# CHAPTER 11 SHAPESHIFTERS

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*Logic and equity would seem to demand that when administrative agencies are creditors to a bankrupt debtor, they should have the same status as other creditors. But a creditor agency retains its regulatory authority over the debtor, permitting it to continue with agency business such as conducting enforcement proceedings and awarding licenses. As a result, though bankruptcy law and policy both strongly support equal distribution of the estate, administrative agencies have been able to circumvent these goals through the use of "shapeshifting" behaviors. This Article evaluates two dangerous shapeshifting scenarios: (1) where the agency avoids the limitations of creditor status by piercing the corporate veil and bringing its claims against the debtor's individual stakeholders; and (2) where the agency operates in two distinct roles within a single proceeding, such as its dual identity as creditor and regulator under the* Second Thursday *doctrine. Through these behaviors, agencies take advantage of deferential judicial review to prioritize the debts they are owed over other creditors.*

*This Article concludes that, when administrative agencies maintain a self-interested position in bankruptcy litigation, the balance must shift away from traditional judicial deference to offer stronger protections to other creditors and to maintain the separation of powers. To begin the work of remedying shapeshifting behavior, this Article proposes two modest solutions. First, existing Bankruptcy Code provisions suggest that Congress may favor a statutory amendment that enhances the scrutiny of shapeshifting agencies. This could be accomplished through a statutory bar on creditor veil piercing or, at minimum, the imposition of a notice and hearing requirement. Second, shapeshifting behavior, once recognized, should be afforded only* Skidmore *deference.*

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## INTRODUCTION

The integrity of the bankruptcy system relies primarily on the bankruptcy court's ability to maximize recoveries for a debtor's stakeholders and equitably distribute the remaining assets. When a debtor files for bankruptcy protection, creditors often do not recoup their debts in full and may receive only "pennies on the dollar."[1] Forgiving unpaid debt in this way conflicts with our fundamental notions of fairness. Congress sought to impose a degree of equity on an inherently inequitable process by

1. *See* Charles R. Sterbach & Keriann M. Atencio, *Why Johnny Can't Get Paid on His General Unsecured Claims: A Potpourri of Lingering Abuses in Chapter 11 Cases*, 14 J. BANKR. L. & PRAC. 111, 112 (2005) ("Based on the priority schemes embedded in the Bankruptcy Code, unsecured creditors assume the risks associated with the debtor's insolvency, and often expect pennies on the dollar in any bankruptcy case."). For example, a Delaware bankruptcy judge recently confirmed a plan of reorganization in the Quicksilver, Inc. Chapter 11 case that provided less than 10% recovery to general unsecured claims. *See* Findings of Fact, Conclusions of Law and Order Confirming Plan of Reorganization of the Debtors, *In re* Quicksilver, Inc., No. 15-11880-BLS (Bankr. D. Del. Jan. 29, 2016).

enacting bankruptcy laws under its Article I, Section 8 powers.[2] Without the order and structure created by the Bankruptcy Code (the Code), debtors could selectively pay only preferred debts and savvy creditors could siphon off as much value as possible from the estate to the detriment of the remaining creditors. Thus, orderly administration of the bankruptcy process is vital to Congress's constitutional entitlement to aptly, and appropriately, legislate a bankruptcy system.

Creditors take many forms, including employees, trade vendors, equity holders, secured lenders, and taxing authorities.[3] Administrative agencies looking to recover debts for unpaid regulatory fees or penalties may also be among the creditors of a bankrupt corporation. Yet, these agencies are not ordinary creditors. Administrative agencies operate through legislative grants of executive authority. Such grants, called "organic acts," set forth relevant standards for agency action, including the agency's breadth of authority, jurisdiction, mandates, and general policy objectives.[4] The Administrative Procedure Act (APA) provides additional guidance for agency behavior.[5] Under the APA, agencies receive deferential review when they have been granted "interpretive or adjudicatory power" to perform their regulatory goal, usually through rulemaking and case-specific adjudication, respectively.[6] The limits of agency actions and the standards by which they should be judged are a common subject of legal scholarship, yet few have discussed whether agencies should be treated differently when they are also creditors in a bankruptcy case. Notably, agency creditors maintain their regulatory abilities during the pendency of a bankruptcy

2. *See* Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 25 (1995) (discussing the development of American bankruptcy law to "facilitat[e] the equitable and efficient administration and distribution of the debtor's property to creditors").

3. *See* Mark J. Roe & Frederick Tung, *Breaking Bankruptcy Priority: How Rent-Seeking Upends the Creditors' Bargain*, 99 VA. L. REV. 1235, 1243–46 (2013) (evaluating the various classes of creditors and their distribution priorities under the Bankruptcy Code (the Code)).

4. *See, e.g.*, Communications Act of 1934, Pub L. No. 73-416, 48 Stat. 1064 (1934).

5. *See* Administrative Procedure Act of 1946 (APA), Pub. L. No. 79-404, 60 Stat. 237 (codified as amended at 5 U.S.C. §§ 500–96 (2012)). The 1947 Attorney General's Manual on the APA explains four basic goals of the Act: (1) "To require agencies to keep the public currently informed of their organization, procedures and rules (sec. 3)"; (2) "To provide for public participation in the rule making process (sec. 4)"; (3) "To prescribe uniform standards for the conduct of formal rule making (sec. 4 (b)) and adjudicatory proceedings (sec. 5), i.e., proceedings which are required by statute to be made on the record after opportunity for an agency hearing (secs. 7 and 8)"; and (4) "To restate the law of judicial review (sec. 10)." ATTORNEY GENERAL TOM C. CLARK, U.S. DEP'T OF JUSTICE, ATTORNEY GENERAL'S MANUAL ON THE ADMINISTRATIVE PROCEDURE ACT 9 (1947).

6. *See In re* UAL Corp., 468 F.3d 444, 449 (7th Cir. 2006) (noting in which cases deference is appropriate)).

case, complete with the judicial deference that Article III courts give to their actions.[7]

This Article addresses the unchecked manipulation that occurs when administrative agencies shift between their roles as creditor and regulator to obtain preferential treatment in bankruptcy cases, a process I call "shapeshifting." A "shapeshifter" is defined as "one that seems able to change form or identity at will,"[8] which is a concept that has been a mainstay of folklore, mythology, religious tradition, and science fiction for centuries.[9] By strategically shifting between overlapping roles, creditor agencies may overstep their statutory purpose and threaten the integrity of both the administrative state and the bankruptcy process. The treatment of shapeshifting agencies within the bankruptcy process has until now remained a silent scandal. Recent cases indicate that agencies are extending the boundaries of their statutory role and using their deferential standard of review to gain preferential treatment in bankruptcy cases where they are creditors.[10] If left unchecked, shapeshifting agencies have the power to disrupt the careful balance of incentives supporting public trust in the bankruptcy system.

After evaluating two key shapeshifting scenarios and balancing the underlying policy motivations—namely, the structure of the bankruptcy process and the role of administrative agencies—this Article concludes that the traditional deferential approach to regulatory actions must fade away when administrative agencies maintain a self-interested creditor position in a bankruptcy case. The danger of abuse is greatest when an agency (1) shapeshifts to collect debts outside of the bankruptcy process; and (2) acts as both creditor and regulator within a single bankruptcy case in a way that creates an unacceptable conflict of interest. This Article does not attempt to evaluate or modify the shapeshifting behavior of administrative agencies outside the context of bankruptcy. Though attention should be cast upon such behavior in all settings, a shapeshifting agency's actions are

7. *See infra* Part II (discussing the Federal Communication Commission's (FCC's) regulation of certain bankrupt entities). Such proceedings will be upheld on appeal to an Article III court unless they are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A).

8. *Shapeshifter*, MERRIAM-WEBSTER ONLINE DICTIONARY, http://www.merriam-webster.com/dictionary/shape-shifter (last visited May 21, 2016).

9. *See, e.g.,* Stephan Grundy, *Shapeshifting and Berserkergang*, *in* 3 DISPUTATIO 104, 104–05, 118 (Carol Poster & Richard Utz, eds., 1998) ("The assumed form exists, in some manner, separately from the being who is donning it: it embodies the foreign capabilities and nature which the shapeshifter wishes to assume."); *Shapeshifters, Shapeshifting*, THE ENCYCLOPEDIA OF FANTASY 858–59 (John Clute & John Grant eds., 1999) (detailing famous shapeshifters throughout literary history).

10. *See infra* Parts II.A, II.B.

particularly concerning when used to circumvent the established equitable distribution procedures of the bankruptcy process.

This Article proceeds in four Parts. Part I first discusses the core purposes of the Code, including the preservation of the estate's remaining assets through the automatic stay and the equitable distribution of those assets to creditors. Next, Part I highlights the tension that occurs when agencies assume the role of a creditor within a bankruptcy case, yet retain (and utilize) their regulatory authority to circumvent the equitable distribution of the estate, a core bankruptcy purpose. By looking to Supreme Court precedent, this Part sets forth the established boundaries of regulatory actions within or connected to a corporation in bankruptcy while also exposing open questions that remain.

Part II addresses two problematic instances of shapeshifting agency behavior: (1) piercing the corporate veil to affix an insolvent corporation's liability onto an individual; and (2) using agency-created tools—such as the *Second Thursday* doctrine—to act as both creditor and regulator in the same bankruptcy case. Part II additionally extends the factual situations to their hypothetical end to fully portray the potential impact of unchecked shapeshifting behavior. Part III provides an analytical framework to highlight the inadequacy of existing checks by looking to the principal–agent model. Part IV suggests two potential solutions to protect the intended flexibility of the existing regulatory scheme while also limiting shapeshifting behavior that undermines the Bankruptcy Code's protections. This proposal includes statutory modification to limit regulatory action when the agency is a creditor and decreased deference in situations where shapeshifting may occur in a way that undermines core bankruptcy purposes.

## I. BACKGROUND

### *A. Restructuring Incentives: The Protection of the Automatic Stay*

Facing unsustainable debt obligations, insolvent corporations or other business entities find refuge in the Code. Designed to restructure or liquidate a company, Chapters 7 and 11 of the Code provide a mechanism for a company to discharge debts while also allocating resources to the creditor classes in an orderly fashion.[11] Under either Chapter, the restructuring process provides a number of protections to the debtor, the creditors, and the general public, including a provision to freeze the

11. *See generally* 11 U.S.C. §§ 721–27 (2012) (Chapter 7) (providing for liquidation of a debtor's assets and distribution of proceeds to its creditors); *id.* at §§ 1101–74 (Chapter 11) (providing for reorganization of a debtor's business or personal affairs).

metaphorical clock to evaluate and organize the estate. Under 11 U.S.C. § 362(a), once a bankruptcy petition is filed, all entities are automatically stayed from collecting, commencing, and continuing a litany of pre-petition actions, including litigation.[12] This stay is designed to "grant complete, immediate, albeit temporary relief to the debtor from creditors, and also to prevent dissipation of the debtor's assets before orderly distribution to creditors can be effected."[13]

One exception to the automatic stay is the "police or regulatory power" language in § 362(b)(4), which allows governmental units—such as administrative agencies—to enforce their police powers.[14] By creating the exception, Congress responded to concerns that the automatic stay was "particularly vulnerable to abuse by debtors improperly seeking refuge under the stay in an effort to frustrate necessary governmental functions."[15] The § 362(b)(4) exception is designed to apply "where a governmental unit is suing a debtor to prevent or stop violation of fraud, environmental protection, consumer protection, safety, or similar police or regulatory laws, or attempting to fix damages for violation of such a law . . . ."[16] Legislative history indicates that the provision is to be "narrowly construed" to guard public health and safety, and should "not apply to actions by a governmental unit to protect a pecuniary interest in property of the debtor or property of the estate."[17]

Unlike instances of public safety concerns, police power enforcement is not allowed under § 362(b)(4) for the collection of "money judgment[s]."[18] Thus, bankruptcy courts must decide whether an agency's actions are more like a collection effort, which should not qualify under § 362(b)(4), or instead are actions to protect the public. To evaluate whether an action falls within the police or regulatory power exception, courts often look to

12. *Id.* at § 362(a) (describing scenarios subject to the automatic stay when a debtor files for bankruptcy protection).

13. Penn Terra Ltd. v. Dep't of Envtl. Res. of Pa., 733 F.2d 267, 271 (3d Cir. 1984).

14. NLRB v. Cont'l Hagen Corp., 932 F.2d 828, 832 (9th Cir. 1991) ("There is widespread agreement among the circuits that the [NLRB] and other Congressionally established administrative agencies fall within the category of a governmental unit.").

15. United States v. Nicolet, Inc. (*Nicolet I*), 857 F.2d 202, 207 (3d Cir. 1988); *see also* Equal Employment Opportunity Commission (EEOC) v. Rath Packing Co., 37 B.R. 614, 616–17 (Bankr. S.D. Iowa 1984) ("The exclusive authority of [the agency] to enforce federal law and policy against discrimination would be obstructed by the escape mechanism that § 362(a) would provide if [agency] enforcement actions would be stayed on the filing of a bankruptcy petition.").

16. H.R. REP. NO. 95-595, at 342 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6299.

17. Apex Oil Co. v. Dep't of Energy (DOE) (*In re* Apex Oil Co.), 91 B.R. 860, 863 (Bankr. E.D. Mo. 1988) (quoting H.R. REP. NO. 95-595, at 549).

18. 11 U.S.C. § 362(b)(4) (2012).

either of two tests. First, the "pecuniary purpose test" asks whether the government action relates primarily to a "pecuniary interest in the debtor's property"—an action not excepted under § 362(b)(4) and, therefore, subject to the automatic stay—or, to matters of the public's "general safety and welfare," which are excepted and therefore not subject to the automatic stay.[19] When the agency is acting as "little more than a surrogate to enforce contract, tort, or wage claims against the Debtor," its claims should not gain preferential treatment through an exception to the automatic stay.[20] The second test, called the "public policy test, distinguishes between proceedings that effectuate public policy and those that adjudicate private rights: only the former are excepted from the automatic stay."[21]

Bankruptcy courts addressing this issue focus on the difference between *entry* of judgment, which they hold does not conflict with protections of the automatic stay, and *enforcement* of that judgment, which they have decided is an established violation of the stay.[22] When an agency enters judgment against a bankrupt corporation for regulatory violations, its actions serve the desired deterrent purpose against other regulated parties.[23]

19. *See Nicolet I*, 857 F.2d at 209.

20. *In re* Bennett Paper Corp., 63 B.R. 8, 11–12 (Bankr. E.D. Mo. 1985) (holding that an EEOC action to "make whole" all parties affected by employment discrimination was subject to automatic stay because the purpose of the enforcement was "to protect a pecuniary interest in the debtor's property" and not to enforce laws affecting "health, welfare, morals and safety").

21. NLRB v. Edward Cooper Painting, Inc., 804 F.2d 934, 942 (6th Cir. 1986) (internal quotation marks omitted) (quoting Herr v. Maine (*In re* Herr), 28 B.R. 465, 468 (Bankr. D. Me. 1983)); *see also* Burns v. Burns (*In re* Burns), No. 5–bk–07–50140 RNO, 2008 WL 3246244, at *4 (Bankr. M.D. Pa. 2008) ("In this case, the Attorney General, as part of its mandate to ensure consumer protection, is seeking restitution not only to assist those who were allegedly harmed by the Debtor's conduct, but also to fulfill the broader goal of protecting the public at large from unsavory practices.").

22. *See In re* Burns, 2008 WL 3246244, at *4 ("Even if such enforcement of the judgment is prevented by the automatic stay, the government can still pursue the claim to the point of the entry of a money judgment, without violating the automatic stay."); *In re* UAL Corp., 468 F.3d 444, 455 (7th Cir. 2006) ("What the [parties] are entitled to is not full payment but an unsecured claim equal to the value of these benefits."); Illinois v. Elec. Utils., 41 B.R. 874, 877 (Bankr. N.D. Ill. 1984) ("Congress allows governmental units to get money judgments in pursuit of their police power, but forces them to wait in line like all other creditors to get the judgment enforced.").

23. *See* Apex Oil Co. v. United States (*In re* Apex Oil Co.), 91 B.R. 860, 864 (Bankr. E.D. Miss. 1988) ("Even a penalizing proceeding might be considered a police and regulatory activity due to its deterrent effect. . . ."); *see also* Hunt v. Commodity Futures Trading Commission (CFTC) (*In re* Hunt), 93 B.R. 484, 491 (Bankr. N.D. Tx. 1988) (emphasis added) ("The civil monetary penalties assessed by the CFTC are not in the nature of a recovery of pecuniary loss; rather, they are remedial in nature and are imposed *as a deterrent to violation of the* [*Commodities Exchange Act*]. . . .").

