# CONTROL RIGHTS AND CHAPTER 11'S EXPANDING SCOPE

*by*

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*Control rights are rights to control how a debtor uses certain resources, such as rights to foreclose on collateral, terminate a contract, or prevent assignment of contractual rights. Law and economics scholars have mused whether bankruptcy law should supplant control rights, but they assumed that all control rights share the same goal: to protect a party's investment in a company.*

*This Article rejects that assumption. It shows that there are two kinds of control rights that bankruptcy law should treat differently. One kind—what this Article dubs "investment-backed control rights"—aims to protect a party's investment in the debtor. Since the debtor is best positioned to put its assets to their highest and best uses, the debtor should be able to convert investment-backed control rights from property rules to liability rules. The other kind—what the Article calls "spillover control rights"—is designed to protect a counterparty's enterprise from how a debtor uses a resource. Franchisor-franchisee, sports league-team, and partnership-partner relationships illustrate these dynamics. Since the right holder has the incentives and knowledge to determine how to optimally use that resource, bankruptcy law should respect the property-rule remedies used to enforce spillover control rights.*

*This Article reveals that these different control rights create their own sets of complementarities at different levels of an organization. Traditional law and economics accounts call for courts to maximize the debtor's, and only the debtor's, resources. This Article suggests bankruptcy law should have a broader scope: it should aim to preserve the complementarities that investment-backed and spillover control rights generate.*

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## I. Introduction

Control rights determine how a party may use a particular resource or set of resources.[1] The right to foreclose on collateral, appoint members to a company's board of directors, prevent a counterparty from assigning a contract to a counterparty, and terminate a contract are all examples of control rights. They're embedded in endless contracts that comprise a large portion of a firm's value.[2] They're also important because they allow the right holder to call the shots on how a resource is used.[3]

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[1] In this Article, I use "control rights over resources," "control rights over a debtor's resources," and "control rights" interchangeably.

[2] *See* Kenneth Ayotte & Henry Hansmann, *Legal Entities as Transferable Bundles of Contracts*, 111 MICH. L. REV. 715, 725 (2013) (observing that "a legal entity is, quite literally, a 'nexus of contracts' in the sense that it serves as the common party to . . . many contracts . . . with suppliers, employees, and customers" and that "[i]n many cases, the most important assets the firm holds are its contractual rights").

[3] *See* Robert K. Rasmussen, *Taking Control Rights Seriously*, 166 U. PA. L. REV. 1749,

Bankruptcy law usually forces control right holders to make do with cash.[4] Put differently, bankruptcy law usually converts control rights from property rules to liability rules.[5] While law and economics scholars have debated to what extent bankruptcy law should supplant control rights, they uniformly view control rights as a way to protect a party's investment in a distressed company.

This Article challenges that assumption by distinguishing between two kinds of control rights. One kind is "investment-backed control rights," which protect a counterparty's investment in a company. Foreclosure, termination, anti-assignment, and governance rights all fall into this category. The other is "spillover control rights." They are designed to protect a counterparty's *enterprise* from how a debtor uses a shared resource that impacts the value of the counterparty's enterprise. To be precise, spillover control rights arise between parties A and B when (1) A has rights to control a resource, (2) B uses the resource, (3) A's enterprise is sensitive to how the resource is treated, and (4) B's enterprise value is dependent upon the resource's value and, consequently, the A's enterprise value. This description accounts for franchisor-franchisee, team-league, and joint venture relationships.

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1753 (2018) (distinguishing between control rights, which "determine the size of the pie," and cash flow rights, which "merely determine how the pie is divided").

[4] In this Article, I use "bankruptcy," "bankruptcy law," and "chapter 11" interchangeably. This Article focuses on business bankruptcies (including small business bankruptcies under subchapter V of chapter 11) and brackets the issue of control rights and personal (as opposed to business) bankruptcies. Personal bankruptcies privilege the "fresh start" policy, which "prevent[s] economic oppression by relieving honest unfortunate debtors of their burdens and so allowing them to start again." *See* Joseph E. Simmons, Note, *Reconstructing the Bankruptcy Power: An Originalist Approach*, 131 YALE L.J. 306, 358 (2021). The same concerns don't arise with business debtors since limited liability shields business owners from their businesses' debts and allows them to start new businesses. *See* Douglas G. Baird, *A World Without Bankruptcy*, 50 L. & CONTEMP. PROBS. 173, 181–85 (1987) [hereinafter Baird, *A World Without Bankruptcy*].

[5] *See* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089, 1092 (1972) (distinguishing between property rules and liability rules); *see also* Vincent S.J. Buccola, *Bankruptcy's Cathedral: Property Rules, Liability rules, and Distress*, 114 N.W. L. REV. 705, 708–09 (2019) [hereinafter Buccola, *Bankruptcy's Cathedral*] (applying the distinction between property and liability rules to bankruptcy proceedings).

Bankruptcy policy calls for treating these control rights differently. Bankruptcy law, like property law, seeks to give control rights to the party that is optimally suited to determine how to best use a resource. When a firm is economically viable but faces financial distress, it has resources that, when used in concert, create complementarities; the whole is greater than the sum of its parts. Parties may try to extract value from the firm, however, leading them to create commons and anticommons problems that threaten to tank the firm's going-concern value. To ameliorate these problems and preserve the complementarities between the debtor's resources, bankruptcy law rightly enforces investment-backed control rights with liability, not property, rules. Where spillover control rights are concerned, the resource's value—and some portion of the debtor's value—is in the counterparty's enterprise. That relationship generates complementarities between the debtor and the counterparty. Since the counterparty's enterprise is the locus of the resource's value and will internalize the cost of how that resource is used, the counterparty is best positioned to preserve those complementarities and consequently should determine how to use the shared resource. Bankruptcy law largely reflects this distinction in control rights in the policies most important to maximizing the value of the debtor's resources: the automatic stay, § 363 sales, and executory contracts.

The distinction between investment-backed and spillover control rights sheds new light on chapter 11's scope. Conventional wisdom states that chapter 11 ought to maximize the value of the debtor's resources alone. It must not cross the "bankruptcy partition" and maximize value elsewhere. The distinction between control rights shows that chapter 11 should adopt a more nuanced goal: chapter 11 should preserve the complementarities the various control rights generate. A debtor baseball team, for instance, creates complementarities between its stadium, ticket revenues, player and vendor contracts, and so on, but Major League Baseball creates complementarities across teams. The key is for chapter 11 to salvage the set of complementarities that are created at different levels of an organization, even if that requires looking past the bankruptcy partition.

The Article proceeds as follows. Section II provides an overview of prior theories of control rights in bankruptcy. Section III lays out the distinction between investment-backed and spillover control rights. Section IV shows how bankruptcy law properly distinguishes between and treats both kinds of control rights. Section V illustrates how this Article's account of control rights reveals bankruptcy law's mandate to preserve

complementarities across the bankruptcy partition. Section VI concludes by highlighting control rights' importance and calling for increased study of the roles they play in corporate reorganizations.

## II. The Conventional Wisdom

When a debtor files for bankruptcy, it has a set of resources at its disposal. The bankruptcy filing creates an estate consisting of all the debtor's legal and equitable rights in property,[6] property the debtor's creditors would have been able to reach outside of bankruptcy,[7] and property subject to avoidance actions.[8]

Resources come into the debtor's estate with whatever nonbankruptcy restrictions saddle the property¾no more and no less.[9] A debtor cannot bring bailed goods into its estate.[10] A debtor who files for bankruptcy with only a half undivided interest in an oil well only brings that interest into the estate.[11] A properly perfected lien on the debtor's property is attached to it no less inside bankruptcy proceedings than outside.[12]

Thus, resources enter the debtor's bankruptcy estate with control rights intact. Control rights are rights to control how a debtor uses a resource. Control rights include the right to foreclose on collateral upon a debtor's default;[13] terminate a contract upon a debtor's default;[14] prevent a debtor

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[6] *See* 11 U.S.C. § 541(a).

[7] *See id.* § 544 (vesting bankruptcy estate with powers of hypothetical lien creditor and powers available to creditors under nonbankruptcy law).

[8] *See id.* §§ 547, 548.

[9] *In re* Sanders, 969 F.2d 591, 593 (7th Cir. 1992) ("[A] trustee takes the property subject to the same restrictions that existed at the commencement of the case."). Because a debtor in a chapter 11 case is usually vested with most of the trustee's powers and responsibilities as a debtor in possession, the same restrictions apply. *See* 11 U.S.C. § 1107.

[10] *See In re* Quigley Motor Sales, Inc., 75 F.2d 253, 255 (2d Cir. 1935) ("Mere possession of another's property passes no interest to the bailee's trustee in bankruptcy.").

[11] *See* Richardson v. The Huntington Nat'l Bank (*In re* CyberCo Holdings, Inc.), 382 B.R. 118, 135 (Bankr. W.D. Mich. 2008).

[12] *See* David A. Skeel, Jr., *What is a Lien? Lessons from Municipal Bankruptcy*, 2015 U. ILL. L. REV. 675, 680 (describing that an "attribute of a paradigmatic lien is that the property interest it creates is effective both inside and outside of bankruptcy").

[13] *See, e.g.*, U.C.C. § 9-609 (AM. L. INST. & UNIF. L. COMM'N 2010).

[14] *See, e.g.*, Suburban Beverages v. Pabst Brewing Co., 462 F. Supp. 1301, 1312 (E.D. Wis. 1978) (observing that "plaintiff's failure to comply with that term in the contract

from assigning a contract to a counterparty;[15] insist upon a right of first refusal over one of the debtor's assets;[16] require the debtor to comply with quality controls in a franchise agreement;[17] and shape how a debtor manages a fund's capital.[18]

How should bankruptcy law treat these control rights? The classic law and economics theory of corporate reorganizations, the "Creditors' Bargain," tells us that bankruptcy law should respect those control rights so long as they keep resources in the bankruptcy estate. On that account, chapter 11 should focus on maximizing the value of the debtor's resources.[19] But since altering creditors' rights in bankruptcy may reduce companies' access to capital ex ante, a debtor cannot wholly sacrifice counterparties' rights to maximize the value of its resources.[20] The Creditors' Bargain consequently commands bankruptcy courts to both respect nonbankruptcy rights and modify them only as needed to facilitate bankruptcy's collective

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constituted a material breach and thereby entitled defendant to terminate the contract"); 14 WILLISTON ON CONTRACTS § 43:10 (4th ed. 2008) [hereinafter WILLISTON ON CONTRACTS] (outlining circumstances under which breach by contract party allows counterparty to consider obligations under contract terminated).

[15] *See, e.g.*, 29 WILLISTON ON CONTRACTS, *supra* note 14, at § 74:22.

[16] *See, e.g.*, 25 WILLISTON ON CONTRACTS, *supra* note 14, at § 67:89.

[17] *See, e.g.*, 3 MCCARTHY ON TRADEMARKS AND UNFAIR COMPETITION § 18:48 (5th ed. 2023) [hereinafter MCCARTHY ON TRADEMARKS] (discussing importance of quality controls in franchise and trademark licensing schemes).

[18] *See, e.g.*, Paul Gompers & Josh Lerner, *The Use of Covenants: An Empirical Analysis of Venture Partnership Agreements*, 39 J. L. & ECON. 463, 479–84 (1996).

[19] *See* Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 582 (1998) (positing that "the aim should be to ensure that a firm's assets are put to their best use"); Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 824 (1987) [hereinafter Baird, *A Reply to Warren*]; Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 103 (1984) [hereinafter Baird & Jackson, *Comment on Adequate Protection*] ("A collective insolvency proceeding is directed toward reducing the costs associated with diverse ownership interests and encouraging those with interests in a firm's assets to put those assets to the use the group as a whole would favor.").

[20] *See* Baird, *A Reply to Warren*, *supra* note 19, at 825–26 (describing the debtor's incentives to engage in forum shopping); Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807, 1816 (1998) (noting wide agreement over the importance of making a bankruptcy system that encourages efficient investment in firms ex ante).

proceeding.[21] Since removing resources from the debtor's bankruptcy estate would undermine the collective proceeding, bankruptcy law neuters those rights and replaces them with cash.[22]

Secured credit is a classic example of how the analysis works. Consider the case of a lender who extends a $1,000 loan to a newspaper publisher secured by the publisher's printing press. When the publisher files for bankruptcy, the printing press remains a resource at the company's disposal, subject to the lender's lien. The automatic stay prevents the lender from foreclosing on the machine.[23] The lender obtains the right to adequate protection payments to preserve the value of the collateral in lieu of its foreclosure rights.[24]

The Creditors' Bargain theory takes a different approach when it comes to control rights that leave resources out of the bankruptcy estate. Those control rights should be respected in full because they are essentially

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[21] *See* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 22 (Beard Books 2001) [hereinafter JACKSON, LOGIC AND LIMITS] (arguing that bankruptcy law "should act to ensure that the rights that exist are vindicated to the extent possible"); Baird & Jackson, *A Comment on Adequate Protection*, *supra* note 19, at 100 ("Bankruptcy law should change a substantive nonbankruptcy rule only when doing so preserves the value of assets for the group of investors holding rights in them."); Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 860–68 (1982) (modeling how, absent transaction costs, creditors would hypothetically agree to collective debtor-creditor proceeding to maximize the value of the debtor's estate for the benefit of its creditors).

[22] *See* Barry E. Adler, *The Creditors' Bargain Revisited*, 166 U. PA. L. REV. 1853, 1855 (2018); JACKSON, LOGIC AND LIMITS, *supra* note 21, at 14 ("To the extent that a non-piecemeal collective process . . . is likely to increase the aggregate value of the pool of assets, its substitution for individual remedies would be advantageous to the creditors as a group."); DOUGLAS G. BAIRD, ELEMENTS OF BANKRUPTCY 97 (6th ed. 2014) [hereinafter BAIRD, ELEMENTS]; Thomas H. Jackson, *Translating Assets and Liabilities to the Bankruptcy Forum*, 14 J. LEG. STUD. 73, 75–76 (1985) [hereinafter Jackson, *Translating Assets and Liabilities*]; Baird & Jackson, *Comment on Adequate Protection*, *supra* note 19, at 106–08; Jackson, *Bankruptcy, Non-Bankruptcy, and the Creditors' Bargain*, *supra* note 21, at 866–70.

