bankruptcy may produce a better framework for analyzing the rights of a debtor in possession to injunctive relief to prohibit exercise of shareholder control rights. To apply the priority rights-procedural rights distinction, it is necessary to characterize appropriately the control rights of shareholders. If these are properly categorized as priority rights, then their exercise in bankruptcy is properly subject to protection under the Bankruptcy Code, as present law provides. If these rights are procedural, on the other hand, then consistency demands that these rights of shareholders should not be any more inviolate than are such rights of creditors.

The control rights of shareholders are the right to annual meetings, to call special meetings, and to vote shares at a meeting for the purpose, among others, of ousting present management. These rights are primarily created by state law\textsuperscript{291} and are the mechanisms for shareholders to define, direct, and control the activities of a corporation. The essence of these rights, since the corporation is purely an economic unit, is the right to direct the deployment of the corporation’s assets. The shareholders’ control over assets, however, is indirect: shareholders elect the board of directors; the board controls the officers of the corporation; and the officers direct the use of the corporate assets.

How do these rights compare to the corresponding rights of creditors? In the case of a creditor who attempts to enforce priority rights in the debtor’s assets by exercising procedural rights, the ac-

\textsuperscript{288} 11 U.S.C. § 1123(b)(1) (providing that a reorganization plan may impair either secured or unsecured claims).

\textsuperscript{289} 11 U.S.C. § 1124(1) (defining “impairment” as the alteration of “legal, equitable, and contractual rights” owed to the claim holder).

\textsuperscript{290} See supra notes 258-282 and accompanying text.

\textsuperscript{291} See supra notes 58, 62, 117, 235, 240, and accompanying text.
Corporation is direct. It is the wresting of possession and control of assets from the debtor. The end of this creditor activity is the collection of a claim—the realization of priority rights. The means by which this is accomplished is the exertion of procedural rights—judgment, execution, and levy—upon the property of the debtor. This activity is prohibited by the Bankruptcy Code after the inception of a bankruptcy case.\textsuperscript{292}

While more subtle, the exercise of control rights by shareholders is no less an act to realize on an interest claimed in assets of the debtor. Assertion of control rights is the exercise of procedural rights with the aim of realizing on priority rights granted to the shareholders—the distributive rights to which shareholders are entitled under the priorities set by state and federal law. Control rights are the procedural means, therefore, for realizing substantive priority rights for shareholders—just as foreclosure and other creditor prerogatives under state law are the means of realizing priority rights for creditors. Control rights are no more substantive than are the rights of secured creditors to foreclose on property of the estate. These creditor rights are powers to divest others, that is, other creditors and interest holders, of control over specific property. By taking control of property, its value is extracted for the benefit of the specific creditor. Similarly, the exercise of control by shareholders is an act to wrest control of property from creditors who, as a matter of substantive law, are entitled to the value of that property and to have that property used to pay their claims.\textsuperscript{293} Though the method of extraction of value by a foreclosing creditor differs from that of a shareholder taking control of a corporation, the ends and motivations are identical. The exercise of shareholder control rights is, therefore, the exercise of procedural rights generally subject to prohibition and control in Chapter 11; and, accordingly, such shareholder rights do not warrant the protection they are traditionally accorded.

\textsuperscript{292} See supra notes 243-282 and accompanying text.

\textsuperscript{293} It must be assumed that the ends of the shareholders are, to the extent practicable, to exercise control for the purpose of realizing on their parochial interests to the exclusion of others, and that the shareholders act in their own best interest. Case law justification for protecting the rights of shareholders to hold meetings is based on the assertion that shareholders will not attempt to destroy the corporation through acts of control. See, e.g., Saxon Indus. v. NKFW Partners, 488 A.2d 1298, 1301 (Del. 1984). Thus, shareholders generally will not be prohibited from exercising these prerogatives under \textit{Saxon Industries}. Shareholders' self-interest suggests, however, that the rights will be used to obtain compensation to the exclusion of others—to extract value not otherwise rightly available. Concerning the extortionate use of shareholder power, see infra notes 303-308 and accompanying text.
In contrast, the substantive priority rights of shareholders are their distributive rights, that is, the right to be paid after unsecured creditors and any preferred equity interests, and before subordinated interests. These rights are shielded in the Bankruptcy Code by the cram-down provisions protecting such distributive priority in the event of dissent by equity security holders.294

There is even less justification for permitting shareholders to exercise procedural rights than there is for permitting creditors to do so. Secured creditors have specifically bargained for the right to realize on their collateral, and it is not illogical to argue that these procedural rights should be preserved in bankruptcy.295 Moreover, the exercise of secured creditors' rights results in immediate realization of value that is more justifiably protected than the attenuated rights of shareholders to control the insolvent corporation. Even unsecured creditors, by virtue of their priority position over shareholders, could more justifiably argue for the exercise of procedural rights than can shareholders.