Additionally, unlike enforcement actions, the agency's entry of judgment "will not interfere with the bankruptcy court's control of the bankruptcy estate."[24] In contrast, allowing agencies to *enforce* monetary judgments "would give the governmental unit an unfair advantage over other creditors, would effectively subvert the scheme of priorities set forth in § 507, and would deny to the debtor the benefits of discharge."[25] Even if some marginal deterrent value were to come from enforcing monetary judgments, the corresponding damage to the bankruptcy priority scheme weighs against permitting such behavior. Thus, bankruptcy courts adjudicating the propriety of agency collection efforts conclude that such actions fall outside the scope of the police and regulatory power exception. Even agencies in their internal adjudications recognize that their jurisdiction to recover funds is not subject to similar protections and "are for the district court as a matter of judgment execution."[26]

Administrative agencies have standing as a creditor in bankruptcy cases when they act as an "appointed statutory enforcer" of a federal law.[27] While the police and regulatory power exception allows some agency actions to avoid the automatic stay, in large part their claims are reduced to the type held by members of the general class of creditors.[28] As discussed above, an agency's unsecured claims are frequently not paid in full and instead receive only a pro-rata portion of the remaining value of the estate

24. EEOC v. Rath Packing Co., 37 B.R. 614, 617 (Bankr. S.D. Iowa 1984). *But see In re* Hunt, 93 B.R. at 495–98 (temporarily enjoining a CFTC proceeding to impose civil monetary penalties to prevent the "irreparable harm" that would accompany parallel proceedings, including litigation costs and disruption of the Chapter 11 proceeding).

25. 3 COLLIER ON BANKRUPTCY ¶ 362.05[5][b] (Alan N. Resnick & Henry J. Sommer eds., 16th ed. 2010).

26. Hwang v. Bull Mkt. Commodities, Inc., CFTC No. 82-R505, 1987 WL 106866, at *3 (CFTC July 7, 1987). Though the Code clearly states that monetary enforcement of a penalty is not exempted from the stay and must be accomplished through the Bankruptcy Court, NLRB v. Cont'l Hagen Corp., 932 F.2d 828, 835 (9th Cir. 1991), in rare instances the estate *is* obligated to make payments. *See, e.g.*, Wheeling-Pittsburgh Steel Corp. v. Pa. Human Rel. Comm'n (*In re* Wheeling-Pittsburgh Steel Corp.), 63 B.R. 641, 644 (Bankr. W.D. Pa. 1986) (distinguishing "back to work" pay as a valid police power exception because it is monetary expense to prevent future harm, not remedy past harm); Commonwealth Oil Ref. Co. v. U.S. Envtl. Prot. Agency (EPA) (*In re* Commonwealth Oil Ref. Co.), 805 F.2d 1175, 1183–84 (5th Cir. 1986) (allowing the EPA enforcement actions under the police and regulatory exception, "notwithstanding the fact that [the regulated party] will be forced to expend funds in order to comply [with environmental requirements]").

27. *See* Sec. Exch. Comm'n v. Cross (*In re* Cross), 218 B.R. 76, 79 (B.A.P. 9th Cir. 1998) (listing cases that also assign creditor status to regulatory bodies tasked with enforcing federal statutory obligations).

28. *See* 11 U.S.C. § 507(a)(8) (2012) (categorizing most government claims as category eight priority unsecured claims).

according to the priority structure set forth in § 507 of the Code.[29] Unlike other unsecured creditors, however, agencies have regulatory tools that can help maximize the amount of recovery on their debts. For example, agencies may have the regulatory authority to collect their debts in administrative proceedings—even if the automatic stay would prevent the agency from doing so within the related bankruptcy case.

Faced with the choice between standing in line with other unsecured creditors for partial recovery and taking the opportunity to collect debts in full, case law indicates that agencies adopt shapeshifting measures that maximize their collection value.[30] Such actions are not fundamentally illegal. After all, Congress enabled agencies like the Federal Communications Commission (FCC or the Commission) to conduct their own proceedings, and no current provision of the Code prevents such actions.[31] However, when agencies adopt shapeshifting behavior solely to avoid creditor status, the analysis must change. The same reasoning that supports a carve-out for collection efforts from the police and regulatory power exception to the automatic stay also justifies a similar distinction in the case of shapeshifting behavior.[32] This is because Chapter 11 shapeshifters threaten the equitable distribution of the estate by collecting greater sums than they would otherwise receive, all with no apparent regulatory end. Once agencies are acting for their own pecuniary benefit, their actions no longer fall within the intended scope of authority granted by Congress. Accordingly, their actions should not be reviewed under the same standard of deference. To better explain the circumstances that pose the greatest problems, the next Section discusses one example of a shapeshifting agency that evaded the bankruptcy process. That Section then evaluates unsettled questions left by the Supreme Court.

### *B. Established Groundwork and Open Questions:* NextWave *and Beyond*

The Supreme Court's most recent instruction on the struggle between administrative agencies and the restructuring process offered partial clarity

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29. *Id.*

30. *See, e.g.*, *In re* Telseven, LLC, 27 F.C.C. Rcd. 6636, 6649–50 (June 14, 2012) (piercing the corporate veil to affix an insolvent company's liability onto the individual owner, instead of pursuing the claim as a creditor in the company's concurrent bankruptcy proceeding).

31. *See, e.g.*, 47 USC §§ 503(b)(3)(A)–(B) (2012) (outlining procedure for FCC administrative forfeiture actions).

32. *See infra* Part II (outlining "shapeshifting" as an agency's transition between creditor and regulator status in related proceedings or an agency simultaneously acting as creditor and regulator within a single case).

by firmly prohibiting one form of agency shapeshifting.[33] Yet, due to the limited factual circumstances the Court was asked to evaluate, the opinion left ongoing uncertainty about whether other forms of shapeshifting behavior will be similarly prohibited.[34] In 2003, the Supreme Court was asked in a watershed case to address a conflict between the Code's protection against cancellation of a debtor's licenses and the FCC procedure to revoke telecommunications licenses due to non-payment. In *FCC v. NextWave Personal Communications*,[35] the FCC cancelled NextWave's broadband personal communications service (PCS) licenses after NextWave filed for Chapter 11 bankruptcy protection. The FCC was originally a creditor within the bankruptcy case and challenged the bankruptcy court's treatment and classification of the FCC's claim over the PCS licenses.[36] After successfully litigating a fraudulent conveyance adversary proceeding, the FCC next challenged a proposed plan of confirmation in the bankruptcy case.[37] Around the same time, the agency revoked NextWave's PCS licenses—a valuable part of the estate—and advertised them for re-auction in a concurrent FCC proceeding.[38] NextWave challenged the FCC's cancellation, and on appeal the Court of Appeals for the D.C. Circuit found that the cancellation violated § 525 of the Code.[39] Because the APA requires agency actions to be "in accordance with law," the court concluded that the FCC's cancellation was an invalid agency action.[40] On appeal, without explicitly addressing the FCC's shapeshifting behavior, the Supreme Court rested its decision on the Code's blanket prohibition on license cancellation that is "solely" due to debtor licensee's unpaid dischargeable debts.[41] Writing for the Court, Justice Scalia explained that § 525 of the Code blocked the FCC's cancellation action.[42] Nothing in the Communications Act of 1934, the FCC's enabling statute, requires cancellation as a response to non-payment.[43] Thus, the FCC offered no valid regulatory justification or conflict that would excuse its non-compliance with § 525.

The FCC's action in *NextWave* was an explicit example of Chapter 11

33. *See* FCC v. NextWave Pers. Commc'ns Inc., 537 U.S. 293 (2003).

34. *Id.* at 295 (explaining the specific facts and issue before the Court).

35. *Id.* at 297–99.

36. *See id.* at 298.

37. *Id.* at 298–99.

38. *Id.*

39. *Id.* at 299.

40. *See id.* at 300 (citing 5 U.S.C. § 706 (2012)).

41. *Id.* at 300–01 (citing 11 U.S.C. § 525 (2012)).

42. *See id*. at 304.

43. *Id.* *See generally* Communications Act of 1934, Pub. L. 73-416, 48 Stat. 1064 (codified as amended at 47 U.S.C. §§ 151–61(2012)).

shapeshifting: the Commission initially participated in the bankruptcy case, and then shifted its role from creditor to regulator by cancelling the licenses instead of retaining a security interest in their value. The FCC's ability to cancel and re-auction licenses offered an efficient and unencumbered path to regain as much money as possible, unlike the FCC's alternative option to remain as a low-priority creditor in the bankruptcy case. Though the Supreme Court's holding refused to consider the FCC's reasons for cancelling the licenses—it explained that such motives are "irrelevant" in light of § 525's plain meaning—the *NextWave* Court recognized that one potential motive behind the FCC's cancellation was "making itself financially whole."[44]

*NextWave* should serve as a warning for future conflict between the bankruptcy process and an agency's self-interested motivation to maximize collection of its debts. Though the obvious impact of *NextWave* was to check the FCC's shapeshifting behavior, the underbelly of the holding projects that future cases may not provide a similar check in the absence of a similarly explicit provision in the Code. In the aftermath of *NextWave*, certain types of discriminatory regulatory actions are prohibited by the Code's provisions; however, situations involving similar shapeshifting behavior remain untested by the Court. For example, an agency cannot cancel or revoke a license as a result of non-payment to re-auction it—the exact circumstances in *NextWave*—due to § 525's prohibition.[45] Assuming, as the *NextWave* Court did, that the agency's motive is to avoid creditor status and find an efficient way to collect its debts, several maneuvers remain available.

One shapeshifiting possibility that allows an agency to benefit its own pecuniary interest is to pierce the corporate veil and attach a debtor corporation's liability to an individual who is beyond the protection of the automatic stay. The FCC has previously acknowledged the possibility that the Commission will pierce the corporate veil to attach licensee installment payment debt to a new party to the licensing entity.[46] Though we know

44. *NextWave*, 537 U.S. at 301.

45. *Id.* at 298, 299, 304 (explaining the FCC's position that NextWave's licenses were "canceled automatically" and "available for auction" to other parties, and then rejecting that position in light of § 525).

46. *In re* Amend. of Part 1 of the Comm'ns Rules, 15 F.C.C. Rcd. 21520, 15313 (FCC Aug. 14, 2000) (Competitive Bidding Procedures). Though this FCC rulemaking is an abstract statement without application guidance, it poses another interesting twist. Assuming that veil-piercing for the purpose of proper license assignment falls under the traditionally-protected regulatory reach of the FCC, extending debt liability for installment payment participation does not necessarily carry the same public policy incentive for deference when looking behind the corporate form. Regulating proper license control is not automatically connected with ensuring the payment of installment debt. The latter action

that discriminatory license cancellation is barred by § 525 of the Code, in the absence of a similar provision addressing attachment of license debt, it is an open question whether the Court would allow shapeshifting through piercing the corporate veil. Like the revocation of NextWave's licenses, veil-piercing behavior results in a similar circumvention of the Code's automatic stay and preference payment provisions.[47] Yet, *NextWave* was not decided on those grounds. We are left to wonder whether the Supreme Court would reject shapeshifting behavior solely due to its impact on the equitable distribution of a bankruptcy estate.

A second shapeshifting scenario that remains unchecked by *NextWave*'s holding involves an agency acting as both regulator and creditor in a single case. As explained in detail below, the *Second Thursday* doctrine allows the FCC to transfer telecommunications licenses through an expedited process in bankruptcy. The *NextWave* Court prohibited selective revocation of licenses, but did not reach the issue of *granting* licenses.[48] Yet, when the FCC is sitting in a position to approve or deny the transfer of a bankrupt corporation's licenses, a similar tension with § 525 exists.[49] Challengers to § 525's prohibition suggest that "there *ought* to be an exception" in the case of "a valid regulatory purpose."[50] Even assuming, arguendo, that a valid-regulatory-purpose exception exists, it should disappear when the agency is a creditor while simultaneously sitting in judgment of license grants—a shapeshifting scenario discussed in Part II.

## II. AGENCY SHAPESHIFTING SCENARIOS

### *A. Administrative Shapeshifting and the Corporate Veil*

#### *1. Veil-Piercing Uncertainty and Application to Agencies*

One way that administrative agencies shapeshift to maximize recovery of their debts is through piercing the veil of a debtor corporation. Administrative agencies express a willingness to pierce the corporate veil to collect debts that would otherwise be subject to the Code's automatic stay. Instead of embracing their role as creditors, veil-piercing agencies

more closely parallels traditional contract disputes, and should not fall under the police and regulatory power exceptions to the automatic stay.

47. 11 U.S.C. § 362 (2012).

48. *See NextWave*, 537 U.S. at 304.

49. It could be argued that, by refusing to approve the license transfer to the debtor's selected bidder, the FCC is "deny[ing]" or "condition[ing] such a grant to . . . another person with whom such bankrupt or debtor has been associated" in violation of 11 U.S.C. § 525.

50. *NextWave*, 537 U.S. at 302.

shapeshift and use their regulatory authority to attach the same debt they would hold as creditors to an individual behind the corporation. This would be worrisome enough if it occurred within the bankruptcy case; yet, agency veil-piercing is most commonly done in a concurrent agency enforcement proceeding.[51] To better understand the threat posed by agency veil-piercing, this Section will continue in three parts. First, it will explain the origins of piercing the corporate veil and discuss why veil-piercing is generally an uncertain concept. Next, it will highlight additional complexities that are introduced in the specific context of administrative veil-piercing. This includes uncertainty about whether administrative agencies have the authority to engage in veil-piercing behavior, as well as the different standards that agencies employ to determine when veil-piercing is appropriate. Finally, this Section discusses alternatives agencies have used to mirror piercing the corporate veil. Such actions should also be considered in any possible solution to shapeshifting behavior.

*a. Origins of Piercing the Corporate Veil*

Incorporated entities benefit from a number of protections, including the well-established reverence for the corporate form as a liability shield for the individuals behind it. The "corporate veil" serves a number of purposes, including "encouraging risk taking by individual investors as well as overall convenience of financial administration."[52] The doctrine of veil-piercing involves an exception to the general corporate form where "courts disregard the separateness of the corporation and hold a shareholder responsible for the corporation's action as if it were the shareholder's own."[53] Though incorporation is designed in part to limit liability, "it is not enough to simply have the requisite papers for incorporation drawn up and filed. *The entity must then function as a corporation in fact*."[54]

Piercing the corporate veil is an equitable remedy at its core, seeking to redress harms that would otherwise be unenforceable against a corporation.[55] It is often described as an extraordinary action that should only be "undertake[n] reluctantly": "There is a presumption of corporate

51. For example, the FCC pierced the corporate veil of a Telseven-regulated company in a parallel FCC proceeding after the same company filed for Chapter 7 protection in bankruptcy court. *See* discussion *infra* Part II.

52. Valley Fin., Inc. v. United States, 629 F.2d 162, 171 (D.C. Cir. 1980).

53. Robert B. Thompson, *Piercing the Corporate Veil: An Empirical Study*, 76 CORNELL L. REV. 1036, 1036 (1991).

54. *In re* Safe & Sure Prods., Inc., No. I.F. & R. 04-907003-C, 1998 WL 422206, at *20 (EPA June, 26 1998).

55. *See generally* STEPHEN B. PRESSER, PIERCING THE CORPORATE VEIL (2015) (discussing the equitable origins of veil-piercing).

regularity which usually requires the party seeking to have the corporate entity disregarded to come forward with a substantial showing that the corporation was really a dummy for the person sought to be held liable."[56]

At a fundamental level, the focus of a veil-piercing evaluation is that "corporateness will not be recognized to produce unjust or undesirable consequences inconsistent with the purpose of the concept."[57] Not surprisingly, this commonsense objective provides little guidance for crafting a concrete standard, perhaps an underlying reason that veil-piercing is among the most litigated issues in corporate law.[58]

The corporate veil-piercing doctrine developed from several underlying equitable theories, leading to many formations of a veil-piercing standard. Frederick J. Powell developed the most prominent test,[59] involving a three-part analysis that is "perhaps the most frequently applied and most clearly articulated of the rules in the corporate veil area. . . ."[60] The test evaluates: (1) an "alter-ego," or "mere instrumentality" test, requiring that the subsidiary be completely under the control and domination of the parent; (2) the "fraud or wrong" or "injustice" test, requiring that the defendant-parent's conduct in using the subsidiary to have been somehow unjust, fraudulent, or wrongful toward the plaintiff; and (3) the "unjust loss or injury" test, requiring the plaintiff actually to have suffered some harm as a result of the defendant parent.[61] These factors form the foundation of many veil-piercing standards, yet rampant modification was a common practice throughout the doctrine's development. Due to uncertain standards and divergent motivations, the fiction of limited liability and the proper role of piercing the corporate veil have been called "a legal quagmire,"[62] and described as "enveloped in the mists of metaphor."[63]

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56. Pardo v. Wilson Line of Wash., Inc., 414 F.2d 1145, 1149–50 (D.C. Cir. 1969); *see* John H. Matheson, *Why Courts Pierce: An Empirical Study of Piercing the Corporate Veil*, 7 BERKELEY BUS. L.J. 1 (2010) (discussing the basic incentives of veil-piercing).