[23] *See generally* 11 U.S.C. § 362(a).

[24] *See id.* § 361; Contrarian Funds, LLC v. Aretex, LLC (*In re* Westpoint Stevens, Inc.), 600 F.3d 231, 260 (2d Cir. 2010) ("In bankruptcy proceedings, a secured creditor ordinarily has a statutory right to adequate protection payments to protect its interests against the diminution in value of its security."), *abrogated by* MOAC Mall Holdings LLC v. Transform Holdco LLC, 598 U.S. 288 (2023).

property rights that belong to a party other than the debtor.[25] So, for instance, the Creditors' Bargain theory posits that bankruptcy law ought to respect anti-assignment provisions in executory contracts.[26] Running roughshod over these restrictions allows debtors to do far too much in the name of rehabilitating themselves.[27]

Other law and economics scholars similarly take current bankruptcy law to task for wrongfully overriding control rights. One recent contribution to the literature argues that bankruptcy properly converts control rights' remedies from property rules to liability rules when the parties are unable to cost-effectively allocate control rights among themselves across all states of affairs.[28] But when parties are able to create state-contingent toggles for their control rights, bankruptcy law has a limited role to play.[29] The automatic stay, for instance, wrongfully prevents secured creditors from using state-contingent control rights to take over a company when it faces financial distress.[30] Another article similarly observes that lenders can bargain for control rights over their borrowers and queries whether they should be able to do so both in and out of bankruptcy.[31]

All these theories have a conception of what control rights do. On these accounts, control rights give the right holders the power to direct the company's use of its resources.[32] Control rights consequently increase the

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[25] *See, e.g.*, BAIRD, ELEMENTS, *supra* note 22, at 98 (explaining that restrictions on selling assets that apply outside of bankruptcy equally apply in bankruptcy); JACKSON, LOGIC AND LIMITS, *supra* note 21, at 104 (noting the general principle "that assets become property of the estate but are fully subject to their nonbankruptcy attributes"); Jackson, *Translating Assets and Liabilities*, *supra* note 22, at 102 (noting that control rights "are tantamount to having a property (and priority) right in the asset and should be treated like other recognized property rights in bankruptcy").

[26] *See, e.g.*, BAIRD, ELEMENTS, *supra* note 22, at 130–32; JACKSON, LOGIC AND LIMITS, *supra* note 21, at 115–16.

[27] Professor Mooney's "Procedure" theory similarly calls for bankruptcy to respect counterparties' control rights if they keep resources in the debtor's estate. *See* Charles W. Mooney, Jr., *A Normative Theory of Bankruptcy Law: Bankruptcy as (is) Civil Procedure*, 61 WASH. & LEE L. REV. 931, 1043–45 (2004).

[28] *See* Buccola, *Bankruptcy's Cathedral*, *supra* note 5, at 726.

[29] *See id.* at 742.

[30] *See id.* at 743–44.

[31] *See* Rasmussen, *supra* note 3, at 1757, 1769–75.

[32] *See id.* at 1757 (identifying control rights with the ability to "affect and constrain management's exercise of the control that it enjoys over the company"); Buccola, *Bankruptcy's Cathedral*, *supra* note 5, at 713–15 (associating control rights with

lenders' chances at obtaining greater recoveries on their investments. The more the company puts its resources to higher and better uses, the more cash it can make and return to the lenders.

## III. Two Kinds of Control Rights

Not all control rights are designed to protect a party's investment in a company. Some are designed to protect a party from the company. This Section will explore both kinds of control rights.

### A. Investment-Backed Control Rights

Enterprises are inherently collaborative. Investors pool capital in discrete entities to fund projects they think will generate returns sufficient to make the investment worthwhile. Each investment consequently gives the investor a stake in the enterprise. Loans, equity investments, and contracts all represent different investments in the enterprise.

At their core, investments represent rights to the company's value that are effective against the company and other investors.[33] A secured creditor is entitled to that value before the company's unsecured creditors receive any of that value, and the unsecured creditors are entitled to that value before any of the equity holders can obtain that value.[34] When the firm does well, equity holders are entitled to the firm's residual value; that is, they're entitled to the firm's value after it satisfies its creditor's claims.[35] When it does poorly, some subset of the firm's creditors becomes its residual owners.[36]

Ideally, investments should enhance the company's value, not interfere

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determining how to use borrower's resources); Baird & Jackson, *Comment on Adequate Protection*, *supra* note 19, at 106–09 (associating nonbankruptcy remedies with the ability to capture part of a firm's value).

[33] *See* DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS, AND MATERIALS ON SECURITY INTERESTS IN PERSONAL PROPERTY 1 (1984) (distinguishing between property and priority rights, where property rights are rights as against the debtor and priority rights are rights as against the debtor's other stakeholders).

[34] *See* Anthony J. Casey, *The Creditors' Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759, 774–75 (2011).

[35] *See id.*

[36] *See* Baird, *A World Without Bankruptcy*, *supra* note 4, at 192.

with it. Finance theory teaches that there is no inherent connection between a firm's value and its capital structure.[37] How assets are used and the value they generate has in principle little to do with how value is divided among stakeholders.

Yet that's too simple a story. Attentive investors care about how a company conducts its business. They may try to control the company so that it makes good on the investment.[38] These are "investment-backed control rights." These control rights essentially give counterparties downside protections to increase the expected value of their investments.

Some investors will stake control rights over particular resources. Merchants' remedies illustrate the point.[39] Nonpayment entitles a seller to withhold delivery of goods that a company purchased.[40] If a company purchases goods but the seller discovers the company may be insolvent, the seller may refuse to deliver the goods,[41] insist the company present cash on delivery for the goods,[42] and reclaim some of those goods that were delivered.[43] The same goes for other trade creditors. A mechanic who performs maintenance on a company's fleet of trucks can assert mechanics' liens on the trucks if the company requested the mechanic's services yet failed to pay for them.[44]

Other investors wield control over substantially all of a company's resources. Shareholders wield control either directly in closely-held corporations or indirectly by electing the directors of publicly traded ones.[45] Creditors can obtain security interests in substantially all of a company's

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[37] *See generally* Franco Modigliani & Merton H. Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment*, 48 AM. ECON. REV. 261 (1958).

[38] *See* Douglas G. Baird & Robert K. Rasmussen, *Control Rights, Priority Rights, and the Conceptual Foundations of Corporate Reorganizations*, 87 VA. L. REV. 921, 922 (2001) [hereinafter Baird & Rasmussen, *Control Rights*] ("Investors care intensely about ensuring that control of a firm's assets resides in able hands in good times; they care even more in bad times.").

[39] *See* John A. Pearce II & Ilya A. Lipin, *Supplier Tactics for Dealing with Financially Distressed Corporate Customers*, 8 HASTINGS BUS. L.J. 405, 432–36 (2012).

[40] *See* U.C.C. § 2-703 (AM. L. INST. & UNIF. L. COMM'N 1977).

[41] *See id.* § 2–702(1).

[42] *See id.*

[43] *See id.* § 2-702(2).

[44] *See, e.g.*, Gen. Elec. Capital Auto Lease v. Violante, 848 A.2d 732, 737 (N.J. 2004) (describing New Jersey's Garage Keeper's Lien Act).

[45] *See* FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 63, 232–34 (1991).

assets.[46] After the firm nears or triggers a violation of a covenant in the underlying loan,[47] creditors can bargain for the right to influence the firm's management in exchange for waiving or forbearing their remedies.[48]

Investment-backed control rights can conflict when several counterparties seek to use them.[49] Bond indentures illustrate the point. A corporation's shareholders are its initial constituency, but when it issues bonds, the bondholders become a second one. Until the company satisfies them, the bondholders have priority over the shareholders to the company's cashflows. The shareholders, though, still control the company's policies. Shareholders can use their control rights to divert value away from the bondholders and toward themselves, such as by increasing the company's dividend rate or issuing additional debt that primes the bondholders'

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[46] *See* Edward J. Janger, *The Logic and Limits of Liens*, 2015 U. ILL. L. REV. 589, 596 (noting "that loan documents are often structured to manifest an intention to encumber all assets in favor of a secured lender: mortgages are granted against all real property; leases are assigned; and an Article 9 security interest is granted in all property within the scope of Article 9"); Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 813 (2004) (defining "enterprise control" as "giv[ing] the secured creditor control of an entire enterprise and mak[ing] it possible for the creditor to realize going concern value").

[47] *See generally* Greg Nini et al., *Creditor Control Rights, Corporate Governance, and Firm Value*, 25 REV. FIN. STUD. 1713 (2012) (finding that covenant violation leads to amended terms that provide creditors with increased controls over violating firms).

[48] *See* Frederick Tung, *Leverage in the Board Room: The Unsung Influence of Private Lenders in Corporate Governance*, 57 UCLA L. REV. 115, 135–40 (2009); Douglas G. Baird & Robert K. Rasmussen, *Private Debt and the Missing Lever of Corporate Governance*, 158 U. PA. L. REV. 1209, 1216–23, 1233–34 (2006) [hereinafter Baird & Rasmussen, *Private Debt*]. To be sure, the secured lender's threat to foreclose on the collateral may be an empty one. The lender and the company may both know that the collateral will generate more cash in the company's hands than if sold at a foreclosure auction. *See* Baird & Rasmussen, *Private Debt*, *supra*, at 1229. But the secured creditor may only have to declare a general default. Because the secured creditor is assumed to monitor the firm, declaring a general default broadcasts to other creditors to steer clear of the firm. *See id.* at 1232; *see also* Saul Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 YALE L.J. 49, 56 (1982) (arguing that secured creditors may be entitled to priority because they are better able to monitor debtors for misbehavior). This signal can plague the firm's ability to obtain new capital. *See* Kenneth M. Ayotte & David A. Skeel, Jr., *Bankruptcy Law as Liquidity Provider*, 80 U. CHI. L. REV. 1557, 1579–85 (2013).

[49] *See* George G. Triantis & Ronald J. Daniels, *The Role of Debt in Interactive Corporate Governance*, 83 CAL. L. REV. 1073, 1090 (1995).

claims.[50] Bondholders write restrictive covenants into bond indentures to forestall these efforts.[51]

B. Spillover Control Rights

Some control rights are not about maximizing one's investment in an enterprise. Sure, a party with these control rights usually invests in the enterprise and it, too, expects a return on that investment. But these control rights perform a very different function from investment-backed control rights. Rather than protect an investment in the enterprise, spillover control rights seek to protect the right holder (party A) from the harms that stem from how a resource user (party B) uses a resource. More specifically, these control rights arise when (1) A has rights to control a resource, (2) B uses the resource, (3) A's enterprise is sensitive to how the resource is treated, and (4) B's enterprise value is dependent upon the resource's value and, consequently, the A's enterprise value. In these relationships, parties share access to a resource, and complementarities between the debtor and the counterparty can be created only if the debtor (and other resource users) use the resource correctly. The debtor draws on that resource in its ordinary operations, and so some part of its value as a going concern is tied to the counterparty's value. Since the counterparty, not the debtor, internalizes the costs and benefits of how that resource is used, the counterparty has control rights over it.

1. Franchises

Franchises illustrate this dynamic. A franchise features a franchisor who owns and maintains a brand and intellectual property associated with that brand. The franchisor licenses its rights to franchisees, who operate as dealers of goods or services associated with the franchisor's brand. To maintain the brand, the franchisor exercises control rights over how the franchisees operate their businesses. Those control rights arise because (1)

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[50] *See* Clifford W. Smith Jr. & Jerold B. Warner, *On Financial Contracting: An Analysis of Bond Covenants*, 7 J. FIN. ECON. 117, 118–19 (1979).

[51] *See id.* at 125–46 (describing and analyzing covenants commonly featured in bond indentures). For a discussion of how these dynamics evolved in the shadow of § 316(b) of the Trust Indenture Act of 1939, see William W. Bratton & Adam J. Levitin, *The New Bond Workouts*, 166 U. PA. L. REV. 1597 (2018).

the franchisor has the right to control the brand and its associated intellectual property; (2) franchisees use those resources; (3) the franchisor's enterprise is sensitive to how those resources are treated; and (4) the value of each franchisee's enterprise is dependent upon those resources and, in turn, the value of the franchisor's enterprise.

Take, for instance, Best Western International, which operates the Best Western hotel franchise.[52] To operationalize the franchise, Best Western International obviously needs hotels in which to host guests. These hotels, in turn, will use the Best Western brand.

The point of operating as a franchise is not to merely aggregate hotels, but to create a brand that signals to consumers the quality of service they will receive at any of those hotels.[53] To operationalize the franchise's signaling function, Best Western International will impose quality controls on the franchisees. Each one will have to live up to certain standards of cleanliness and provide specific amenities.

Best Western International is sensitive to how the resource is treated. Quality controls are crucial to protecting the Best Western franchise. Without them, Best Western's marks will fail to signal any information about Best Western's hotels, and it risks diminishing the value of—if not abandoning—its trademarks.[54]

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[52] Best Western is technically structured as a non-profit "membership organization," not a franchise. *See* Best W. Int'l, Inc. v. Twin City Lodging, LLC, No. CV-18-03374-PHX-SPL, 2019 WL 2881270, at *3 (D. Ariz. July 3, 2019). The following analysis should remain the same. *See generally* Sharon M. Oster, *Nonprofit Organizations and Their Local Affiliates: A Study in Organizational Forms*, 30 J. ECON. BEHAV. & ORG. 83 (1996) (discussing how non-profit organizations use franchising despite not being organized as franchises under state law).

