

ESSAY

FOR THE GREATER GOOD: THE USE OF PUBLIC POLICY CONSIDERATIONS IN CONFIRMING CHAPTER 11 PLANS OF REORGANIZATION

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I. INTRODUCTION

Chapter 11 of the Bankruptcy Code was intended to provide a mechanism by which a financially distressed business could escape from the weight of oppressive debts without destroying creditors' hopes that such debts would be paid.¹ As such, a Chapter 11 plan providing for complete satisfaction of all debts while offering the debtor a feasible payment plan is, in basic theory, an optimal situation. But should such a plan be deemed optimal if, despite paying creditors 100 cents on the dollar, the reorganized business will be operated by, for example, a known embezzler or a person previously convicted of securities fraud? The Bankruptcy Code provides an answer to such questions.

While the "twin pillars" of bankruptcy law in the United States are creditor repayment and a fresh start for distressed debtors,² the Bankruptcy Code provides protection to another

1. See *In re Walker*, 165 B.R. 994, 1001 (E.D. Va. 1994) ("[R]eorganization under Chapter 11 was intended to afford the earnest debtor an opportunity to restructure its finances in such a fashion as to permit continued operation of business ventures so as to enable payment of creditors Indeed, prompt payment of creditors is a primary objective of a Chapter 11 reorganization."); *In re Campesinos Unidos, Inc.*, 219 B.R. 886, 887 (Bankr. S.D. Cal. 1998) ("Chapter 11 was intended to afford an opportunity for financially troubled businesses, and individuals, to reorganize their financial affairs, submit a plan to their creditors providing for some measure of repayment, and allowing those creditors to vote on the plan.").

2. *In re Sissom*, 366 B.R. 677, 708 (Bankr. S.D. Tex. 2007); *In re Ortiz*, No. 05-39982, 2006 WL 2946500, at *9 (Bankr. S.D. Tex. Oct. 13, 2006); see also *Chemetron Corp. v. Jones*, 72 F.3d 341, 351 (3d Cir. 1995) (Sarokin, J., concurring in the judgment) ("[B]ankruptcy law . . . is concerned not merely with affording a fresh start to those who

interest—public policy. For example, during confirmation proceedings for a Chapter 11 plan, a bankruptcy court is to evaluate whether the reorganized entity's proposed management is consistent with public policy.³ Unfortunately, the proper scope and procedure of this consideration are ill defined and, as such, it is no surprise that such provisions are rarely discussed during confirmation proceedings.

It is the purpose of this Essay to address two primary issues: (1) what public policy issues pertaining to the proposed management of a reorganized Chapter 11 debtor should be considered when confirming a plan; and (2) what procedure a bankruptcy court should adopt when addressing such issues. Section II describes the history of, and justifications behind, public policy considerations in the confirmation of Chapter 11 plans. Specifically, this Section—and this Essay in general—will focus on public policy considerations pursuant to 11 U.S.C. §§ 1123(a)(7) and 1129(a)(5), both of which provide that management of a reorganized entity must be consistent with public policy.⁴ Section III of this Essay sets forth a nonexhaustive list of public policy considerations that may be of significance when considering whether the proposed management of a reorganized business is consistent with public policy. These considerations may include policies associated with securities law, corporate law, and the competent management of reorganized business entities. Section IV proposes implementing a burden shifting system to guide courts when considering whether a plan is consistent with public policy under Sections 1123(a)(7) and 1129(a)(5). Further, the proposed system will explain certain apparent contradictions between the bankruptcy laws and the operation of bankruptcy courts. Lastly, Section V contends that the Bankruptcy Code, as it currently stands, provides both the opportunity and the incentive for parties to object to Chapter 11 plans that are inconsistent with public policy. Such objections may be necessary to properly

warrant it, but also with protecting the interests of creditors and claimants who may be adversely affected by the bankruptcy proceeding.”)

3. See 11 U.S.C. §§ 1123(a)(7), 1129(a)(5)(A)(ii) (2006) (stating that a court should consider whether the selection process and appointment of corporate management in a reorganized business is consistent with public policy).

4. The Author recognizes that Section 1123(a)(7) pertains specifically to the manner in which a reorganized business's governance is selected, and Section 1129(a)(5)(A) relates specifically to parties who are selected to serve as corporate management of a reorganized entity. However, in the interest of simplicity, this Essay may generally refer to these sections as “ensuring that management of a reorganized entity is consistent with public policy” (or serving another, but similar, generalized purpose).

enforce the public policy provisions of Sections 1123(a)(7) and 1129(a)(5).

II. DEVELOPMENT AND EARLY POLICY BEHIND SECTIONS 1123 AND 1129

A. *The Chandler Act*

In the 1930s, the newly created Securities and Exchange Commission (SEC) engaged in a thorough investigation of fraudulent activities against public bondholders and stockholders during business reorganizations overseen by the judicial system.⁵ On June 22, 1938, these investigations reached their pinnacle when the SEC-recommended Chandler Act took effect.⁶ This Act provided for significantly increased court involvement in business reorganizations.⁷ This increase in judicial participation appears, for example, in sections 616(11) and 621(5) of the Chandler Act.⁸ Specifically, Section 616(11) provided:

A plan of reorganization under this chapter . . . shall include provisions which are equitable, compatible with the interests of creditors and stockholders, and *consistent with public policy*, with respect to the manner of selection of the persons who are to be directors, officers, or voting trustees, if any, upon the consummation of the plan, and their respective successors⁹

Section 621(5) echoed the policy set forth in Section 616(11), stating:

The judge shall confirm a plan [of reorganization] if satisfied that . . . the identity, qualifications, and affiliations of the persons who are to be directors or officers, or voting trustees, if any, upon the consummation of the plan, have been fully disclosed, and that the appointment of

5. Anne M. Burr, *The Unproposed Solution to Chapter 11 Reform: Assessing Management Responsibility for Business Failures*, 25 CAL. W. INT'L L.J. 113, 128 (1994).

6. *Id.*; see also Chandler Act, ch. 575, 52 Stat. 840 (1938), repealed by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549, 2682.

7. Burr, *supra* note 5, at 128.

8. 11 U.S.C. §§ 616(11), 621(5) (1976) (repealed 1978). References to 11 U.S.C. § 621(5) are commonly used interchangeably with references to Section 221(5). See, e.g., *In re Spectrum Arena, Inc.*, 340 F. Supp. 794, 802 (E.D. Pa. 1971) (referring to Section 221(5) as Section 621(5)). References to "Section 221(5)" employ the section enumeration found in the Chandler Act, ch. 575, § 221(5), 52 Stat. 840 (1938) (repealed 1978), while references to "11 U.S.C. § 621(5)" refer to the codification in Title 11. *Id.* In the interest of simplicity, this Essay will refer to Section 621(5) (unless a reference to Section 221(5) is contained in a direct quote). 11 U.S.C. § 616(11) is likewise related to Section 216(11) and will be referred to in the same manner. *Id.* at 796.

9. 11 U.S.C. § 616(11) (1976) (repealed 1978) (emphasis added).

such persons to such offices, or their continuance therein, is equitable, compatible with the interests of the creditors and stockholders and *consistent with public policy*.¹⁰

This newly enacted policy was intended “to inject a proper measure of federal control, through the authorized discretion of the reorganization court, in supervising the rebirth of financially embarrassed enterprises . . . for the benefit of the security holders and the *public generally*.”¹¹ Furthermore, Sections 616(11) and 621(5) required the court to consider the “public interest in general, over and beyond the immediate interest of the creditors and stockholders” when evaluating prospective management of a reorganized business.¹²

In discussing these sections of the Chandler Act, bankruptcy courts have acknowledged the interaction between public policy and the interests of creditors and equity security holders.¹³ For example, the court in *In re Spectrum Arena* held that the public interest served by a particular Chapter 11 plan compelled confirmation, even though an alternative plan arguably better served the interests of creditors. The court considered various public interest factors in reaching this determination, such as avoiding delay and uncertainty in the execution of the case. The court reasoned that “Section 221(5) (11 U.S.C. § 621(5)) talks in terms of consistency with public policy. On this issue, why should . . . the public have to be subjected to such unnecessary contingencies as are required in the [alternative plan] when there is a viable plan available now[?]”¹⁴ While considering the interests of creditors, the court emphasized the negative public policy implications that would arise from a failure to confirm the plan. As such, the *Spectrum Arena* court concluded that while a better plan could potentially be drafted, public policy favored immediate confirmation of the proposed Chapter 11 plan.¹⁵ The court’s application of Section 621(5) exemplifies its use by bankruptcy courts in considering public policy issues when approving business management for a reorganized entity.

10. 11 U.S.C. § 621(5) (1976) (repealed 1978) (emphasis added).

11. *In re Am. Solar King Corp.*, 90 B.R. 808, 815 (Bankr. W.D. Tex. 1988) (quoting 6A COLLIER ON BANKRUPTCY ¶ 11.10, at 251 (14th ed. 1977)) (emphasis added).

12. *Spectrum Arena*, 340 F. Supp. at 802 (quoting COLLIER, *supra* note 11, ¶ 11.10, at 652).

13. *Id.*

14. *Id.* at 803 (noting further that one of the many contingencies of the alternative plan was that it “would require a ruling by the United States Internal Revenue Service that the proposed revenue bonds will be tax exempt, and [the Court had] not been advised of any [such] ruling”).

15. *Id.* at 803–04.