57. Harry G. Henn & John R. Alexander, Laws of Corporations and Other Business Enterprises § 146, at 344 (3d ed. 1983).

58. *See* PRESSER, *supra* note 55, at 8 ("Any brief perusal of the state or federal reporters shows as many corporation law cases on piercing the veil as those devoted to any other issue, and occasionally more than the other various issues combined."); *see generally* Thompson, *supra* note 53.

59. *See* FREDRICK J. POWELL, PARENT AND SUBSIDIARY CORPORATIONS 1–10 (1931) ("Underlying Theory of Parent Corporation's Liability; The Three Elements").

60. Cathy S. Krendl & James R. Krendl, *Piercing the Corporate Veil: Focusing the Inquiry*, 55 DENV. L.J. 1, 13 (1978).

61. POWELL, *supra* note 59, at 5–9.

62. Henry W. Ballantine, *Separate Entity of Parent and Subsidiary Corporations*, 14 CAL. L. REV. 12, 15 (1925).

63. Berkey v. Third Ave. Ry. Co., 155 N.E. 58, 61 (N.Y. 1926) (Cardozo, J.).

As lamented by noted veil-piercing scholar Steven Presser, "There has been a real reluctance on the part of courts clearly to define piercing the veil standards."[64] The standards are "like lightning . . . rare, severe, and unprincipled"; evaluating limited liability and piercing the corporate veil is "among the most confusing in corporate law."[65] State courts are far from uniform in their veil-piercing analysis, and a parallel federal veil-piercing system has developed, creating a web of competing approaches. Federal courts often adopt a "federal common law" standard that "allows for more easy piercing of the corporate veil than does comparable state law."[66] Courts have held that litigation involving "federal interests" leads to a "more liberal" standard of veil-piercing than in traditional state claims.[67] Because the adoption has been piecemeal, federal veil-piercing standards seem to be "an even more confused and chaotic form than state law," and "mastering its complexities will be a daunting test for lawyers in the years to come."[68] In *United States v. Bestfoods*,[69] the Supreme Court unanimously declined to enter the fray to resolve the choice of law concern, leaving the topic subject to "heated debate in the Circuit and District Courts";[70] subsequent cases have not provided additional clarity.[71]

*b. Agency Veil-Piercing: Authority and Standards*

Agency veil-piercing builds upon the doctrine's general uncertainty in two ways. First, no authority firmly establishes that agencies are entitled to pierce the corporate veil in administrative proceedings. Courts have found

64. PRESSER, *supra* note 55, at 8.

65. Frank Easterbrook & Daniel R. Fischel, *Limited Liability and the Corporation*, 52 U. CHI. L. REV. 89, 89 (1985).

66. PRESSER, *supra* note 55, at 927.

67. *In re* Capitol Hill Healthcare Grp., 242 B.R. 199, 203 (Bankr. D.D.C. 1999) (listing cases and noting the frequency of "liberal veil-piercing" in regulatory contexts).

68. PRESSER, *supra* note 55, at 928.

69. 524 U.S. 51 (1998).

70. *Id.*; PRESSER, *supra* note 55, at 949 (addressing the open choice between state veil-piercing law from the place of incorporation or significant contacts, or federal common law standards and discussing United States v. Bestfoods, 524 U.S. 51).

71. One example of the heated debate in veil-piercing doctrine is the ongoing conflict between state and federal standards. Federal standard advocates attribute the inapplicability of state veil-piercing standards to divergent underlying incentives. States developed the corporate shield "to encourage the formation and use of capital," leading to "rather stringent limitations" on veil-piercing to remove the shield, Lloyd Myers Co., 51 Agric. Dec. 747 (USDA Mar. 27, 1992), while federal law and agencies intend to "regulate interstate commerce and to control and outroot some evil practices in it," focusing less on the "refinements of common-law definitions" when determining how an agency's power to accomplish its Congressional directives. Goodman v. Fed. Trade Comm'n, 244 F.2d 584, 590–91 (9th Cir. 1957).

that an agency "cannot be prevented from *regulating* within its proper domain by the creation of paper entities; it can pierce the corporate veil in order to prevent frustration of its regulatory tasks."[72] An agency's ability to pierce the veil for regulatory purposes, however, does not necessarily include veil-piercing in enforcement actions. Some agencies assume the authority to pierce the corporate veil without further analysis. Instead, they proceed directly to the issue of what standard to apply. Other courts are less convinced that federal standards automatically govern an administrative veil-piercing situation,[73] and some judges lament that the concepts of limited liability "lose much of their sacrosanctity when urged in the context of regulated industries."[74] Other agency adjudicators choose to avoid the action completely, suggesting that "piercing the corporate veil generally should be reserved for proceedings to enforce a reparation award in federal court."[75]

Second, even assuming that agencies are able to pierce the corporate veil, their varying approaches to veil-piercing further complicate the doctrine. The wide variety of agency veil-piercing standards indicates that each agency adheres to a slightly different flavor of the traditional common law rule.[76] Agencies that look to pierce the corporate veil under "federal

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72. N. Am. Telecomms. Ass'n v. FCC, 772 F.2d 1282, 1293 (7th Cir. 1985) (emphasis added).

73. *See* Chao v. Occupational Safety and Health Review Comm'n, 401 F.3d 355, 365 n.3 (5th Cir. 2005) ("We provide no discussion of whether state or federal alter ego law applies in this administrative case not arising under diversity jurisdiction.").

74. Capital Tel. Co. v. FCC, 498 F.2d 734, 738 (D.C. Cir. 1974).

75. Boring v. Apache Trading Co., CFTC No. 88-R30, 1992 WL 212380, at *8 n.25 (CFTC Aug. 27, 1992) (vacating the ALJ's conclusions without prejudice to "raise the [corporate veil] theory in the appropriate forum").

76. *See, e.g.*, Mitsui O.S.L. Lines, Ltd. v. Global Link Logistics, Inc., No. 09-01, 2011 WL 7144008, at *25 (FMC Aug. 1, 2011) (quoting Kirno Hill Corp. v. Holt, 618 F.2d 982, 985 (2d Cir. 1980) (providing that under federal maritime law "the individual must have used the corporate entity to perpetuate a fraud or have so dominated and disregarded the corporate entity's corporate form that the corporate entity primarily transacted the individual's personal business rather than its own corporate business"); NLRB v. Bolivar-Tees, Inc., 551 F.3d 722, 728 (8th Cir. 2008) ("We have adopted the following two-prong test as the 'federal common law' standard. . . ."); *In re* Safe & Sure Prods., Inc., No. I.F. & R. 04-907003-C, 1998 WL 422206, at *18–19 (EPA June 26, 1998) (adopting the NLRB two-prong standard for the EPA); *In re* Midland Banana & Tomato Co., 54 Agric. Dec. 1239, 1995 WL 493881, at *17 (USDA Aug. 16, 1995) ("The [U.S. Department of Agriculture] examines the totality of the circumstances surrounding the violation rather than the form of the business entity involved in order to effectuate the purposes of the statutes it administers."); Pel-Star Energy, Inc., 65 FERC P 61079, 61502–03 (1993) ("The Commission identified two primary questions in determining whether an individual should be personally liable: (1) is there such unity of interest and ownership that the separate personalities of the corporation and the controlling individual no longer exist and (2) will

regulatory statutes" tend to eschew state standards.[77] In response to litigants who assert that specific state corporation law provisions could prevent federal veil-piercing action, administrative courts swiftly note that a state "statute would not trump federal law on the subject."[78] Beyond the question of state versus federal common law veil-piercing standards, other agencies create their own tests to determine when piercing the veil is appropriate. For example, some agency veil-piercing standards require "a showing of improper conduct,"[79] while others explicitly reject the evaluation of willfulness or fraud.[80] Still others focus on use of the corporate form to avoid statutory purposes.[81] Commentators have suggested that agency-specific precedents are the result of a "deliberate strategy" to develop a preferential approach to the veil-piercing doctrine.[82]

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adherence to the corporate fiction or the failure to disregard the corporate form result in fraud or injustice"); Pickett v. Traders Int'l, Inc., CFTC No. 83-R189, 1986 WL 66150, at *2 (CFTC Sept. 22, 1986) (listing "some of the factors considered [by the CFTC] in piercing the corporate veil").

77. Sebastopol Meat Co. v. Sec'y of Agric., 440 F.2d 983, 984–86 (9th Cir. 1971) (rejecting the idea that "state law limitations on the alter ego theory or doctrine are necessarily controlling," and noting that the agency's order was "to insure that regulation will not be thwarted by continued unlawful conduct" and "does not impose personal liability upon [the individual] for past acts").

78. *In re* Frank Acierno Christiana Town Ctr., LLC, No. CWA-03-2005-0376, 2006 WL 3361629, at *13 (EPA June 2006); *see also* Domsey Trading Corp., No. 29-CA-14548, 2011 WL 5868411, at *1 (NLRB Feb. 14, 2011) ("To the extent that [state] statutes or case law may have a different standard for holding a corporation's shareholders personally liable, that standard is not . . . applicable to cases litigated [within the NLRB] . . . ."); MCI Telecomms. Corp. v. O'Brien Mktg., Inc., 913 F. Supp. 1536, 1541 (S.D. Fla. 1995) ("The Court concludes that federal common law, rather than state law, applies to the issue of piercing the corporate veil in these [FCC] proceedings. . . .").

79. *Bolivar-Tees*, 551 F.3d at 727.

80. *Pel-Star Energy*, 52 FERC at 65019 ("Willfulness and fraud are simply not part of the test for piercing the corporate veil.").

81. *See, e.g.*, Transcon. Gas Pipe Line Corp. v. Fed. Energy Regulatory Comm'n (FERC), 998 F.2d 1313, 1321 (5th Cir. 1993) (approving of FERC's veil-piercing because to do otherwise "would frustrate a statutory purpose by allowing [the corporation] to set up subsidiaries to sell gas at prices at which the company could not legally sell"); Town of Highlands v. Natahala Power & Light Co., 19 FERC P 61152, 61276, 1982 WL 41323, at *4 (1982) ("The central question to resolve here is whether a preponderance of the evidence supports a finding that [a parent corporation] has used the separate corporate identities . . . to frustrate the purposes of the [federal statute].").

82. Kristin E. Hickman, *Agency-Specific Precedents: Rational Ignorance or Deliberate Strategy?*, 89 TEX. L. REV. SEE ALSO 89, 91–92 (2011).

> Rather, it seems reasonable to conclude that at least some of these attorneys are aware of the differences between general and agency-specific precedents yet decline to bring them to the attention of the courts. Instead, one might theorize that deliberate strategy rather than rational ignorance explains why attorneys in at least some cases ignore general administrative law doctrine in favor of agency-specific precedents in

Further complicating the situation, regulatory bodies often use the common law tests and terms interchangeably; for example, veil-piercing analysis often shifts to a discussion of alter ego status without acknowledging any distinction.[83]

*c. Alternatives to Agency Veil-Piercing*

Perhaps due to uncertain veil-piercing standards, some agencies reach the same result as veil-piercing through two alternative approaches. First, in many instances Congress has drafted or modified the governing statutes to contemplate individual liability, eliminating the need to rely on veil-piercing behavior.[84] In the landmark *United States v. Bestfoods* decision, the Supreme Court held that "in order to abrogate a common-law principle

> formulating their arguments . . . . Rational ignorance may apply in either case, but so may deliberate strategy as clever attorneys utilize the precedents most favorable to their clients' positions. In short, deviations between agency-specific precedents and general administrative law norms likely arise from many sources and develop in multiple ways.

*Id.*

83. *See, e.g.*, *In re* Capitol Hill Healthcare Grp., 242 B.R. 199, 203 (Bankr. D.D.C. 1999) ("Treating a corporation as the alter ego of another entity is the same thing as piercing the corporate veil: it comes down to disregarding the corporation's separate existence.").

84. *See, e.g.*, *In re* FRM Chem, Inc., No. FIFRA-07-2008-0035, 2010 WL 2470252, at *10 (EPA May 27, 2010) ("It is clear that individual corporate officers and shareholders may properly be charged with individual FIFRA liability. . . ."); *In re* Frank Acierno Christiana Town Ctr., LLC, No. CWA-03-2005-0376, 2006 WL 3361629, at *12 (EPA June 2006) (concluding that "it is unnecessary to 'pierce the corporate veil'" to hold an individual liable when the facts lead to individual liability); *In re* Coast Wood Preserving, Inc., 2003 WL 21213226, at *2 (EAB 2003) (refusing to superimpose a veil-piercing analysis onto clear statutory aggregation policies under the Emergency Planning and Community Right to Know Act, 42 U.S.C. § 11023 (2012)); Bannistor v. Ullman, 287 F.3d 394, 407–08 (5th Cir. 2002) (finding bankruptcy court's independent analysis of individual appellants "unnecessary" due to statutory definitions under the Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974)); McDowell v. Krawchison, 125 F.3d 954, 963 n.11 (6th Cir. 1997) ("Because we hold that Krawchison was directly liable as the plan administrator . . . we need not address the district court's veil-piercing analysis."); Monieson v. CFTC, 996 F.2d 852, 859 (7th Cir. 1993) (refusing to limit § 13(b) of the Commodity Exchange Act to the "alter ego situation" because Congress "would have been more specific" if it wanted to limit the statute); Pupillo v. United States, 755 F.2d 638, 643 (8th Cir. 1985) (holding that the piercing analysis was not warranted, in part due to the per se liability under the Perishable Agricultural Commodities Act (PACA), 7 U.S.C. § 499a(b)(9) (2012)). *But see* Quinn v. Butz, 510 F.2d 743, 759 (D.C. Cir. 1975) (piercing the corporate veil despite statutory definitions and text because "nothing in the legislative history . . . suggests that the Secretary [of Agriculture] is powerless . . . to apply a doctrine commonplace in judicial decision-making . . . . Section (1)(9) [of PACA] is not so all-inclusive . . . as to negate the normal function of administrative interpretation of its terminology.").

[veil-piercing], the statute must speak directly to the question addressed by the common law."[85] This opinion reinforced the protections of the corporate form, but also established "an equally important proposition, that Congress may legislate direct accountability for persons involved in an enterprise."[86]

Absent individual liability provisions in the governing statute, an agency may also mirror piercing the veil by categorizing its behavior under alternate theories. Under this approach, an agency can re-classify an action that would otherwise be called veil-piercing, creating a fiction of terminology just to avoid the doctrine's restraints. For example, in the FCC's declaratory ruling that led to the ICO Global Communications, Ltd. (ICO) litigation, the Commission insisted that they were evaluating "enterprise liability" instead of piercing the veil when they considered attaching liability to a parent entity.[87] Perhaps under certain factual scenarios, a valid distinction exists between veil-piercing to find an individual parent liable (our traditional understanding of piercing the corporate veil) and enterprise liability for a parent's own participation in a corporate enterprise. However, the FCC's "enterprise liability" analysis in ICO is in effect no different than veil-piercing; liability was attached to the parent *only* when its subsidiary was unable to pay debts and filed for bankruptcy protection.[88] Beyond the FCC's conclusory assertion that enterprise liability is a different doctrine, no evidence supports a distinction from traditional veil-piercing as applied in ICO. An agency that re-classifies its veil-piercing actions should be subject to the same limitations on veil-piercing discussed in Part IV of this Article, so it is worthwhile to bring attention to this additional layer of shapeshifting behavior.[89]

85. 524 U.S. 51, 63 (1998) (quoting United States v. Texas, 507 U.S. 529, 534 (1993)).

86. *Coast Wood Preserving*, 2003 WL 21213226, at *12.

87. *In re* Improving Pub. Safety Commc'ns in the 800 MHZ Band, 25 F.C.C. Rcd. 13,874, 13,892, 13,889 (FCC Sept. 29, 2010).