In sum, analysis of shareholder control and other rights leads to the following conclusions concerning categorization of the various rights of shareholders: (1) The rights of shareholders to realize on their claims in the priority order provided by applicable law are properly considered priority rights and are properly preserved in a Chapter 11 case. (2) Control rights fall into the procedural rights category. As such, these latter rights are subject to court control and are properly limited in a bankruptcy case. Thus, the ideal of protection of these rights in bankruptcy is the result of either faulty analysis or some overriding policy justification. Without such a justification, the present theory shielding these rights is untenable.296

This analysis of priority and procedural rights of creditors and shareholders shows that the right of shareholders to exercise con-

294. See supra notes 48-50 and accompanying text.
295. In United Sav. Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 365 (1988), the Supreme Court acknowledged that the American Mariner conception of the compensable value of the right to foreclose, see supra notes 249-250 and accompanying text, is not without theoretical appeal. Timbers, 484 U.S. at 371 ("[V]iewed in the isolated context of Section 362(d)(1), the phrase ['interest in property'] could reasonably be given the meaning petitioner asserts.").
296. For an analysis of potential policy justifications for special treatment of the procedural rights of shareholders, see infra notes 344-350 and accompanying text. The anomaly of allowing shareholders, whose economic interests are subordinate to creditors, the right to control management of the Chapter 11 debtor in possession has previously been recognized. See David A. Skeel, Jr., The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases, 78 VA. L. REV. 461, 510 (1992).
trol is no more appropriately protected than the typical state law rights of creditors to foreclose and exercise judicial remedies.

D. Policy Justifications for a New Theory of Shareholder Control Rights

Consistency with the treatment of creditors is not the only argument against exalting the rights of shareholders to vote, hold meetings, and control the debtor. There are significant policy reasons embracing the proposed theory of control rights.

Apart from shareholder control rights, the creditors and shareholders stand on virtually level ground in the ability to assert their rights in a bankruptcy case. Creditors are entitled to priority, but this is their bargained-for right. Creditors are also provided the benefits of representation by a committee, but this advantage is also available to shareholders in an appropriate case, and even unsecured creditors sometimes do not have committees due to lack of creditors willing to participate. The rights of creditors and shareholders to be heard and involved in the Chapter 11 process are comparable.

There is, thus, no apparent reason for shareholders to be granted powers beyond the powers of those whose economic interests in the debtor are more substantial. Indeed, it is an anomaly that shareholders—whose economic interest in the debtor is subordinate to that of creditors—should be granted greater rights over the insolvent debtor.

If the control rights of shareholders were exercised in a fashion beneficial to all those with rights in the estate, there would be little reason to decry the exertion of these rights. It is well known, however, that the efforts of shareholders to enforce their control rights are often not generated by a true belief in the solvency of a debtor’s estate and a bona fide attempt to save it, but are simply geared to extract unjustifiable compensation. This “extortion” is accomplished through litigation and threats of litigation. The delay and costs involved in opposing these actions often result in agreements that increase compensation to undeserving shareholders. The scholarly literature not only notes this phenomenon but has empiri-

298. Id.
299. Id. § 1109(b).
300. See supra note 63 and accompanying text.
301. See supra notes 90, 100-110 and accompanying text.
302. See supra notes 61-65, 90-110 and accompanying text; infra notes 303-309 and accompanying text.
cally established that it occurs.\textsuperscript{303} Professors LoPucki and Whitford, in a study of large, publicly held debtors who confirmed plans prior to March 31, 1988, found that in a substantial number of cases of insolvent debtors, where shareholders had no right to a distribution, such a distribution nonetheless occurred, at the expense of unsecured creditors.\textsuperscript{304} Among the reasons given for this by those involved in these cases was that such payments were the "price of peace" and that they avoided delay and the costs of litigation.\textsuperscript{305} Another factor resulting in compensation to undeserving shareholders was the inertia in the reorganization process toward negotiated settlements of disputes, as opposed to litigation of controversies.\textsuperscript{306} This phenomenon of illegitimate use of control rights of shareholders has also been noted in recent court opinions.\textsuperscript{307}

While it is arguable that this use of control rights as a bargaining tool merely permits the shareholders to enforce legitimate rights, the result, as the LoPucki-Whitford analysis reveals, is often to the contrary.\textsuperscript{308} The reasons given for compensating shareholders of insolvent corporations do not—as a matter of policy, as opposed to practical reality—justify departing from the rule of absolute priority in distributions. Wielding control rights to extract concessions does not promote a distribution system in line with what is called for under state and otherwise applicable law. Instead, by permitting shareholders to interfere unjustifiably with the reorganization process, the free exercise of control rights sanctions behavior that results in unwarranted distributions to a class that is often entitled to nothing, or at least less than it actually receives. Unchecked, the exercise of control rights has a result that no one could support: the priority scheme is subverted.

There is also a statutory argument against the present deference shown for shareholder control rights.\textsuperscript{309} Under 11 U.S.C. § 1107(a), the debtor in possession has the rights and powers of a

\textsuperscript{303} See LoPucki & Whitford, supra note 40, at 141-64.
\textsuperscript{304} Id. at 141-43.
\textsuperscript{305} Id. at 144.
\textsuperscript{306} See id. at 154-58.
\textsuperscript{307} The bankruptcy and district courts in Johns-Manville considered the admitted motivation of the shareholders—to obtain bargaining advantage—to be a reason for granting of an injunction against a shareholders' meeting. See supra notes 129-136 and accompanying text. This consideration of shareholder motives was disapproved, however, in the Second Circuit decision in that case. See supra notes 146-149 and accompanying text. Thus, to the extent that shareholder abuses of this kind now occur, it is with judicial blessing.
\textsuperscript{308} See supra notes 303-306 and accompanying text.
trustee.\footnote{310} It is often said that the debtor in possession takes on the "role" of a trustee in a Chapter 11 case.\footnote{311} To the extent that the management team of the debtor in possession is actually to be treated like a trustee, the shareholders should not be able to unilaterally dislodge it. While the Bankruptcy Code provides mechanisms for removal of a trustee,\footnote{312} shareholders cannot accomplish this through their own nonjudicially sanctioned act. The same principle can be applied to the debtor in possession; if the debtor in possession is truly a "trustee," shareholders should not have the unilateral power to remove management by using their control rights without court approval. There are other statutorily prescribed methods for the removal of the existing management.\footnote{313}

Ordinarily, officers and directors of a solvent corporation have a fiduciary duty to the corporation and its shareholders.\footnote{314} Not surprisingly, shareholders have control over management in this context. But in Chapter 11, a fiduciary duty is created in officers and directors in favor of a large group of beneficiaries including not only shareholders but also secured and unsecured creditors.\footnote{315} In this context, should exclusive control over management remain in the hands of shareholders? It would seem more logical to spread control to all of the groups to whom the officers and directors owe a fiduciary duty.