B. The Bankruptcy Reform Act of 1978

On November 6, 1978, Congress enacted the Bankruptcy Reform Act of 1978 (Reform Act).¹⁶ The Reform Act was the result of over ten years of effort focused on modernizing the bankruptcy system.¹⁷ The far-reaching statute repealed every section of Title 11 of the United States Code and enacted the current Bankruptcy Code.¹⁸ While the Reform Act was intended to remove the bankruptcy judge from his previous position as the “administrat[or] of bankruptcy estates,” Congress nevertheless intended for bankruptcy judges to actively supervise cases to protect the public interest.¹⁹

Despite codification in separate sections of the Bankruptcy Code, 11 U.S.C. §§ 1123(a)(7)²⁰ and 1129(a)(5)(A)²¹ work together to govern the appointment of a reorganized business entity’s management.²² These sections were derived from 11 U.S.C. §§ 616(11) and 621(5), respectively.²³ Section 1123 pertains to the manner in which a reorganized business’s governance is selected. It provides:

Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall . . . contain only provisions that are consistent with the interests of creditors and equity security holders and with public policy with respect to the manner of selection of any officer, director, or trustee under the plan and any successor to such officer, director, or trustee²⁴

16. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).

17. H.R. REP. NO. 95-595, at 3 (1977) (“The major purpose of [the Reform Act] was the modernization of the bankruptcy laws.”); Hon. William Houston Brown, *Bankruptcy as a Method of Dealing with Insolvency*, in 2 THE LAW OF DEBTORS AND CREDITORS § 10:7 (2008).

18. Frank R. Kennedy, *Foreword: A Brief History of the Bankruptcy Reform Act*, 58 N.C. L. REV. 667, 667–68 (1980).

19. *In re Gusam Rest. Corp.*, 32 B.R. 832, 833–34 (Bankr. E.D.N.Y. 1983) (quoting H.R. REP. NO. 95-595, at 88 (1977)) (“In bankruptcy cases, however, active supervision is essential.”), *rev’d on other grounds*, 737 F.2d 274 (2d Cir. 1984).

20. Hereinafter, 11 U.S.C. § 1123(a)(7)(A) will be referred to as “Section 1123.” Any reference to other subsections of Section 1123 will be expressly referenced.

21. Hereinafter, 11 U.S.C. § 1129(a)(5) will be referred to as “Section 1129.” Any reference to other subsections of Section 1129 will be expressly referenced.

22. HON. WILLIAM L. NORTON, JR. & WILLIAM L. NORTON III, *NORTON BANKRUPTCY LAW AND PRACTICE* § 112:12, at 112-39 to -40 (3d ed. 2008).

23. *See In re Am. Solar King Corp.*, 90 B.R. 808, 815–16 (Bankr. W.D. Tex. 1988) (“The entirety of [§ 1125(a)(5)] is derived from section 221 of the Bankruptcy Act [11 U.S.C. § 621(5)].”); *In re Mahoney*, 80 B.R. 197, 201 (Bankr. S.D. Cal. 1987) (“[Section] 1123(a)(7) . . . is derived substantially from former § 216(11) of the Bankruptcy Act [11 U.S.C. § 616(11)].”).

24. 11 U.S.C. § 1123(a)(7) (2006).

Section 1129, which relates to persons selected to serve as corporate management of a reorganized entity, states:

The court shall confirm a plan only if . . . (i) [t]he proponent of the plan has disclosed the identity and affiliations of any individual proposed to serve, after confirmation of the plan, as a director, officer, or voting trustee of the debtor, an affiliate of the debtor participating in a joint plan with the debtor, or a successor to the debtor under the plan; and (ii) the appointment to, or continuance in, such office of such individual, is consistent with the interests of creditors and equity security holders and with public policy²⁵

Pursuant to its express terms, Section 1129 imposes on the plan proponent a twofold responsibility, consisting of a disclosure component and a substantive component.²⁶ The substantive evaluation, i.e., consistency with public policy, can only proceed after the court has obtained information about the proposed business management pursuant to the statute's disclosure requirement.²⁷

One case suggests that the legislature did not intend the public policies embodied in Sections 616(11) and 621(5) to continue into the present Bankruptcy Code. The court in *In re American Solar King Corp.* construed Section 1129, in light of the Reform Act and its legislative history, as narrowing the bankruptcy court's ability to consider public policy when confirming Chapter 11 plans (relative to its predecessor statute, 11 U.S.C. § 621(5)).²⁸

Initially, the *American Solar* court recognized that Section 621 was intended "to inject a proper measure of federal control, through the authorized discretion of the reorganization court."²⁹ However, the court then posited that the successor to Section 621(5)—Section 1129—was not enacted for the same reasons as Section 621(5) despite the very similar language in the two statutes.³⁰ Specifically, the court stated that Section 1129

25. 11 U.S.C. § 1129(a)(5)(A)(i)–(ii) (2006).

26. *In re Beyond.com Corp.*, 289 B.R. 138, 144 (Bankr. N.D. Cal. 2003).

27. 7 COLLIER ON BANKRUPTCY ¶ 1129.03[5][b], at 43 (15th ed. rev. 2008).

28. *In re Am. Solar King Corp.*, 90 B.R. 808, 815–16 (Bankr. W.D. Tex. 1988).

29. *Id.* at 815–16 (quoting COLLIER, *supra* note 11, ¶ 11.10, at 251).

30. *Id.* at 815–16. Section 616 provided that proposed management in a Chapter 11 plan must be "compatible with the interests of the creditors and stockholders, and consistent with public policy," 11 U.S.C. § 616(11) (1976) (repealed 1978), whereas Section 1129 provides that such a plan must be "consistent with the interests of creditors and equity security holders and with public policy." 11 U.S.C. § 1129(a)(5)(A)(ii) (2006). The similarity of the statutes is obvious when viewing the insertions and deletions necessary to arrive at the successor statute from the predecessor statute. Section 1129 provides that a Chapter 11 plan must be "compatible consistent with the interests of

removed the court from the “pervasive watchdog role” it held under Section 621(5).³¹ Under the new statute, public investors were protected through the application of pertinent nonbankruptcy laws rather than through judicial scrutiny.³² The court concluded that a “court discharges its supervisory function [under Section 1129] by determining that the corporation’s system of governance will remain undisturbed.”³³ This conclusion was premised on the idea that the previous selection of management was scrutinized under applicable nonbankruptcy law and was therefore consistent with the public policies contained therein, thus satisfying Section 1129.³⁴ However, this interpretation of the Bankruptcy Code significantly hampers the bankruptcy courts’ ability to consider the public interest pursuant to Sections 1123 and 1129. Such a narrow reading of the courts’ obligations under Section 1129 is improper because it contradicts the plain language of the statute.

As the U.S. Supreme Court has recognized, “[t]he plain meaning of legislation should be conclusive, except in the ‘rare cases [in which] the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters.’”³⁵ Section 1129 expressly states that the court must confirm a plan only if the business management’s “*continuance in[] such office . . . is consistent with . . . public policy.*”³⁶ Bankruptcy courts have an affirmative duty to evaluate whether a proposed plan satisfies each part of Section 1129(a).³⁷ Pursuant to this plain language, a court considering confirmation of a Chapter 11 plan of reorganization must evaluate whether the reorganized entity’s

creditors and ~~stockholders~~ *equity security holders* and consistent with public policy.” 11 U.S.C. § 1129(a)(5)(A)(ii) (2006) (insertions in italics and deletions struck through).

31. *Am. Solar*, 90 B.R. at 815–16.

32. The court supported this position by noting that the SEC, an entity that was necessary to confirmation of a plan under Section 621(5), does not have to appear in court under Section 1129 but rather can exert control through the application of pertinent securities laws outside of the bankruptcy court. *Id.* at 816.

33. *Id.* *American Solar* did not expressly address the implications of § 1129 on Chapter 11 plans that propose to change management of the reorganized entity. *See id.*

34. *Id.*

35. *United States v. Ron Pair Enters.*, 489 U.S. 235, 242 (1989) (quoting *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982)).

36. 11 U.S.C. § 1129(a)(5)(A)(ii) (2006) (emphasis added).

37. *See In re Ambanc La Mesa Ltd. P’ship*, 115 F.3d 650, 653 (9th Cir. 1997) (“The bankruptcy court had an affirmative duty to ensure that the Plan satisfied all 11 U.S.C. § 1129 requirements for confirmation.”); *In re Simplot*, No. 06-00002-TLM, 2007 WL 2479664, at *7 (Bankr. D. Idaho Aug. 28, 2007) (“The bankruptcy court has an affirmative duty to ensure a debtor’s plan satisfies all of the requirements of § 1129(a). The court shall confirm a [C]hapter 11 plan if its proponent proves by a preponderance of the evidence [that] the plan meets all of the § 1129(a) requirements . . .”).

proposed governance is consistent with public policy. The *American Solar* court's view that "[t]he court discharges its supervisory function [under Section 1129] by determining that the corporation's system of governance will remain undisturbed" stands in direct contrast to this statutory mandate.³⁸ Such a rule plainly neglects the court's obligations to evaluate whether the proposed management is consistent with public policy and is necessarily incorrect.

In contrast to *American Solar*, *In re Toy & Sports Warehouse, Inc.* exemplifies a court's use of Section 1129 to consider public policy in determining whether to approve a Chapter 11 plan.³⁹ The *Toy* court discussed Section 1129 in determining whether to allow continued employment of the debtor company's founder and president of twenty-five years. The plan's opponents—shareholders who would remain personally liable for unpaid taxes under the plan—challenged the current president's business judgment and sought to appoint new management.⁴⁰ Nonetheless, the court held that keeping a competent founder in charge of the reorganized debtor business was consistent with public policy.⁴¹ Thus, it is apparent that the *Toy* court recognized public policy as a distinct concern apart from the other considerations under Section 1129 (i.e., whether the proposed management is consistent with the interests of creditors and equity security holders). Specifically, *Toy* evaluated these distinct considerations and determined that the public interest in the sustained management of the debtor should prevail, despite its contrast with the interests of the objecting equity security holders (shareholders). Such logic suggests that it is proper for a bankruptcy court to consider and act upon public policy concerns when evaluating proposed management under a Chapter 11 plan.