> Although the presence of the factors supporting veil piercing or an alter ego finding can also be relevant to determining enterprise liability, enterprise liability does *not* seek to make a parent corporation liable for the actions of its subsidiary, but rather recognizes in appropriate cases that the parent is liable for its *own* actions as part of the overall enterprise that it has created and operated.

*Id.* at 13,889 (first emphasis added).

88. *Id.* at 13, 889, 13,891–92.

89. Because agency behavior that mirrors veil-piercing is challenging to identify, such behavior is even more difficult to stop. It is possible that the additional checks on veil-piercing agency behavior for which I advocate in Part IV of this Article will encourage agencies to turn instead to informal veil-piercing. Though a solution designed for informal veil-piercing is beyond the scope of this Article, I nonetheless suspect that the same solutions can apply once bankruptcy courts, litigants, and Congress are aware of the risk that such shapeshifting can pose.

So long as agencies have uncertain guidance as to the appropriate veil-piercing analysis, they have the opportunity to develop standards selectively that most effectuate their unique incentives. Because the field is fundamentally mired, it seems unlikely that a reviewing court would evaluate and reject an inequitable variation of the veil-piercing analysis. This uncertainty is especially relevant in bankruptcy cases where the stakes are high. When agencies utilize their own flavor of veil-piercing to shapeshift away from creditor status, it threatens an estate's value along with the integrity of the bankruptcy process. The next Section categorizes patterns of agency veil-piercing behavior to highlight the area of greatest threat.

### *2. Agency Piercing Patterns*

The pattern of veil-piercing in administrative agencies can be distilled down to a structure of objectives within the enforcement context. By evaluating each agency's underlying purpose for piercing the corporate veil, three distinct categories emerge to serve as the basis for discussing the need to modify statutory provisions and deference standards.

First, agencies look beyond the corporate form in a number of cases in the interest of public safety or to comply with the agency's policy directives. For example, in one case involving the Federal Mine Safety and Health Review Commission (FMSHRC), the veil of a corporation was pierced to attach penalties and additional scrutiny to a responsible individual.[90] The regulations were designed to encourage safe mining environments, and evidence indicated that the corporation's owners had fabricated their insolvency to evade regulatory fines and obligations; they were already operating other mines with similarly-dangerous practices.[91] The FMSHRC held that preserving the corporate veil "would merely further a scheme to circumvent effective enforcement of the Mine Safety Law."[92] Similarly, the U.S. Department of Agriculture found that veil-piercing was necessary to prevent an individual from violating the Packers and Stockyards Act[93] in a subsequent livestock business, especially after the first entity was dissolved.[94] The National Oceanic and Atmospheric Administration pierced the

90. Sec'y of Labor v. NBC Energy, Inc., 4 FMSHRC 1860, 1872, 1982 WL 176154, at *4–5 (Oct. 22, 1982) ("Indeed, the fiction of a corporate entity *must* be disregarded whenever it has been adopted or used to defeat a paramount public policy such as that designed for protection of a vital national resource—the nation's miners.").

91. *Id.* at 1870–73.

92. *Id.* at 1871.

93. 7 U.S.C. §§ 181–229c (2012).

94. *In re* Trenton Livestock, Inc., 41 Agric. Dec. 1965, 1976, 1982 WL 37604, at *9–10 (USDA Oct. 27, 1982).

corporate veil by combining an individual's previous violations with their subsequent corporation, all to deter corporations from hiring people who have violated the Magnuson Fishery Conservation and Management Act.[95] Similarly, the Department of Transportation looked behind the veil to prevent continued evasion of Public Charter regulations.[96] Agencies also pierce the corporate veil as a prerequisite to granting or revoking licenses, looking to the full set of circumstances surrounding an applicant so as not to frustrate the policy behind such regulation.[97] In all cases of this kind, including those explicitly discussed herein, agencies used veil-piercing to protect the public and effectuate the purposes of their regulatory authority.

The second category of veil-piercing behavior involves restoring the state of the world to a financial status quo. In such situations, the corporation generally failed to meet some form of financial regulatory obligation, and in an administrative proceeding the agency seeks to hold an individual[98] liable for restitution.[99] In labor cases, the National Labor Relations Board often

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95. 16 U.S.C. §§ 1801–84 (2012); *In re* Tampico, Inc., 7 O.R.W. 232, 236 n.2 (NOAA July 9, 1993) ("Assessing penalties in this way, while apparently harsh, creates the proper incentives for hiring within the industry: fishing companies are discouraged from having directors who have previous fishery violations and captains [are] discouraged from committing violations because the penalty assessed will reflect the corporation's second violation, not his first."); *see also In re* Atl. Spray Corp., No. NE950010FM/V, 1997 WL 1402870, at *27–28 (NOAA Apr. 2, 1997) (recognizing the "substantial impact" of severe penalties on the individual parties imposed through veil-piercing, but finding them "most appropriate").

96. 14 C.F.R. pt. 380 (2015); *see* Robert O. Nay, No. 45663, 1991 WL 247769, at *9 (DOT Nov. 18, 1991) ("The companies were created for the sole purpose of avoiding the regulations concerning the operation of such charters and that disregarding the asserted corporate identities in this case is necessary to prevent injustice through subversion of the regulatory system for charter operations.").

97. *See, e.g.*, Capital Tel. Co. v. FCC, 498 F.2d 734, 737–39 (D.C. Cir. 1974) (combining the individual and corporation for one radio frequency license application); S.O.U.P., Inc. v. FTC, 449 F.2d 1142, 1142 (D.C. Cir. 1971) (piercing the veil to determine whether it was reasonable to waive the corporation's filing fees *in forma pauperis*); Mansfield Journal Co. v. FCC, 180 F.2d 28, 37 (D.C. Cir. 1950) (piercing the veil to deny separate applications for radio station licenses because the entities were controlled by one family).

98. Though the focus of this Section is primarily directed at the pattern of piercing to affix individual liability, a significant portion of veil cases involve parent-subsidiary combinations where liability or obligations are attached to a corporate parent. *See* Easterbrook & Fischel, *supra* note 65, at 110.

99. Repayment via veil-piercing is also encouraged by Article III courts, perhaps because in such situations the public at large was harmed, not merely a government agency or regulated corporation. *See, e.g.*, Carpenters & Millwrights, Local Union 2471 v. NLRB, 481 F.3d 804, 813 (D.C. Cir. 2007) (vacating the NLRB's initial decision not to pierce the corporate veil against individuals to collect money for a back pay order issued against the "by-then defunct company" and remanding for further proceedings—which, unsurprisingly, resulted in veil-piercing).

pierces the corporate veil to remedy back pay obligations that would likely not be satisfied by the remaining corporate assets.[100] In another example of "status quo" veil-piercing, the Federal Energy Regulatory Commission looks to individuals to collect overcharges on crude oil in violation of antilayering regulations.[101] Status quo piercing results in financial payments, yet the money does not merely go to the agency—the funds may be passed through to restore the injured party to the position they were entitled to under federal law.

A third category of cases involves piercing the corporate veil to affix penalties against a corporation to individuals, independent of an established statutory purpose for such liability. Penalty piercing can be done by the agency itself in an enforcement proceeding,[102] or alternatively by a regulated party who is given authority to bring an individual action under the agency's statutory grant.[103] The latter situation is not without potential concerns, as the agency is approving veil-piercing in a case between two private, albeit regulated, parties.[104] In such a case, the agency could be considered a "proxy" for purposes of veil-piercing, particularly if credence is given to the concept of agency capture.[105] The agency can preference or

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100. *See, e.g.*, NLRB v. Bolivar-Tees, Inc., 551 F.3d 722, 731, 733 (8th Cir. 2008) ("Substantial evidence exists to support a finding that adherence to the corporate fiction would sanction a fraud and lead to the evasion of a legal obligation."); Domsey Trading Corp., No. 29-CA-14548, 2011 WL 5868411 (NLRB Feb. 14, 2011) ("To state the obvious, this category of cases would not be litigated if the corporate entity or entities that had incurred liabilities could pay the debts. It is only when the coffers are empty that one begins to look elsewhere for payment."); Rome Elec. Sys., Inc., 356 N.L.R.B. No. 38, at 178 (Nov. 24, 2010) (approving back pay obligations by individual respondent through veil-piercing analysis).

101. *See* Pel-Star Energy, Inc. v. DOE, 890 F. Supp. 532, 543–44 (W.D. La. 1995) (reversing veil-piercing due to improper analysis of the facts but reaffirming the validity of overlooking the corporate form and determining the proper standard for the FERC).

102. *See* Ariel Mar. Grp., Inc., No. 84–38, 1987 WL 209051, at *18 (FMC Sept. 24, 1987) (holding an individual "jointly and severally liable for all of the civil penalties assessed against the corporate respondents").

103. MCI Telecomms. Corp. v. O'Brien Mktg., Inc., 913 F. Supp. 1536, 1543–44 (S.D. Fla. 1995) (allowing a regulated party to pierce the corporate veil to collect unpaid charges for interstate telecommunication services against alter ego of defendant corporation).

104. *See infra* notes 115–118 (discussing agency jurisdiction over public, rather than private, rights).

105. Mark C. Niles, *On the Hijacking of Agencies (and Airplanes): The Federal Aviation Administration, "Agency Capture," and Airline Security*, 10 AM. U. J. GENDER, SOC. POL'Y & L. 381, 390 (2002).

> The phenomenon of capture has been variously defined, but proponents of the theory have generally observed that capture occurs when a regulated entity . . . succeed[s], through lobbying or other influential devices, in replacing what would otherwise be the public-policy agenda of the agency with its own private and self-serving agenda.

support one regulated party's interest to collect maximum funds, allowing that party to unduly influence what should otherwise be a neutral proceeding.

I suggest the greater risk lies where an agency itself pierces the corporate veil. In that instance an administrative agency can point to regulatory motives from its statutory scheme to support piercing the corporate veil and affixing liability onto an individual, even if the agency has other (self-interested) motivations for its actions. This becomes even more problematic when the corporation is insolvent, because the integrity of the bankruptcy system is at stake. In that circumstance, the agency can look to veil-piercing to avoid its creditor status under the Code and collect its debts in administrative proceedings. To be sure, in many instances the parties that stand behind corporations have individual culpability;[106] however, "outrage at [this] conduct should not obscure the boundaries of settled legal categories."[107] It does not follow that the culpable individual should be held fully liable, merely because an agency is unable to collect from an insolvent corporation—"A corporation's inability to pay its debt alone is not sufficient to support a finding of injustice."[108] Though it is possible that the veil-piercing in such a hypothetical could be valid, I suggest that the agency's incentives are tainted by the opportunity to act in self-interest to maximize collection. Furthermore, any money that is collected through veil-piercing against the culpable individual behind a bankrupt corporation should supplement the estate, not an individual creditor.[109]

The distinction between category one and category three enforcement veil-piercing can be easily blurred. While individual liability may be critical to protect and effectuate a statutory purpose, agencies appear to invoke their regulatory needs in cases in which no such need appears. In one

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> In other words, when a regulated entity succeeds at winning "the hearts and minds of the regulators," regulation becomes "a method of subsidizing private interests at the expense of the public good."

*Id.*

106. For example, the sole shareholder in *Telseven* was likely not an innocent victim. Yet, once agencies show a willingness to evade their creditor status it is important to assume the same behavior could be applied to less egregious facts.

107. Domsey Trading Corp., No. 29-CA-14548, 357 NLRB No. 180, 2011 WL 7080654, at *7 (Dec. 30, 2011) (Hayes, Memb., dissenting) (quoting Chambers v. NASCO, Inc., 501 U.S. 32, 60–61 (1991) (Kennedy, J., dissenting)).

108. NLRB v. Bolivar-Trees, Inc., 551 F.3d 722, 729 (8th Cir. 2008) (citing NLRB v. Greater Kan. City Roofing, 2 F.3d 1047, 1052–53 (10th Cir. 1993)).

109. *See In re* Mass, 178 B.R. 626, 631 (Bankr. M.D. Pa. 1995) (ordering the turnover of assets which were granted to a creditor via veil-piercing in a parallel proceeding, and noting that its order pulling back the individual creditor's award "serves public policy by placing all the assets in the same pot and all creditors on equal footing").

example, the FCC pierced the corporate veil to affix significant penalties against an individual owner of a bankrupt (and defunct) corporation, even though the owner had no continuing involvement with the agency.[110] In *In re Telseven, LLC*, the FCC attached approximately $1.75 million in penalties against the sole owner and shareholder of a corporation because he "apparently solely owns, controls, and manages Telseven . . . ."[111] The Commission relied upon previous FCC precedent that governed licensing procedures.[112] However, unlike category one veil-piercing procedures that focus on determining whether a regulated party poses an ongoing safety threat or deserves a benefit, here, the Commission ignored the corporate form to have a better chance to collect its debt. Implicitly acknowledging the fact that veil-piercing was unnecessary, the Commission noted the availability of individual liability under 47 U.S.C. § 503(b)(1).[113] However, the Commission did not assign individual liability. There is no evidence in the record that the individual did anything in violation of the Communications Act. The FCC also required that, under § 1.80 of the Commission's rules, the full amount of the proposed forfeitures must be paid within thirty days, not mentioning the potential that collection of such debt would be subject to the pending bankruptcy case.[114]

In a subsequent Notice of Apparent Liability order, the FCC again pierced the veil to affix another $1.7 million in enforcement penalties against the individual owner.[115] The Commission noted that veil-piercing can be done "even when the strict standards of common law alter ego would not apply,"[116] citing a list of cases where the Commission previously looked through the corporate veil.[117] Notably, each of the cited cases involved either category one or two veil-piercing situations, protecting the

110. *In re* Telseven, LLC, 27 F.C.C. Rcd. 6636, 6649 (June 14, 2012). The FCC applied its own version of the veil-piercing test:

> The Commission may "pierce the corporate veil" and hold one entity or individual liable for the acts or omissions of a different, related entity when: (1) there is a common identity of officers, directors or shareholders; (2) there is common control between the entities; and (3) it is necessary to preserve the integrity of the Communications Act and to prevent the entities from defeating the purpose and provisions of statutory provisions.

*Id.*

111. *Id.* at 6650.

112. *See id.* at 6649–50.

113. *Id.* at 6650.

114. *Id.* at 6651; *see generally* Voluntary Petition for Bankruptcy, *In re* Telseven, LLC, No. 3:12-bk-2682-PMG (Bankr. M.D. Fl. Apr. 20, 2012).

115. *In re* Telseven, LLC, 27 F.C.C. Rcd. 15,558, 15,570 (Nov. 30, 2012).

116. *Id.* at 15,571

117. *Id.* at 15,571 n.101.

public or restoring status quo through statutory directives.[118] Though the *Telseven* court mentioned the need to fulfill the statute, it never connects its quest for individual liability to any statutory purpose. Without a clear connection, such veil-piercing merely to avoid the automatic stay and maximize the opportunity to collect is in significant tension with the original design of regulatory agencies, not to mention the purposes of the Code. Furthermore, the FCC's lax veil-piercing standard requires only some degree of unity that any small corporation would have with its owner, including a "statutory purpose" factor that could stretch to reach most situations, which provided no additional guidance in *Telseven*.

Faced with concerning agency behavior, litigants could challenge category three veil-piercing by questioning the agency's authority to act. Congress grants the scope of jurisdiction in the agency's organic act.[119] Statutory language can drastically shape the power of an agency through specific provisions,[120] yet often the *absence* of explicit limits can also be the source of authority.[121] Administrative agencies have jurisdiction to hear cases that would otherwise be subject to exclusive jurisdiction in Article III federal courts under a number of theories, including the idea that they may decide cases involving so-called "public rights."[122] Some opinions have dismissed the public-private distinction when faced with a challenge to

118. *See id.* (discussing regulatory veil-piercing cases looking to award licenses and apportion quotas, not affix penalties).

119. *See* Thomas W. Merrill, *Rethinking Article I, Section 1: From Nondelegation to Exclusive Delegation*, 104 COLUM. L. REV. 2097, 2169 (2004).

> Under the exclusive delegation interpretation of Article I, Section 1, agencies generally should be denied authority to act with the force of law unless Congress has delegated such power to them. This entails two subsidiary inquiries: (1) Has Congress delegated legislative power to the agency? and (2) What is the scope of this delegation? The first is a question of agency power; the second is a question of agency jurisdiction.

*Id.* at 2169.