[53] *See* 1 MCCARTHY ON TRADEMARKS, *supra* note 17, at § 3:11; WILLIAM LANDES & RICHARD POSNER, THE ECONOMIC STRUCTURE OF INTELLECTUAL PROPERTY LAW 174 (Harv. U. Press. 2003); *see also* Eva's Bridal Ltd. v. Halanick Enters., Inc., 639 F.3d 788, 790 (7th Cir. 2011) ("There is no rule that trademark proprietors must ensure 'high quality' goods. . . . The sort of supervision required for a trademark license is the sort that produces consistent quality.").

[54] *See* 3 MCCARTHY ON TRADEMARKS, *supra* note 17, at § 18:48 ("Failure to exercise control over the nature and quality of the goods or services sold by the licensee under the licensed mark can result in the loss of some or all rights in the licensed mark."); *see also* FreecycleSunnyvale v. Freecycle Network, 626 F.3d 509, 512 n.1 (9th Cir. 2010) ("By not enforcing the terms of the trademark's use, the licensor may forfeit his rights to enforce the exclusive nature of the trademark.").

The risk is all the greater since the hotel franchisees are the ones instantiating Best Western's brand in the real world. They're the ones who must furnish the rooms with fluffy pillows, offer troughs of pancakes at the breakfast buffet, and flag the hotel for guests with the correct signage and promotional materials. Enforcing the quality controls is central to protecting the customer goodwill associated with Best Western's trademarks. Given the trademarks' importance to the franchise, Best Western International has the right incentives and access to private information to monitor hotels' compliance with the quality controls.

Preserving Best Western International's value is important not only to it, but also to all of its franchisees. A significant part of the hotel's value is attributable to being part of the Best Western franchise. Patrons may stay at the hotel because it's part of the franchise, which in turn signals that the hotel will provide a specific level of quality. Put differently, there are complementarities that come from each franchisee acting in concert to preserve the franchise's value.

The hotel may consequently have a difficult time leaving the franchise. Defecting from the franchise means the hotel will leave behind the franchise's customer goodwill and the business it generates. Best Western's quality controls also force each franchisee to make relationship-specific investments in the sense that the franchisees can reuse those investments in a different venture "only at a loss of productive value."[55] The pillows, pancakes, and signage that comply with Best Western's quality control standards may not comply with, say, the Holiday Inn's quality controls. Even if the hotel decides to operate independently, it may need to change some of its features to differentiate itself and cater to potential customers. Doing so requires a new business plan and fresh capital, among other things.

This is not to say that only the franchisee makes a relationship-specific investment. Both parties do. Best Western International's relationship-specific investment is an opportunity cost. Investing in *this* hotel means Best Western has fewer resources to invest in other potential hotels.[56] But

[55] *See* Oliver E. Williamson, *The Theory of the Firm as Governance Structure: From Choice to Contract*, 16 J. ECON. PERSPS. 171, 176 (2002); Dan L. Burk & Brett H. McDonnell, *Trademarks and the Boundaries of the Firm*, 51 WM. & MARY L. REV. 345, 392 (2009).

[56] The opportunity cost here is significant because, like other franchises, Best Western gives each hotel franchisee an internal geographic monopoly. An incumbent hotel has the right to veto potential entrants into its territory. *See* Verified Compliant, Ex. B § 3(A),

the hotel's business is dependent on Best Western International's brand (and therefore its enterprise) in a way that's not reciprocal. The hotel will have a difficult time walking away from the Best Western franchise because the Best Western brand is crucial to the hotel's success. We might expect that Best Western International will be willing to end its relationship with the hotel more easily, especially if the hotel regularly flouts the quality controls.[57]

In short, the quality controls are spillover control rights because (1) Best Western International has rights to control the franchise; (2) the hotel uses the franchise; (3) Best Western International is sensitive to how the hotel uses the franchise; and (4) the hotel's value is tied to the franchise and, in turn, Best Western International.

### 2. Professional Sports Leagues

The North American sports market—an $83.1 billion industry as of 2023[58]—is organized around sports leagues, such as the National Basketball Association (NBA), National Football League (NFL), National Hockey League (NHL), and Major League Baseball (MLB).[59] The leagues' control over their respective teams meets the four criteria characteristic of spillover control rights.

(1) Enforcing the league's rules allows teams to act like a single entity.[60]

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Best W. Int'l, Inc. v. Twin City Lodging, LLC, No. CV-18-03374-PHX-SPL (D. Ariz. Oct. 19, 2018), ECF 1 (providing that an application to join the Best Western franchise within a "Member Market Area of a Qualified Hotel will not be accepted" without the affected hotel's consent).

[57] Franchisors routinely try to terminate their franchisees' franchise agreements when the franchisees file for bankruptcy or otherwise face financial distress. *See, e.g.*, *In re* Tornado Pizza, LLC, 431 B.R. 503, 512 (Bankr. D. Kan. 2010); *In re* 717 Grand St. Corp., 259 B.R. 1, 2–3 (Bankr. E.D.N.Y. 2000); Baskin-Robbins Inc. v. Neiberg (*In re* Neiberg), 161 B.R. 606, 609–11 (Bankr. W.D. Pa. 1993).

[58] *See* Christina Gough, *North America Sports Market Size from 2009 to 2023 (in Billion U.S. Dollars)*, STATISTA (Jan. 25, 2024), https://www.statista.com/statistics/214960/revenue-of-the-north-american-sports-market/.

[59] *See* Roger G. Noll, *The Organization of Sports Leagues*, 19 OXFORD REV. ECON. POLICY 530, 531 (2003) ("Team sports are almost always organized into leagues.").

[60] *See* Am. Needle, Inc. v. Nat'l Football League, 560 U.S. 183, 202 (2010) (noting that

To be sure, leagues are frequently set up as unincorporated associations, which have no legal identity apart from their constituent members.[61] But sports leagues are more than the sum of their parts; leagues act like distinct entities all the same. Sports leagues use governance mechanisms, separate and aside from each team's internal governance mechanisms, to replicate how a single owner of the league would operate it, regardless of the league's organizational form.

(2) The league reduces the cost of repeated coordination by serving as a central authority that sets the rules and policies for all teams.[62] Because the league plays a significant role in coordinating games, negotiating players' compensation, and so on, the teams use the league in most facets of their existence.

(3) How each team treats the league's rules affects the league's value. If one team defects from the league's rules, other teams can do so too. A collective action problem emerges, jeopardizing the benefits that league coordination provides to the teams in the first place.

(4) Each team's value is dependent on the league's ability to perform its functions and, consequently, the value of the league. It offers an all-or-nothing bundle of goods that provides significant value for each team. While leagues are not strictly speaking necessary for a team to operate, playing outside of a league can leave much value on the table.[63] And once a team operates as part of the league, it can be hard to see how leaving the league will be the team's best course of action.

Of course, leagues need the teams, too. If a team fails, the league stands to lose revenue because the team no longer plays games, curries favor with hometown fans, and generates further viewer goodwill for itself and the

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it is "a perfectly sensible justification for making a host of collective decisions" that sports teams "share an interest in making the entire league successful and profitable, and that they must cooperate in the production and scheduling of games").

[61] *See, e.g.*, 1550 MP Rd. LLC v. Teamsters Local Union No. 700, 131 N.E.3d 99, 107 (Ill. 2019) ("Under the common law, voluntary unincorporated associations . . . were not legal entities distinct from their individual members.").

[62] *See* Noll, *supra* note 59, at 530–31.

[63] *See id.* at 531 n.2 (discussing teams that have historically played outside of a league structure).

league.[64] By the same token, if a team defects, the risk other teams will defect looms large, creating a new collective action problem.

In contrast with franchisors and franchisees, then, leagues may be more unwilling to part ways with their teams, even if their constitutions and bylaws permit them to do so. These hampered termination rights can place even greater pressure on leagues to exert significant control over each team instead of terminating their membership. The NBA constitution, for example, provides that once the entity that owns a team is terminated, the NBA may continue to operate the team, wind down the entity's financial affairs, and transfer the team's membership to a new owner.[65] So while the value of each team is dependent on the league, the league may adopt more muscular control rights if it's impossible to walk away from a team.

### 3. Joint Ventures

A joint venture "encompass[es] a broad range of relationships between parties whereby they pool certain resources and share the rewards."[66] Joint ventures can be extremely valuable; one study found joint ventures' value grew 20% annually between 1995 and 2015, and a survey of over 250 companies that invested in joint ventures found that more than 80% of participants claimed their joint ventures met or exceed their expectations.[67]

Parties frequently structure joint ventures as partnerships and limited liability companies (LLCs).[68] When parties create the joint venture, they allocate economic and management rights among themselves.[69] Economic

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[64] *See* Paul M. Lopez, K.M. Lewis & D.M. Lynn, *Valuation of the Professional Sports Franchise in Bankruptcy: It's a Whole Different Ballgame*, 18 LEWIS & CLARK L. REV. 299, 329–30, 333–34 (2014) (discussing these factors in sports franchise valuations).

[65] *See* NAT'L BASKETBALL ASS'N, NATIONAL BASKETBALL ASSOCIATION CONSTITUTION AND BY-LAWS art. 14A(a) (2019), at https://ak-static.cms.nba.com/wp-content/uploads/sites/4/2019/09/NBA-Constitution-By-Laws-September-2019-1.pdf.

[66] *See* FARRER & CO. LLP, ESTABLISHING A JOINT VENTURE: A BASIC GUIDE TO THE LEGAL PROCESS 2 (2020), https://www.farrer.co.uk/globalassets/clients-and-sectors/businesses/a-basic-guide-to-etablishing-a-jv.pdf.

[67] *See* Arnaud Leroi & Philip Leung, *The Secrets to Successful Joint Ventures*, FORBES (Apr. 11, 2017), https://www.forbes.com/sites/baininsights/2017/04/11/the-secrets-to-successful-joint-ventures/.

[68] *See* FARRER & CO. LLP, *supra* note 66, at 5.

[69] When talking about partnerships and LLCs together, I refer to partners and members jointly as "participants."

rights are rights to some allocation of the entity's profits and losses.[70] By default, only economic rights are transferable. This rule applies, for example, to general partnerships,[71] limited partnerships,[72] and LLCs.[73] Since only economic rights are transferable, it follows that a participant can only convey economic rights.[74] By the same token, a participant's creditors can only levy upon the participant's economic interests.[75]

Though not transferable by default, management rights are powerful. Those vested with management rights direct the entity's operations and set the entity's operational and financial strategies, which in turn affect the entity's value. General partners in general and limited partnerships are

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[70] *See* Pearce v. Woodfield (*In re* Woodfield), 602 B.R. 747, 754 (Bankr. D. Or. 2019); *In re* Cardinal Indus., Inc., 116 B.R. 964, 970–71 (Bankr. S.D. Ohio 1990).

[71] *See* REV. UNIF. P'SHIP ACT § 503 (UNIF. L. COMM. 1997, amended 2013) [hereinafter RUPA] (permitting assignment of partner's "transferable interest"); *id.* § 102(23) (defining "transferable interest" as partner's right to receive distributions from partnership, or any fraction of that right).

[72] *See* REV. UNIF. LTD. P'SHIP ACT § 701 (UNIF. L. COMM. 2001, amended 2013) [hereinafter RULPA] (providing that "transferable interest" is personal property); *id.* § 102(25) (defining "transferable interest" as "the right, as initially owned by a person in the person's capacity as a partner, to receive distributions from a limited partnership").

[73] *See* REV. UNIF. LTD. LIAB. CO. ACT § 501 (UNIF. L. COMM. 2006, amended 2013) [hereinafter RULLCA] (providing that a member's "transferable interest is personal property"); *id.* § 102(24) (defining "transferable interest" as a right to receive LLC member's distributions, or a fraction of that interest); 6 Del. C. § 18-701 (providing that member's limited liability company interest is personal property); *id.* § 18-101(10) (defining "limited liability company interest" as the member's right to the LLC's profits and losses, as well as the member's right to receive distributions from the LLC).

[74] *See* RUPA § 503; Interpool Ltd. v. Patterson, 890 F. Supp. 259, 266 (S.D.N.Y. 1995) (noting that a partner's "assignee is entitled to receive only the profits to which the assigning partner otherwise would have been entitled"); RULPA § 702 (permitting assignment of partnership interest and specifying that assignee is only entitled to distributions that assignor-partner would have received); RULLCA § 502(a)–(b) (providing that transfer of transferable interest is permissible and entitles transferee to distributions that member would have otherwise received); 6 Del. C. § 18-702(a)–(b) (permitting assignment of limited liability company interest and entitling assignee only to that interest, not management rights); *see also* Anderson Excavating, LLC v. Weiss World L.P., 638 F. Supp. 3d 525, 534 (W.D. Pa. 2022) ("It is a fundamental legal principle that *nemo dat quod non habet*—nobody can give what he does not have.").

[75] *See* RUPA § 504(a) cmt. (permitting charging order solely upon partner's transferable interest and vesting charging creditor with the rights of a partner's transferee); RULPA § 703; RULLCA 503(a)–(b); 6 Del. C. § 18-703(a)–(b).

traditionally vested with management rights.[76] By default, members manage LLCs.[77]

Management rights implicate fiduciary duties to other members in the entity.[78] While some states (like Delaware) allow parties to waive fiduciary duties altogether,[79] the core intuition is that the more a party governs an entity, the more it must take the entity's other stakeholders into account.[80]

Entities can also dissociate participants pursuant to the entity agreement or if a participant files for bankruptcy.[81] Whether a dissociated participant loses its economic rights varies.[82] Across the board, though, dissociation divests participants of their management rights.[83]

Entity default rules under state law leave all the ways in which entities can exert control over their participants unenumerated.[84] But the default rules related to fiduciary duties and dissociation shed light on what entity control rights are trying to do. They're designed to prevent participants

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[76] *See* RUPA § 306(a); RULPA § 404(a).