38. *Am. Solar*, 90 B.R. at 816. A proponent of *American Solar's* interpretation of Section 1129 could argue the continuation of current management is per se consistent with public policy because the current management was (presumptively) selected within the bounds of public policy as set forth in nonbankruptcy statutes controlling the selection of such management. However, this argument fails because Section 1129 pertains to public policy generally; the statute is not expressly limited to public policy concerns associated with the methods employed in selecting business management.

39. *In re Toy & Sports Warehouse, Inc.*, 37 B.R. 141, 149–50 (Bankr. S.D.N.Y. 1984).

40. *Id.* at 150. The objecting creditors "question[ed] management's decision not to satisfy the unpaid sales tax liability and to use the proceeds on hand for business purposes." *Id.*

41. *Id.* at 149–50.

III. PUBLIC POLICY ISSUES OF CONCERN

Section 1129(a)(1) states that a plan should be confirmed only if it complies with all applicable provisions of the Bankruptcy Code.⁴² Sections 1123 and 1129 state that, when considering whether to confirm a Chapter 11 plan, bankruptcy courts should determine whether the proposed management is consistent with public policy.⁴³ While the Bankruptcy Code defines many words and phrases, the phrase “consistent with public policy” is not one of them. Not surprisingly, the phrase “inconsistent with public policy” is also left undefined.⁴⁴ The absence of a definition necessarily means that bankruptcy courts are left to exercise their sound discretion on the issue. In doing so, the courts should look to various sources that have fashioned public policy regarding both what is and what is not appropriate conduct in managing a corporate entity. These sources include state constitutions, acts of Congress, acts of state legislatures, and judicial decisions.⁴⁵

A. *Public Perception of the Bankruptcy System*

It is important for the public to have faith in the judiciary and in the legal profession. Indeed, the continued existence of “the American concept that we are to be governed by rules of law requires that the people have faith that justice can be obtained through our legal system.”⁴⁶ In particular, public confidence in the bankruptcy system warrants attention because many people remain skeptical of the bankruptcy process.⁴⁷ One bankruptcy court noted that some members of the public view the

42. 11 U.S.C. § 1129(a)(1) (2006).

43. 11 U.S.C. §§ 1123(a)(7), 1129(a)(5)(A)(ii) (2006).

44. See 11 U.S.C. § 101 (2006) (defining various terms in the title); 11 U.S.C. § 102 (2006) (stating the rules of construction).

45. *In re Machne Menachem, Inc.*, 304 B.R. 140, 143 (Bankr. M.D. Pa. 2003).

46. *In re I Successor Corp.*, 321 B.R. 640, 651 (Bankr. S.D.N.Y. 2005) (quoting MODEL CODE OF PROF'L RESPONSIBILITY EC 9-1 (1969)) (emphasis added).

47. For example, see W. Clarkson McDow, Jr., *Protecting the Integrity of the Bankruptcy System in Chapter 7 No-Asset Cases*, http://www.usdoj.gov/ust/eo/public_affairs/articles/docs/nabtalkfall2001.htm (last visited Mar. 19, 2009), which states:

Because there has traditionally been a belief that one loses everything in bankruptcy, many people have trouble understanding concepts such as fresh start and exemptions. They expect to see men walking around wearing barrels as [seen] in the funny papers

. . . There is a need to rid the system of the taint of bankruptcy fraud and to reduce the mystery of bankruptcy, so that even the casual observer will have confidence in the system.

. . . [T]he small percentage of debtors who for whatever reason do not play by the rules[] creat[e] the perception that the entire system is flawed.

bankruptcy system as “a vehicle for bankruptcy practitioners to earn a comfortable living.”⁴⁸ It is thus crucial that the bankruptcy system function both efficiently and equitably to dispel any notions of impropriety and to garner the trust of the American public.

To this end, some bankruptcy courts have considered whether “the public will lack faith in the bankruptcy process” not because a statute is violated, but because there are apparent conflicts of interest.⁴⁹ *In re Beyond.com* exemplifies a bankruptcy court’s consideration of nonstatutory public policy—preserving the integrity of the bankruptcy system as a whole.⁵⁰ In *Beyond.com*, the bankruptcy court refused to confirm a Chapter 11 plan that failed to disclose a potential conflict of interest for a newly appointed manager who was also an unsecured creditor of the bankruptcy estate. In his managerial position, the proposed officer would have influence over whether to sue former executives—himself included—to recover funds for the benefit of the bankruptcy estate.⁵¹ The court declined to confirm the plan of reorganization because the plan proponent, by failing to disclose the conflict of interest, “overlooked the

48. *In re Walker*, No. 89-11748, 1991 WL 186585, at *5 (Bankr. N.D. Ind. May 21, 1991). *Walker* further stated:

Bankruptcy exists for the benefit of creditors; not for the benefit of the professionals who practice before the bankruptcy courts. Every dollar that is paid on account of administrative expenses is a dollar which will not be available for distribution to the creditors of a debtor. Far too often, the court is confronted with scenarios where the vast majority of the available funds are sought not for creditors, but, instead, by those who have played a role in administering the case. In light of the frequency of these events, the court must be concerned with the growing perception of creditors and the general public that bankruptcies are becoming a vehicle for bankruptcy practitioners to earn a comfortable living, rather than generating assets for distribution on account of creditors’ claims. Such a perception, whether or not it is accurate, risks undermining public confidence and faith in the integrity of the bankruptcy process and the judicial system which oversees it.

Id.

49. *In re Contractor Tech., Ltd.*, No. Civ. A. H-05-3212, 2006 WL 1492250, at *9 (S.D. Tex. May 30, 2006).

50. *In re Beyond.com Corp.*, 289 B.R. 138, 145–46 (Bankr. N.D. Cal. 2003).

51. *Id.* at 144–45. The court noted:

As a former executive of the debtor, [the proposed officer] is subject to potential conflicts of interest, particularly with respect to the administration of the Executive Trust. Notably, the Executive Trust was created as a vehicle that allowed *Beyond.com* executives, presumably including [the proposed officer], to receive 50% of their “golden parachutes,” an amount substantially in excess of the less than 20% distribution anticipated to other unsecured creditors of the estate. [The proposed officer] and the [unsecured creditors’] committee have the responsibility of deciding whether to sue the executives to recover the funds.

Id. at 145.

requirements of § 1129(a), which provide a framework ensuring the integrity of the system.”⁵² Thus, it may be appropriate for a court, pursuant to Section 1129, to refuse to confirm a plan that would undermine public faith in the bankruptcy system.⁵³

B. Corporate Law

1. *The Chapter 11 Plan’s Compliance with Corporate Law.*

Public policy can be found in the laws promulgated by legislative bodies.⁵⁴ As such, and because corporations are creatures of the law,⁵⁵ public policy is expressed in state statutes through which corporations are governed. These statutes mandate, among other things, the manner by which corporate entities may be established, raise capital, and designate governance.⁵⁶ Only by complying with such statutes can a corporation behave in accordance with public policy.

52. *Id.* at 146.

53. *See Contractor Tech.*, 2006 WL 1492250, at *9 (discussing the apparent conflict of interest between a debtor and counsel hired by a trustee); *N. Crawfish Frog v. Fed. Highway Admin.*, 858 F. Supp. 1503, 1528 (D. Kan. 1994) (“Unabated perceptions of conflicts of interest undermine public confidence in decisions possibly tainted by avarice and greed.”); *In re I Successor Corp.*, 321 B.R. 640, 651 (Bankr. S.D.N.Y. 2005) (stating that disqualification of an attorney may satisfy the public interest—even if there is merely an appearance of impropriety—because “some conduct which is in fact ethical may appear to the layman as unethical and thereby erode public confidence in the judicial system and the legal profession” (quoting *Liu v. Real Estate Inv. Group, Inc.*, 771 F. Supp. 83, 87 (S.D.N.Y. 1991))); *Id.* at 662 (noting that “disqualification is in the public interest” and a court “cannot act contrary to that interest” by allowing delay by the party moving to disqualify to justify continued misconduct (quoting *Emle Indus., Inc. v. Patentex, Inc.*, 478 F.2d 562, 574 (2d Cir. 1973))); *Acierno v. Folsom*, 337 A.2d 309, 316 (Del. 1975) (quoting *Josephson v. Planning Bd.*, 199 A.2d 690, 692 (Conn. 1964)) (noting that conflicts of interest weaken public confidence); *see also* Natalie L. Bender, Note, *Deterrence, Integrity, and the Public Good: The Disgorgement and Restitution of Third Party Fees as a Condition of Reinstatement in In re Hager*, 18 GEO. J. LEGAL ETHICS 611, 622 (2005) (“Conflict of interest cases have the potential to undermine public confidence in lawyers.” (citing *In re Hager*, 812 A.2d 904, 922 (D.C. 2002))).

54. *Bldg. Serv. Employees Int’l Union, Local 262 v. Gazzam*, 339 U.S. 532, 537–38 (1950).

55. *See Heritage Realty Mgmt., Inc. v. Symbiot Snow Mgmt. Network, LLC*, No. 06-47, 2007 WL 2903941, at *4 (W.D. Pa. Sept. 28, 2007) (“[A] corporation is an entity created by statute . . .” (quoting *LaFountain v. Webb Indus. Corp.*, 951 F.2d 544, 547–48 (3d Cir. 1991))); *Cent. States, Se. & Sw. Areas Pension Fund v. Minneapolis Van & Warehouse Co.*, 764 F. Supp. 1289, 1295 (N.D. Ill. 1991) (“[C]orporations are by definition the creatures of state corporate law . . .”); *State ex rel. Cullitan v. Stookey*, 113 N.E.2d 254, 258 (Ohio Ct. App. 1953) (“It is fundamental that a corporation, being a mere creature of the statute, can act in no other manner than that prescribed by the corporate laws of the State, and cannot be permitted to disregard the absolute and manifest provisions contained therein.”).