120. *See, e.g.*, Rapaport v. U.S. Dep't. of Treasury, 59 F.3d 212, 220 (D.C. Cir. 1995) (rejecting the agency's enforcement action in an administrative proceeding "where the safeguards and standards appurtenant to Article III courts apply" because Congress "simply made their remedy of choice . . . a suit in district court under 12 U.S.C. § 93 [(2012)];" to interpret 12 U.S.C. § 1818 otherwise "is in effect an unlimited reading of a statute upon which the Congress intended to place a limit").

121. *See* Nathan Alexander Sales & Jonathan H. Adler, *The Rest is Silence:* Chevron *Deference, Agency Jurisdiction, and Statutory Silences*, 2009 U. ILL. L. REV. 1497, 1505–07 (2009) (examining the challenges posed by evaluating agency jurisdiction).

122. For a description of the line of cases that develop the "public rights" theory, *see* Granfinanciera v. Nordberg, 492 U.S. 33, 65–71 (1989) (Scalia, J., concurring); *see also* Thomas W. Merrill, *Article III, Agency Adjudication, and the Origins of the Appellate Review Model of Administrative Law*, 111 COLUM. L. REV. 939, 981–87 (2011) (discussing the adjunct and public right theories of authority).

agency jurisdiction in individual penalty enforcement cases.[123] Even assuming the distinction applies, agency jurisdiction should not extend to category three veil-piercing because agencies are acting ultra vires, or beyond their authority—thus, not involving a public right.[124] However, if courts continue to interpret the public rights doctrine broadly or if the concept of ancillary jurisdiction extends to enforcement action,[125] the challenge to agency jurisdiction may fail and Article III courts currently have little choice but to extend established principles of deference when evaluating appeals of agency actions.

The act of administrative veil-piercing is well established and generally correlates with one of three basic objectives. I suggest that the first two objectives, returning to the status quo and preventing or remedying a public policy risk that the agency was tasked to regulate, are unproblematic uses of the veil-piercing doctrine. In each of these categories the agency is acting in the interest of the public to remedy or prevent harm in line with its statutory directive, and therefore there is no urgent need to deviate from the established administrative deference system. In contrast, the third category of veil-piercing objectives merits additional scrutiny. Actions designed to penalize corporations and, subsequently, the individuals behind the corporate veil, should not be automatically extended in any context. Though enforcement penalties serve a deterrent purpose, the pressing need for affixing and collecting penalties against individuals does not always serve that same purpose.

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123. *See, e.g.*, Pel-Star Energy, Inc., 52 FERC P 63,006, 65014–15 (FERC July 26, 1990).

124. This is similar to the argument against extending established deference standards to agencies acting for their own financial benefit—and arguably no longer for their public policy statutory purpose.

125. One possible counterpoint to this argument is that an agency's so-called "ancillary jurisdiction" can extend to this very circumstance because individual enforcement proceedings are closely related to other agency actions. FLEMING JAMES, JR. & GEOFFREY C. HAZARD, JR., CIVIL PROCEDURE § 2.7, at 61–62 (3d ed. 1985).

> The concept of ancillary jurisdiction is that the federal court, having jurisdiction of the action between the original parties, may hear and determine claims between those parties and other parties when the other claims are closely related to those already before the court. The concept is the product of decisional law rather than statute . . . .

*Id.* Ancillary jurisdiction remains a nebulous concept in the relevant literature, most often focusing on expanding jurisdiction to subject areas not explicitly contemplated in the organic statute. *See, e.g.*, James B. Speta, *The Shaky Foundations of the Regulated Internet*, 8 J. ON TELECOMM. & HIGH TECH. L. 101, 110–11 (2010) (outlining the plausible extension of FCC jurisdiction to regulate the Internet, which is not affirmatively discussed in the Federal Communications Act). It remains unclear whether the concept of ancillary jurisdiction can additionally extend to agency action beyond regulation (namely, adjudication and enforcement), and if so, whether that action contemplates use of corporate law principles to avoid creditor classification.

If the facts of a situation indicate that passing penalties onto an individual is critical to prevent that individual from circumventing a statutory directive, then use of the corporate veil doctrine aligns with the accepted cases above. However, if veil-piercing behavior serves a different purpose, such as when used to maximize collection in bankruptcy proceedings, then greater scrutiny should attach. In such a situation, the agency shapeshifts away from its creditor status under the guise of protected statutory grants. The bankruptcy process is delicately balanced to protect creditors from inappropriate access to estate funds. When an agency has a penalty claim against a corporation, they should not be permitted to concurrently pierce the veil to affix liability to a solvent individual. To better provide a check on the dual identity of administrative agencies in this scenario, Congress should prohibit such behavior and courts reviewing these veil-piercing transactions should not afford the same degree of deference.[126]

### *B. Shapeshifting Between Creditor and Regulator: the* Second Thursday *Problem*

Although the Supreme Court in *NextWave* held that an agency cannot cancel a debtor's license solely due to nonpayment,[127] PCS licenses may still be transferred if a debtor corporation is liquidating or is no longer a qualified licensee. The bankruptcy court is not authorized to transfer licenses unilaterally to a new entity upon reorganization because only the agency can qualify entities and subsequently award qualified entities licenses.[128] With that limitation in mind, imagine an administrative agency with statutory control over the transfer of assets from a bankrupt estate, selecting between two prospective bidders. The policy incentives justifying such control—namely the agency's interest in determining who is the best party to use certain regulated assets, such as spectrum licenses governed by the FCC—are accepted and established by courts and legislators alike.[129]

Now imagine that the same administrative agency is additionally an unsecured creditor in the bankruptcy case. The incentives that allow the agency to stand in judgment of asset distribution are significantly weakened when the agency's decision can impact collection of its own debts. Rather, under these facts the competing bankruptcy interest of maximizing the estate value and distributing the assets in an equitable fashion are at a greater risk of self-interested regulatory action. "When the government

126. *See infra* Part IV.B (arguing the same).

127. *See* FCC v. NextWave Pers. Commc'ns Inc., 537 U.S. 293 (2003).

128. *See* 47 U.S.C. § 310(d) (2012).

129. *See, e.g.*, Nat'l Broad. Co. v. United States, 319 U.S. 190, 215–17 (1943) (confirming the integral role of the FCC to manage public access to radio technology).

wears two hats . . . of regulator and creditor, courts have had to determine which hat the government is wearing in connection with the conduct at issue."[130] It is difficult to accurately weigh the regulator-creditor distinction when agency shapeshifting is based on an established doctrinal authority.

As a general matter of public policy, the FCC does not allow a licensee that exhibits ongoing qualification problems to directly assign its licenses.[131] Instead, the licenses are usually returned to the agency's control and assigned after administrative hearings. Through the "*Second Thursday* doctrine,"[132] the Commission has identified a "limit[ed] exception . . . in the case of licensees in bankruptcy or receivership" in which the FCC approves the transfer of licenses without the standard process if it is "convinced that the alleged wrongdoers will derive no benefit, either direct or indirect, from the sale, or will derive only minor benefit which is outweighed by the equities in favor of innocent creditors."[133] The FCC makes *Second Thursday* determinations through an "ad-hoc balancing" test, weighing the erosion of regulatory authority caused by benefitting the wrongdoer against the public interest benefit conferred onto innocent creditors who are able to recover from the sale.[134]

The *Second Thursday* doctrine involves a careful partnership between bankruptcy courts that manage the debtor's estate and the FCC, which is responsible for protecting its regulatory goals. It is intended to "protect innocent creditors and to accommodate the policies of federal bankruptcy law with those of the Communications Act."[135] Recognized benefits of the *Second Thursday* doctrine include preventing "loss of service to the public" and preserving administrative resources that would otherwise be spent evaluating license applications.[136] Assumption of risk is also commonly

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130. *See In re* Kan. Pers. Commc'n Servs., Ltd., 252 B.R. 179, 191 (Bankr. D. Kan. 2000); *In re* Kan. Pers. Comm'ns Servs., Ltd., 56 F. App'x 910 (10th Cir. 2003).

131. *In re* Eddie Floyd, 26 F.C.C. Rcd. 5993, 5994 (2011). This policy recognizes that "permitting a licensee to evade the consequences of alleged or adjudicated misconduct by transferring his interest or assigning his license will diminish the deterrent effect that revocation or renewal proceedings should have on broadcast licensees." *In re* Family Broadcasting, Inc. Order to Show Cause, 25 F.C.C. Rcd. 7591, 7596 (June 4, 2010).

132. *In re* Application of Second Thursday Corp., 22 F.C.C. 2d 515, 516 (1970), *reconsideration granted*, 25 F.C.C. 2d 112 (1970).

133. *In re* Application of Mid-State Broad. Co., 61 F.C.C. 2d 196, 197 (1976).

134. LaRose v. FCC, 494 F.2d 1145, 1149 (D.C. Cir. 1974).

135. Third Amended Disclosure Statement, *In re* Mar. Commc'ns/Land Mobile, LLC, No. 11BK13463, 2012 WL 5380513, at *32 (Bankr. N.D. Miss. Sept. 25, 2012) (citing *LaRose*, 494 F.2d at 1149). *But see* FCC v. NextWave Pers. Commc'ns Inc., 537 U.S. 293, 294 (2003) ("The fact that the FCC had a valid regulatory motive for its action is irrelevant.").

136. *See Family Broad.*, 25 F.C.C. Rcd. 7591, 7599 (2010); *see also Mar. Commc'ns*, 2012 WL 5380513, at *33 ("There are also important public interest benefits that will flow from

discussed in *Second Thursday* cases. The Commission weighs the interests of the creditor, but ultimately recognizes that remedying the inherent risk in broadcast investing (not to mention the general risk of becoming a creditor) should not fall to the FCC.[137]

Once the bankruptcy judge determines that the debtor's licenses should be sold, the transfer is always "subject to FCC approval."[138] The FCC generally will not determine whether the *Second Thursday* doctrine applies before the bankruptcy court has approved the proposed transaction.[139] Bankruptcy courts are careful to respect the regulatory jurisdiction of the FCC,[140] and the Agency's exclusive power to grant licenses provides an opportunity for manipulation when the Agency is also a creditor. For example, the Agency could strategically reject a bidder's proposed transfer and informally "suggest" that the bidder's plan or asset sale be modified to further compensate or provide guarantees to certain classes of creditors (which include the Agency). While such explicit tactics at first blush seem farfetched, they become more plausible upon consideration of the fact that bankruptcy plan formation may often involve a high degree of negotiation and gamesmanship.[141] In the interest of promoting settlement or agreement, some bankruptcy courts prefer to stay out of the fray and let the parties negotiate desirable terms at arm's length.[142] An agency's "negotiation tactics" to secure license approval is in many ways similar to the plan formation process. Because plan proponents and bidders are willing and able to adjust their offers to increase their chances, undue influence by shapeshifting agencies through *Second Thursday* approvals is a plausible concern.

In the *Maritime Communications/Land Mobile, LLC* (*MCLM*) bankruptcy, the

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the already-assumed and court approved sales to critical infrastructure entities.").

137. *See Mid-State Broad.*, 61 F.C.C. 2d at 200 ("Any supplier of financial support, goods, or services to a broadcast licensee assumes a certain amount of risk, as do all creditors in all situations . . . [but the FCC is] not required to eliminate it totally.").

138. Order, *In re* Mar. Commc'ns/Land Mobile, LLC, No. 11-13463-DWH, 2012 WL 6215456, at *5 (Bankr. N.D. Miss. Dec. 7, 2012).

139. Third Amended Disclosure Statement, *Mar. Commc'ns*, 2012 WL 5380513, at 32 (requiring a creditor not to "[have] knowledge of, nor [be] involved in, the alleged wrongdoing").

140. Order, *Mar. Commc'ns*, 2012 WL 6215456, at *2 ("The Court is not attempting through this Order, or otherwise, to superimpose its rulings or judgments upon the FCC . . . .").

141. For a general discussion of the role of gamesmanship in the context of bankruptcy sales, including the permissive patterns of bankruptcy courts, see Matthew A. Bruckner, *Improving Bankruptcy Sales by Raising the Bar: Imposing a Preliminary Injunction Standard For Objections to § 363 Sales*, 62 CATH. U. L. REV. 1, 27–30 (2012).

142. *Id.*

FCC was asked to apply the *Second Thursday* doctrine to approve license transfers to one of two bidders.[143] However, unlike other *Second Thursday* cases, in *MCLM* the FCC was also an unsecured creditor with a claim of more than $6 million.[144] Two bidders submitted offers: one bidder proposed to pay unsecured creditors (including the FCC) the "full amount" of their claims only after all other creditors "have received the full amounts of their Claims . . . and assuming there is sufficient revenue";[145] and the other bidder guaranteed an immediate distribution of $1 million with subsequent payment of the remaining full amount. Notwithstanding the bankruptcy court's ultimate determination, the facts of the *MCLM* case constitute a quintessentially problematic shapeshifting scenario.

Imagine a situation in which the FCC, dissatisfied with the existing plan options, refuses to grant the license to either bidder. The bankruptcy court already acknowledged that "if the FCC does not approve the *Second Thursday* plan as presented, [the debtor] will endeavor to modify the plan as necessary to address the agency's concerns."[146] Confronted with the possibility of a *Second Thursday* rejection, the debtor would have to scramble to find another bidder to address agency "concerns." While the doctrine likely contemplates the concerns of the ability of the new licensee to adequately carry out the statutory purpose, one can imagine an agency with unsecured creditor status raising additional, self-interested concerns such as adequate assurance that creditors' claims will be satisfied or automatic pay-outs to certain classes.

This hypothetical is also in tension with the Supreme Court's decision in *NextWave*. Arguably, if a debtor-licensee decides to transfer a license that is subject to *Second Thursday* approval, it has some connection to the protections of § 525. Though the FCC is not directly revoking a license as in *NextWave*, refusing a sale effectuates the same agency interference with the restructuring process. The agency is not authorized to make regulatory decisions that are, or could be, based on their consequences to individual creditors.

The *Second Thursday* doctrine is enmeshed in the FCC's regulatory doctrine, so it may appear at first glance that the shapeshifting concern is limited to a single statutory arena. However, it is altogether plausible that other agencies can create parallel doctrines, particularly when a particular asset of a bankrupt estate is subject to regulatory approval. Without

143. Third Amended Disclosure Statement, *In re* Mar. Commc'ns/Land Mobile, LLC, 2012 WL 5380513, at *19 (Bankr. N.D. Miss. Sept. 25, 2012) ("Feasibility [of the Plan] depends upon, among other things, a successful '*Second Thursday*' approval by the [FCC].").

144. *Id.* at *17.

145. *Id.* at *26.

146. *Id.* at *34 (italics added).

independent oversight, there is no check on an agency using its regulatory authority to hold the bankruptcy process hostage until its unsecured claims are adequately compensated. In some instances, the agency's desire to maximize its recovery will correspond with the interests of the estate, other creditors, and even the bankruptcy court. Yet, the fictional parallel breaks down upon consideration of ways in which their interests diverge. The shapeshifting agency in *Second Thursday* situations will work to maximize value to its specific claim, normally a general unsecured claim under § 507 of the Code. Bidders who act to please the agency may maximize recovery to certain classes of creditors at the expense of others. The agency may grant licenses to a bidder's plan that would not be the highest or otherwise best in the eyes of the debtor. Finally, the delay and hassle caused by an agency's manipulation may deter robust bidding, which would result in fewer options for debtors and courts to restructure an insolvent corporation.

A purely textual argument might provide one solution to the *Second Thursday* shapeshifting problem. Under the test, the FCC evaluates the "equities . . . in favor of innocent creditors."[147] This "innocent creditor" language at first blush relates to the underlying concerns with the distressed licenses, namely that they will be sufficiently utilized to satisfy creditors.[148] However, the same language could also be read to require the compensated creditors to be disinterested in the proceeding. Here, the FCC is not an "innocent" creditor, as it stands in judgment of the existing licensee and the future bidders. Ironically, under this construction the FCC's dual creditor-regulator status could be prohibited by the very same *Second Thursday* text it invokes to shapeshift. This interpretation has not been cited in the literature, and it seems most likely that adoption of a strict impartial creditor requirement would face resistance by the FCC. This interpretation may face similar backlash from litigants and bankruptcy courts, particularly in light of the pragmatic and precedential momentum that supports swift license approval under *Second Thursday*.

## III. USING THE PRINCIPAL–AGENT FRAMEWORK TO HIGHLIGHT INADEQUACY IN EXISTING CHECKS AND BALANCES

In a vacuum, the two patterns of shapeshifting agency behavior described above—piercing the corporate veil and the *Second Thursday* doctrine—pose grave threats to the equitable distribution of assets in a bankruptcy case. Fundamental notions of fairness dictate that, unless the action satisfies a regulatory purpose, an agency should not be permitted to

147. *In re* Application of Second Thursday Corp., 22 F.C.C. 2d 515, 518 (1970).