[77] *See* RULLCA § 407(a)–(b); 6 Del. C. § 18-402.

[78] Sally S. Neely, *Partnerships and Partners and Limited Liability Companies and Members in Bankruptcy: Proposals for Reform*, 71 AM. BANKR. L.J. 271, 276, 283 (1997) (discussing fiduciary duties that partners and members owe to other partners in partnership or members of LLC, respectively).

[79] *See* 6 Del. C. § 17-1101(d) (permitting blanket waiver of fiduciary duties for limited partnerships); *id.* § 18-1101(e) (permitting same for LLCs).

[80] *See* LARRY E. RIBSTEIN, THE RISE OF THE UNCORPORATION 166 (2010) ("Fiduciary duties should be applicable only when a firm's owners delegate substantial powers to managers.").

[81] *See* RUPA § 601(2)–(3), (4)(B), (5), (6)(A); RULPA §§ 601(b)(2)–(3), 4(B) (omitting bankruptcy filing as grounds for dissociating a limited partner) and 603(2)–(3), (4)(B), (5), 7(A); RULLCA § 602(2), (4), 5(B), 6, 8(A); 6 Del. C. § 18-304(1)(b).

[82] A general partnership that continues to operate after dissociating a partner must buy out the dissociated partner's economic interest. *See* RUPA § 701. A dissociated limited partner retains its economic interest alone. *See* RULPA § 602(a)(3). Under the Revised Uniform LLC Act, a dissociated member retains its economic interest. *See* RULLCA § 603(a)(3). But under Delaware law, a dissociated LLC member loses its management and economic interests alike. *See* Milford Pwr. Co., LLC v. PDC Milford Pwr., LLC, 866 A.2d 738, 754 (Del. Ch. 2004) (describing Delaware law as "embrac⟦ing⟧ a default rule that terminates an LLC member's interest upon a bankruptcy filing").

[83] *See* RUPA § 603(b); RULPA § 605(a)(1); RULLCA § 603(a)(1); 6 Del. C. § 18-304(1)(b).

[84] Parties can alter most, but not all, of the rules discussed here. *See* RUPA § 105; RULPA § 105; RULLCA § 105; 6 Del. C. § 18-1101(b), (e).

from undermining the entity's value. Those control rights meet the four criteria that mark spillover control rights:

> (1) An entity has the right to control its resources, such as the business it operates and the investments it makes.
>
> (2) A participant's economic and management rights allow the participant to benefit from and manage those resources, respectively. A participant most obviously benefits from the profit distributions to which it is entitled because of its economic rights. The participant's management rights, in turn, allow it to set the entity's policies, such as an entity's investment strategy.
>
> (3) Management rights, not economic rights, can affect the value of the entity's resources. Economic rights only allot a percentage of the entity's profits and losses to each participant. Sure, economic rights affect how the entity distributes its profits and losses, but they underdetermine how the entity uses its resources. Those vested with management rights, by contrast, direct the entity to use its resources in particular ways. Since the entity bears the brunt of any mismanagement, it will be sensitive to how a participant uses its management rights.[85]
>
> (4) The entity's resources tie the participant's value to the entity's value. That is clearest when it comes to economic rights; the greater one's economic rights in an entity, the more one will be sensitive to changes in the entity's value. Yet even management rights can tie a party's fortunes to the entity's value. Mismanagement of a joint venture can lead to its demise and force parties to abandon an otherwise promising project.[86]

[85] *See, e.g.*, *In re* LMJ Co-Inv., L.P., 866 A.2d 762, 767–70 (Del. Ch. 2004) (discussing dispute between general and limited partners of limited partnership, where limited partners attempted to oust general partner for allegedly mismanaging limited partnership's business).

[86] *See* James Bamford & David Ernst, *How to Structure a Joint Venture: The Five Essential Elements of JV Dealmaking*, ANKURA (July 2016), https://jvalchemist.ankura.com/transactions/how-to-structure-a-joint-venture-the-five-

To see these dynamics in action, consider Vice TV, a cable television channel that featured "news, documentaries, film and reality television series."[87] Vice TV was a joint venture between Vice Group Holdings, Inc. (Vice) and A&E Television Networks, LLC (A&E).[88] Vice TV was an LLC formed under Delaware law.[89] Vice owned 49.9% while A&E owned the remaining 50.1% of the LLC.[90] Both parties contributed to Vice TV's core business—such as content development and negotiating distribution arrangements with cable networks and other digital platforms—as well as auxiliary tasks related to taxes, information technology, accounting, and human resources.[91]

Both parties also controlled the LLC. The LLC's operating agreement called for Vice and A&E to each appoint specific numbers of directors and officers.[92] It further gave each party consent and consultation rights over Vice TV's content, among other key decisions.[93] Given the specialized roles Vice and A&E played in operating Vice TV, the operating agreement prohibited them from assigning their respective membership interests without the other's consent.[94]

The control rights embedded in Vice TV's operating agreement were spillover control rights designed to protect Vice TV's enterprise. Vice TV was a resource Vice and A&E shared. That resource could only come about through Vice and A&E's collaboration. Both provided "decades of industry expertise, relationship capital and highly-specialized content."[95] Vice TV,

essential-elements-of-jv-dealmaking/.

[87] *See Declaration of Frank A. Pometti in Support of the Debtors' Chapter 11 Petitions and First Day Relief* at 13, *In re* Vice Grp. Holdings, No. 23-10738 (JPM) (Bankr. S.D.N.Y. May 15, 2023), ECF 3 [hereinafter Pometti Declaration].

[88] *See id.*; *Reservation of Rights of A&E Television Networks, LLC to (I) Debtors' Notice of Proposed Assumption and Assignment of Certain Executory Contracts and Unexpired Leases and (II) the Sale of Substantially All of the Debtors' Assets Pursuant to Section 363 of the Bankruptcy Code* at 1, *In re* Vice Grp. Holdings, No. 23-10738 (JPM) (Bankr. S.D.N.Y. June 19, 2023) ECF 180 [hereinafter A&E Reservation of Rights].

[89] A&E Reservation of Rights, *supra* note 88, at 2.

[90] *Id.*

[91] *Id.* at 4–5.

[92] *Id.* at 4.

[93] *Id.*

[94] *Id.* at 5.

[95] *See id.* at 5.

as a discrete entity, had an interest in ensuring the parties preserved that mix of capital.[96]

Overriding the delicate balance of power between Vice and A&E would push one or both parties out of the enterprise, compromising its value. By the same token, if either party unilaterally assigned its rights to a counterparty, Vice TV's resources and operations may not have existed any longer. Vice and A&E shared those resources, and the value of Vice TV's enterprise was highly sensitive to how Vice and A&E treated them. And those resources, in turn, partly determined the value of Vice and A&E's own enterprises.[97] Protecting Vice TV's resources inured not only to Vice TV's benefit, but to Vice and A&E's benefit, too.

## IV. Control Rights in Chapter 11

This Section will show that control rights should be enforced with property rules when the control right holder is the residual owner of the resource. Given the different interests they protect, bankruptcy law should enforce investment-backed control rights with liability rules and spillover control rights with property rules. As this Section will demonstrate, the Bankruptcy Code largely captures this division in how control rights should be enforced with respect to the automatic stay, § 363 sales, and executory contracts.

### A. Control Rights and Bankruptcy Policy

Control rights are valuable because they are usually enforced with property rules.[98] Property rules give right holders a "lumpy" set of privileges and restrictions across time.[99] Enforcing property rights through property

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[96] *See, e.g.*, Wood v. U.S. Bank, Nat'l Ass'n, 246 A.3d 141, 148 (Del. Ch. 2021) (noting that the Delaware LLC Act "makes clear that an LLC has a separate juridical existence distinct from its members").

[97] *Cf.* Pometti Declaration, *supra* note 87, at 13–14 (noting that Vice family of companies obtained advertising, affiliate fee, and sponsorship revenues through Vice TV).

[98] *See* Peter DiCola, *Valuing Control*, 113 MICH. L. REV. 663, 666 n.10 (2015) (noting that if given the option, "most parties will favor having [[its]] entitlement . . . protected with a property rule").

[99] *See* LEE ANNE FENNELL, SLICES AND LUMPS: DIVISION AND AGGREGATION IN LAW AND LIFE 8–26 (2019) (describing and defining "lumpiness").

rules makes investing in the property over time worthwhile,[100] and forces the right holder to internalize the costs and benefits of the property's use.[101] Property rules also solve the epistemic problem of figuring out which uses are the highest and best ones.[102] As Professor Smith notes, we can regulate how people use property on a "use-by-use" basis or by bundling several uses together.[103] Use-by-use regulation seems efficient in the abstract, but it soon gets too costly to administer; what about unknown uses or risky ones?[104]

Here's where property rights' epistemic and economic functions converge: property rights are valuable because they delegate to the right holder how to use the property.[105] This aspect of property rights has a temporal element to it. Liability rules force courts to value property rights *now*, but now might not be the optimal time to do so.[106] Perhaps the property owner has a different use in mind, one that will pan out in the future. Only time will tell. But the property owner is the one who internalizes that gamble's costs and benefits.[107] Put differently, the property right holder is the resource's residual owner.[108]

Control rights and their property-rule remedies matter the least when distress is a distant thought and bargaining frictions are low. Parties can bargain in the shadow of property-rule entitlements.[109] Just as a company can encumber its resources for the right price, it can also unencumber them, all without court intervention.

When financial distress looms, transaction costs increase and bargaining dynamics change.[110] The debtor must mediate relationships with several

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[100] *See* Carol M. Rose, *The Shadow of* The Cathedral, 106 YALE L.J. 2175, 2196–97 (1997).

[101] *See* Harold Demsetz, *Toward a Theory of Property Rights*, 57 AM. ECON. REV. 347, 348 (1967).

[102] *See* Henry E. Smith, *Property and Property Rules*, 79 N.Y.U. L. REV. 1719, 1763–64 (2004).

[103] *See id.* at 1754.

[104] *Id.* at 1760–62.

[105] *Id.* at 1763–64.

[106] *See id.*

[107] *See id.*

[108] *See id.* at 1795–97.

[109] Calabresi & Melamed, *supra* note 5, at 1093–98; James E. Krier & Stewart J. Schwab, *Property Rules and Liability Rules: The Cathedral in Another Light*, 70 N.Y.U. L. REV. 440, 450 (1995).

[110] *See* Jared I. Mayer, *Bankruptcy's Equity Canon*, 30 AM. BANKR. INST. L. REV. 231,

parties, each of whom may have property-rule-protected control rights over the debtor's resources. Each party exercises its right against the debtor, increasing its own payout and squandering the debtor's value.

Bankruptcy resolves conflicts like this in two key ways. First, bankruptcy solves the commons problem. It stays attempts to remove resources from the debtor's estate,[111] and authorizes the debtor to claw back value that parties took ahead of the collective bankruptcy proceeding.[112]

Second, bankruptcy solves the anticommons problem.[113] The anticommons problem arises when multiple parties each have the right to exclude someone else from using a resource.[114] That situation fuels rent seeking and encourages hold outs. A party with a right to exclude others from an asset will exercise that right in hopes of receiving a bribe. The same issue replicates itself when multiple parties hold exclusionary rights. It only takes one holdout to render a resource underutilized.[115]

The following example illustrates the point.[116] Suppose a debtor owns and operates a bridge. A, B, and C are the debtor's lenders. The debtor owes each of them $10 and each contracted with the debtor to control

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238 (2022) (noting that "parties in bankruptcy face high transaction costs—which stymie their ability to make efficient transactions—and incentivize them to maximize their recovery even at other parties' expense") (citations omitted).

[111] *See* 11 U.S.C. § 362(a).

[112] *See id.* §§ 547, 548.

[113] *See* Stephan Madaus, *Leaving the Shadows of US Bankruptcy Law: A Proposal to Divide the Realms of Insolvency and Restructuring Law*, 19 EUR. BUS. ORG. L. REV. 615, 632–36 (2018) (discussing anticommons problem that gives rise to restructurings); Rolef J. de Weijs, *Harmonisation of European Insolvency Law and the Need to Tackle Two Common Problems: Common Pool and Anticommons*, 21 INT'L INSOLV. REV. 67, 73–82 (2012) (discussing anticommons dynamics that can arise in insolvency proceedings); Douglas G. Baird & Robert K. Rasmussen, *Antibankruptcy*, 119 YALE L.J. 648, 687–98 (2010) (discussing anticommons dynamics that arise from claims trading and parties adopting complicated financial positions vis a vis the debtor); Edward J. Janger, *Privacy Property, Information Costs, and the Anticommons*, 54 HASTINGS L.J. 899, 925–29 (2003) (discussing anticommons dynamics with respect to selling assets in bankruptcy proceedings).

[114] *See* Michael A. Heller, *The Tragedy of the Anticommons: Property in the Transition from Marx to Markets*, 111 HARV. L. REV. 621, 668 (1998) [hereinafter Heller, *Tragedy of the Anticommons*].

[115] *See id.* at 624, 666.