Another reason for the proposed analysis of control rights of shareholders is the typical lack of an economic interest in shareholders of the corporation. While not universally so, Chapter 11 debtors are usually insolvent, despite what their original schedules of assets and liabilities may imply. To strive zealously to promote the rights of a class of interests that has no genuine right to distributions from the assets of the estate is to pursue a withering mirage to absurdity.

\footnote{310. Section 1107(a) states in relevant part: "Subject to any limitations on a trustee serving in a case under [Chapter 11], and to such limitations or conditions as the court prescribes, a debtor in possession shall have all rights, . . . and powers, and shall perform all the functions and duties . . . of a trustee serving in a [Chapter 11 case]." Id.}
\footnote{312. 11 U.S.C. § 324(a).}
\footnote{313. Id. § 1104(a),(b). See also supra notes 229-230 and accompanying text.}
\footnote{314. See, e.g., REVISED MODEL BUSINESS CORP. ACT §§ 8.30(a), 8.42(a) (1991).}
\footnote{315. See Kelch, supra note 210, at 1333-35; Nimmer & Feinberg, supra note 210, at 29-37.}
To the extent that a debtor is insolvent, its shareholders deserve no voice in the disposition of the assets of the estate. Having no economic interest, they have no more justifiable claim to control of the estate than the general public. Despite this common-sense result, it is one with only meager support in the Chapter 11 case law.

In light of the bargain struck initially by the shareholders, their continued participation in the face of insolvency is inappropriate. The essence of the corporate form is its limited liability for shareholders balanced by a low priority level in relation to the claims of creditors. This is part of their bargain, and those—like the creditors—who bargained for a more favored position should be entitled to more protection. To magnify shareholders' power by permitting them to control the debtor in bankruptcy and pursue protection of their interests—thereby permitting extraction of unjustified compensation—is to strip their bargain of substance, and engage in ex post facto conjury eviscerating the bargained-for superior rights of the creditors.

If shareholders wish to continue their relationship with the insolvent corporation, they may contribute new value to the corporation and thereby retain rights in the debtor. Denying control

316. There are theories of proper corporate governance that would place some role in corporate decision making in the broad community affected by a corporate entity. See Eisenberg, supra note 3, at 19-24. Although this theory is not generally accepted in the real world, at least one corporate statute recognizes the possibility of considering the general interests of the community and other non-owner groups in the decision-making process. See 15 PA. CONS. STAT. ANN. § 1716 (Supp. 1992) (providing that, in making decisions on behalf of the corporations, the board of directors may consider the effect of their actions "upon employees, upon suppliers and customers of the corporation and upon communities in which offices or other establishments of the corporation are located"); see also Marshal E. Flora, Comment, Redefining Pennsylvania Corporate Law: Eliminating Corporate Directors' Fiduciary Obligations, 96 DICK. L. REV. 231, 239-40 (1992).

317. See, e.g., Manville Corp. v. Equity Sec. Holders Comm. (In re Johns-Manville Corp.), 52 B.R. 879, 888-89 (Bankr. S.D.N.Y. 1985), rev'd, 801 F.2d 60 (2d Cir. 1986); Haugh v. Industries, Inc. (In re Public Serv. Holding Corp.), 141 F.2d 425, 426 (2d Cir. 1944) (holding that the district court was well within its judicial discretion in enjoining a proposed shareholder meeting during the pendency of reorganization proceedings under chapter X of the Bankruptcy Act).

rights does not, therefore, preclude participation in the reorganization.

The bankruptcy court is not infrequently used as a forum for the resolution of shareholder disputes, and such disputes are the source of some Chapter 11 filings. But the bankruptcy court is not the appropriate forum for resolution of these issues.\(^{319}\) The aim of a bankruptcy case should be to maximize value for interested parties, not to resolve family battles.

Perhaps the most forceful of the policy bases for denying shareholder control rights in Chapter 11 cases is that these rights are not necessary for the protection of shareholders. The Bankruptcy Code and case law provide numerous protections for the rights of shareholders, apart from shareholder control rights. As parties in interest, shareholders always have a right to be heard in a bankruptcy case.\(^{320}\) Mismanagement of the debtor may be terminated through the shareholders' ability to obtain appointment of a trustee in an appropriate case,\(^ {321}\) and parties in interest may file competing plans of reorganization in certain circumstances.\(^ {322}\) Committees may be appointed to protect the rights of the shareholders at the expense of the estate.\(^ {323}\) In fact, these committees have had significant success in protecting the rights of shareholders.\(^ {324}\) There are also certain protections provided for postpetition shareholders, such as the prohibition on the issuance of nonvoting stock in a reorganization plan.\(^ {325}\)

There are, therefore, substantial policy bases for a new view of shareholder control rights in Chapter 11 cases.