56. *See* ROBERT W. HAMILTON, *THE LAW OF CORPORATIONS* 78–80, 163, 322 (5th ed. 2000) (describing statutory requirements for creating a corporation, raising capital, and designating corporate officers).

In re Machne Menachem, Inc. illustrates this point. The Chapter 11 debtor in *Machne Menachem* was a not-for-profit corporation governed by New York's Not-For-Profit Corporation Law (the NFPCL).⁵⁷ A plan of reorganization was proposed and accepted by each class of creditors. However, corporate directors who would be replaced under the plan asserted that the proposed board of directors was not selected pursuant to the requirements of the NFPCL. The opponents claimed that such an action was contrary to public policy embodied in the NFPCL, and therefore the plan was not confirmable pursuant to Section 1123. The court agreed, noting that members of the proposed board had previously been chastised for failure to comply with corporate formalities, and held that the designations were inconsistent with public policy (beyond the noncompliance with the NFPCL).⁵⁸ This determination of the *Machne Menachem* court exemplifies public policies associated with the internal operation of a corporation and the effects that noncompliance with such policies may have on plan confirmation.

2. *Malfeasant Corporate Management.* Protecting corporations from the “unauthorized acts of their officers and agents is a matter of public policy in which the whole community is concerned.”⁵⁹ To this end, courts generally hold that corporate managers owe fiduciary duties to their respective corporations.⁶⁰ Corporate law has established two primary fiduciary duties that management owes to its corporation: the duties of care and loyalty.⁶¹

The duty of care has been described as “requir[ing] officers and directors to manage the corporation’s affairs with diligence and prudence.”⁶² This duty imposes on a corporate fiduciary the responsibility to display the level of care that a similarly situated person of reasonable prudence would exercise.⁶³ The majority of states utilize the deferential “business judgment rule” in assessing compliance with this standard.⁶⁴ This standard

57. *In re Machne Menachem, Inc.*, 304 B.R. 140, 143 (Bankr. M.D. Pa. 2003).

58. *Id.* at 143–44.

59. *Thomas v. City of Richmond*, 79 U.S. 349, 357 (1870).

60. *See, e.g., In re Stat-Tech Int'l Corp.*, 47 F.3d 1054, 1058 (10th Cir. 1995).

61. *Norlin Corp. v. Rooney, Pace Inc.*, 744 F.2d 255, 264 (2d Cir. 1984); HAMILTON, *supra* note 56, at 444.

62. *FDIC v. Henderson*, 849 F. Supp. 495, 498 (E.D. Tex. 1994).

63. *Norlin*, 744 F.2d at 264.

64. William F. Kroener, III, *The Professional Liability Programs at the FDIC and the RTC: Some Myths Past, the Experience Presented*, 19 ANN. REV. BANKING L. 227, 255 (2000).

precludes judicial review of a corporate director's acts that were made in good faith, while exercising honest judgment, and for legitimate corporate purposes.⁶⁵ Despite the deferential nature of this standard, a breach of the duty of care would violate the public policy it embodies.

The duty of loyalty arises from the general prohibition of self-dealing by a fiduciary.⁶⁶ This duty "requires that officers and directors act in good faith and forbids them from [participating in] transactions in which they have a financial interest that are unfair to the corporation."⁶⁷ A corporate manager must ensure that the corporation "receive[s] the full benefit of transactions in which an officer engages on the corporation's behalf, without thought to personal gain."⁶⁸ As such, corporate governors are broadly prohibited from engaging in fraud,⁶⁹ bad faith,⁷⁰ usurpation of corporate opportunities,⁷¹ and self-dealing.⁷²

3. *The Successful Reorganization of a Corporation.* As discussed above, public policy is often embodied in statutory enactments.⁷³ Chapter 11 was created to "allow the Debtor to emerge from bankruptcy as a viable corporation with the ability to pay its creditors the full amount to which they are entitled, to continue providing a return for its stockholders, to pay taxes . . . and to provide jobs for its employees."⁷⁴ Accordingly,

65. *Auerbach v. Bennett*, 393 N.E.2d 994, 1000 (N.Y. 1979).

66. *Norlin*, 744 F.2d at 264 ("[T]he duty of loyalty[] derives from the prohibition against self-dealing that inheres in the fiduciary relationship.").

67. *Henderson*, 849 F. Supp. at 498.

68. *Geller v. Allied-Lyons PLC*, 674 N.E.2d 1334, 1336 (Mass. App. Ct. 1997).

69. "Fraud connotes perjury, falsification, concealment, [or] misrepresentation." *Knauer v. United States*, 328 U.S. 654, 657 (1946).

70. Bad faith "implies the conscious doing of a wrong because of dishonest purpose or moral obliquity; it is different from the negative idea of negligence in that it contemplates a state of mind affirmatively operating with furtive design or ill will." *Desert Equities, Inc. v. Morgan Stanley Leveraged Equity Fund, II, L.P.*, 624 A.2d 1199, 1208 n.16 (Del. 1993) (quoting BLACK'S LAW DICTIONARY 72-73 (5th ed. 1983)).

71. "[A] corporate officer may not act in any . . . double capacity to appropriate business for himself belonging legitimately to his corporation and to reap the profits of it." *Looney v. M-Squared, Inc.*, 586 S.E.2d 44, 47-48 (Ga. Ct. App. 2003) (citation omitted).

72. *United States v. De La Mata*, 266 F.3d 1275, 1293 (11th Cir. 2001). "Self-dealing occurs when the majority shareholders cause the dominated corporation to act in such a way that the majority shareholders receive something from the corporation to the exclusion and detriment of the minority shareholders." *In re Reading Co.*, 711 F.2d 509, 518 (3d Cir. 1983).

73. *Bldg. Serv. Employees Int'l Union, Local 262 v. Gazzam*, 339 U.S. 532, 537-38 (1950) (quoting *Twin City Pipe Line Co. v. Harding Glass Co.*, 283 U.S. 353, 357 (1931)).

74. *In re Dow Corning Corp.*, 244 B.R. 673, 677 (Bankr. E.D. Mich. 1999).

public policy favors the successful reorganization of a corporate debtor.⁷⁵

When a corporation fails to comply with statutory regulations, it risks depletion of assets from defending lawsuits for such violations—through the expenditure of attorney’s fees and the incurrence of liability.⁷⁶ Such depletion necessarily impairs the reorganized entity’s ability to repay its debts and continue to provide jobs for its employees. Accordingly, public policy favoring successful reorganization of distressed businesses is undermined when corporate officers (or the corporation they control) violate the provisions of corporate law. The selection and employment of corporate officers during reorganization—and the likelihood that a particular officer will comply with corporate law—may have a significant effect on public policies associated with the successful functioning of a Chapter 11 case.

C. Securities Law

Securities laws exist to ensure the general public’s confidence in the marketplace.⁷⁷ As the Supreme Court has stated, “Congress’[s] purpose in enacting the securities laws was to regulate investments, in whatever form they are made and by whatever name they are called.”⁷⁸ Such regulation is intended to serve as a means to protect public investors from malfeasance that might undermine their investments.⁷⁹ The federal spectrum of securities laws is comprised of seven primary statutes, two of which are of particular note in the present discussion: the Securities Act of 1933 (the 1933 Act) and the Sarbanes–Oxley Act of 2002 (SOX).⁸⁰

75. See *id.* (observing that a reorganized corporate debtor can meet its financial obligations and provide jobs).

76. See, e.g., *In re Hi-Lo Powered Scaffolding, Inc.*, 70 B.R. 606, 609 (Bankr. S.D. Ohio 1987) (noting that lawsuits against a debtor may adversely affect the bankruptcy estate).

77. *Ryan v. Flowserve Corp.*, 245 F.R.D. 560, 568 (N.D. Tex. 2007).

78. *Reves v. Ernst & Young*, 494 U.S. 56, 61 (1990) (emphasis omitted).

79. *Randall v. Loftsgaarden*, 478 U.S. 647, 659 (1986); *SEC v. Lauer*, 52 F.3d 667, 670 (7th Cir. 1995); see also *Blythe v. Deutsche Bank AG*, 399 F. Supp. 2d 274, 279 n.29 (S.D.N.Y. 2005) (“A central purpose of the securities laws is to protect investors and would-be investors . . . against misrepresentations.”); *SEC v. Comcoa Ltd.*, 887 F. Supp. 1521, 1524 (S.D. Fla. 1995) (“The principal purpose of the federal securities laws is to protect investors by requiring the full disclosure of information material to investment decisions, by compensating defrauded investors, and by deterring fraud and manipulative practices.”).

80. Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified in scattered sections of 11, 15, 18, 28, and 29 U.S.C.); Securities Act of 1933, 15 U.S.C. §§ 77a–77aa (2006); THOMAS LEE HAZEN & DAVID L. RATNER, SECURITIES REGULATION 10–11 (9th ed. 2006).

The primary purposes of the 1933 Act are “to protect investors against manipulation of stock prices, to promote fair, equitable trading practices, and to insure fairness in securities transactions.”⁸¹ To this end, the 1933 Act seeks to ensure that the purchaser of stock possesses the same level of information as the management of the issuing corporation.⁸² The requirement that securities be registered prior to their sale attempts to ensure this equality of information.⁸³

Congress enacted SOX in response to the exposure of mass corporate fraud that threatened to undermine public faith in American financial markets.⁸⁴ The reform was intended to improve corporate governance standards and “[t]o protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws.”⁸⁵ SOX thus sets forth rules and procedures making corporate officers responsible and accountable for the information contained in any publicly filed documents.⁸⁶

While the broad spectrum of federal securities laws governs investments nationwide, federal legislation does not retain exclusive control over the national marketplace.⁸⁷ In addition to federal mandates, the “blue sky laws” of each state may also regulate business interests.⁸⁸ Blue sky laws—or state securities laws—generally regulate, among other things, “the registration of securities offered or traded within the state . . . and set forth penalties for securities fraud.”⁸⁹ Blue sky laws often extend beyond the scope of federal legislation to assess the merits of offered securities, allowing administrators to refuse or cancel registration of an investment found to be unfair, unjust, or

81. *Abada v. Charles Schwab & Co.*, 127 F. Supp. 2d 1101, 1103 (S.D. Cal. 2000).