[116] This example is inspired by a historical one discussed in Michael Heller, *The Tragedy of the Anticommons: A Concise Introduction and Lexicon*, 76 MOD. L. REV. 6, 9–10 (2013).

discrete segments of the bridge when the debtor defaults. Assume the debtor defaults, each lender is owed $10, and each one gets control of its respective segment. Assume further that all the parties need to agree on what to do with the bridge, which can be monetized in only one of two ways: it can either be sold for scrap for $15 or the debtor can operate it and generate $35. The optimal solution would be to let the debtor operate the bridge. Each lender would be paid in full, and the debtor would receive $5, too. But any of the parties can threaten to undermine that optimal solution and try to extract more value from the other lenders. If the debtor, A, and B agree to operate the bridge, C can hold out to extract more value from everyone else. Since liquidation will bring each lender $5 and the debtor $0, the debtor, A, and B would still be better off if they each paid C a maximum of $4 each. Under those circumstances, the debtor would receive $1, A and B would each receive $6, and C would receive $22. But since any of them can be the holdout, each one may refuse to let the debtor operate the bridge. With no agreement in sight, the bridge will be liquidated; each lender will receive only $5, the debtor will receive nothing, and the parties will fail to put the bridge to its highest and best use.

This anticommons problem replicates itself in a world where A, B, and C wield control rights over resources that create complementarities such that their aggregate value is maximized when used in concert.[117] In such a world, everyone stands to benefit from the debtor orchestrating how it will use its resources and putting them to their highest and best uses. Yet since the debtor needs the consent of every party with a control right to do that, each party holding a control right will try to engage in rent seeking and holdout behavior. Without more, consent may be withheld and resources will go underutilized.[118]

[117] *See* FENNELL, *supra* note 99, at 11–12 (discussing complementarity).

[118] *See* Anthony J. Casey, *Chapter 11's Renegotiation Framework and the Purpose of Corporate Bankruptcy*, 120 COLUM. L. REV. 1709, 1737 (2020) [hereinafter Casey, *Chapter 11's Renegotiation Framework*]. It is tempting to think that the problem arises solely because of transaction costs. One may hope that in a transaction cost-free world, the debtor and each control right holder would bargain among themselves to put the resources to their most valued uses. *See* Heller, *Tragedy of the Anticommons*, *supra* note 114, at 673; *see also* Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 314 (1993) (arguing that creditors could irrevocably bind themselves ex ante to not exercise individual remedies against a company). But even in a transaction cost-free world, parties may be unwilling to contractually bind themselves

Bankruptcy solves both the commons and anticommons problems by converting many property-rule entitlements to liability-rule entitlements.[119] The debtor has inside knowledge about the firm that usually makes it best suited to determine how to put the debtor's resources to their highest and best uses.[120] And by forcing the debtor to honor entitlements with cash, the debtor internalizes the costs and benefits of its actions.[121] Bankruptcy law resolves the commons and anticommons problems by identifying the debtor as the residual owner and vesting it with property-rule entitlements.[122]

Bankruptcy law defuses those problems that investment-backed control rights create. Investment-backed control rights can conflict in both good and bad states of affairs. The debtor may be able to navigate these conflicts in sunny times, yet in times of financial distress, each investor might exercise its control rights in hopes of maximizing its returns, squandering the aggregate value of the company's assets.[123] Bankruptcy law can help the debtor preserve the complementarities between its assets while at the same time protecting investment-backed control rights with liability, not property,

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to negotiate with other parties who hold rights in the resources. Opting out of negotiations allows a party to insist on its control rights over the resources, even to the group's detriment. *See* Stanley D. Longhofer & Stephen R. Peters, *Protection for Whom? Creditor Conflict and Bankruptcy*, 6 AM. L. & ECON. REV. 249, 262–65 (2004). Moreover, strategic behavior—which lurks behind every contract, real and hypothetical—can undermine this bargain. *See* Casey, *Chapter 11's Renegotiation Framework*, *supra*, at 1734–43.

[119] *Cf.* Robert K. Rasmussen, *The End of Bankruptcy Revisited*, *in* RESEARCH HANDBOOK ON CORPORATE BANKRUPTCY LAW 36, 38 (Barry E. Adler, ed. 2020) (noting that the classic justification for chapter 11 is to resolve the problems when "control rights are not parceled out in a coherent manner").

[120] *See* Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 370 (1993) ("In most businesses, the debtor best fits the description of the well-informed decisionmaker."); Douglas G. Baird, *The Initiation Problem in Bankruptcy*, 11 INT'L REV. L. & ECON. 223, 228–29 (1991).

[121] *See* Baird & Jackson, *Comment on Adequate Protection*, *supra* note 19, at 104–05 (advocating for debtor's assets in bankruptcy to be handled as a single owner of them would handle them).

[122] Professor Buccola makes a similar point. *See* Buccola, *Bankruptcy's Cathedral*, *supra* note 5, at 732–42.

[123] *See* Triantis & Daniels, *supra* note 49, at 1111 ("While stakeholder interests in solvent firms normally coalesce around the goal of controlling managerial slack, this convergence weakens as the financial condition of the firm deteriorates.").

rules.

Spillover control rights are a different story. On first pass, allowing parties to exercise spillover control rights may exacerbate the commons and anticommons problems bankruptcy law is supposed to solve. But spillover control rights reflect a complex relationship between the debtor and a counterparty. When spillover control rights are at play, the debtor and counterparty's enterprises are uniquely intertwined. The resource the debtor uses both affects the counterparty's enterprise and tethers the debtor's value to the counterparty's enterprise. The hotel's use of the Best Western brand both affects the value of the Best Western franchise and ties the hotel's value to the franchise's value. A team's participation in the sports league both affects the value of the league, which in turn affects the value of the team. Vice and A&E's respective participation in Vice TV affects its value, and Vice TV's fortunes in turn affect Vice and A&E's respective values. In other words, when spillover control rights are at hand, there are complementarities between the debtor and the counterparty.

Moreover, as we saw before, the counterparty who wields spillover control rights internalizes the cost of using the resource.[124] Thus, the counterparty is best positioned to know the resource's optimal use across states of affairs, whether the debtor is in or out of bankruptcy. Indeed, the optimal use may be the same in both states of affairs.[125] Thus, the hotel should abide by the quality controls, the team should abide by the league's rules, and Vice and A&E should abide by all of Vice TV's restrictions, whether those entities are in or out of bankruptcy.

Allowing the debtor to ignore spillover control rights will discourage investment ex ante and press the debtor to gamble with the resource.[126] Yet there's another risk when the debtor shirks spillover control rights. The debtor will wreak havoc on the counterparty's enterprise and undermine the complementarities between it and the counterparty. The debtor may insist that it can replicate the counterparty's downside protection, but

[124] *See supra* note 54 and accompanying text.

[125] *Contra* Buccola, *Bankruptcy's Cathedral*, *supra* note 5, at 725–26.

[126] *See* Baird & Jackson, *Comment on Adequate Protection*, *supra* note 19, at 108–09 ("Bankruptcy rules that enable classes of investors to gain from any upswing in the firm's fortunes, while avoiding the full costs of an attempt to keep the assets together, create an incentive for those investors to make such an attempt, even if it is not worth making for the investors as a group.").

figuring out the extent of the debtor's harm to the counterparty's enterprise may be difficult to do.[127]

More importantly, as the counterparty's position becomes precarious, so does the debtor's. The debtor may be tempted to freeride on the counterparty's value, but that will only undermine the debtor's value in the long run. A franchise that cannot police its franchisees, a league that cannot police its teams, and an entity that cannot control its members will quickly lose value. If it is valuable for the debtor to share the counterparty's resources, then abiding by the counterparty's spillover control rights is valuable, too.

Admittedly, a spillover control right effectively gives the counterparty a priority right over other stakeholders.[128] One might be concerned about ostensible ownership problems: that the party armed with a spillover control right holder gets priority over other stakeholders even though it gave no advance notice to them.[129]

In some instances, public filings will inform counterparties of the debtor's interests in the resource that is subject to spillover control rights. Vice TV is a Delaware entity that is registered with the Delaware Secretary of State. Diligence will reveal its existence to Vice and A&E's future investors. In other cases, the public will know about the spillover control rights or at least the relationship between the debtor and the counterparty more broadly.[130] It is no surprise that any given "major league" baseball

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[127] This is why courts in and out of the bankruptcy context regularly afford non-monetary relief to parties seeking to protect their businesses or prospective business opportunities. *See, e.g.*, DOUGLAS LAYCOCK, THE DEATH OF THE IRREPARABLE INJURY RULE 39–40 (1991) (observing that courts have employed specific performance for cases involving "franchises, businesses, closely held corporate stock, and controlling blocks of publicly traded stock" since "money is not an adequate remedy for their loss," and citing cases); *see also, e.g.*, Peek v. Spartanburg Reg'l Healthcare Sys., 626 S.E.2d 34, 37 n.2 (S.C. Ct. App. 2005) (citing cases), *holding modified by* Poynter Invs., Inc. v. Century Builders of Piedmont, Inc., 694 S.E.2d 15 (S.C. 2010); *In re* Ben Franklin Hotel Assocs., 186 F.3d 301, 306–07 (3d Cir. 1999) (holding "that monetary damages are not an alternative to" the remedy of reinstating a foreclosed partnership interest).

[128] *See* Joshua Macey & Jackson Salovaara, *Bankruptcy as Bailout: Coal Company Insolvency and the Erosion of Federal Law*, 71 STAN. L. REV. 879, 956 (2019).

[129] *See* Douglas G. Baird, *Notice Filing and the Problem of Ostensible Ownership*, 12 J. LEG. STUD. 53, 55–59 (1983).

[130] *See* Douglas G. Baird & Thomas H. Jackson, *Possession and Ownership: An Examination of the Scope of Article 9*, 35 STAN. L. REV. 175, 190–91 (1983) ("[W]hen there is widespread knowledge that the possessor of an asset is not the owner . . . . there

team is associated with MLB, and that each hotel brandishing the Best Western name is associated with the Best Western International. There may be some situations where other stakeholders are unaware that a spillover control right exists at all.[131] Even so, allowing the counterparty to enforce its spillover control rights protects the debtor and its creditors from the long-term, broader value destruction that would occur if the debtor had its way.[132]

### B. Control Rights and the Bankruptcy Code

Bankruptcy law is largely consonant with the distinction between investment-backed and spillover control rights, especially when it comes to three of the most important policies for maximizing a debtor's value: the automatic stay, § 363 sales, and the treatment of executory contracts.

#### 1. The Automatic Stay

Start with the automatic stay. When a company files for bankruptcy, the automatic stay prevents parties from unilaterally exercising their control rights.[133] Bankruptcy law also swaps investment-backed control rights' property-rule remedies for liability-rule remedies. In lieu of its foreclosure rights, oversecured creditors receive interest payments to the extent they are oversecured.[134] The debtor must also compensate an undersecured creditor from any diminution in the value of its collateral.[135] If the debtor

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really is no ostensible ownership problem.").

[131] *See* Douglas G. Baird & Anthony J. Casey, *No Exit? Withdrawal Rights and the Law of Corporate Reorganizations*, 113 COLUM. L. REV. 1, 42 (2013) [hereinafter Baird & Casey, *No Exit*] (cautioning against permitting "withdrawal" rights where counterparties cannot clearly identify that the right exists and who has it).

[132] Of course, counterparties are not required to enforce their spillover control rights. Like other entitlements protected by property rules, spillover control rights can be bargained away. It is simply a matter of who decides what those rights are worth. *See* Buccola, *Bankruptcy's Cathedral*, *supra* note 5, at 708 (describing property rule regime as one in which "voluntary exchange alone can extinguish" the entitlement).

[133] *See* 11 U.S.C. § 362(a).

[134] *See id.* § 506(b).

[135] *See id.* § 361. The Supreme Court held that undersecured creditors are not entitled to adequate protection payments for the time value of their liens because of the automatic stay. *See* United Sav. Ass'n of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S.

cannot make those payments, the court must lift the automatic stay so the secured creditor can foreclose on the collateral.[136] Similarly, if the debtor wishes to obtain DIP financing secured by superpriorty liens on its resources,[137] it must adequately protect existing liens with cash or replacement liens.[138] If it cannot, the court must reject the debtor's DIP financing proposal.[139]

The automatic stay allows parties to exercise some investment-backed control rights, to be sure. The automatic stay generally permits shareholders to exercise their control rights.[140] Lenders can obtain control rights by providing a debtor with DIP financing.[141] But even these rights are limited to the extent they interfere with the debtor's fiduciary obligation to maximize the value of its estate.[142] Courts prevent shareholders from exercising control rights when exercising those rights would result in a

365, 372 (1988). The debtor should rather have to compensate the secured creditor for the time value of being unable to foreclose on the collateral. *See* Baird & Jackson, *Comment on Adequate Protection*, *supra* note 19, at 121–25.

[136] *See* 11 U.S.C. § 362(d); Emplexx Software Corp. v. AGI Software, Inc. (*In re* AGI Software, Inc.), 199 B.R. 850, 861 (Bankr. D.N.J. 1995) ("Relief from the automatic stay is granted where a secured creditor's interest is not being adequately protected.").

[137] *See* 11 U.S.C. § 364.

[138] *See id.* § 361.

[139] *See, e.g.*, Desert Fire Prot. v. Fontainebleau Las Vegas Holdings, LLC (*In re* Fontainebleau Las Vegas Holdings, LLC), 434 B.R. 716, 751–52 (S.D. Fla. 2010) (reversing bankruptcy court's approval of DIP financing because it inadequately protected mechanics' lienholders' liens on debtor's property).

[140] *See In re* SS Body Armor I, Inc., 527 B.R. 597, 606–07 (Bankr. D. Del. 2015) ("The right of a shareholder to compel a shareholder's meeting for the purpose of election of a new board of directors continues during bankruptcy and the automatic stay is inapplicable to the exercise of that right.").

[141] *See* Kenneth M. Ayotte & Edward T. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEG. ANALYSIS 511, 520–26 (2009) (showing pervasive use of DIP financing as tool to exert control over debtors); David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 930–32 (2003) (discussing use of DIP financing to exert control over firm before and after it files for chapter 11).