\section*{E. Justifications Advanced for Retention of Shareholder Control Rights}

As noted at the outset of this Article, there is considerable impetus behind the position that the control rights of shareholders

\begin{footnotesize}
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\item[1991)] aff'd, 968 F.2d 647 (8th Cir. 1992); \textit{In re Outlook/Century Ltd.}, 127 B.R. 650, 654-57 (Bankr. N.D. Cal. 1991).
\item[320] See supra note 229 and accompanying text.
\item[322] Id. § 1121(c).
\item[323] Id. § 1102(a). If one believes that the committees provided for in § 1102 are inadequate to ensure proper shareholder protection, the appropriate response is to seek congressional amendment of that statute to provide for mandatory appointment where there are a designated number of shareholders.
\item[324] See supra note 225 and accompanying text.
\item[325] 11 U.S.C. § 1123(a)(6). Such a provision will, of course, provide protection for prepetition shareholders only to the extent they participate in the plan as equity security holders.
\end{itemize}
\end{footnotesize}
need to be "protected" in bankruptcy cases. One method of providing that protection has been the application of very strict standards to any attempt to limit the control rights of shareholders.\textsuperscript{326} As used by the shareholders, however, this is not a shield, but a sword.\textsuperscript{327} Moreover, control rights provide the shareholders with more powers than creditors, who have a higher priority.\textsuperscript{328}

The most popular—and emotionally, though not logically, most powerful—argument for the protection of shareholder control rights is that following the ensign of "shareholder democracy." The assumption of this argument is that there is some normative value and substantive reality in shareholder "democracy" rights. Analytically, however, this is perhaps the weakest argument in favor of retaining shareholder control. To have these rights one must posit that shareholders have an economic interest in the corporation. As discussed previously, however, there is typically no such interest in shareholders in the Chapter 11 context.\textsuperscript{329}

In the abstract, there is no logical reason for shareholders to have a right to vote on any issue or to have any other "democratic" rights in a corporation.

The fundamental error of the proponents of shareholder democracy is their failure to recognize that no reason exists why investors, who provide the firm with capital in anticipation of receiving a certain rate of return generated by the firm's assets, should have any input into the firm's decision making processes. On the contrary, investors are willing to supply capital, as opposed to starting and operating the enterprise themselves, precisely because they trust the expertise of professional managers.\textsuperscript{330}

The position of an equity investor does not in itself suggest any need for control over the enterprise in which the investment is made. In fact, every economic decision is, in a sense, a decision to invest in an entity. A lender to a corporation takes the risk that the debtor will fail and the money may not be repaid. The same is true of depositing money in a bank. These are the same sorts of risks that stockholders take but at different risk levels. There is no reason, however, to award creditors or bank depositors a right to con-

\textsuperscript{326} See supra notes 99-195 and accompanying text.
\textsuperscript{327} See supra notes 303-307 and accompanying text.
\textsuperscript{328} See supra notes 303-304 and accompanying text.
\textsuperscript{329} See supra notes 316-317 and accompanying text.
control or vote on the affairs of the corporation or bank. The creation of such rights in the shareholders may be no more than historical accident, since there is no *a priori* reason for the existence of such rights.

Moreover, it is recognized that, in bankruptcy, the decision-making process should include all interested parties, to whom, in a manner of speaking, the franchise is extended. Though they all have a voice, the ultimate decision-making power is placed in the bankruptcy court. This extended franchise in bankruptcy is contrary to the unilateral power granted shareholders with respect to control rights.

Another fundamental difficulty with the corporate-democracy justification is that there is substantial question concerning the existence, in any real sense, of anything that can be called shareholder "democracy." There is authority challenging the existence and efficacy of corporate "democracy." There are, indeed, many reasons for supposing that there is no such thing as corporate democracy deserving of protection. First, most shareholders have no real control over the corporate agenda on which they exercise their right to vote. Second, there is a lack of reliable information on which shareholders may make their voting decisions. The issues presented to shareholders are, for the most part, beyond the ability of ordinary investors to frame; present management determines and frames the issues presented to shareholders. Third, broad application of the "business judgment" standard to corporate decision making insulates the managers from concern over liability for im-

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331. See Korobkin, *supra* note 18, at 771 ("Under the Bankruptcy Code, . . . participation in the estate's decisionmaking widens to include any 'party in interest'. . . . ").

332. See *id.* (noting that the courts have the power to make "fundamental decisions" in bankruptcy cases).

333. See *infra* text accompanying notes 334-350.

334. See Buxbaum, *supra* note 3, at 1681-82 (finding "troubling" the lack of control shareholders have over the corporate agenda).

335. See *id.* at 1679-80 (discussing the deficiencies of state corporate law in ensuring that shareholders receive the level of information required for informed participation in the decision-making process).

336. One response to these arguments is that current inadequacy of information and other problems with corporate democracy are not reasons to deny shareholders the right to vote but are reasons to change the structure of the corporation, to accommodate a corporate framework more adequately controlled by the shareholders. While this is a legitimate position, the issue is beyond the scope of this Article. The present discussion is limited to the existing state of corporate democracy. In any event, theories originated to solve the problems of shareholder participation must first address the question of whether shareholders should have voting rights at all. See *supra* note 330 and accompanying text.
proper actions or actions contrary to the wishes of groups of shareholders. Fourth, there are many possible sources of contractual limitation on shareholder voting rights that further erode any concept of real shareholder democracy. These contractual restrictions often take the form of voting restrictions in certificates of incorporation or in charters of corporations. Directors are also sometimes given the power, in articles of incorporation, to decide issues on which super-majority votes are required of shareholders, thereby further diluting the shareholder franchise. Fifth, there is little shareholder control over the proxy mechanism or over nomination of directors voting on which is apparently the most revered of shareholder powers in the bankruptcy context. In view of the shareholders' lack of control over the "democratic" process, shareholder control over the election of directors is truly illusory.