148. Third Amended Disclosure Statement, *Mar. Commc'ns*, 2012 WL 5380513, at *32.

maneuver its litigation status through procedural devices that are unavailable to other similarly-situated creditors. Simply put, when a regulatory body interacts with the bankruptcy process as creditor or other interested party, the extra trappings and protections that accompany agency status must fall away. The need to prevent agency shapeshifting behavior is even more pressing when considered in the context of the government's existing system of checks and balances. Traditional notions of separation of powers provide a web of protection against too much power accumulating in any branch of government, each operating to prevent abuse within a delegated area of control. The political checks on administrative agencies, typically categorized as acting through the executive branch,[149] are often attributed to the voting public (by way of replacing the executive officials that appoint agency heads), the legislature (through increased or modified statutory grants of authority), and the judiciary (providing judicial review of agency actions). Yet, shapeshifting behavior is ongoing, even with existing preventative checks.

### *A. Agency Relationships and Administrative Law*

This Section highlights the insufficiency of existing checks by applying a principal–agent framework to instances of shapeshifting agency behavior. A principal–agent connection is "the fiduciary relationship that arises when one person (a 'principal') manifests assent to another person (an 'agent') that the agent shall act on the principal's behalf and subject to the principal's control, and the agent manifests or otherwise consents so to act."[150] Agents are authorized to make choices for the principal, yet their actions must be reasonably related to the principal's intended grant of authority.[151] The principal–agent structure is useful for delegating tasks to trusted actors, allowing the principal to efficiently accomplish goals that are best done by others, either because of logistical constraints or the agent's superior expertise.[152] Principals create procedures and guidelines for agent behavior, defining a "discretionary window"—the agent's allowable realm

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149. *But see* Niles, *supra* note 105, at 385 (internal quotation marks omitted) ("Independent administrative agencies (independent because they are intentionally structured to function outside the direct control of the Executive Branch) have been created to assist Congress, and even at times the Judiciary, in performing their required functions.").

150. RESTATEMENT (THIRD) OF AGENCY § 1.01 (2006).

151. *Id.* § 2.01.

152. A universal assumption of the principal–agent model in public law is the ally principle: "Voters, legislators, or other principals will rationally delegate more authority to agents who share their preferences ('allies')." Jacob E. Gersen & Adrian Vermeule, *Delegating to Enemies*, 112 COLUM. L. REV. 2193, 2194–95 (2012).

of authority.[153] Unfortunately, agents do not always act in desirable ways. Agency law has long relied upon the principal actor to assume the cost of ensuring appropriate agency behavior, yet "agency dilemma"[154] concerns will often prevent an effective or efficient principal check. As a result, agency law principles are most often utilized to determine which party is responsible for the consequences of undesirable behavior.[155]

However, case law delineating agency relationships and obligations is at best inconsistent, casting doubt on the doctrine's utility in light of agency dilemma issues. The common law application of agency law has in many cases led to a functionalist result—the varying doctrines are "applied haphazardly, giving rise to the suspicion that judges are deciding how the cases should come out on commonsense grounds (however just these intuitive decisions may be) and then groping for legal formalisms."[156] The "least-cost-avoider principle" offers a theoretical response to such skepticism while also providing an approach to address the agency dilemma. Borrowed from tort concepts—the so-called "Posnerian" features of agency law—the least-cost-avoider principle assigns the responsibility and cost of agency-dilemma prevention to the party that can most efficiently accomplish it.[157] The least-cost-avoider principle most closely aligns with *ex ante* prevention of harm and also with fundamental sentiments of fairness, two concerns that are integral to reform shapeshifting behavior. As such, when evaluating principal–agent relationships and the value of potential checks, the desirable result for purposes of this Article requires prevention efforts that minimize costs by assigning responsibility to the party (or parties) that can most efficiently prevent future harm.

Though legal scholars have previously explored the principal–agent model in the context of regulatory behavior, none has fully analyzed the conflicting and overlapping relationships that are inherent in the current administrative framework.[158] Political scientists and economists have more

153. Matthew C. Stephenson, *Information Acquisition and Institutional Design*, 124 HARV. L. REV. 1422, 1440 (2011) ("The principal, in other words, may use legal rules to establish the agent's 'discretionary window.' When deciding how much discretion to delegate (that is, the size and location of the discretionary window), the principal must weigh the potential informational gains of delegation against the costs associated with potential agency bias.").

154. *See infra* Part III.A.1.

155. Eric Rasmusen, *Agency Law and Contract Formation*, 6 AM. L. & ECON. REV. 369, 370 (2004) ("When the agent takes a mistaken action, the damage must be allocated to someone—principal, agent, or third party. . . .").

156. *Id.* at 375.

157. *Id.* at 380 (arguing that, although the least-cost-avoider principle reduces incentive for the other parties to take care, the principle has "efficiency properties," is easily applied, and invokes "common ideas of fairness").

158. *See, e.g.*, Matthew D. McCubbins et. al, *Administrative Procedures as Instruments of*

fully developed the reality of multiple-principal relationships,[159] yet much of the existing literature fails to apply the results to the separation of powers implications that are of concern to the legal academy. Scholarship most commonly highlights the principle–agent relationship between the regulatory agency and either the President or Congress, or both.[160] Legal academics often focus on the "simple setting involving a single principal and a single agent."[161] What few recognize is that in certain circumstances, the agency may also assume an agent role to the judiciary.[162] Yet, courts are frequently cited as a check on regulatory behavior through judicial review of agency actions.[163] Overlooking the principal–agent relationship between agencies and the courts places reliance on hollow protection.

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*Political Control*, 3 J.L. ECON. & ORG. 243, 254–55 (1987) ("The analysis of this 'meta-game' between principals is beyond the scope of this paper.").

159. *See, e.g.*, GEORGE A. KRAUSE, A TWO-WAY STREET 117 (1999) ("In all likelihood, the principal–agent theory of political control over bureaucracy is an oversimplification of social and political realities, which represent a particular class of administrative agency-political institution relationships from a broader spectrum."); Richard W. Waterman, Book Review, 576 ANNALS AM. ACAD. POL. & SOC. SCI. 135, 136 (2001) (reviewing GEORGE A. KRAUSE, A TWO-WAY STREET (1999)) ("Hence, there is an interactive component both between principals and their agents and between various principals that has been largely overlooked in past studies of bureaucratic politics.").

160. *See, e.g.*, Manik Roy, *Pollution Prevention, Organizational Culture, and Social Learning*, 22 ENVTL. L. 189, 206 (1992) (discussing "the agent–principal information problems between the [state] Agency and its 'owners,' the governor and the legislature"); KRAUSE, *supra* note 159, at 7 ("Principal–agent based models of political control (or influence) state that the preferences of elected officials (principals) are imposed on administrative organizations (agents) through a variety of dependent relationships.").

161. Stephenson, *supra* note 153, at 1438 (analyzing institutional design options to maximize agency research initiatives).

162. Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543, 572–73 (2000) (concluding that "governance in this more complicated light underlines the need for a less agency-centered and more dynamic administrative law agenda," yet failing to highlight the role of judiciary as principal); *see also* Waterman, *supra* note 159, at 136–37 (noting that even Krause, who otherwise re-frames the analysis of principal–agent relationships in the public law setting, does not address the role of the courts, a critical participant in the web of agency behavior).

163. Aaron R. Cooper, Note, *Sidestepping* Chevron*: Reframing Agency Deference for an Era of Private Governance*, 99 GEO. L.J. 1431, 1455 (2011) ("In reviewing an agency interpretation, a court ensures that an agency stays within its statutory parameters—this is, at its most basic level, a check against the possibility that by delegating to an agency Congress has circumvented the constitutional system of separation of powers."); Freeman, *supra* note 162, at 573 n.108 ("In administrative law scholarship, legislative and executive oversight and judicial review are mechanisms for controlling the temptation of agents to deviate from their mandates."). *But see* McCubbins et al., *supra* note 158, at 245 ("To the extent the courts pursue policy objectives that do not conform to the wishes of elected officials, administrative law (through legislation or executive order) may be in part a means for controlling the judiciary as well as for assuring adherence to democratic values.").

Because shapeshifting agencies are susceptible to agency dilemma problems and serve as "agents" to multiple principals, the existing system of checks (wherein abuse prevention may lie exclusively with another principal) will fall short of a desirable degree of protection.

*1. The Agency Dilemma*

Agents always have incentives that diverge from the principal. Economics can point to ways to make the incentives more aligned, and law can supply incentives for agents not to pursue their own interests. But a principal cannot write a contract that entirely avoids agency costs. In any form of principal–agent relationship, problems occur when the incentives of the agent diverge from those of the principal.[164] This conflict is described as the "agency dilemma" and is the subject of much scholarship.[165] Information asymmetry contributes to ongoing agency dilemmas. Because the agent might develop more expertise and have access to data unknown to the principal, the agent may be in a position to take actions that benefit itself without the principal's awareness. Assuming the principal *knows* about the conflict, limited financial resources pose another challenge to eliminating agency dilemmas. Often the cost of re-directing the agent to act in accordance with the principal's directive is prohibitive, so the principal instead tolerates the agent's ultra vires behavior.

Administrative agencies are particularly prone to the agency dilemma for a number of reasons. Agencies lack "strict accountability to the voters[,] . . . are divided into units that are also sometimes terribly miscoordinated and isolated from each other . . . . They are influenced by both policy advocates and social networks, and are not able to enforce the law absolutely."[166] Furthermore, agencies are given a large scope of judicial deference, creating a sense of autonomy that encourages

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164. Gersen & Vermeule, *supra* note 152, at 2196.

> Almost any delegation entails a grant of authority by a principal to an agent whose preferences are not identical to the principal's; some degree of preference divergence is a ubiquitous if not inevitable feature of delegation. In reality, there will always be a space of possible preferences and thus a continuum ranging from perfect alliance, in which the preferences of principal and agent are perfectly aligned, to perfect enmity, in which the preferences of principal and agent are at opposite extremes.

*Id.*

165. *See, e.g.*, Carol B. Swanson, *Corporate Governance: Sliding Seamlessly into the Twenty-First Century*, 21 J. CORP. L. 417, 448 (1996) (discussing the agency dilemma in corporate governance issues); Thomas W. Hazlett, *Duopolistic Competition in Cable Television: Implications for Public Policy*, 7 YALE J. ON REG. 65, 117 n.185 (1990) (discussing "the agency dilemma [that] forms a vital consideration in [cable franchising] markets").

166. Roy, *supra* note 160, at 232.

independent incentives and actions. Regulatory bodies operate with guidance—from Congress, the Executive, or the courts—yet their actions are more detached from the principal than in many agency relationships. To utilize the expertise that justifies agency grants of authority, regulators are frequently given the discretion to create rules, structure and manage enforcement actions, and conduct parallel judicial proceedings. This degree of self-government creates conditions ripe for self-serving incentives, especially when agency budgets are comprised, in part, of collected fees and penalties and enforcement that directly benefit their bottom line.[167]

Pinpointing instances of the agency dilemma can be difficult. As an initial matter, evaluating the exact intent of any single regulatory action is challenging. While it is possible that an agency may be acting in line with the principal's goals, it may alternatively act to benefit its own interests in the exact same action. In those instances—where an agent's action on the surface appears to align with that of its principal—it becomes even more challenging to recognize whether an agency dilemma impacted the final action. Because such scenarios are harder to detect, especially by the principal, they are even more costly to prevent. Additionally, agencies are aware that their authority is directly limited by the bounds of the organic act. To minimize the perception of self-interested actions, agencies make efforts to characterize their behavior to fit within statutory lines—for example, by justifying an action as serving the public purpose.

By shapeshifting from creditor to regulator, agencies exhibit the self-interested behavior common to the agency dilemma. Penalty veil-piercing of a bankrupt corporation is the clearest example of the agency dilemma. The agency's incentive to pierce the veil of a bankrupt corporation to affix liability onto an individual appears to be avoidance of creditor status. Though Congress often drafts individual liability provisions into organic acts, agencies may deliberately try to avoid such provisions by piercing the veil. Similarly, to justify their veil-piercing behavior, agencies may cite their intent to effectuate statutory goals through enforcement actions, emphasizing the deterrent impact on other regulated entities. Yet, as evidenced by the limited regulatory power exception to the automatic stay, affixing a penalty and then becoming a creditor to a bankrupt corporation's estate satisfies the same deterrent purpose. Agency veil-piercing for purposes of *collecting* a penalty outside of the restructuring process moves beyond action that is necessary to accomplish deterrence. Such actions are beyond the principal's discretionary window and would only be done in an

167. *See, e.g.*, Glenn Bischoff, *FCC Increases Enforcement Amid Budget Shortfall*, URGENT COMMC'NS (May 12, 2011), http://urgentcomm.com/policy_and_law/news/fcc-increases-enforcement-20110512.

agency's self-interest to obtain maximum collection.[168]

In the context of *Second Thursday* manipulation, the existence of an agency dilemma is equally plausible, yet more challenging to separate from the principal's regulatory dictate. The FCC is tasked with assigning and transferring licenses, and in *Second Thursday* evaluations the agency is doing just that.[169] When the FCC is a creditor to the bankrupt entity, its regulatory purpose does not fade—it simply merges with the FCC's self-interest in maximizing its return on an unsecured claim. The principal (Congress) is unlikely to know that the FCC is doing anything but transferring licenses. Members of Congress also lack the expertise to evaluate whether the FCC's decision is based on (1) which party can best provide spectrum service or (2) merely which plan better satisfies unsecured creditors like the FCC. The agency dilemma in this example is not only harder to prove, but it also exhibits the principal's inability, through information asymmetry, to evaluate and prevent the self-interested behavior from continuing.

Both veil-piercing and *Second Thursday* situations present instances where an agency dilemma stands between the principal's interest and the agent's underlying motivations to act. Redressing agency dilemmas is challenging due to costs of prevention and information asymmetry, yet these challenges only contemplate the existence of one principal. In many instances multiple principals connect with a single agent, creating an additional layer of complications that further threatens the ability of traditional checks to prevent shapeshifting behavior.

### *2. The Problem of Multiple Principals*

The existence of multiple principals only compounds the challenges posed by an agency dilemma. When an agent is connected and owes obligations to multiple parties, conflicts arise if the desired course of action diverges. For example, an administrative agency may be the agent of many principals: the Executive, the Legislature, and the Judiciary, to name a few.[170] To prevent certain behavior *ex ante*, the traditional motivations

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168. It may be true that collecting debts is partially aligned with the principal's interest. Yet, similar to the dividing line in 11 U.S.C. § 362(b)(4) (2012) between *attachment* and *enforcement*, here the regulating function is far stronger in attachment. Additionally, as discussed *supra* in Part I, the costs of enforcement far outweigh any marginal benefit.

169. *See* 47 U.S.C. § 310(d) (2012) (providing the FCC with authority to assign and transfer licenses).

170. Public choice theorists would also point out that regulatory agencies are agents of the American public. *See, e.g.*, Christopher H. Schroeder, *Public Choice and Environmental Policy*, *in* RESEARCH HANDBOOK ON PUBLIC CHOICE AND PUBLIC LAW 450, 454–55 (Daniel A. Farber & Anne Joseph O'Connell eds., 2010) (summarizing public choice scholars'

suggested in agency law literature include increased sanctions and rewards, more oversight, and additional procedures imposed by the principal.[171] However, in a multiple-principal situation, these motivating actions can only prevent such undesirable behavior if the motivating principal, or principals, of an agent's action is known. If an agent is acting to serve one principal, preventative efforts taken by a different principal *ex ante* are less likely to be effective because they have divergent motivations and are otherwise inadequate mechanisms. Furthermore, if an agent is acting on behalf of two principals, one that wants to deter a certain behavior and the other that wants to encourage it, traditional motivating actions may be altogether inadequate. Thus, if the Legislature is the driving motivator in a hypothetical scenario, then the Executive alone may not efficiently be able to check the agent's behavior.

This challenge becomes still more complicated when evaluating and attempting to counteract the impact of an agency dilemma. An agent's own motivations may diverge from each of its principals, resulting in action that any one principal alone cannot remedy or prevent. For example, an agency's desire to shapeshift for maximized payment of penalties may somewhat align with one principal (the Executive), but still be antagonistic to its other principals (such as the Judiciary and Legislature). Agency dilemma issues are in part driven by information disparities between principal and agent; imagine the complications that arise when three different principals operating with the same agent have three different pools of information. The influence of multiple principals on one another is key to understand and modify undesirable agent behavior.[172] Working to prevent agency action that is inconsistent with the principals' directives should be done collaboratively, with each principal taking some of the cost to incentivize desirable behavior.[173] If the principals cannot agree on what

consideration of broader interests in evaluating agency behavior, including those of the general public). Without reaching the issue, this paper focuses on the three traditional branches of government with the understanding that a dissatisfied public has the ability to voice their concerns through the democratic process.