82. *Freeman v. Decio*, 584 F.2d 186, 189 n.10 (7th Cir. 1978) (quoting 77 CONG. REC. 2,918 (1933)).

83. *HAZEN & RATNER*, *supra* note 80, at 39–41.

84. *See Bechtel v. Competitive Techs., Inc.*, 448 F.3d 469, 484 (2d Cir. 2006) (Straub, J., dissenting) (quoting S. REP. NO. 107-146, at 10 (2002)).

85. Joelle A. Berle, Comment, *Attorney–Client Privileges of In-House Counsel in the United States and Canada*, 13 SW. J. L. & TRADE AM. 459, 462–63 (2006) (quoting Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745, 745).

86. John B. Kennedy, *A Primer on Key Information Security Laws in the United States*, 934 PLI/PAT 117, 171 (2008).

87. *See, e.g.*, Robert J. Haft & Peter M. Fass, *Limited Liability Companies*, in 2 VENTURE CAPITAL AND SMALL BUSINESS FINANCINGS § 3:3 (2009) (addressing possible state law treatment of interests in limited liability companies as “securities”).

88. *UIU Severance Pay Trust Fund v. Local Union No. 18-U, United Steelworkers of Am.*, 998 F.2d 509, 512 & n.11 (7th Cir. 1993).

89. Mary Ann Frantz, *Overview of Securities Laws*, in 1 ADVISING SMALL BUSINESSES § 16:4 (2008).

inequitable.⁹⁰ However, blue sky laws ordinarily further the same purposes and public policy goals as federal securities laws, and both provide similar defenses and similar remedies.⁹¹

In sum, securities laws within the United States attempt to protect the investing public by ensuring that the securities offered for sale are legitimate and that the public has truthful information about such securities. It follows that with respect to selection of officers and directors of a corporation, public policy considerations weigh against naming an individual who has previously abused a position of business power by misleading the public with regard to securities offered for sale. Such an appointment may undermine the goals of securities laws.

Furthermore, public policy considerations set forth in the securities laws are of enhanced concern in light of 11 U.S.C. § 1145(a). Section 1145 states that bankrupt entities are not required to comply with securities regulations mandating registration before the sale of a security when selling securities under a plan of reorganization.⁹² The policy behind this section is to “encourage reorganization and to relieve bankrupt entities of the strict requirements of securities laws.”⁹³ Section 1145,

90. *Id.*

91. *Carothers v. Rice*, 633 F.2d 7, 13–14 (6th Cir. 1980); Mary Ann Frantz, *Private Placements and Limited Offerings of Securities*, in 1 *ADVISING SMALL BUSINESSES* § 17:28 (2008).

92. Section 1145(a) states:

[S]ection 5 of the Securities Act of 1933 and any State or local law requiring registration for offer or sale of a security or registration or licensing of an issuer of, underwriter of, or broker or dealer in, a security do not apply to—

(1) the offer or sale under a plan of a security of the debtor, of an affiliate participating in a joint plan with the debtor, or of a successor to the debtor under the plan—

...

(2) the offer of a security through any warrant, option, right to subscribe, or conversion privilege that was sold in the manner specified in paragraph (1) of this subsection, or the sale of a security upon the exercise of such a warrant, option, right, or privilege;

(3) the offer or sale, other than under a plan, of a security of an issuer other than the debtor or an affiliate

11 U.S.C. § 1145(a) (2006); *see also* *SEC v. Universal Express, Inc.*, 475 F. Supp. 2d 412, 425 (S.D.N.Y. 2007) (noting that 11 U.S.C. §§ 1125(e) and 1145(a) “serve essentially the same function, which is to shield from liability under the federal securities laws those individuals participating in the reorganization of an entity in bankruptcy”); *In re Frontier Airlines, Inc.*, 93 B.R. 1014, 1020 (Bankr. D. Colo. 1988) (acknowledging § 1145(a)’s exemption from securities law of the “offer and sale of certain defined securities ‘under a plan’”).

93. *In re Amarex, Inc.*, 53 B.R. 12, 14 (Bankr. W.D. Okla. 1985); *see also In re Food City, Inc.*, 110 B.R. 808, 810 (Bankr. W.D. Tex. 1990) (stating that Section 1145 “operates to excuse debtors from the cumbersome registration process that might otherwise be imposed by state and federal securities laws on proposed reorganization plans”).

however, may serve as a vehicle to contradict public policy if it permits an individual who has previously engaged in dubious behavior to exploit the market without the restriction of certain securities laws.⁹⁴ Public policy considerations embodied in securities laws should be considered when approving corporate officers of a reorganized entity due to the ability of previously malfeasant management—under the auspices of encouraging reorganization—to continue, despite their past misdeeds.

D. *The Contractual Nature of Partnership Agreements*

A partnership is a business venture consisting of multiple parties that agree to combine their property, labor, or skill for mutual gain.⁹⁵ A partnership arises from a partnership agreement, which is a contract (express or implied) governing that particular relationship.⁹⁶ Accordingly, the agreement giving rise to a partnership is construed under state contract law.⁹⁷

Courts have recognized that “[p]ublic policy favors enforcing contracts entered into freely and voluntarily by competent adults.”⁹⁸ Furthermore, valid contracts are presumed to be legal and enforceable⁹⁹ unless enforcement of the contract is against public policy.¹⁰⁰ A Chapter 11 plan that seeks to alter the current

94. See *In re Pub. Serv. Co. of N.H.*, 108 B.R. 854, 869 (Bankr. D.N.H. 1989) (discussing Section 1145 and urging “that the laudable but limited purposes of bankruptcy not be perverted into an escape from regulation” (quoting *In re MCorp*, 101 B.R. 483, 489 (S.D. Tex. 1989))).

95. Rhue v. Rhue, 658 S.E.2d 52, 59 (N.C. Ct. App. 2008) (quoting *Zickgraf Hardwood Co. v. Seay*, 298 S.E.2d 208, 211 (N.C. Ct. App. 1982)); see also *Norber v. Marcotte*, 134 S.W.3d 651, 658 (Mo. Ct. App. 2004) (“Partnership is defined by the courts as a contract of two or more competent persons to place their money, effects, labor and skill, or some or all of them, in lawful commerce or business and to divide the profits and bear the loss in certain proportions.” (quoting *Fischer v. Brancato*, 937 S.W.2d 379, 382 (Mo. Ct. App. 1996))).

96. *Lenz v. Associated Inns & Rest. Co. of Am.*, 833 F. Supp. 362, 383 (S.D.N.Y. 1993); *Ayerslee Corp. v. Overlook Sponsor Corp.*, 618 F. Supp. 1398, 1403 (S.D.N.Y. 1985) (citations omitted); *In re Fineberg*, 202 B.R. 206, 222 (Bankr. E.D. Pa. 1996); *Waugh v. Waugh*, 595 S.E.2d 647, 649 (Ga. Ct. App. 2004) (quoting *Clark v. Schwartz*, 436 S.E.2d 759, 760 (Ga. Ct. App. 1993)); *Liechty v. Liechty*, 231 N.W.2d 729, 731 (N.D. 1975) (quoting ALAN R. BROMBERG, CRANE AND BROMBERG ON PARTNERSHIP § 5 (1968)).

97. *Rahemtulla v. Hassam*, 539 F. Supp. 2d 755, 770 (M.D. Pa. 2008); *In re LaBrum & Doak, LLP*, 222 B.R. 749, 756 (Bankr. E.D. Pa. 1998).

98. *Jackson v. Jones*, 804 N.E.2d 155, 158 (Ind. Ct. App. 2004); see also *Pods, Inc. v. Paysource, Inc.*, No. 8:05-CV-1764-T-27EAJ, 2006 WL 1382099, at *4 (M.D. Fla. May 19, 2006) (“[P]ublic policy favors the enforcement of contracts.”).

99. *Walsh v. Schelcht*, 429 U.S. 401, 408 (1977); *The Harriman*, 76 U.S. 161, 173 (1869); *Bronson v. Rodes*, 74 U.S. 229, 245 (1868).

100. *Bohne v. Computer Assocs. Int'l, Inc.*, 514 F.3d 141, 144 (1st Cir. 2008); *Leonard v. Nationwide Mut. Ins. Co.*, 499 F.3d 419, 435 (5th Cir. 2007); *Beth Israel Med. Ctr. v. Horizon Blue Cross & Blue Shield of N.J.*, 448 F.3d 573, 580 (2d Cir. 2006).

governance of a partnership may run afoul of a partnership agreement if the changes are not made pursuant to the terms of the contract. Therefore, a proposed change in partnership management under a plan of reorganization may conflict with certain pro-enforcement public policies.

In re Sovereign Group, 1984-21 Ltd. is instructive on this issue. In *Sovereign*, the sole general partner of the limited partnership debtor sought to abate confirmation proceedings in the debtor's Chapter 11 case. The general partner contended that the plan was not confirmable because it provided for actions in contravention of the partnership agreement.¹⁰¹ In considering this argument, the court reasoned that it was in the public's interest to uphold the sanctity of the partnership agreement during reorganization because "the Bankruptcy Code is not intended to be used as a tool to restructure onerous partnership agreements."¹⁰² As such, the *Sovereign* court held that it would not confirm a Chapter 11 plan that was directly contrary to the partnership agreement's provisions for selection of management.¹⁰³ Changes made to a partnership in contravention of the partnership agreement—including changes made pursuant to a plan of reorganization—encroach upon the contract that created the partnership and therefore offend public policies favoring the enforcement of contractual agreements.