Apart from systemic difficulties with the shareholder democracy theory, shareholders themselves have personal limitations that contribute to their ineffectiveness. One of the symptoms of these limitations is shareholder apathy, which causes many shareholders to remain uninvolved in the supposedly democratic process. This apathy exhibits itself in a lack of interest in the process—the ignoring of communications and the failure to complete and return proxy materials—and a seeming satisfaction with, or inertia regarding, present management. Accordingly, challenges to management are infrequent and monitoring of its performance is desultory.

337. Buxbaum, supra note 3, at 1683.
338. See id. at 1684, 1693-95.
339. See generally Barnard, supra note 3 (noting the failure of current proxy rules to provide shareholders with an effective role in the selection of directors and formulating board policies). See also George W. Dent, Jr., Toward Unifying Ownership and Control in the Public Corporation, 1989 Wis. L. Rev. 881, 903-07 (recognizing that separation of corporate ownership and control is a result of management's "domination" of the proxy system).
340. See supra note 59 and accompanying text. Obviously, however, when shareholders are clamoring to hold a meeting in bankruptcy, they have decided on a new slate of directors.
341. Professor Dent proposed to solve this problem by creating committees of the ten or twenty largest shareholders to nominate directors. See Dent, supra note 339, at 907-24. For a general discussion of issues of corporate control, and the separation of ownership and control, see Adolfe A. Berle & Gardiner C. Means, The Modern Corporation and Private Property (1933).
342. Daniel R. Fischel, Organized Exchanges and the Regulation of Dual Class Common Stock, 54 U. Chi. L. Rev. 119, 134 (1987) (suggesting that shareholders have "little interest in managing the firm and insufficient incentive to learn the details of management").
343. See id.
Procedural rights of shareholders, other than rights to meetings and to vote on directors, are limited in bankruptcy. For example, shareholders do not retain the right to vote on major sales of the estate's assets outside the ordinary course of business, as would be their right under state law. There is no veto power in the shareholders over a plan of reorganization. These procedural rights are limited, as are those of the creditors, which suggests that special treatment of shareholders with respect to control rights is unjustified.

Moreover, the role of shareholders in the process of plan development and confirmation is frequently destructive. The chief goals of shareholders frequently appear to be blackmail and delay, rather than assertion of justifiable managerial or economic interests. The result of "shareholder democracy" is often extortion of unwarranted consideration by threats of litigation. And these efforts are often successful in obtaining shareholder distributions not based upon economic reality. This type of activity, however, is inappropriate and should not be promoted. The "leverage" necessary for the proper assertion of shareholder rights exists in the new value exception to the absolute priority rule, and in the other protections provided for the interests of shareholders in Chapter 11.

Thus, the normative and other justifications for protection of control rights in bankruptcy reveal themselves under meticulous scrutiny to be substantively void. There is no existing corporate democracy worthy of protection. In and outside of the bankruptcy context, it is a myth which, in some circumstances, is advantageously asserted by shareholders in bankruptcy.

V. Application of the Theory

A. Two Approaches

Although control rights of shareholders are procedural rights not properly subject to protection in Chapter 11, rather than prior-

344. See 11 U.S.C. § 363(b) (1988); see also supra notes 235-237 and accompanying text.
345. See supra note 235 and accompanying text.
346. See 11 U.S.C. § 1129(b) (1988) (providing for the confirmation of a reorganization plan despite nonacceptance by one or more classes of claim or interest holders).
347. See supra notes 220-240 and accompanying text.
348. See supra notes 303-307 and accompanying text.
349. See supra notes 303-307 and accompanying text.
ity rights which are subject to such protection, the inquiry is not at an end. Although shareholder control rights in bankruptcy cannot be defended logically or normatively, this conclusion does not define the result that should follow.

Certain results do, however, flow from the indefensibility of continued shareholder control rights. If these rights are not worthy of protection, then the assumption that shareholders have the prerogative to exercise them dissolves. Without this assumption, the issue is not whether the exercise of these rights should be subject to prohibition through an injunction. The clear-case-of-abuse and related standards become historical paperweights of no utility or place in bankruptcy. Instead, the threshold assumption under the theory to be proposed is that shareholders do not have the ability in Chapter 11 to assert control rights. Beyond this, however, the theory does not tell us whether the exercise of control rights should ever be permitted and, if so, under what type of review or standard.

There are two possible paths for resolution of this question. One approach follows from the priority rights-procedural rights distinction. That distinction is based on the premise that bankruptcy law generally endeavors to preserve the substantive rights of parties, whether creditors or interest holders, under nonbankruptcy law. The rights actually preserved in bankruptcy are substantive priority rights, that is, entitlements created primarily under state law. Though bankruptcy law endeavors to protect these prebankruptcy entitlements, it does, at least temporarily, affect procedural rights. The control rights of shareholders are in this category.

Procedural rights are not forever and invariably annihilated in bankruptcy. There are circumstances in which they may be exercised, typically in those cases excepted from application of the Code's automatic stay provisions or where relief from the stay is

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351. See supra text accompanying notes 253-274.
352. In regard to the premise that the control rights of shareholders have value in themselves, which should be protected in bankruptcy, see supra notes 327-350 and accompanying text.
353. See supra notes 242-296 and accompanying text.
354. See supra text accompanying notes 253-274. Professors Jackson and Scott note, however, that bankruptcy does have some distributional effects: for purposes of this Article, it alters the "priority rights" of creditors in some circumstances. See Jackson & Scott, supra note 275, at 162-64, 178-202. Examples of these distributional effects are executory contract assumption, the "strong arm" clause of § 544, and the power to reinstate loans in Chapter 11 cases. 11 U.S.C. §§ 544(a), 365(a), 1129(b)(2)(A)(i) (1988).
355. See supra text accompanying notes 253-274.
356. See supra text accompanying notes 291-296.
granted on either of two grounds. Because creditors can exercise procedural rights in bankruptcy in some circumstances, shareholders should have similar rights.