[142] *See, e.g.*, *In re* Innkeepers USA Tr., 442 B.R. 227, 235 (Bankr. S.D.N.Y. 2010) ("In a bankruptcy case, it is 'Bankruptcy 101' that a debtor and its board of directors owe fiduciary duties to the debtor's creditors to maximize the value of the estate."); Harvey R. Miller, *Corporate Governance in Chapter 11: The Fiduciary Relationship Between Directors and Stockholders of Solvent and Insolvent Corporations*, 23 SETON HALL L. REV. 1467, 1487–88 (1993).

"delay and real jeopardy to a debtor's reorganization."[143] Similarly, doctrines that punish lenders for exerting too much control over the debtor, such as lender liability and equitable subordination, reign in lenders' worst impulses.[144]

The Bankruptcy Code also authorizes bankruptcy courts to lift the automatic stay if debtors violate counterparties' spillover control rights. Section 362(d)(1) of the Bankruptcy Code requires a bankruptcy court to lift the automatic stay "for cause, including the lack of adequate protection of an interest in property."[145] "Cause" is an undefined, flexible concept.[146] A court can lift the automatic stay so that the counterparty can enforce its spillover control rights. For instance, if the hotel violates the quality controls in the Best Western franchise agreement, the court can lift the automatic stay to permit Best Western International to terminate the franchise agreement.[147]

Courts will at times hesitate to lift the automatic stay to allow counterparties to enforce their spillover control rights. The thought goes like this. Bankruptcy gives entities the breathing space needed to

[143] *See In re* Johns-Manville Corp., 801 F.2d 60, 65 (2d Cir. 1986) (noting that shareholders right to elect directors could be enjoined if shareholders "demonstrate a willingness to risk rehabilitation altogether in order to win a larger share for equity"); *see also In re* Korean W. Presbyterian Church of L.A., 618 B.R. 282, 287–88 (Bankr. C.D. Cal. 2020) (holding that litigation between church factions over who controlled church governance violated the automatic stay).

[144] Lender liability is a family of theories in which a lender is held liable for controlling a borrower and consequently harming it. *See generally* Frances E. Freund, *Lender Liability: A Survey of Common-Law Theories*, 42 VAND. L. REV. 855 (1989) (outlining several lender liability theories). Equitable subordination empowers a court to displace a lender's claim from its original priority if the lender acts inequitably to gain an "unfair advantage" over other creditors. *See* 11 U.S.C. § 510(c); Enron Corp. v. Ave. Spec. Situations Fund II, LP (*In re* Enron Corp.), 333 B.R. 205, 217 (Bankr. S.D.N.Y. 2005).

[145] *Id.* § 362(d)(1).

[146] *See* Laguna Assocs. Ltd. P'ship v. Aetna Cas. & Sur. Co. (*In re* Laguna Assocs. Ltd. P'ship), 30 F.3d 734, 737 (6th Cir. 1994) ("Because the Code provides no definition of what constitutes 'cause' under . . . Section 362(d) . . . , courts must determine whether discretionary relief is appropriate on a case-by-case basis."), *as amended on denial of reh'g en banc* (Sept. 1994).

[147] *See, e.g.*, *In re* Tudor Motor Lodge Assocs., Ltd. P'ship, 102 B.R. 936, 956–57 (Bankr. D.N.J. 1989) (granting franchisor's motion to lift the automatic stay to terminate franchise agreement with debtor-franchisee because evidence showed that franchisee was unable to abide by the franchise agreement's quality controls).

successfully reorganize.[148] Giving them that breathing space means the debtor has more leeway than it otherwise would outside of bankruptcy. Thus, for instance, foreclosing on collateral is verboten, even if the debtor has no equity in the property, if the debtor can maximize the value of its estate by keeping that property as part of its estate.[149]

That intuition is mistaken when spillover control rights are at play. Consider *Plastech*.[150] The debtors manufactured plastic automobile parts such as bumpers and interior trims.[151] Their customers were some of the largest car manufacturers in the country, including General Motors, Ford Motor Company, and—central to this story—Chrysler.[152] The debtors used tools that were specific to each of its customers and for which each of its customers paid to make the parts.[153] The debtors contractually stipulated that Chrysler owned the tools used to create Chrysler vehicles parts and that the debtors had no interest in those parts.[154] Chrysler eventually terminated its relationship with the debtors but the debtors filed their chapter 11 cases before Chrysler could retrieve the tools.[155] Chrysler then moved for the court to lift the automatic stay to allow it to retrieve the tools.[156]

The court declined to do so. It recognized that Chrysler faced the risk of substantial harm if it left the tools in Plastech's hands, including potential shutdown of Chrysler's operations and layoffs of its employees.[157] It balanced that harm against the risk that the debtors' plants "will have to be immediately shut down" if Chrysler removed the tools.[158] Since Chrysler sought to collect the tools at the outset of the cases, the court believed it was

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[148] *See, e.g.*, Lykes Bros. S.S. Co. v. Hanseatic Marine Serv. GmBH (*In re* Lykes Bros. S.S. Co., Inc.), 207 B.R. 282, 284 (Bankr. M.D. Fla. 1997) ("A clear purpose of Chapter 11 is to benefit all parties, including the debtor and its creditors, by providing a breathing space to enable a debtor to reorganize.").

[149] *See* 11 U.S.C. § 362(d)(2).

[150] *In re* Plastech Engineered Prods., Inc., 382 B.R. 90 (Bankr. E.D. Mich. 2008).

[151] *Id.* at 95.

[152] *Id.* at 94–95.

[153] *See id.* at 96.

[154] *See id.* at 97–101.

[155] *Id.* at 103.

[156] *Id.*

[157] *Id.* at 107.

[158] *Id.* at 108.

inappropriate to doom the debtors so early in the case.[159]

Though understandable, the court's decision under appreciated the economic structure of the spillover control rights at play.[160] The court wanted to give the debtors a chance to successfully reorganize. And as we've seen, allowing parties to pursue their nonbankruptcy entitlements can unravel bankruptcy's collective proceeding. Spillover control rights, such as Chrysler's rights to repossess the tools, work differently. Chrysler had the right to control how the tools were used, and its enterprise was sensitive to how the debtors used the tools. The tools were fitted for Chrysler's vehicles; without them, Chrysler's orders would go unfulfilled. Chrysler's inability to fulfill orders in a timely fashion would spell doom for not only Chrysler, but the debtors, too. While the debtors would certainly falter if Chrysler collected the tools, they would not do much better if Chrysler's business was jeopardized. Since Chrysler was the tools' residual owner, Chrysler was best positioned to know what the tools highest and best uses were.

2. Section 363 Sales

Section 363 empowers the debtor to put sell its resources. Section 363(f)(5) permits a debtor to sell its property free and clear of any interest so long as the interest holder can be compelled to accept a money satisfaction for the interest under nonbankruptcy law.[161] Courts have interpreted "interests" broadly, giving debtors significant latitude to sell property with clean title.[162] A debtor who sells property free and clear of any interests must adequately protect those interests, but that is easy enough to do. A

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159 *See id.* at 109–11.

160 Of course, different facts might call for different treatment. If Chrysler did not face severe economic repercussions from the debtor withholding the tools, or if the debtor had a valid dispute about its alleged prepetition default, the court would be right to maintain the status quo and decline to lift the stay. *Plastech*'s facts, however, likely called for the court to treat Chrysler more favorably.

161 11 U.S.C. § 363(f)(5).

162 *See, e.g.*, *In re* Old Carco LLC, 538 B.R. 674, 684–85 (Bankr. S.D.N.Y. 2015) ("experience ratings," which would permit states to tax assets' buyer at higher rates); *In re* Signature Devs., Inc., 348 B.R. 758, 766–68 (Bankr. E.D. Mich. 2006) (real estate covenants); *In re* Trans World Airlines, 322 F.3d 283, 290–91 (3d Cir. 2003) (employment discrimination claims).

debtor adequately protects an interest if the sale proceeds can compensate the interest holder.[163]

Section 363 sales exemplify how bankruptcy law exchanges property rules with liability rules for investment-backed control rights. So long as the debtor can provide the investment-backed control right holder with cash, the debtor is free to sell the property.

Despite its flexibility, § 363 uses a broad mandate to protect spillover control rights.[164] Section 363(e) requires a court to "prohibit or condition" the use, sale, or lease of property in ways "necessary to provide adequate protection" to a party's interest in the property.[165] Since a debtor jeopardizes a counterparty's enterprise when it ignores spillover control rights, courts rightly limit or prevent debtors from selling property free and clear of those control rights.

Consider the bankruptcy case of the Phoenix Coyotes—now known as the Utah Hockey Club.[166] The hockey team filed for bankruptcy in 2009, looking to sell itself to PSE Sports and Entertainment LP (PSE) for $240 million and move to Hamilton, Ontario, Canada.[167] The NHL made the next highest bid at $140 million.[168] The NHL also submitted that, since it rejected both the purchase and the move per its constitution and bylaws, the court could not approve the sale.[169]

The court agreed.[170] Though PSE asserted that it could compensate the NHL by paying a sufficiently high relocation fee, the court worried "how it ⟦could⟧ adequately protect the NHL's membership selection right and control over home team location rights if the court were to allow PSE to move the Coyotes to Hamilton."[171]

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[163] *See, e.g.*, MacArthur Co. v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 837 F.2d 89, 94 (2d Cir. 1988) ("It has long been recognized that when a debtor's asserts are disposed of free and clear of third-party interests, the counterparty is adequately protected if his interest is assertable against the proceeds of the disposition.").

[164] *See* 11 U.S.C. §§ 363, 365.

[165] *See id.* § 363(e).

[166] *See Former Arizona Coyotes Will Be Utah Hockey Club Next Season*, KJZZ PHOENIX (June 13, 2024), https://www.kjzz.org/news/2024-06-13/former-arizona-coyotes-will-be-utah-hockey-club-next-season.

[167] *In re* Dewey Ranch Hockey, LLC, 414 B.R. 577, 580, 587 (Bankr. D. Ariz. 2009).

[168] *Id.* at 588.

[169] *Id.* at 582–85, 589.

[170] *Id.* at 592.

[171] *Id.* at 591.

Though somewhat startling, the bankruptcy court's decision to deny the sale coheres with the account of spillover control rights. Each team's value derives from taking part in the league, and the league stands to gain or suffer when its member-teams abide by or defect from the league's rules. The league stands in the position of the residual owner, and as such, it is best positioned to know how to use the league's rules.

Of course, the league did not have to enforce its rights against the debtors. For the right price, we can imagine that the NHL would have acceded to PSE's demands to move the Coyotes to Hamilton. But since the NHL's spillover control rights were protected with property rules, it was up to the NHL, not the bankruptcy court, to decide at what price it would waive its spillover control rights. The spillover control rights reflected the NHL's second-order decision, as it were, not to put a price on its membership selection and location rights.[172]

### 3. Executory Contracts

Section 365 also replaces property rules with liability rules for investment-backed control rights in executory contracts. Again, the automatic stay prevents the counterparty from terminating the contract, even if the debtor is in default.[173] So too, ipso facto clauses are unenforceable.[174] Before the debtor decides to assume or reject a contract, the counterparty alone must continue performing under the contract,[175] but it receives administrative expense priority for doing so.[176] If the contract is advantageous to the estate, the debtor can assume it so long as it can cure its past defaults and adequately assure the counterparty of the debtor's future performance.[177] If the contract is burdensome, the debtor can reject it and

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[172] *See* Smith, *supra* note 102, at 1754 (noting that property rules reflect second-order decisions not to address first-order questions of pricing individual uses of property).

[173] *See In re* Bd. of Directors of Compania Gen. de Combustibles, S.A., 269 B.R. 104, 113 (Bankr. S.D.N.Y. 2001) (noting that prior to the debtor assuming or rejecting an executory contract, "a creditor is ordinarily barred by the automatic stay from terminating the contract").

[174] *See* 11 U.S.C. § 365(e)(1).

[175] *See In re* Nat'l Steel Corp., 316 B.R. 287, 305 (Bankr. N.D. Ill. 2004).

[176] *See* 11 U.S.C. § 503(b)(1).

[177] *See id.* § 365(a), (b)(1).

will no longer be bound to perform under it.[178] So while the counterparty is prohibited from exercising its property-rule right to terminate the contract, the debtor must provide the counterparty with liability-rule protections if it wants to assume the contract or use the counterparty's services under it.

The same logic generally applies to anti-assignment clauses.[179] Anti-assignment clauses can be investment-backed control rights in that they protect an investment a counterparty makes in the debtor. The counterparty depends on the debtor's performance and liquidity profile, among other features. Bankruptcy law generally makes these clauses unenforceable,[180] but the debtor must adequately assure the counterparty that the assignee can replicate the debtor's performance.[181]

Section 365 also vindicates spillover control rights, albeit in a cumbersome way. While the debtor has the option to assume (and assign) or reject contracts, § 365(c) carves out an exception for (what may be somewhat inaccurately called) "personal services contracts."[182] Section 365(c) complicates the analysis by providing that a debtor "may not assume *or* assign" a personal services contract without the counterparty's consent.[183] This language has generated a split between "hypothetical test" and "actual test" jurisdictions.[184] Section 365(f) of the Bankruptcy Code similarly enforces anti-assignment clauses in personal services contracts.[185] Yet the language in §§ 365(c) and (f) mismatches, leaving open the question of how they fit together.[186]

As numerous bankruptcy scholars have observed, § 365 of the

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[178] *See* Caliber N.D., LLC v. Nine Point Energy Holdings, Inc. (*In re* Nine Point Energy Holdings, Inc.), 633 B.R. 124, 135 (D. Del. 2021).

[179] *See* 11 U.S.C. § 365(f)(1).

[180] *See id.*

[181] *See id.* § 365(f)(2).

[182] *See* 11 U.S.C. § 365(c)(1)(A); *In re* Lil' Things, Inc., 220 B.R. 583, 587–88 (Bankr. N.D. Tex. 1998) (discussing doctrinal development).