171. *See, e.g.*, John Armour et al., *Agency Problems and Legal Strategies, in* THE ANATOMY OF CORPORATE LAW 35 (Reinier Kraakman et al. eds. 2004) (setting forth a number of solutions to the principal–agent problem, including agent constraints, regulating the terms between principals and agents, giving principals appointment and decision rights, and offering incentives to agents).

172. Waterman, *supra* note 159, at 136 ("In addition, political principal behavior is conditioned by the behavior of other principals. Hence, there is an interactive component both between principals and their agents and between various principals that has been largely overlooked in past studies of bureaucratic politics.").

173. It is possible that a single principal could develop a mechanism so powerful that it counteracts the agent's desire to operate in its own interest or in the conflicting interest of

action is desirable, a solution that results in *predictable* agency action—let alone action that is preferable by any principal—becomes less plausible.

*a. A Simple Illustration: Attorney Billing*

For a better understanding of how discouraging self-interested agent behavior is more difficult in multiple-principal situations, consider these challenges in the familiar context of attorney billing.[174] First, an attorney is a fiduciary and agent of his client: the attorney (or firm) has signed an agreement to represent the client in exchange for reasonable payment.[175] The attorney is also an agent of the law firm. The attorney performs services and represents clients on behalf of the firm and is obligated to charge clients in a manner that compensates the firm's contribution. Finally, an attorney is also an agent of the profession governed by the rules of ethics and the obligations of faithful adherence to standards of practice. An outcome that satisfies professional standards will in all likelihood align with fundamental notions of fairness (a relevant concern in the least-cost-avoider model).[176]

In addition, the attorney has personal interests and incentives that will at times conflict with the perspective of his different principals; he may want to give better deals to his clients to encourage loyalty and develop relationships; he might alternatively want to increase billing so he can look better to the firm, make his hours, and get a yearly bonus. Thus, the attorney's interests and motivations align with those of each of his principals in some setting; yet, it will be difficult to determine *ex ante* which principal will be served by each action or for each principal to evaluate an

other principals. Accepting that possibility, this Article proceeds under the assumption that such a measure would be so challenging to create (due to information asymmetry, enforcement, and oversight concerns) that the costs would be prohibitive and it is unlikely to occur.

174. Perhaps due to its simplicity, this example is not novel to the agency literature. *See, e.g.*, Aaron Tang, *The Ethics of Opposing Certiorari Before the Supreme Court*, 35 HARV. J.L. & PUB. POL'Y 933, 940 (2012) ("The academic literature is replete with observations regarding self-interested attorney action across a wide array of situations that arise in typical client-attorney relationships."); *see also* John W. Pratt & Richard J. Zeckhauser, *Principals and Agents: An Overview*, *in* PRINCIPALS AND AGENTS 1, 1 (John W. Pratt & Richard J. Zeckhauser eds., 1985).

175. While payment structures have evolved to utilize alternative billing methods in response to client demands (i.e., flat rate, contingency fee, etc.), the billable hour remains the dominant form of payment. *See* Catherine Ho, *Law Firms Look for Alternatives to the Billable Hour*, WASH. POST (Apr. 15, 2012), http://articles.washingtonpost.com/2012-04-15/business/35451323_1_law-firms-alternative-fee-arrangements-intellectual-property.

176. *See* Rasmusen, *supra* note 155, at 380 (discussing the merits of the least-cost-avoider principle).

effective way to incentivize desired agent performance.

For example, assume that an attorney actually needs $x$ hours to complete a client's motion for summary judgment. In that case, $x$ also represents the number of hours that would be supported as ethical by the legal profession to bill the client. Perhaps the client mentions that he would appreciate the attorney billing for $x - 10$ hours, while the firm would prefer the attorney to take $x + 10$ hours to complete the work. The attorney is asked to serve the profession and bill ethically, to maintain and develop the client's loyalty by giving him a "deal," and to please the firm by contributing to the bottom line. The attorney could also be driven by different personal incentives, independent of the principals: perhaps a sense of personal integrity to "do the right thing," a desire to protect a valuable client relationship so a different attorney does not get future business, or the need to maximize billing to be successful at the firm. Attorneys faced with this situation must ultimately make a choice (some form of bill is inevitably sent to the client), yet absent a form of "exit-polling" it is almost impossible to determine what ultimately motivated the attorney to act, or not act, in line with each principal's desired outcome. As such, it is equally challenging to incentivize the attorney's future behavior without additional information.

Now, suppose instead that the principals have jointly decided that, within a certain range, billing should most closely align with actual costs. The firm might make less money, but it will avoid negative press and the potential loss of future clients. The client might pay more, but it will not be utilizing an underpaid, and perhaps less enthusiastic, agent. Assuming that over- or under-billing is an undesirable outcome, and that the only parties that can impact the attorney's behavior are the principals, relying on any single party to correct the agent's behavior is unlikely to succeed. If the client alone says that he does not want to be under-billed, nothing is in place to prevent the attorney from over-billing in line with the firm's ongoing incentives. Similarly, if the firm sets a policy that billing in excess of the work completed will not be condoned, the attorney may still under-bill in his interest to foster the client relationship. An effective system of checks will require the collaboration of multiple principals to change the agent's behavior. Working together, the principals can structure incentives that minimize positive reinforcement for undesired deviations and encourage the attorney to conform, despite the potential for ongoing independent motivations.

The ongoing prominence of attorney billing as the core of "lawyer jokes"[177] and the focus of mainstream media[178] indicate that this dilemma is

177. *See, e.g.*, *Lawyer Jokes*, http://unijokes.com/joke-905/ (joke 905) (last visited May. 24, 2016).

not merely hypothetical. Yet, the example also provides a simple illustration of the overlapping, and sometimes conflicting, principal–agent issues that may frustrate prevention of shapeshifting agency behavior.

*b. Multiple Principals in Shapeshifting Behavior*

Regulatory agency behavior is often connected to multiple principals. As discussed above, administrative agencies are most obviously evaluated as agents of the Executive Branch. At a basic level, the President is unable to perform the countless tasks that must be completed to administer a functional government. Not only does the Executive not have the time to properly oversee each government role, it often lacks the expertise to make the decisions necessary to guide state actions. As a result, regulatory agencies were created to oversee and manage the day-to-day needs of government programs. Agency leaders are usually appointed by the Executive, tend to respond to Executive influences, and answer to the Executive when mistakes occur. The relationship between the Executive and agencies is a classic embodiment of a principal–agent connection.

Agencies are also agents of the Legislature. Though agencies are responsible for the regulations that constitute the majority of standards governing regulated parties, the organic statutes that create and empower agencies come directly from Congress. In the case of independent agencies, the Legislature assumes a primary principal role in absence of executive oversight. By shaping the organic acts, Congress dictates objectives and a preferred course of action to its agents. Often, Congress does not have the necessary information or expertise to provide detailed guidelines; general grants of authority and expressed purpose are designed to allow the agency breathing room to best accomplish the legislature's goals. It also leaves room for agency manipulation,[179] and in many cases may limit the check of

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> A lawyer died and arrived at the pearly gates. To his dismay, there were thousands of people ahead of him in line to see St. Peter. But, to his surprise, St. Peter left his desk at the gate and came down the long line to where the lawyer was standing. St. Peter greeted him warmly. Then St. Peter and one of his assistants took the lawyer by the hands and guided him up to the front of the line into a comfortable chair by his desk. The lawyer said, "I don't mind all this attention, but what makes me so special?" St. Peter replied, "Well, I've added up all the hours for which you billed your clients, and by my calculation you must be about 193 years old!

*Id.*

178. *See, e.g.*, Peter Lattman, *Suit Offers a Peek at the Practice of Inflating a Legal Bill*, N.Y. TIMES (Mar. 25, 2013, 8:52 PM), http://dealbook.nytimes.com/2013/03/25/suit-offers-a-peek-at-the-practice-of-padding-a-legal-bill/ (detailing a suit between law firm DLA Piper and a client, and discussing the problem of overbilling generally).

179. *See* McCubbins et al., *supra* note 158, at 257 ("If greater delegation allows agencies greater opportunities to pursue their own goals, it only helps the agencies, not the political

the Judiciary.

Most analysis of the principal–agent structure to date has completely ignored the possibility that agencies may be acting for the Judiciary. For this reason, it is not surprising that the Judiciary is frequently cited as a check on the agency dilemma. However, the shapeshifting behavior evaluated in this Article brings attention to the need for a new discussion of multiple-principal relationships in administrative law due to the judiciary's potential principal role. By piercing the corporate veil to circumvent creditor status, administrative agencies are operating as agents of the Judiciary. Though the corporate veil is a fiction of business law, its protection, and thus its viability, rests with the Judiciary. Courts tread gently behind the veil only in dire circumstances, and in all other instances work to protect the corporate form. Restructuring courts also are obligated to maximize the value of the bankrupt estate for equitable distribution to creditors.[180] By piercing the corporate veil in a parallel administrative judicial proceeding, agencies are acting as agents of the Judiciary when they seek to collect penalties against individuals instead of obtaining their portion of the corporation's estate as an unsecured creditor.[181] A bankruptcy court has the power to pierce the corporate veil and attach liability to individuals behind debtor corporations when it sees fit, after weighing the circumstances at issue in any particular case. While many agencies have the power to affix individual liability through independent provisions in the organic statute—an action that would be strictly regulatory and fall outside the principal–agent relationship—veil-piercing and connecting liability of the corporation to an individual in the shadow of bankruptcy circumvents the bankruptcy court's interest in protecting and disbursing the debtor's estate and preserving the corporate form.[182]

A regulatory agency is also operating as an agent of the Judiciary in the

principals. Hence, the greater delegation implies a greater need for effective control mechanisms.").

180. *See* Dennis J. Connolly, *Current Issues in Auction Sales*, *in* 2005 ANN. SURV. BANKR. L. 41, 48 (William L. Norton, Jr. ed., 2005) ("The goal and duty of the bankruptcy court is to ensure, as best possible, that the highest and best value for the property has been obtained.").

181. Much of the judicial function of administrative agencies is created by Congress and found in the APA. While legislation by a third party may be an unlikely foundation for a principal–agent relationship between the judiciary and administrative agencies, the courts' accession to and adoption of agency proceedings through its deferential approach suggest that such a relationship exists.

182. Harry D. Lewis, *Enjoining Regulatory Action Against Chapter 11 Debtors*, 96 COM. L.J. 335, 350 (1991) ("The regulatory agency and the reorganization court can function concurrently in most situations. It is only when the proposed agency action threatens property of the estate or the reorganization process that court intervention is necessary.").

*Second Thursday* license transfer situation. Though approving, transferring, and controlling spectrum licenses is an exclusively regulatory task, the situation transforms when the FCC is also an unsecured creditor evaluating two competing license applications. The bankruptcy court traditionally holds the role of approving the best restructuring plan; when plan approval is contingent upon FCC license grants, in effect the FCC is acting as the court's agent because it has the exclusive authority to determine which of two plans will succeed. By selectively awarding licenses that maximize creditor returns, the FCC is in essence operating as the judge of its own case.[183] If the Judiciary, as principal actor, allows the FCC to act as its agent (through a *judicially-created* doctrine), it is less likely that the courts will also serve as an independent check on self-interested shapeshifting behavior. Though the Judiciary should stand guard between the administrative actor and the estate,[184] alignment of interests may lessen the vehemence of protection afforded by the court. The bankruptcy judge has an interest in encouraging swift confirmation of plans to maximize the estate value and encourage finality.[185] If the agency's incentive to get top dollar on its unsecured claim (by encouraging competing bidders to maximize recovery for certain classes of creditors) does not conflict with, and potentially encourages, swift confirmation, the judicial principal may approve of the agent's behavior. At a minimum, it seems likely that the bankruptcy court will hesitate to incur the cost to shift the agent's incentives. Even if the agency's behavior is undesirable to the other principals, third party regulated actors, or the general public under notions of fairness, the Judiciary may not provide an adequate check.

Because shapeshifting behavior involves inherent agency dilemma problems—particularly when the agency's behavior is motivated by maximizing financial recovery as an unsecured creditor—and multiple-

183. This violates the longstanding norm of "*nemo iudex in su causa*"—that no man should be judge in his own case. *But see generally* Adrian Vermeule, *Contra* Nemo Iudex in Sua Causa*: The Limits of Impartiality*, 122 YALE L.J. 384 (2012) (discussing instances in which violating the *nemo iudex* principle might not be universally prohibited).

184. Lewis, *supra* note 182, at 349–50.

> If the agency is attempting to create, perfect or enforce a lien, or to control property of the estate, or holds a monetary claim against the debtor much like any other party in interest in the bankruptcy proceeding, then restraint of the agency by the reorganization court, including injunction if necessary, is warranted. Striking such balances should be an inherent part of the work of the reorganization court.

*Id.*

185. *See* DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 245–49 (1992) (explaining that, due to rapid fluctuation in value, delays in the restructuring process are contrary to the interests of both debtors and creditors who seek to maximize the value of the estate).

principal complications, the existing separation of powers checks are inadequate to deter ongoing harm. In many ways the agency incentives do not deviate significantly from expressed incentives of the principal. Seeking to collect penalties does deter other violators, thus it can be classified as serving the regulatory purpose set forth by Congress; the problems posed by the particular method of collection (veil-piercing) may not justify the expense necessary for the Legislature as principal to prevent future harm. In veil-piercing situations, the Judiciary acting as principal might find the agent's behavior to be more troubling because it undermines two carefully-protected court roles—observing the corporate form and equitably dispersing the insolvent estate; however, without assistance from the Legislative Branch, any remedial effort to counteract the agency's desire to collect money may be too costly to justify. For example, the *NextWave* Court noted in the context of license cancellation that, if the agency "were allowed to enforce its rights outside the bankruptcy process, that would create an 'anomaly' compared to the rights of ordinary secured creditors."[186] However, in *NextWave* the agency's action was prohibited by § 525 of the Code, a provision Congress designed to protect against regulatory discrimination.[187] It was the combination of legislative and judiciary protections that prevented undesirable agency behavior; either aspect alone might not have redressed the FCC's action.

### *B. Silent Regulated Parties*

Another strand of agency theory might suggest that private entities can protect themselves within the agency process. Recent scholarship focuses on a "new" model of governance in the modern administrative state, highlighting the role of private actors and the regulated industry in an increasingly collaborative agency process.[188] If private actors do indeed

186. Thacker v. FCC, 533 U.S. 1004 (2008) (No. 07-803), 2008 WL 899315, at *5 (Reply Brief) (citing FCC v. NextWave Pers. Commc'ns. Inc., 537 U.S. 293, 307–08 (2003)).

187. *See NextWave Pers. Commc'ns.*, 537 U.S. at 313–14 (Breyer, J., dissenting).

188. *See, e.g.*, Robert F. Weber, *New Governance, Financial Regulation, and Challenges to Legitimacy: The Example of the Internal Models Approach to Capital Adequacy Regulation*, 62 ADMIN. L. REV. 783, 854 (2010) ("The involvement of third-party stakeholders such as public interest groups to supervise and contribute to regulatory compliance enhances the legitimacy and effectiveness of a broad participatory regime and minimizes the risks of capture."); Freeman, *supra* note 162, at 571.

> In contrast to those presenting hierarchical models of administrative law, I conceive of governance as a set of negotiated relationships. This alternative conception of policy making, implementation, and enforcement is dynamic, nonhierarchical, and decentralized, envisioning give and take among public and private actors. Information, expertise, and influence flow downward, from agency to private actors; upward, from private actor to agency; and horizontally, among public and private

play a significant role in the regulatory process, then it could be argued that their influence as a different form of principal (or a substitute third party) could offer an additional check on undesirable agency behavior. Advocates of the "new governance" model suggest that "increased participation and power-sharing allow for structuring collaborative solutions to complex problems."[189] Yet, the ability of these entities—whether they are specially-formed industry organizations, or merely regulated individuals or corporations—is low to provide a meaningful check on shapeshifting.