Under this first approach, shareholders will only be able to exercise procedural rights when they can establish grounds for relief from stay. The ultimate result of the first approach, then, is not the total destruction of the procedural control rights of the shareholders, but essentially a shift in the burden of proof in determining whether they may be exercised. Under existing law, the onus is on the debtor in possession to enjoin the exercise of shareholder control rights. The evaporation of the premise favoring exercise of these rights results in a more logical placement of the burden on the shareholders. They should have to initiate a request for exercise of control rights, and to justify it as reasonable under the fundamental policies of bankruptcy law.

Whether shareholders will be permitted to wield control rights under this first approach is a question of relief from stay. If shareholders desire to exercise their rights, how will their request be analyzed? Assume that the shareholders are dissatisfied with the present course of a Chapter 11 case, and that a plan has been proposed that does not comport with their vision, due to a proposed distribution they consider inadequate. The automatic stay provides alternative grounds for relief that shareholders might assert. The Code allows relief from the stay concerning an act against property upon a showing of a debtor’s lack of equity in the property and the lack of necessity of the property for an effective reorganization. This ground for relief is not applicable here, however, because the enforcement of control rights is not the enforcement of an interest in property. Moreover, a showing of a lack of equity would undermine the shareholders’ request for relief.

The applicable standard is set forth in 11 U.S.C. § 362(d)(1), which states that the bankruptcy court shall grant relief from stay “for cause, including the lack of adequate protection of an interest in property of such party in interest ....” Cause is a broad and flexible standard, which can encompass many substantive ar-

358. Id. § 362(d).
359. See supra notes 100-105 and accompanying text.
361. Property interests are typically limited to the rights of secured creditors or those with specifically enforceable ownership interests in specific property. See supra notes 248-282 and accompanying text.
363. For a detailed application of the many factors to be considered in determining
arguments; but since the standard is being applied here to the novel
circumstance of shareholder control rights, there are no precedents
for determining whether "cause" for relief from stay exists in these
circumstances.

Before reaching the issue of the appropriate "cause" standard,
one difficulty with this first approach must be considered. The
problem arises from the peculiar nature of relief from stay. The
burden on all issues other than the issue of equity is on the person
opposing relief from the automatic stay, here the debtor in posses-
sion.\textsuperscript{364} As a result, the ultimate outcome in litigation over share-
holder control rights under a relief-from-stay approach might
arguably be the same as in a case analyzing injunctive relief under
existing standards.\textsuperscript{365} In both cases, the burden is on the debtor in
possession, though perhaps a stronger burden would be imposed in
the context of present standards concerning injunctive relief. Thus,
it can be argued that my approach, even if accepted, causes the same
result—the debtor in possession must establish grounds for block-
ing exercise of shareholder control rights. This argument runs
counter to the logic and policy behind the criticism of current prac-
tice dictated by the priority rights-procedural rights analysis.\textsuperscript{366}

This supposed difficulty dissipates, however, upon detailed
analysis of an analogy to an attempt by an unsecured creditor to
obtain relief from stay and enforce its procedural rights. Not having
a specifically enforceable interest in property of the estate, it is
highly unlikely that the unsecured creditor would be granted relief
from stay and allowed to proceed with litigation, or otherwise assert
procedural rights. Relief from stay is not restricted to persons hav-
ing a specifically enforceable interest in property,\textsuperscript{367} but such relief
is typically sought by and granted only to such a person. An un-
secured creditor's request to have its claim determined in another
court would typically be denied, since such claims are ordinarily de-
termined by the bankruptcy court under section 502 of the Bank-
ruptcy Code.\textsuperscript{368} A creditor's attempt to assert procedural rights to

\textsuperscript{365} See supra notes 100-195 and accompanying text.
\textsuperscript{366} See supra notes 242-296 and accompanying text.
U.S.C.C.A.N. 5836; Holtkamp v. Littlefield (In re Holtkamp), 669 F.2d 505, 508 (7th Cir.
1982) (holding that unsecured creditors may in certain circumstances be granted relief
from stay under § 362(d)).
execute and levy on property of the estate would also be denied to prevent violation of the principle of equality of treatment embedded in bankruptcy. In sum, courts are properly parsimonious in granting relief from stay to persons with unsecured claims. Only in extraordinary cases will an unsecured claimant be permitted relief from stay to pursue its claim outside the bankruptcy court. It has been held that to obtain relief of this kind an unsecured creditor must show that the debtor has engaged in morally reprehensible conduct, and that the creditor does not intend to enforce its claim against assets of the estate. Such relief might also be granted for reasons of judicial economy, where a complicated case involving an unsecured creditor's claim has been pending for a long period in a nonbankruptcy forum.

In the same way, it is evident that a shareholder's request for relief from stay to exercise procedural rights during a bankruptcy case would be subject to strict standards of analysis and would likely be denied. Application of these strict standards differs from the result in the typical case involving a request for injunctive relief by a debtor in possession, where shareholders typically triumph. If shareholders contend that their priority rights are not being properly taken into account and they are not slated to receive appropriate distributions under the plan, this kind of contention is precisely the type of issue to be determined by the bankruptcy court, and a request for relief from stay on this basis will undoubtedly be denied. To the extent the shareholders wish to obtain some preference in treatment, their request will likewise be denied as violating the priority principles of the Bankruptcy Code. The standard applicable to a shareholder request for relief to exercise control rights should logically be the same stringent standard applicable to requests for


372. This concept is exemplified in the idea that judicial economy is a factor to consider in determining whether relief from stay will be granted to allow litigation to proceed. See Sonnax Indus. v. Tri Component Prods. Corp. (In re Sonnax Indus.), 907 F.2d 1280, 1287 (2d Cir. 1990).