E. Competency of Business Management

The federal judiciary has recognized a "strong public interest" in the successful reorganization of businesses in Chapter 11.¹⁰⁴ To this end, the "[c]ontinued service by prior management may be inconsistent with . . . public policy if it directly or indirectly perpetuates incompetence, lack of discretion, inexperience, or affiliations with groups inimical to the best interests of the debtor."¹⁰⁵ The choice to preclude continued inept management of a reorganized company is in line with other policy concerns associated with bankruptcy, including: (1) preservation of jobs within the reorganized entity; and (2) protecting "unsecured creditors whose only recovery is often

101. *In re Sovereign Group, 1984-21 Ltd.*, 88 B.R. 325, 327 (Bankr. D. Colo. 1988).

102. *Id.* at 329.

103. *Id.* It is of note that the *Sovereign* court found that the replacement of the sole general partner did not contradict the partnership agreement and was therefore not against public policy. *Id.* at 330–32.

104. *In re N-Ren Corp.*, 64 B.R. 773, 778 (Bankr. S.D. Ohio 1986).

105. *In re Beyond.com Corp.*, 289 B.R. 138, 145 (Bankr. N.D. Cal. 2003).

equity in the reorganized company.”¹⁰⁶ Poor management of a reorganized entity is antithetical to these goals and necessarily against public policy. Under such considerations, the next logical evaluation is what quantum or type of mismanagement is necessary to render a party’s service as a business manager in a reorganized company against public policy.

A seemingly obvious point from which to begin such an evaluation is the business judgment rule (BJR).¹⁰⁷ The BJR precludes the imposition of personal liability on corporate management for poor business choices that were “honest errors or mistakes of judgment if [the corporate manager] acted without corrupt motive and in good faith.”¹⁰⁸ The BJR creates a presumption that a corporate manager’s business decisions were informed, made in good faith, and made with an honest belief that the act was in the best interest of the business.¹⁰⁹ To rebut this presumption, a party must prove that a business manager acted in violation of his duties of good faith, loyalty, or due care.¹¹⁰ Thus, only “directors and officers who do not believe, or do not *rationaly* believe, that their business judgments are in the best interests of the corporation” may be held liable for the effects of their ill-conceived choices.¹¹¹

Although it seems appropriate to discern applicable public policy from the BJR, such a leap would be improper. The BJR sets forth public policy regarding whether a corporate manager should be held liable for poor management.¹¹² However, the BJR does not directly set forth public policy pertaining to whether

106. John H. Rains IV, Note, *Searching for Fairness in all the Wrong Places: Valuing the Pension Benefit Guaranty Corporation’s Unsecured Claim in Bankruptcy*, 58 FLA. L. REV. 1107, 1119 (2006); see also Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 350–52 (1993) (discussing the importance of maintaining the value of a failing business in order to maximize the amount repaid to the business’s creditors).

107. “The business judgment rule . . . has been adopted in principle in most states—even those states that have statutorily codified standards of care” Carla M. Miller, *Directors and Officers Liability: Theories, Defenses and Strategies*, 586 PLI/PAT 405, 409 (1999).

108. *Miller v. Robertson*, No. 22157-8-II, 1999 WL 65638, at *13 (Wash. Ct. App. Feb. 12, 1999); see also *Scott v. Trans-System, Inc.*, 38 P.3d 379, 383 (Wash. Ct. App. 2002) (refusing to apply the business judgment rule because the corporate officers acted in “bad faith and with a corrupt motive”), *rev’d on other grounds*, 64 P.3d 1 (Wash. 2003).

109. *Aronson v. Lewis*, 473 A.2d 805, 812 (Del. 1984), *overruled on other grounds by Brehm v. Eisner*, 746 A.2d 244 (Del. 2000).

110. *Cede & Co. v. Technicolor, Inc.*, 634 A.2d 345, 361 (Del. 1993).

111. *Harhen v. Brown*, 710 N.E.2d 224, 236 (Mass. App. Ct. 1999) (quoting PRINCIPLES OF CORPORATE GOVERNANCE § 4.01(c), cmt. f (1994)), *rev’d on other grounds*, 730 N.E.2d 859 (Mass. 2000).

112. See generally Charles Hansen, *The Duty of Care, the Business Judgment Rule, and the American Law Institute Corporate Governance Project*, 48 BUS. LAW. 1355 (1993).

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corporate management should continue to manage the previously mismanaged business entity. It is therefore inapplicable to the present considerations.

Pursuant to past cases, mere “incompetence, lack of discretion, [or] inexperience” may be sufficient grounds upon which to deem particular corporate management as against public policy.¹¹³ This stands in significant contrast to the deferential BJR standard.¹¹⁴ As courts have recognized, “[O]ne of the important reasons for the existence of the business judgment rule is the institutional incompetence of courts to pass upon the wisdom of business decisions.”¹¹⁵ Thus, the BJR establishes a policy of judicial deference to the *past* business decisions of a corporate officer. However, the pertinent policy question at present is whether the *future* service of particular management is in the best interest of the reorganized business. Accordingly, when considering the competence of business management proposed under a Chapter 11 plan, the court should view incompetence, lack of discretion, or inexperience as indicia that such a plan is not confirmable under the public policy provisions of Sections 1123 and 1129.

F. Summary of Factors to Consider in Assessing Whether Proposed Management is Consistent with Public Policy

There is no definitive list of factors a bankruptcy court should consider in determining whether proposed management is consistent with public policy. Nevertheless, the discussion above provides a nonexhaustive list of factors for consideration, given this country’s history of generally providing freedom for businesses to operate while maintaining some degree of regulation to ensure the integrity of these operations. These factors include:

- (1) Focusing on whether proposed management has any conflicts of interest;
- (2) Assessing whether proposed management has ever violated any state law, including blue sky laws;

113. *In re Polytherm Indus., Inc.*, 33 B.R. 823, 829 (W.D. Wis. 1983), *discussed with approval in In re Beyond.com Corp.*, 289 B.R. 138, 145 (Bankr. N.D. Cal. 2003); *In re Sherwood Square Assocs.*, 107 B.R. 872, 878 (Bankr. D. Md. 1989).

114. *See In re Trans World Airlines, Inc.*, No. 01-0056, 2001 WL 1820019, at *4 (Bankr. D. Del. Mar. 16, 2001).

115. *Freedman v. Rest. Assocs. Indus., Inc.*, 1987 WL 14323, at *8 (Del. Ch. Oct. 16, 1987) (mem.).

- (3) Reviewing whether proposed management has ever violated any federal law, including securities laws, SOX, and not surprisingly, the Bankruptcy Code;
- (4) Scrutinizing whether proposed management is attempting to use the plan confirmation process to renegotiate the terms of a partnership agreement;
- (5) Evaluating the competence of proposed management in managing the specific business of the reorganized debtor; and
- (6) Comparing the compensation of proposed management with other managers in the same or similar industry in the Debtor's business.

Exactly how much weight a bankruptcy court should give to each of these factors will depend upon the facts and circumstances of each case. It would be illogical to create a per se rule that a plan may not be confirmed upon any showing that any one of these factors is present. For example, suppose one of the proposed officers of the reorganized debtor received a \$25,000 fine from the SEC for a past violation of securities laws. In and of itself, this fact might well be sufficient to find that his appointment is not consistent with public policy. However, suppose that the evidence also shows that the lender providing the exit financing—the proceeds of which will be used to pay unsecured claims 100 cents on the dollar—will only do so if this particular individual is appointed to serve as president of the reorganized debtor. Moreover, suppose that the evidence demonstrates that the reorganized debtor will be in the business of developing nuclear power, thereby generating alternative sources of energy for citizens of this country. And suppose also that this individual has a Ph.D in physics and a successful track record in constructing nuclear energy plants in France. Despite this person's previous violation of securities laws, the fact that his appointment as president of the reorganized debtor will result in a complete payout of unsecured creditors *and* the presentation of an entity with a reasonable likelihood of developing an alternative source of energy for the country might well provide a basis for finding that his proposed management is consistent with public policy.

This hypothetical example underscores the need for both proponents and opponents of plans of reorganization to ensure that, when preparing for a confirmation hearing, they consider the entire background of those individuals who are proposed to serve in the management of the reorganized debtor. Introduction

of one piece of evidence could be the difference between victory and defeat.

IV. THE PROPOSED RULE

It is the goal of this section to set forth a method by which opponents of a Chapter 11 plan may raise public policy considerations pursuant to Sections 1123 and 1129.¹¹⁶ However, it is important that such a method not unduly alter the current procedure for approving a Chapter 11 plan.¹¹⁷ To this end, this Essay proposes the implementation of a shifting evidentiary burden as follows:

- (1) The plan proponent bears the initial burden of production. This burden is satisfied by a presumption that a duly filed Chapter 11 plan is consistent with public policy.
- (2) The plan opponent then bears the burden of production to set forth a legitimate argument as to why the proposed plan would run afoul of public policy considerations and should therefore be rejected pursuant to Sections 1123 or 1129.
- (3) Finally, pursuant to Section 1129(a)(1), the plan proponent bears the ultimate burden to establish compliance with all applicable provisions of the Bankruptcy Code (including Sections 1123 and 1129).

This system is not statutorily mandated. However, the procedure is consistent with past considerations of public policy when reviewing proposed business leadership under a Chapter 11 plan. Therefore, this method of considering public policy pursuant to Sections 1123 and 1129 when reviewing a plan may be adopted without significant change to the current procedures associated with Chapter 11.

116. "Little has been written on § 1123(a)(7)." *In re Machne Menachem, Inc.*, 304 B.R. 140, 142 (Bankr. M.D. Pa. 2003). As such, it is of no great surprise that there is no standardized method for objecting to a Chapter 11 plan for noncompliance with Sections 1123 or 1129. See generally Ali M.M. Mojdehi, *Appraising Postconfirmation Leaders: The Underutilized Confirmation Requirement*, 77 AM. BANKR. L.J. 199 (2003) (discussing the underutilization of Section 1129).