[183] *See* 11 U.S.C. § 365(b) (emphasis added).

[184] *Compare, e.g.*, *In re* West Elecs., Inc., 852 F.2d 79, 82–83 (3d Cir. 1988) (adopting hypothetical test); Perlman v. Catapult Ent., Inc. (*In re* Catapult Ent., Inc.), 165 F.3d 747, 750–51 (9th Cir. 1999) (same), *with* Institut Pasteur v. Cambridge Biotech Corp., 104 F.3d 489, 493–94 (1st Cir. 1997) (adopting actual test); Bonneville Pwr. Admin. v. Mirant Corp., (*In re* Mirant Corp.), 440 F.3d 238, 248–49 (5th Cir. 2006) (same).

[185] *See* 11 U.S.C. § 365(f)(1).

[186] *Compare id.* § 365(c)(1)(A) *with id.* § 365(f)(2).

Bankruptcy Code is in disarray.[187] Courts have tried to reconcile §§ 365(c) and (f),[188] but it is hard to escape the conclusion that, at best, those provisions fit together awkwardly.[189]

A more fruitful approach to reconciling those subsections begins with first principles. The exceptions in §§ 365(c) and (f) protect spillover control rights designed to prohibit or limit to whom the debtor may assign the contract. The value of the counterparty's enterprise will fluctuate based on who performs under the contract. Sections 365(c) and (f) consequently prevent the debtor from assigning the contract without the counterparty's consent.

Of course, § 365's exceptions are geared not to protecting spillover control rights but personal services contracts. Personal services contracts include, but are not limited to, spillover control rights. Some of § 365's exceptions are consequently too broad. For instance, counterparties armed with spillover control rights should be barred from terminating executory contracts merely because the debtor filed for bankruptcy, yet § 365(c) arguably requires that result.[190] Others are too narrow. Section 365(f)(1) nullifies an anti-assignment clause even if it is a spillover control right because it is not a personal services contract under nonbankruptcy law. Even so, § 365's exceptions are best viewed as imperfectly protecting spillover control rights.

Courts should generally nullify ipso facto clauses even for spillover control rights. The debtor's bankruptcy filing or financial condition may have no effect on the resource the spillover control right is attached to. Bankruptcy law, however, should enforce an ipso facto clause if the debtor's bankruptcy filing automatically affects the shared resource.

A debtor's management rights in a joint venture illustrates the point. Outside of bankruptcy, the debtor may owe fiduciary duties solely to its

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[187] *See, e.g.*, BAIRD, ELEMENTS, *supra* note 22, at 132 (commenting that § 365 "lacks internal coherence that we see in other parts of the Bankruptcy Code"); Daniel J. Bussel & Edward A. Friedler, *The Limits on Assuming and Assigning Executory Contracts*, 74 AM. BANKR. L.J. 321, 322 n.6 (2000) (compiling scholarship).

[188] *See* Michelle M. Harner et al., *Debtors Beware: The Expanding Universe of Non-Assumable/Non-Assignable Contracts in Bankruptcy*, 13 AM. BANKR. INST. L. REV. 187, 198–203 (2005).

[189] *See* Bussel & Friedler, *supra* note 187, at 326–30 (outlining and criticizing conventional judicial approach to reconciling §§ 365(c) and (f)).

[190] *See supra* notes 182 to 184 and accompanying text.

other participants in the entity. Once the debtor files for bankruptcy, it owes fiduciary duties to its creditors. Allowing the debtor to exercise its management rights presages a conflict between the debtor's divergent sets of fiduciary duties.[191] It may press the entity to adopt riskier or shorter-term projects that, if they pan out, will better allow the debtor to pay off its creditors but fail to be in the best interests of the entity or its participants.[192] Because those interests are usually not freely tradeable, there's little opportunity for disgruntled investors to exit.[193] So, bankruptcy law should enforce ipso facto clauses for spillover control rights when filing for bankruptcy automatically jeopardizes the shared resource and, in turn, the value of the counterparty's enterprise.[194]

Some may object that the counterparty should be able to protect its enterprise by incorporating ipso facto clauses into its suite of spillover control rights. If the debtor and counterparty can create state-contingent control rights, why not respect that allocation?[195] After all, exercising an ipso facto clause can police a debtor by removing an important resource from its estate, incentivizing it to put the resource to its optimal use.[196]

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[191] *See* Lawrence J. LaSala, Note, *Partner Bankruptcy and Partnership Dissolution: Protecting the Terms of the Contract and Ensuring Predictability*, 59 FORDHAM L. REV. 619, 633–34, 638–39 (1991) (discussing potential conflicts of interest that debtor may have given its fiduciary duties to its creditors and its fellow partners/members).

[192] *See* Larry E. Ribstein, *Partner Bankruptcy and the Federalization of Partnership Law*, 33 WAKE FOREST L. REV. 795, 800–01 (1998).

[193] *See id.* at 800 (discussing non-alienability of partnership and LLC interests); ALBERT O. HIRSCHMANN, EXIT, VOICE, AND LOYALTY 33–34 (1970) (discussing how parties increasingly use "voice" to express disagreement with an organization's policies when exiting the organization is not an option).

[194] Courts are currently split on whether to enforce ipso facto clauses in entity agreements. *Compare, e.g.*, *In re* Envision Healthcare Corp., 655 B.R. 701, 711–12 (Bankr. S.D. Tex. 2023) (holding that § 365(e) renders ipso facto clause in entity agreement wholly unenforceable) *with* Northrop Grumman Tech. Servs., Inc. v. The Shaw Grp. Inc. (*In re* The IT Grp., Inc.), 302 B.R. 483, 487 (D. Del. 2003) (holding that ipso facto clause in entity agreement and § 365(e) only work to strip debtor of management, not economic, rights), *and with* Breeden v. Catron (*In re* Catron), 158 B.R. 624, 626–29 (Bankr. E.D. Va. 1992) (holding that ipso facto clause in partnership agreement and § 365(e) stripped debtor of management and economic rights), *aff'd*, 158 B.R. 629 (E.D. Va. 1993), *aff'd sub nom.*, Catron v. Breeden (*In re* Catron), 25 F.3d 1038 (4th Cir. 1994).

[195] *See* Buccola, *Bankruptcy's Cathedral*, *supra* note 5, at 726 (noting that bankruptcy is justified in providing parties with mandatory state-contingent control rights only when those parties were unable to create them themselves).

[196] *See* Baird & Casey, *No Exit*, *supra* note 131, at 9–10 (discussing disciplining role

Allowing counterparties to enforce ipso facto clauses risks giving them rights over the debtor even when the debtor's bankruptcy filing leaves how the debtor uses the resource intact.[197] It would be the counterparty who destroys the complementarity between it and the debtor. The counterparty should instead be able to object to the debtor's conduct when it risks harming the counterparty's enterprise.

By the same token, not all policing tactics will be cost effective. We should first question how pronounced the policing effects will be on the debtor, since they'll be spread across the debtor and its stakeholders.[198] Even if they are effective, drastic tactics like withdrawal rights—rights to remove resources from the estate—may be warranted. They're most effective when resources are difficult to monitor and managers need to be reined in.[199] Those conditions do not hold when a counterparty has spillover control rights. The counterparty has these control rights because its enterprise is sensitive to how the debtor may use it. That sensitivity presses the counterparty to carefully monitor how the debtor uses the resource.[200] When a counterparty already has the incentives to heavily monitor the debtor, withdrawal rights' risks outweigh their benefits.

### C. Control Rights and Entity Partitioning

The interrelatedness of the debtor and the counterparty raises the following concern: if a counterparty's enterprise is so sensitive to how a debtor uses a resource, why should the counterparty not file for bankruptcy

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of right to withdraw key assets from debtor's use).

[197] *See* BAIRD, ELEMENTS, *supra* note 22, at 126 ("Counterparties should not be able to change their relationship with the debtor merely because of the happenstance of bankruptcy.").

[198] This is a function of multiple stakeholders investing in the debtor. Benefits and harms that are targeted at the debtor are diffused among its stakeholders, diluting the effects they will have on the debtor alone. *See* JACKSON, LOGIC AND LIMITS, *supra* note 21, at 42.

[199] *See* Baird & Casey, *No Exit*, *supra* note 131, at 11 ("Withdrawal rights make the most sense when there are hard-to-monitor assets and a greater need to discipline managers.").

[200] *Cf.* Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901, 921 (1986) (identifying ways in which counterparties can use monitoring and bonding mechanisms to curb debtor misbehavior).

when the debtor files? This line of thought has weaker and stronger versions.

The weaker version posits that both entities should file for bankruptcy, but their respective assets and liabilities should remain separate. The thought goes like this. If the two enterprises are so intertwined that the actions of one affects the value of the other, then when one party files for bankruptcy, so should the other.

The case that lionizes this possibility is *In re General Growth Properties, Inc.*[201] The parent debtors of the debtor group owned or managed 200 shopping centers and spawned roughly 750 fully or partially owned subsidiaries and affiliates.[202] Some of the debtors were set up as bankruptcy-remote special purpose entities (SPEs), where the entities could file for bankruptcy only if their secured creditors consented.[203] The SPEs' boards, though, circumvented the secured creditors and filed for bankruptcy along with the other debtors.[204] The secured creditors moved to dismiss the SPEs' bankruptcy filings, insisting that, when viewed in isolation, each SPE was solvent and thus each entity filed for bankruptcy in bad faith.[205]

The court denied the motions to dismiss, reasoning that it should analyze the financial distress of the debtors as a group, not as siloed entities.[206] The secured creditors knew "that they were extending credit to a company that was part of a much larger group" and that "[i]f the ability of the Group to obtain refinancing became impaired, the financial situation of the [SPE] would inevitably be impaired."[207] The parent debtors faced $8.4 billion in debt on behalf of the debtor group and depended on cash flows from their subsidiaries, including the SPEs, to service it.[208] Drawing the SPEs into the bankruptcy case would benefit the corporate group.

The stronger version of the thesis goes further: a bankruptcy court should substantively consolidate the entities. Substantive consolidation treats the assets and liabilities of discrete entities as though they belonged to

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[201] 409 B.R. 43 (Bankr. S.D.N.Y. 2009).

[202] *See id.* at 47.

[203] *Id.* at 49.

[204] *Id.* at 58–59.

[205] *See id.* at 55.

[206] *See id.* at 61 ("The few cases on point support the Debtors' position that the interests of the group can and should be considered."), 72.

[207] *Id.*

[208] *Id.* at 62–63.

a single entity.[209] There are two main approaches to substantive consolidation. One searches for "a substantial identity between the entities" and weights the costs and benefits of substantive consolidation.[210] The other determines whether "(i) prepetition [the entities] disregarded separateness so significantly their creditors relied on the breakdown of entity borders and treated them as one legal entity, or (ii) postpetition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors."[211] Under either analysis, if the enterprises are so intertwined, one may think there's reason to substantively consolidate them.

Though distinct, both the weak and strong versions understate the virtues of entity partitioning. An entity is an isolated pool of assets and liabilities, which benefits the entity's owners and creditors alike.[212] The owners can commit capital to the entity,[213] and the entity shields that capital from their personal creditors.[214] Since the owner's creditors are unable to reach the entity's assets, the entity's creditors only need to monitor the entity and evaluate its credit risk.[215] These features also allow the entity to create a capital structure tailored to the assets it houses and projects it undertakes.[216]

Requiring the counterparty to file for bankruptcy when the debtor does so undermines entity partitioning. The debtor and the counterparty have their own sets of resources and creditors, and each one's financial condition

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[209] *In re* GC Cos., 274 B.R. 663, 672 (Bankr. D. Del. 2002), *rev'd on other grounds sub nom.*, Walton v. Post-Confirmation Comm. of Unsecured Creditors, 298 B.R. 226 (D. Del. 2003).

[210] *See* Drabkin v. Midland-Ross Corp. (*In re* Auto-Train Corp.), 810 F.2d 270, 276 (D.C. Cir. 1987).

[211] *In re* Owens Corning, 419 F.3d 195, 211 (3d Cir. 2005), *as last amended* (Nov. 2007). This standard is essentially the one the Second Circuit promulgated. *See* Union Sav. Bank v. Augie/Restivo Baking Co. (*In re* Augie/Restivo Baking Co.), 860 F.2d 515, 518 (2d Cir. 1988).

[212] *See* Henry Hansmann & Reinier Kraakman, *The Essential Role of Organizational Law*, 110 YALE L.J. 387, 393 (2000).

[213] *See* Morgan Ricks, *Organizational Law as Commitment Device*, 70 VAND. L. REV. 1303, 1334–42 (2017) (discussing how entities facilitate capital commitment).

[214] *See* Hansmann & Kraakman, *supra* note 212, at 394–95.

[215] *Id.* at 401–03.

[216] *See* Edward M. Iacobucci & George G. Triantis, *Economic and Legal Boundaries of the Firm*, 93 VA. L. REV. 515, 543–57 (2007) (showing how company's optimal capital structure depends in part on the kinds of assets the company operationalizes).

may not have anything to do with the other. Indeed, one of the parties may be so financially healthy that it is ineligible to file for bankruptcy.[217]

What's more, requiring the counterparty to file for bankruptcy to enforce its control rights is a category mistake because it conflates two different sources of (potential) distress.[218] One is the debtor's misuse of the shared resource; the other is financial distress, such as liquidity constraints and upcoming maturities. One has nothing to do with the other.[219]

For similar reasons, substantive consolidation is inappropriate. The fact that a debtor uses a resource subject to a counterparty's control rights does not entail a "substantial identity" between the entities. Far from it. It rather presupposes distinct parties that share a resource and potentially harbor adverse interests. Enforcing spillover control rights does not collapse the two entities or muddle their assets and liabilities in any way.