373. See supra text accompanying notes 100-195.

relief by unsecured creditors.375

The second potential approach generated by the determination that shareholder control rights are not entitled to protection, while perhaps lacking in some sense in consistency, gains in overall logic what the first has in consistency. Under this approach, it is posited that exercise of shareholder control rights in bankruptcy—having been found to be unworthy of protection when analogized to similar rights of creditors—should not be permitted at all. A request for relief from stay would not even be countenanced under this proposal. In support of this proposal, it must be noted that shareholders have no economic interest in an insolvent corporation and are, in any case, protected in their priority rights by various mechanisms.376 The creditors, despite their superior priority rights, have no control rights; and, no such control rights should logically be granted to shareholders. Under this approach, shareholders should be content to have rights similar to those of senior classes, the creditors. To these rights, shareholders must be limited.

For one enamored of consistency, the first approach may seem attractive. For policy reasons, however, the second is more palatable. Nonetheless, it is not certain that results will differ under either approach. It is hard to imagine a case under the first approach where shareholders could establish justification to obtain relief from stay. Such a case would probably be one where a trustee should be appointed instead. Outcomes under the two approaches may thus be consistent. Ultimately, either approach will result in very few, if any, cases in which shareholders are permitted to exercise control rights over the insolvent corporation.

Adoption of either approach would result in at least the following foreseeable benefits: increased efficiency, distributional honesty, and an increased asset fund for distribution to creditors. Efficiency would result from the inability of shareholders to delay and sabotage plan negotiations through unjustified use of control rights.377 Knowing that control rights are not protected, shareholders will not ordinarily attempt to assert them. Less time would be spent litigating and posturing over shareholder control issues, and more time would be expended in attempting to maximize values for creditors, and in confirming and consummating a plan. Distributions will more faithfully mirror congressional intent, since the abil-

375. See supra notes 367-372 and accompanying text.
376. See supra notes 220-240, 316, 317, and accompanying text.
377. See supra notes 303-308 and accompanying text.
ity of shareholders to make illicit demands through threatened and actual exercise of control rights will be eliminated. Shareholders will no longer have tools to distort the priority scheme dictated by state and bankruptcy law. In this way, lower payments to shareholders and higher payments to unsecured creditors will follow. Assets of the estate will not be funneled into fruitless disputes, thereby retaining more assets in the estate for ultimate distribution to creditors. Thus, the value of estates will be enhanced, and the fundamental goal of distributional maximization will be served.

B. Implications of the Analysis

While the focus of this Article has been the narrow issue of shareholder dominion over the debtor in possession through exercise of control rights, and the availability of injunctive relief to check those rights, the resulting analysis has implications for issues of corporate governance generally. To conclude that shareholders are not—and probably should not be—free to dictate the personnel and policy of the debtor in possession creates a control vacuum into which substance must be added. Logically and economically, the shareholders are not the proper pilots of the debtor in possession. From this point, it is easy to conclude that control must devolve upon creditors.

The heightened fiduciary duty said to reside in the debtor in possession runs to creditors.378 Thus, one may contend that this duty ordains control in the creditor body, after the focus of the duty is wrested from the shareholders upon insolvency. This fiduciary duty, however, is still owed to other parties, including shareholders.379 Thus, it cannot be the fiduciary duties of the debtor in possession alone that compels us to champion the cause of creditors.

From an economic perspective, it is clear in the case of insolvency that the shareholders have no justifiable claim to control. When equity investors own shares of a corporation that has become insolvent, all economic interest in the debtor in possession devolves upon creditors. Control must rightly be exercised by those with an economic interest in the debtor. The debtor in possession should thus be controlled by the creditor body.

Such a theory of corporate governance over a debtor in posses-

378. See supra note 210 and accompanying text.
379. See supra note 210 and accompanying text.
sion has been proposed by Christopher Frost.\textsuperscript{380} Under this theory, the governance structure of a corporation changes upon insolvency; it is those persons with "residual claims"—shareholders while the corporation is solvent, creditors in the case of insolvency—who should control the deployment of assets.\textsuperscript{381} The focus here is on proper allocation of economic control. The group properly in control of the corporate governance mechanism is the group having residual claims in the debtor's assets—that is, the last priority level entitled to a distribution under application of the absolute priority rule.\textsuperscript{382} This group may be secured creditors, administrative claimants or some other level of priority claimants, or it may be the mass of unsecured creditors.

A difficulty with this idea recognized by Professor Frost is that identifying the group with the residual claims can be problematic.\textsuperscript{383} To make this determination with a reasonable degree of certainty requires a valuation of the debtor's assets.\textsuperscript{384} Such an exercise is neither desirable nor practicable in many cases. Moreover, valuation is not a science and is itself fraught with uncertainty. We can never be certain that we have chosen the right group as the one with residual claims. To recognize this is to comprehend that we can never be assured that corporate control is vested in the economically correct party.