117. See, e.g., Katharine M. Zandy, Note, *Too Much, Too Little, or Just Right? A Goldilocks Approach to Patent Reexamination Reform*, 61 N.Y.U. ANN. SURV. AM. L. 865, 905 (2006) (concluding that, in the patent reexamination context, small incremental changes that increase the use of current procedure are preferable to more drastic methods).

A. The Plan Proponent's Burden of Production

A Chapter 11 plan of reorganization must satisfy a list of statutory prerequisites for confirmation under Section 1129(a).¹¹⁸ Included is a requirement that plans comply with the “applicable” provisions of the Bankruptcy Code, including Section 1123.¹¹⁹ A plan’s proponent bears the burden to prove that these requirements are satisfied by a preponderance of the evidence.¹²⁰ However, despite a clear rule that a plan proponent maintains the burden to establish each element of Section 1129(a)—including the public policy concerns associated with Sections 1129 and 1123—bankruptcy courts rarely require a plan proponent to offer evidence on the issue of public policy and corporate leadership.¹²¹ Accordingly, it would appear that while the plan proponent maintains the ultimate burden of persuasion, the plan opponent actually bears a burden of production to pursue the question of whether a plan of reorganization is consistent with public policy with regard to proposed corporate leadership. These notions are not easily reconciled. This Essay proposes a manner in which prior case law’s allocation of the burden of proof to the plan proponent can be reconciled with bankruptcy courts’ de facto placement of the burden of production regarding public policy and proposed corporate leadership on the plan opponent.

A party bearing the ultimate burden of persuasion, such as a Chapter 11 plan proponent, will lose the issue if no pertinent evidence is presented.¹²² However, where there is a presumption in favor of the party bearing the burden of persuasion, the

118. As the Ninth Circuit has stated:

The bankruptcy court must confirm a Chapter 11 debtor’s plan of reorganization if the debtor proves by a preponderance of the evidence either (1) that the Plan satisfies all thirteen requirements of 11 U.S.C. § 1129(a), or (2) if the only condition not satisfied is the eighth requirement, 11 U.S.C. § 1129(a)(8), the Plan satisfies the “cramdown” alternative to this condition found in 11 U.S.C. § 1129(b), which requires that the Plan “does not discriminate unfairly” against and “is fair and equitable” towards each impaired class that has not accepted the Plan.

In re Ambanc La Mesa Ltd. P’ship, 115 F.3d 650, 653 (9th Cir. 1997).

119. 11 U.S.C. § 1129(a)(1) (2006).

120. See, e.g., *Ambanc La Mesa*, 115 F.3d at 653; *In re Trevarrow Lanes, Inc.*, 183 B.R. 475, 479 (Bankr. E.D. Mich. 1995).

121. See, e.g., *In re Briscoe Enters. Ltd., II*, 138 B.R. 795, 807–08 (N.D. Tex. 1992) (placing the burden on the plan opponent to set forth evidence that a plan was inconsistent with public policy concerns embodied in Section 1123), *rev’d on other grounds*, 994 F.2d 1160 (5th Cir. 1993).

122. See *Monroe v. Children’s Home Ass’n of Ill.*, 128 F.3d 591, 593 (7th Cir. 1997) (“A party with the burden of persuasion who arrives emptyhanded on decision day must expect to lose . . .”).

opposing party must come forward with some evidence to rebut the presumption or lose the issue.¹²³ Should the necessary rebuttal evidence be adduced, the party bearing the ultimate burden must satisfy its burden of persuasion or face defeat on that issue.¹²⁴

Such a burden shifting system appears to have been employed by bankruptcy courts in considering whether a proposed plan of reorganization is consistent with public policy in regards to proposed corporate management. Specifically, because Chapter 11 plans are commonly confirmed without the introduction of evidence pertinent to Sections 1129 or 1123, courts apparently presume that a duly filed plan of reorganization is consistent with public policy. This presumption effectively shifts the burden of production to the objecting party, while the plan proponent maintains the burden of persuasion.

B. The Plan Opponent's Burden of Production

The burden of production is an obligation to produce some evidence of a necessary proposition of fact.¹²⁵ To satisfy this burden, a plan opponent must produce evidence that is “more than frivolous and based on more than conclusory allegations.”¹²⁶

An analogy to the process of objecting to a proof of claim may clarify the plan opponent's burden under the proposed system. A properly filed proof of claim in a bankruptcy case is presumptively valid (similar to the present presumption that a duly filed Chapter 11 plan conforms to public policy).¹²⁷ Rebutting this presumption of validity requires more than a mere formal objection.¹²⁸ Specifically, the claim objector's burden is an obligation to bring forward some evidence that the claim is invalid.¹²⁹ Bankruptcy courts have held that this burden may be satisfied by “the production of specific and detailed allegations that place the claim into dispute . . . or through pretrial pleadings . . . in which evidence is presented which brings the

123. See *In re Ralar Distribs., Inc.*, Civ. A. No. 91-30265-F, 1992 WL 535959, at *3 (D. Mass. Nov. 18, 1992) (“The presumption requires the party against whom the presumption exists . . . to come forward with some evidence to rebut the presumption, but the burden of proof remains on the party in whose favor the presumption exists.”).

124. See *In re Koubourlis*, 869 F.2d 1319, 1322 (9th Cir. 1989).

125. *El v. Se. Penn. Transp. Auth.*, 479 F.3d 232, 237 n.6 (3d Cir. 2007).

126. *United States v. Armstrong*, 48 F.3d 1508, 1512 (9th Cir. 1995), *rev'd on other grounds*, 517 U.S. 456 (1996).

127. *In re Bricker*, No. 08-340, 2008 WL 2727147, at *1 (Bankr. N.D. W. Va. July 2, 2008) (quoting 11 U.S.C. § 502(a) (2006)).

128. *Id.*

129. *In re Orseno*, 390 B.R. 350, 353–54 (Bankr. N.D. Ill. 2008).

validity of the claim into question.”¹³⁰ Thus, by analogy, a plan opponent could satisfy its burden of production under Sections 1123 and 1129 by setting forth detailed allegations or producing evidence showing why the proposed management of a reorganized entity is inconsistent with public policy. Such public policy concerns would include, but are not limited to, the examples set forth in Section III.

C. The Plan Proponent’s Ultimate Burden of Persuasion

As previously discussed, the plan proponent has the burden of satisfying every element of Section 1129(a) by a preponderance of the evidence, including establishing that the proposed management of a reorganized entity is consistent with public policy.¹³¹ However, the statutory text of Sections 1123 and 1129 raises a question as to exactly what must be shown to satisfy these statutes. These sections establish that both the manner of selection and the parties selected to serve as corporate leaders must be consistent with public policy *and* the interests of creditors and equity security holders.¹³² As such, the question arises: Should consistency with the interests of security holders and creditors be evaluated separately from, or in conjunction with, considerations of public policy? In other words, the pertinent inquiry is whether a finding that a plan of reorganization is inconsistent with public policy should be dispositive of whether the plan should be confirmed.

Courts have determined that “[t]he word ‘and’ requires a conjunctive construction of the two requirements.”¹³³ Accordingly, a statute comprised of multiple requirements connected by “and” should be construed to necessitate satisfaction of each requirement to fulfill the statutory mandate.¹³⁴ Therefore, it appears that the proper construction of Sections 1123 and 1129 is that consistency with public policy should be construed as a separate requirement, apart from interests of security holders and creditors. Regardless of other considerations, a court must not confirm a plan of reorganization if the proposed corporate

130. *In re Hight*, 393 B.R. 484, 495–96 (Bankr. S.D. Tex. 2008) (quoting *In re Kilgore Meadowbrook Country Club, Inc.*, 315 B.R. 412, 417–18 (Bankr. E.D. Tex. 2004)).

131. *In re Ambanc La Mesa Ltd. P’ship*, 115 F.3d 650, 653 (9th Cir. 1997).

132. 11 U.S.C. §§ 1123(a)(7), 1129(a)(5)(A)(ii) (2006).

133. *Rodriguez v. Blue Cross of Cal.*, 75 Cal. Rptr. 3d 754, 763 (Cal. Ct. App. 2008).

134. *In re First Magnus Fin. Corp.*, 390 B.R. 667, 676–77 (Bankr. D. Ariz. 2008) (quoting 1A SUTHERLAND STATUTES AND STATUTORY CONSTRUCTION § 21:14 (7th ed. 2008)).

management is inconsistent with public policy.¹³⁵ It is the burden of the plan proponent to establish such consistency by a preponderance of the evidence.¹³⁶

V. IMPLEMENTATION OF THE PROPOSED RULE UNDER THE CURRENT BANKRUPTCY CODE

A Chapter 11 debtor and its creditors are each bound by the terms of a confirmed plan of reorganization, regardless of whether any particular party objects to, accepts, or rejects the plan as proposed.¹³⁷ In order to permit parties to protect their interests, the Bankruptcy Code allows a broad class of entities to bring objections to the confirmation of a Chapter 11 plan.¹³⁸ Specifically, Section 1109(b) provides a nonexclusive list of parties in interest who may object to a proposed plan, including “the debtor, the trustee, a creditors’ committee, an equity security holders’ committee, a creditor, an equity security holder, or any indenture trustee.”¹³⁹

Once a party files an objection to a proposed plan, a contested matter arises and procedure is governed by Bankruptcy Rule 9014.¹⁴⁰ This rule affords an objecting party the right to a hearing and the ability to introduce evidence pertinent to their objection.¹⁴¹ Accordingly, any party that objects to a

135. The interpretation of the phrase “inconsistent with public policy” is best left to the courts. It makes little sense to have a per se rule that a plan may not be confirmed upon *any* showing that *any* element of a proposed plan was inconsistent with public policy (with regard to the proposed business leadership). A better solution is a “totality of the circumstances” test. Such a test would allow a court to determine if the pertinent provisions, when taken as a whole, are consistent with public policy. It is logical too for a court to hold that despite having some inconsistencies with public policy, a plan of reorganization is (as a whole) consistent with public policy with regard to the proposed business leadership. *See* discussion *supra* Part III.F.