## V. Chapter 11's Expanding Scope

Law and economics orthodoxy prescribes a narrow role for chapter 11: to maximize the value of a company's resources for the collective benefit of its claimants.[220] Thus, "[t]he proper focus is entirely on what goes to creditors on account of their claims against the estate."[221] Filing for chapter 11 draws a line in the sand, dividing the world between the estate's

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[217] *See, e.g.*, LTL Mgmt., LLC v. Off. Comm. of Talc Claimants (*In re* LTL Mgmt., LLC), 64 F.4th 84, 101 (3d Cir. 2023) ("Our precedents show a debtor who does not suffer from financial distress cannot demonstrate its Chapter 11 petition serves a valid bankruptcy purpose supporting good faith.").

[218] This is to say nothing about the complexity of enforcing the automatic stay in cross-debtor scenarios. The intractable issues quickly pile up. *See, e.g.*, George W. Shuster, Jr. & Benjamin W. Loveland, *Cross-Border, Cross-Debtor, Multi-Debtor Issues in Proceedings*, 60 AM. BANKR. INST. J. 22 (May 2016) (discussing cross-debtor and cross-border stay issues).

[219] That requirement would essentially convert the control right into a cross-default provision, an asset to a liability. For more on cross-default provisions and their role in corporate reorganizations, see Anthony J. Casey, *The New Corporate Web: Tailored Entity Partitions and Creditors' Selective Enforcement*, 124 YALE L.J. 2680, 2689–92, 2729–37 (2015).

[220] *See* Douglas G. Baird, Anthony J. Casey, & Randal C. Picker, *The Bankruptcy Partition*, 166 U. PA. L. REV. 1675, 1681 (2018) ("[T]he Bankruptcy Code forces the trustee to attend to the assets of the bankruptcy estate and ensure that they are put to their best use.").

[221] *Id.* at 1683 (emphasis omitted).

resources on the one hand and the rest of the world on the other.[222]

Not all corporate bankruptcy scholars abide by this austere approach. Scholars who buck the law and economics party line ascribe chapter 11 the broader mission of providing a forum in which the court reconciles the needs of the debtor, its stakeholders, and the broader public.[223]

Even those firmly rooted in the law and economics tradition struggle to draw the chapter 11 partition. The trouble is defining the debtor's estate. As Professor Buccola observed, "any time one asset's disposition could affect the value of an asset belonging to the debtor, there is . . . at least a prima facie case for bringing the outside asset inside the partition."[224] Others have drawn a more expansive view of the estate's contours. Professor Casey argued that the bankruptcy partition should expand to include the interests of counterparties who made "relationship-specific investments" in the debtor or another counterparty such that "those relationships affect the debtor's going-concern value."[225] The debtor's estate is amorphous because the bankruptcy partition is porous.

Across the board, though, the debtor remains chapter 11's sole item of concern. Only its enterprise should be maximized. If other parties gain from the debtor maximizing the value of its resources, bully for them. But their gains are only attributable to, and justified by, the debtor maximizing the value of its estate. Distinguishing between investment-backed and spillover

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[222] *See id.* at 1679 ("The trustee must try to maximize the value of what falls inside the bankruptcy partition, the line that separates the estate from the rest of the world.").

[223] *See, e.g.*, Jay Lawrence Westbrook, *Equity in Bankruptcy Courts: Public Priorities*, 94 AM. BANKR. L.J. 203, 203 (2020) ("Public interests should guide decisions in bankruptcy cases and often do."); Melissa B. Jacoby, *Corporate Bankruptcy Hybridity*, 166 U. PA. L. REV. 1715, 1721–23 (2018) (noting that corporate reorganizations inherently generate public law concerns); Susan Block-Lieb, *The Logic and Limits of Contract Bankruptcy*, 2001 U. ILL. L. REV. 503, 519 (2001) ("[B]ankruptcy rules should maximize collective welfare, not simply the collective welfare of creditors."); Nathalie D. Martin, *Noneconomic Interests in Bankruptcy: Standing on the Outside Looking In*, 59 OHIO STATE L.J. 429, 436 (1998) ("[R]ather than merely distributing assets, the central purpose of Chapter 11 is to reduce the economic effect of financial disaster."); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 354–56 (1993); Donald R. Korobkin, *Value and Rationality in Bankruptcy Decisionmaking*, 33 WM. & MARY L. REV. 333, 351–52 (1992).

[224] *See* Vincent S.J. Buccola, *The Bankruptcy Firm*, 167 U. PA. L. REV. ONLINE 1, 6 (2019).

[225] *See* Casey, *Chapter 11's Renegotiation Framework*, *supra* note 118, at 1748–49.

control rights reveals how bankruptcy courts may have a broader mission.

Seeing what that mission is requires appreciating that different kinds of control rights are optimally allocated at different levels of an organization. Take the MLB, for instance. It controls its member-teams, and each team, in turn, controls a set of assets—player contracts, stadiums, vendor agreements, and so on.

The debtor and counterparty create value because the assets they respectively control operate at different scales.[226] The MLB's task is to create complementarities across teams. Micromanaging each team's concession stands and ticket price structures is a poor use of its time and resources.[227] Fans' tastes will vary by region, and each team may be better suited to know which hot dogs and ticket prices its fan base will have an appetite for.[228] By the same token, it makes little sense to have teams separately coordinate games with each other. That would defeat the purpose of having a league in the first place.

To be sure, some issues can be handled at the team or league levels, depending on the complementarities to be made. The league may have a role to play in choosing which soft drinks each team offers at its concession stands if the league enters a league-wide deal with Coca Cola or PepsiCo. The point is that there are complementarities to be captured at different scales, and the league and the team may each be well suited at capturing the complementarities at one scale but not another.

When a team faces financial distress, it must solve the commons and anticommons problems that come from widely allocating investment-backed control rights. But shirking the league's spillover control rights threatens to unravel the coordination and compliance benefits the league provides. Defecting from the league's control, in other words, would allow the team

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[226] *See* Nicholas Argyres, *Evidence on the Role of Firm Capabilities in Vertical Integration Decisions*, 17 STRAT. MGMT. J. 129, 147–48 (1996) (finding evidence that "firms outsource when suppliers possess superior capabilities"); Nils Stieglitz & Klaus Heine, *Innovations and the Role of Complementarities in a Strategic Theory of the Firm*, 28 STRAT. MGMT. J. 1, 5 (2007).

[227] *See* Michael C. Jensen & William H. Meckling, *Specific and General Knowledge, and Organizational Structure*, 8 J. APPLIED CORP. FIN. 4, 13 (1995) ("The key to efficiency is to assign decision rights to each agent at each level in such a way that minimizes the sum of the costs owing to poor information and the costs owing to inconsistent objectives.").

[228] *See* Erica Gorga & Michael Halberstam, *Knowledge Inputs, Legal Institutions and Firm Structure: Towards a Knowledge-Based Theory of the Firm*, 101 NW. U. L. REV. 1123, 1166 (2007).

to exercise control across scales. If allowed to do so, the team might solve the commons and anticommons problems at its own scale, but would create new ones at the league scale. By the same token, the MLB may try to override the debtor's strategy for preserving resource complementarities without first showing that the strategy genuinely threatens the league's cross-team complementarities.

The goal, then, is for chapter 11 to try to preserve complementarities across scales.[229] This means there would be a divergence between the debtor's obligations and a court's several economic goals in chapter 11. The debtor, recall, has a fiduciary duty to maximize the value of its estate for its creditors.[230] That is not a court's sole obligation; rather, it should also preserve the complementarities that the debtor's chapter 11 case implicates across scales. Framing the obligation in this way explains why courts preclude the debtor from quashing spillover control rights even when the debtor doing so could maximize the value of the debtor's estate. Allowing that would undercut the complementarities the spillover control right holder could uniquely capture. And it further shows how courts have an obligation to preserve value that goes beyond the confines of the debtor's estate.

This might mean leaving money on the table. Return to the Phoenix Coyotes for a moment. Recall how the court denied PSE's bid to buy the team because the NHL objected to the sale, even though PSE submitted the highest bid by a $100 million margin.[231] Given the parties' history and this Article's assertion that chapter 11's goals include maximizing complementarities at different scales, the court's decision makes even more sense. PSE intimated that it would not abide by the NHL's constitution and bylaws until the team moved to Hamilton.[232] It further blasted the NHL as being anti-Canadian and "an illegal cartel" against which they would potentially initiate antitrust litigation.[233] The evidence thus suggested that

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[229] *See* FENNELL, *supra* note 99, at 231–32; George S. Geis, *The Space Between Markets and Hierarchies*, 95 VA. L. REV. 99, 134 (2009) (noting how "outsourcing partnership . . . allows the parties to carve out enumerated spheres of control, into which they can more safely place relationship-specific investments").

[230] *See supra* note 142 and accompanying text.

[231] *See In re* Dewey Ranch Hockey, LLC, 414 B.R. 577, 587–88, 590–91 (Bankr. D. Ariz. 2009).

[232] *See id.* at 584.

[233] *See id.* at 585.

PSE would not be good partners to the NHL and its other member-teams. Much as cooperation between the teams and the NHL could generate value, acrimony and aggressive behavior could sap it. Selling the team to PSE, then, would compromise the complementarities the NHL could achieve at the inter-team scale. A quick sale of the team paled in comparison to squandering the team's long-term value that it could capture only if it operated in good faith under the NHL's auspices.

A debtor might decide it no longer wants to use the resource subject to the spillover control right. If the debtor can show that disengaging from the counterparty will maximize the value of the estate—that is, the complementarities that the spillover control right holder creates does not generate much value—it should be free to do so.[234] But that will be a tall task. The debtor will be hard pressed to show how it can maximize its value by disengaging from, rather than embracing, the counterparty's enterprise.

Consider the LA Dodgers bankruptcy case.[235] The LA Dodgers faced a liquidity crunch.[236] Immediately after filing for bankruptcy, the debtors moved for the court to approve a $150 million DIP financing facility provided by Highbridge Senior Loan Fund II (Highbridge) and secured by substantially all of the debtors' assets.[237] The MLB offered the team the same amount of DIP financing on an unsecured, administrative priority basis, but team's management allegedly refused to negotiate with it whatsoever.[238]

Beyond offering DIP financing on a secured basis, Highbridge's DIP financing proposal featured more onerous terms than the MLB's proposal. It contemplated greater interest expenses, many more fees, and a wider array

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[234] *See, e.g.*, *In re* Fresh-G Rest. Intermediate Holding, LLC, 580 B.R. 103, 114 (Bankr. D. Del. 2017) ("By permitting the debtor to assume or reject executory contracts, . . . section [365] allows the debtor to maximize the value of the estate by assuming those contracts that are beneficial to the estate and rejecting those that are not."); *In re* MCI, Inc., 151 B.R. 103, 105 n.3 (E.D. Mich. 1992) ("[A] trustee may abandon property of the debtor after notice and hearing if the property is burdensome or is of inconsequential value and benefit to the estate.").

[235] *In re* L.A. Dodgers, LLC, 457 B.R. 308 (Bankr. D. Del. 2011).

[236] *See Declaration of Jeffrey J Ingram in Support of Debtors' Chapter 11 Petitions & First Day Motions* at 8–9, L.A. Dodgers, LLC, No. 11–12010 (Bankr. D. Del. June 27, 2011), ECF 4.

[237] *See L. A. Dodgers*, 457 B.R. at 310.

[238] *See id.* at 311.

of covenants.[239] Yet the debtors submitted that while Highbridge offered the DIP financing for economic purposes, the MLB did so to gain control of the LA Dodgers; as such, Highbridge offered the superior DIP facility.[240]

The court disagreed and denied the debtors' motion.[241] Though it would have ordinarily deferred to the debtors' business judgment on DIP financing decisions, their inability to negotiate with the MLB spelled disaster. The court questioned how the debtors could successfully reorganize yet refuse to negotiate with the MLB.[242]

Courts, like the Delaware bankruptcy court in the LA Dodgers case, are likely mindful of preserving complementarities that cut across the bankruptcy petition line. On other facts, the debtors' desire to obtain the more costly DIP financing would have perhaps been merely foolish. Yet here it warned of the team's unwillingness to cooperate with the MLB going forward. There were complementarities between the debtors and the MLB that the debtors implied they were willing to shirk, squandering value for themselves and the MLB alike. The funding decision, in other words, was not just about the money—it was about preserving complementarities, even if doing so required looking beyond the debtors' confines.

## VI. Conclusion

One scholar recently lamented that "[b]ankruptcy law . . . has little to say about control rights over the running of the business."[243] That is not quite right. To the contrary, bankruptcy law has much to say about control rights over the debtor's business. Bankruptcy scholars have simply underappreciated how prevalent control rights are, the different roles they play, and why it may be appropriate to enforce those control rights differently, even when the remedies depart from how parties enforce those control rights outside of bankruptcy.

It is a complex task to resolve financial distress when the ramifications of that distress bleed beyond the debtor's boundaries and leave the firm at the behest of parties with inconsistent control rights. It is this morass of

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[239] *Id.* at 312.
[240] *Id.* at 313–14.
[241] *Id.* at 314.
[242] *Id.* at 313 n.8.
[243] *See* Rasmussen, *supra* note 3, at 1751.

fragmented and incoherently allocated control rights chapter 11 must face. Chapter 11 must then do the work of property law by telling us how to put resources to their highest and best uses.[244] That goal, in turn, forces us to recognize the myriad ways control rights facilitate or stymie that goal. If we want to make progress on that task, we must take control rights seriously.

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[244] Professor Adler makes a similar point about the connection between bankruptcy and property law, albeit one that focuses on resource allocation. *See generally* Barry E. Adler, *Bankruptcy as Property Law*, *in* RESEARCH HANDBOOK ON THE ECONOMICS OF PROPERTY LAW 206 (Kenneth Ayotte & Henry E. Smith, eds. 2011).