A theory similar to that of Professor Frost has been presented by David Skeel in his thorough analysis of voting rights in Chapter 11 cases.\textsuperscript{385} Professor Skeel argues that in bankruptcy, shareholders are not the appropriate persons to exercise control over management of the debtor in possession through the use of voting rights.\textsuperscript{386} After stripping shareholders of voting power, Skeel deposits this power in the broad, unsecured creditor class as the presumptive residual owners of the debtor.\textsuperscript{387} Professor Skeel thus avoids the problem inherent in the Frost analysis of identifying the residual owners. In so doing, however, Skeel makes the assumption that the class of unsecured creditors are the residual owners of the debtor. While this may be true in most cases, it is clearly wrong in some.

\textsuperscript{381} \textit{Id.} at 111-12, 136-37.
\textsuperscript{382} See id.
\textsuperscript{383} Frost, \textit{supra} note 380, at 136-37.
\textsuperscript{384} See \textit{id.} at 112, 136-37.
\textsuperscript{386} See \textit{id.} at 510-13.
\textsuperscript{387} \textit{Id.} at 511.
Thus, Skeel's conclusion will necessarily cause control to reside in a group not always having an appropriate economic interest in the estate, that is, the "residual" interest in the estate.

The Frost and Skeel theories are far superior to the present scheme—control remaining in the shareholders. Nonetheless, the deficiencies of these theories may properly lead to a search for a superior method of resolving the corporate control problem of the debtor in possession.

When considering the question of who should be in control of the debtor in possession, it is our natural tendency to look for some person or group to point to as being the proper person or group to be in control. Someone must be the "right" person. If one looks closely at the peculiar circumstance of bankruptcy, however, perhaps there is no reason to find a "right" person or "right" group to control the corporation. "Control" rests in a person or group for one purpose, to make decisions. Were there no decisions to be made, there would be no need for "control."

Substantive decisions in bankruptcy are not vested in the debtor in possession. Other than decisions concerning the ordinary course of business, which generally do not affect the substantive rights of parties, the decisions of the debtor in possession are meaningful only after action by the bankruptcy court. Thus, real corporate control resides in the bankruptcy court or perhaps more properly, in the system created by the Bankruptcy Code. The control is exercised through the adversarial process, in which the parties assert their positions and these contending views are synthesized in the decision of the court.

Under this "Adversarial Model," one need not find a person or group for whose benefit control must be exercised. Instead, it would be understood that control does not truly reside in any person or group, but in the adversarial system itself, and in the contending interests represented in that system as synthesized by the bankruptcy court. Corporate governance in bankruptcy, then, is the adversarial system itself and the decisional rules governing that system.

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388. See supra notes 220-240 and accompanying text.
389. See supra notes 220-240 and accompanying text.
390. See Kelch, supra note 210, at 1363-77 (discussing the author's proposed "Adversarial Model" for analyzing the function and duties of the debtor in possession in a Chapter 11 case).
391. Id. at 1364.
392. Id.
It may be contended that this system results in only imperfect representation of the competing interests in the process. There is empirical evidence that the interests of creditors are not well represented in the adversarial system as it exists. To this there are several responses. First, to say that creditors do not protect their own interests assumes that the court does not have the ability to consider these interests independently of their assertion by the creditors themselves. Second, if creditors knew that the system required their vigilance, rather than reliance on the fiduciary duty of the debtor in possession, perhaps they would be more vociferous in asserting their rights. Third, if it is true that the present system does not adequately take into account the many competing interests, this does not mean that there is no way to improve the adversarial system to make it more perfectly reflect the competing interests in the process. For example, incentives for committee membership might be made available, such as compensation for taking a position on the committee. Similar incentives might be provided for parties asserting beneficial positions by expanding the administrative priority for reimbursing the costs of beneficial creditor efforts.

To say that it is the adversarial system itself that is “corporate governance” in Chapter 11 cases is to deny that there is a proper repository for corporate governance, or a proper beneficiary of the fiduciary obligations of the debtor in possession. There is no group that need be identified for whose benefit control must be exercised. For those in control of the debtor in possession, it means that they are free to exercise control for the benefit of whatever group they deem fit, subject to the oversight of the bankruptcy court, and under the control mechanisms in place under the Bankruptcy Code. The consequence of such a system would be the exercise of control in the perceived self-interest of those managing the debtor in possession, without the apparition of a vague fiduciary duty. Such a

393. See Lynn M. LoPucki, The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code? (Second Installment), 57 AM. BANKR. L.J. 247, 272-73 (1983) (concluding from an empirical study of Chapter 11 cases filed in 1979-1980 in the Western District of Missouri, that, with few exceptions, creditors were “effectively excluded from the process of reorganization”).

394. See 11 U.S.C. §§ 503(b)(3)(B)-(D), 507(a)(1) (1988) (providing for priority distribution for certain “actual and necessary” expenses incurred by creditors which benefit the debtor’s estate or contribute to the administration of the bankruptcy case).

395. See supra notes 220-240, 385 and accompanying text.

396. See Kelch, supra note 210, at 1368.
system is predictable, practical and realistic.397

CONCLUSION

It has been assumed in previous analyses of shareholder control rights that these rights have a normative content coloring them with immutability. Analysis of these rights consistently with similar rights of creditors through the mechanism of the priority rights-procedural rights distinction reveals that no such respect is due to these rights of shareholders. The voting, meeting, and other control rights of shareholders are no more than procedural rights, which should be restricted in the same way similar creditors' rights are restricted, if not more. Creditors are not permitted in usual cases to exercise these rights, and shareholders should be treated accordingly. Application of this analysis would result in the more efficient operation of Chapter 11 and increased distributions to creditors in conformance with the priority scheme intended by the Bankruptcy Code. Since Chapter 11 itself has been the subject of considerable dissatisfaction, perhaps this analysis will be useful in making it more acceptable to all constituencies.

397. See id. at 1368-70.