136. *Ambanc La Mesa*, 115 F.3d at 653; *In re Trevarrow Lanes, Inc.*, 183 B.R. 475, 479 (Bankr. E.D. Mich. 1995).

137. 11 U.S.C. § 1141(a) (2006). Section 1141 states:

[Subject to some limitations], the provisions of a confirmed plan bind the debtor, any entity issuing securities under the plan, any entity acquiring property under the plan, and any creditor, equity security holder, or general partner in the debtor, whether or not the claim or interest of such creditor, equity security holder, or general partner is impaired under the plan and whether or not such creditor, equity security holder, or general partner has accepted the plan.

Id.

138. 11 U.S.C. § 1109(b) (2006).

139. *Id.*; *see also In re UNR Indus., Inc.*, 71 B.R. 467, 471 n.9 (Bankr. N.D. Ill. 1987) (“[T]he examples of parties in interest listed in section 1109(b) are not exhaustive. Further, courts have held that section 1109(b) must be interpreted broadly to allow persons affected by a Chapter 11 case to appear and be heard.”).

140. FED. R. BANKR. P. 3020.

141. FED. R. BANKR. P. 9014.

proposed Chapter 11 plan has the right to produce evidence that the plan is not confirmable pursuant to the public policy provisions of Sections 1123 and 1129. While the bankruptcy laws provide for a broad array of parties that may file an objection to a Chapter 11 plan, two groups have a particular interest in ensuring that a proposed plan of reorganization is consistent with public policy: the U.S. Trustee and plan creditors.¹⁴²

A. *The United States Trustee*

As the “watchdog” of the bankruptcy system, the United States Trustee (UST) is responsible for “preventing fraud and abuse and . . . ‘fill[ing] the vacuum’ caused by possible creditor inactivity.”¹⁴³ Further, the UST is generally charged with enforcing the bankruptcy laws and maintaining the integrity and efficiency of the system as a whole.¹⁴⁴ To these ends, the UST has broad powers, including the right to “appear and be heard on any issue in any case or proceeding.”¹⁴⁵

More specifically, the UST is authorized by 28 U.S.C. § 586(a)(3)(B), in his discretion, to submit “comments with respect to . . . plans and disclosure statements.”¹⁴⁶ Courts have interpreted this statutory provision as granting the UST the power to object to plans of reorganization that do not comply with Section 1129(a).¹⁴⁷ This power fits within the notion that the UST is the “watchdog that guards the public interest.”¹⁴⁸ It is thus within the ambit of the UST’s responsibilities to ensure that any Chapter 11 plans of reorganization comply with Sections 1123 and 1129 with respect to consistency with public policy. Thus, no

142. Any party of interest may, pursuant to 11 U.S.C. § 1109(b), object to a plan of reorganization. However, this Essay focuses on creditors and the United States Trustee because they are the most likely candidates to object to a plan under Sections 1123 or 1129.

It is worth noting, as discussed above, that beyond any filed objections to a Chapter 11 plan, bankruptcy courts maintain an affirmative duty to evaluate whether a proposed plan satisfies each part of Section 1129(a) (including Sections 1123 and 1129). *In re Ambanc La Mesa Ltd. P’ship*, 115 F.3d 650, 653 (9th Cir. 1997).

143. *In re Castillo*, 297 F.3d 940, 950 (9th Cir. 2002) (quoting H.R. REP. NO. 95-595, at 100 (1977)); see also *In re A-1 Trash Pickup, Inc.*, 802 F.2d 774, 775 (4th Cir. 1986) (“Congress created the office of [UST] to ‘fill the vacuum of lack of creditor participation’” (quoting H.R. REP. NO. 95-595, at 100)).

144. *In re Ventura*, 375 B.R. 103, 107 (Bankr. E.D.N.Y. 2007) (“[C]onsumer protection and combating fraud and abuse are among the U.S. Trustee program’s central efforts.”).

145. 11 U.S.C. § 307 (2006).

146. 28 U.S.C. § 586(a)(3)(B) (2006).

147. *In re S. Beach Sec., Inc.*, 376 B.R. 881, 893 (Bankr. N.D. Ill. 2007).

148. *Id.* at 892–93 (quoting *Clippard v. LWD, Inc.* (*In re LWD, Inc.*) 342 B.R. 514, 518 (Bankr. W.D. Ky. 2006)).

statutory changes need be made in order to ensure that public policy considerations are weighed when evaluating whether to confirm a Chapter 11 plan because the UST is charged with upholding the policies governing the Bankruptcy Code.¹⁴⁹

B. Creditors and Creditors' Committees

In addition to the UST, another group maintains the right, and has reason, to object to a plan of reorganization that does not comply with the public policy provisions of Sections 1123 and 1129: creditors of the bankruptcy estate.¹⁵⁰ Creditors, acting out of their personal interest to be repaid sums owed to them, are likely to object to a plan of reorganization that does not achieve this objective. As such, creditors will raise any available objection to a disadvantageous plan, including allegations that a proposed plan is inconsistent with public policy with regard to the reorganized entity's leadership. Thus, while not necessarily acting out of an interest for the public good, creditors are a group with an incentive, and the power under the Bankruptcy Code, to object to a plan of reorganization that is not consistent with public policy.

In addition to creditors as individuals, another group shares similar incentives to object to a plan of reorganization: a creditors' committee. Pursuant to statutory mandate, a creditors' committee consisting of creditors with unsecured claims must be appointed in a Chapter 11 case.¹⁵¹ Creditors' committees "have the responsibility to protect the interest of the creditors; in essence, 'the function of a creditors' committee is to act as a watchdog on behalf of the larger body of creditors which it represents.'"¹⁵² The creditors' committee serves a "watchdog" role in bankruptcy based upon the unique powers granted to it by the Bankruptcy Code.¹⁵³ Inherent in this role is the responsibility to safeguard the interests of creditors represented by the committee.¹⁵⁴ The creditors' committee has broad powers to

149. Similarly, the Securities and Exchange Commission has the right to object to a proposed plan of confirmation if it finds that the proposed corporate leadership is inconsistent with public policy. See 11 U.S.C. § 1109(a) (2006) ("The Securities and Exchange Commission may raise and may appear and be heard on any issue in a case under this chapter . . .").

150. 11 U.S.C. § 1109(b) (2006) ("A party in interest, including . . . a creditor . . . may raise and may appear and be heard on any issue in a case under this chapter.")

151. 11 U.S.C. § 1102(a)(1) (2006).

152. *In re* Advisory Comm. of Major Funding Corp., 109 F.3d 219, 224 (5th Cir. 1997) (quoting *In re* AKF Foods, Inc., 36 B.R. 288, 289 (Bankr. E.D.N.Y. 1984)).

153. *In re* W. Pac. Airlines, Inc., 219 B.R. 575, 578 (D. Colo. 1998).

154. *AKF Foods*, 36 B.R. at 289–90.

ensure the success of a Chapter 11 reorganization,¹⁵⁵ including the power to object to a proposed plan of reorganization.¹⁵⁶ As such, similar to both individual creditors and the UST, a creditors' committee maintains the ability to object to a plan of reorganization that is inconsistent with the public policy provisions of Sections 1123 and 1129. Moreover, a creditors' committee has a reason to file, and present evidence on, such an objection—to defeat a plan that is not in the creditors' best interests.

VI. CONCLUSION

Public policy considerations can be found in constitutions, legislative acts, and judicial decisions.¹⁵⁷ The Bankruptcy Code provides for significant deference to such considerations through Sections 1123 and 1129, both of which provide that a proposed Chapter 11 plan should not be confirmed unless its provisions pertaining to the proposed management of the reorganized business are consistent with public policy. Despite such statutory mandate, bankruptcy courts and the parties appearing before them have rarely utilized Sections 1123 or 1129 during confirmation of a Chapter 11 plan. As such, it is of little surprise that the proper scope of, and procedure associated with, these provisions are poorly defined.

This Essay proposes a burden shifting system by which: (1) a plan proponent bears an initial burden of production, which is satisfied by a presumption that a duly filed plan of reorganization is consistent with public policy; (2) a burden of production is then placed upon the plan opponent, which is satisfied by the presentation of a legitimate argument as to why the proposed plan is inconsistent with public policy considerations; and (3) the ultimate burden of persuasion then lies upon the plan proponent to establish compliance with the public policy provisions of Sections 1123 and 1129. This system presents a simple method by which the public policy provisions of the Bankruptcy Code can be implemented. Moreover, such a

155. See 11 U.S.C. § 1103(c)(1)–(4) (2006) (granting the creditors' committee the power to consult with the debtor concerning the conduct of the business; the authority to investigate the acts, conduct, and financial affairs of the debtor; the right to participate in the formulation of the plan; and the right to seek the appointment of a trustee if necessary).

156. 11 U.S.C. § 1109(b) (2006).

157. *In re Machne Menachem, Inc.*, 304 B.R. 140, 143 (Bankr. M.D. Pa. 2003) (quoting *Bldg. Serv. Employees Int'l. Union, Local 262 v. Gazzam*, 339 U.S. 532, 537 (1950)).

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system is consistent with pertinent case law dealing with these statutory provisions and can easily be implemented under the current bankruptcy laws. This proposed rule will allow consideration of public policies pertaining to, among other subjects, the public's perception of the bankruptcy system, corporate law, securities law, partnerships, and competent business management.

Sections 1123 and 1129 specifically provide for consideration of public policy when evaluating a proposed Chapter 11 plan's provisions pertaining to management of the reorganized business. The proposed system provides a method to give vitality to such provisions and, as such, should be utilized by bankruptcy courts considering the confirmation of a Chapter 11 plan.