As an initial matter, the contribution of so-called collaborative private actors is often *ex ante* and directed at creating better-informed practices. Scholars highlight the possibility that private actors will assist primarily in rulemaking and procedure. Though Congress has acknowledged a potential role for third parties to encourage enforcement, that model of participation is inadequate to redress shapeshifting for three reasons. First, reliance on private actors presupposes a layer of transparency in administrative actions that is far from evident.[190] If third parties are unaware that shapeshifting behavior is occurring, they cannot effectively challenge it. Second, private action is directed at encouraging the compliance of other regulated parties, not at reviewing the method or manner of agency enforcement.[191] Focusing on third parties would only stop shapeshifting to the extent that it coincided with instances of regulatory evasion, an unlikely result from the examples discussed in this Article. Finally, even when the statute explicitly waives sovereign immunity and provides a cause of action against agency inaction, the scope of third party challenges has been narrowly confined to non-discretionary behavior, such as forming a review board by a certain date. Manipulating statutory roles and corporate doctrines to gain preferential treatment is not the same as

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actors.

*Id.*

189. Weber, *supra* note 188, at 842.

190. *See, e.g.*, Mark Fenster, *Seeing the State: Transparency as Metaphor*, 62 ADMIN. L. REV. 617, 619–20 (2010).

> Government institutions operate at a distance from those they serve. To be held accountable and to perform well, the institutions must be visible to the public. But in the normal course of their bureaucratic operation, public organizations—sometimes inadvertently, sometimes willfully; sometimes with good intent, sometimes with unethical or illegal intent—create institutional impediments that obstruct external observation. These obstructions must be removed in order for the institutions to be visible and, ultimately, transparent.

*Id.*

191. *See* Matthew C. Stephenson, *Public Regulation of Private Enforcement: The Case for Expanding the Role of Administrative Agencies*, 91 VA. L. REV. 93, 98–100, 108–09 (2005) (discussing a variety of private agency enforcement actions and intended benefits).

the non-discretionary agency inaction that led Congress to provide private causes of action. Some might argue that veil-piercing and selective licensing via the *Second Thursday* doctrine are just the opposite: an agency affirmatively acting to further its statutory mandates. Furthermore, non-state actors must still have constitutional standing to bring such claims. For most private actors, the injury-in-fact requirement[192] will not be satisfied to challenge shapeshifting agency behavior.

Agency law provides for third party claims by the harmed party, directed at either the agent or the principal, to remedy wrongs. In certain instances, third parties are relied upon to prevent undesirable agent behavior; their legal challenges are the most efficient method to prevent ongoing violations, as the principal's efforts may be too costly or ineffective. Similarly, the APA provides for appellate review of agency actions,[193] allowing regulated parties to draw attention to agency missteps so the challenger can be compensated and the behavior will be deterred in the future. Allowing injured parties—such as the bidder who did not receive *Second Thursday* approval or the individual subject to veil-piercing—to bring suit provides the judiciary with another opportunity to check shapeshifting agency behavior.[194] Yet, these actions are unsatisfactory for two reasons. First, the "arbitrary and capricious" standard of judicial review mandates deference to agency discretion in all but the most egregious breaches of statutory guidelines.[195] Second, in many cases the injured parties in shapeshifting scenarios will not be interested in challenging the agency. Corporations that plan to continue operating in a certain industry might hesitate to bring suit against an agency when subsequent approvals, licenses, and other mandatory clearances lie with that same regulatory body. Some actors might find that the risk of agency backlash is worth taking, yet the deterrence of even a small percentage of injured parties calls into question the efficacy of third parties as a check.

The principal–agent model highlights more problems than solutions in the context of administrative agencies. Chapter 11 shapeshifting agencies act to maximize collection of their debts in ways that principals may not have the information or power to stop, a situation that is further

192. Lujan v. Defenders of Wildlife, 504 U.S. 555, 560–61 (1992) (outlining the requirements for standing).

193. *See* 5 U.S.C. §§ 701–09 (2012).

194. If the judiciary is operating as one of multiple principals in the specific situation, then the same questions discussed *supra* in Part III.A.2. apply.

195. *See* 5 U.S.C. § 706(2)(A) (2012). Over time, the courts' recognition of shapeshifting agency behavior may shape the contours of the arbitrary and capricious standard. Such a shift, however, cannot be the sole approach to prevent circumvention of the Bankruptcy Code's priority rules by shapeshifting agencies.

complicated by the presence of multiple principals. When a body that is expected to check undesirable behavior is also a principal to the agent, oversight that may appear sufficient may in fact be illusory. Finally, the role of third parties in the administrative agency setting does not offer sufficient additional scrutiny. Unlike the possibility that third parties may be the least-cost-avoider in agency law, administrative agencies maintain a degree of leverage over the third parties with standing to seek judicial review that prevents robust challenges. Other regulated or interested parties may call attention to shapeshifting behavior, but they lack the mechanism and judicial forum to hold an agency legally accountable for its actions. Existing oversight structures are tangled in the web of principal–agent connections. Thus additional measures must be taken to prevent continuing shapeshifting behavior.

## IV. SOLUTIONS

### *A. Statutory Bar*

One potential solution to prohibit shapeshifting behavior involves an amendment to the Bankruptcy Code. The Code already has various provisions that reflect certain shifts in incentives that may similarly support shapeshifting prevention: namely, the desire to stop parties from acting with their own self-interest in the face of an impending bankruptcy; and the desire to protect the absolute priority scheme against preferential treatment of certain creditors. These congressional priorities were codified in §§ 327(a) and 503(b)(9) and indicate that Congress may be amenable to adding a similar agency-specific provision.[196] The provisions also provide valuable examples upon which such a regulatory provision could be based.

The Code provides an established priority scheme,[197] allowing deviations only in pressing circumstances and with increased judicial oversight. Bankruptcy Code § 503(b)(9) allows a priority payment of certain goods delivered within twenty days of the bankruptcy filing.[198] Commentators have criticized this provision as a "dramatic departure from bankruptcy precedent" because it requires a debtor to pay these claims in full, notwithstanding that such claims previously were classified as general unsecured claims.[199] Section 503(b)(9) offers a valuable example of certain

196. *See* 11 U.S.C. §§ 327(a), 503(b)(9) (2012).

197. *See id.* § 1129(b)(2).

198. *Id.* § 503(b)(9).

199. Brendan M. Gage, *Should Congress Repeal Bankruptcy Code Section 503(b)(9)?*, 19 AM. BANKR. INST. L. REV. 215, 216–17, 217 n.7 (2011) (suggesting drastic reforms to § 503(b)(9) and listing articles that discuss its problematic prioritization effects).

protections that should attach to a measure that circumvents traditional priority structures—a parallel situation to many instances of agency shapeshifting.[200] For instance, the provision requires "notice and a hearing" prior to allowing the select class of administrative expenses, which constitute only a small impact on the estate's value.[201] This suggests that Congress would support similar, if not greater, efforts to draw attention to shapeshifting agencies that seek to manipulate their creditor status through regulatory authority.[202]

The Code also incorporates measures to protect the estate against self-interested representation. For example, § 327(a) of the code prohibits attorneys with conflicting interests to represent the debtor's estate.[203] The conflict prohibition requires attorneys to be "disinterested," which the Bankruptcy Code explicitly defines as, *inter alia*, "a person that . . . is not a creditor, an equity security holder, or an insider."[204] The bankruptcy standard governing conflicts is more narrowly drawn and more strictly applied than general conflict rules dictated by profession-wide ethical standards.[205] For example, conflicts in legal representation can be waived under the model rules of ethics, yet bankruptcy courts may not allow waivers under certain circumstances.[206] Congress's adherence to elevated conflict prevention standards in bankruptcy has been attributed to the "unique pressures inherent in the bankruptcy process."[207] Such pressures

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200. § 503(b)(9).

201. § 503(b).

202. The Bankruptcy Code is full of similar examples that require notice-and-comment procedures, all of which indicate an express congressional intent to highlight situations that might foster inequities and provide creditors with adequate information to make informed decisions. *See, e.g.*, 11 U.S.C. §§ 363(b)(1), 364(b), 366(b), 505(b)(2)(B) (2012).

203. *See id.* § 327(a). The Bankruptcy Code states:

> Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

*Id.*

204. *Id.* §§ 101(14(A), 327(a).

205. *See* Rome v. Braunstein, 19 F.3d 54, 57 (1st Cir. 1994) (explaining the strict conflict rules in bankruptcy cases); *In re* Diamond Mortg. Corp. of Ill., 135 B.R. 78, 90 (Bankr. N.D. Ill. 1990) (noting that the Bankruptcy Code prohibits waiver of the conflict caused by simultaneous representation of a client and his or her creditor, but that such a waiver is permitted outside the bankruptcy context).

206. *See* Matthew L. Warren, *The Continuing Lack of Guidance on Professional Retention in Bankruptcy and its Potential Impact on Corporate Debtors' Retention of Adequate Legal Counsel*, 53 ARIZ. L. REV. 533, 552 (2011) ("Courts have typically explained that conflict waivers simply do not trump the requirements of § 327(a).").

207. NAT'L BANKR. REV. COMM'N, BANKRUPTCY 874 (1997).

include a desire to maintain the public's "confidence in the integrity of the bankruptcy system," a motivation that has led to previous Code reforms.[208] Although § 327(a) relates to professional retention, similar concerns may arise when agencies hold the power to grant licenses. In addition, existing law exhibits Congress's understanding that federal employees may not act in certain situations when they possess a stake in the outcome.[209] Thus, similar prohibitions against self-interested agency action in the bankruptcy context should be well received.

Another instance of the Code's concern with conflicted loyalties is § 1129(a)(10), which governs cramdown procedures in the context of a debtor's plan.[210] Under that section, when a class of claims is impaired under a plan of restructuring, meaning they will not receive full repayment of their debt, the plan can only be crammed down if "at least one class of claims that is impaired under the plan has accepted the plan, determined without including any acceptance of the plan by any insider."[211] In that context, the Code prohibits the counting of votes for insiders, showing its intent to identify and isolate those parties that may be driven by tertiary considerations. Indeed, the Code's definition of "insider" is rather broad,[212] and although an agency with rulemaking powers would not cleanly fit within that definition, the Code's treatment of insiders is illustrative of a broader perspective on divided loyalties that should extend to shapeshifting agencies.

I suggest that the Code should be amended to prohibit agency creditors from taking regulatory actions that solely benefit the agency's financial stake in connection with an ongoing bankruptcy. In most cases, this provision will not prevent an agency from conducting necessary operations. For example, an agency with unsecured creditor status would be prohibited

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208. *See* G. Ray Warner, *Of Grinches, Alchemy and Disinterestedness: The Commission's Magically Disappearing Conflicts of Interest*, 5 AM. BANKR. INST. L. REV. 423, 429–30 (1997).

209. *See, e.g.*, 18 U.S.C. § 208(a) (2012) (forbidding executive officials from participating in actions in which they or persons or entities closely associated with them have "a financial interest"); Evan J. Criddle, *Fiduciary Foundations of Administrative Law*, 54 UCLA L. REV. 117, 156, 156 n.156 (2006) (discussing the same).

210. *See* Bruce A. Markell, *Clueless on Classification: Toward Removing Artificial Limits on Chapter 11 Claim Classification*, 11 BANKR. DEVELOPMENTS J. 1, 2 (1995)

> Cramdown, a bankruptcy term of art, refers to confirmation which occurs even though the plan proponent has not obtained the assent of all creditor classes. To achieve cramdown, the proponent must meet all other confirmation requirements *and* the plan must be 'fair and equitable' and not unfairly discriminatory as to the dissenting class.

*Id.*

211. 11 U.S.C. § 1129(a)(10) (2012).

212. *Id.* § 101(31).

from piercing the debtor corporation's veil to affix regulatory penalties to an individual.[213] The penalty can still be attached to the corporation, which would then be subject to standard priority distribution procedures. Such an action would allow the deterrence impact of a penalty to be realized without using veil-piercing to circumvent unsecured creditor status. Furthermore, an agency could still prevent a single regulated actor from committing offenses by initiating enforcement proceedings against an individual, to the extent that such penalties are condoned by the agency's organic act.

However, in some instances agency action is necessary for the bankruptcy to progress. Unlike the strict application of attorney-conflict rules, in which different representation must be obtained, in the regulatory setting a single agency often has the sole authority to take certain actions, and disqualification is impossible. In those rare instances, under my proposed addition to the Code, the bankruptcy court should have the discretion to approve *conflicted* agency action. For example, in many *Second Thursday* approval situations, the agency will be a creditor sitting in judgment of two plans that require license approval. If both plans afford the same priority and compensation to the agency's claim, then the proposed provision would not apply; however, if there were consequential differences, the agency would not be permitted to grant license transfer because it could benefit its creditor status. In such a case, the bankruptcy court should have a measure of discretion to allow the estate to move forward (and so that the general public does not suffer the disruption caused by regulatory delay). In cases that require a bankruptcy court to use its discretionary approval, the provision should also incorporate a notice requirement. The bankruptcy court should conduct an open hearing about the potential conflict prior to approval, and any record of the agency's parallel action should include an explicit explanation in a disclosure statement that the agency is a creditor in the bankruptcy. Such notice is helpful to prevent the bankruptcy court, as a potential principal of the agency, from issuing discretionary approval without some form of oversight—even if only by the opposing litigants and exposure to public scrutiny. It also serves notice on the other parties to the bankruptcy case, who will be in a better position to raise challenges to shapeshifting behavior before the bankruptcy court.

Previous examples indicate that even the best-laid statutory plans often do not result in the desired outcome. Almost inevitably, some uncontemplated aspect of a new provision gives rise to confusion and

213. *See, e.g.*, *In re* Telseven, LLC, 27 F.C.C. Rcd. 15,558, 15,571–72 (2012) (explaining this to be true "even when strict standards of common law alter ego would not apply").

varying interpretations in the courts. Such was the case with both § 327(a)[214] and § 503(b)(9).[215] For this reason, and because the solution to Chapter 11 shapeshifting behavior will be most effective with efforts from multiple principals, the Judiciary should also implement a deference adjustment.

### *B. Deference Adjustment*

Codifying rules that are designed to prevent Chapter 11 shapeshifting may significantly deter such behavior; however, previous cases demonstrate that Code modifications can often lead to unsettled application in the courts. This potential is heightened in the instance of shapeshifting agencies because, in certain situations, the courts are acting as principals to the agency's action.[216] As such, an additional check should be affixed to agency shapeshifting. I propose a deference adjustment in instances where the agency's regulatory action occurs in the same case where it is a creditor.

Under § 702 of the APA, agency actions are subject to judicial review.[217] Such review entails overturning agency actions that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law."[218] This standard offers a high degree of deference to agency actions, though doctrinal development has also shaped the deference landscape.[219] The concept that courts afford different degrees of deference as necessitated by different factual situations is well-established.[220] It has also long been

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214. *See* Warren, *supra* note 206, at 542 (discussing disagreement in the courts regarding "how strictly the per se rules of [disinterested representation] should be applied").

215. *See* Gage, *supra* note 199, at 219 (explaining that "courts apply their own definitions and form conclusions, often based on whichever policy consideration they assume Congress intended or deem most persuasive," leading to "a remarkable divergence over nearly every legal issue involving § 503(b)(9), highlighting the growing potential for forum shopping").

216. *See supra* Part III.

217. 5 U.S.C. § 702 (2012).

218. *Id.* § 706(2)(A).

219. *See* James M. Puckett, *Embracing the Queen of Hearts: Deference to Retroactive Tax Rules*, 40 FLA. ST. U. L. REV. 349, 360 (2013) (discussing the arbitrary and capricious standard as a "narrow" check, only "requir[ing] that an agency consider relevant factors and arrive at a conclusion in a reasonable manner"). In many instances there is good reason for the deferential standard because it allows agencies to minimize intervention and maximize the impact that their expertise can have on the regulatory subjects. However, this grant presupposes that agencies will behave with certain decorum. *See, e.g.*, Paul Horwitz, *Three Faces of Deference*, 83 NOTRE DAME L. REV. 1061, 1101–02 (2008) (discussing the forms of agency behavior that support an "epistemically based rule of deference").

220. *See, e.g.*, William N. Eskridge, Jr. & Lauren E. Baer, *The Continuum of Deference: Supreme Court Treatment of Agency Statutory Interpretations from* Chevron *to* Hamdan, 96 GEO. L.J. 1083 (2008) (categorizing the Court's spectrum of deference to different agency interpretations); Thomas W. Merrill & Kristin E. Hickman, Chevron*'s Domain*, 89 GEO. L.J.

observed that an agency may act for its own self-benefit, and such actions should receive less deference:[221] "It would exceed the bounds of fair play to allow an institutionally self-interested advocacy position, which may properly carry a bias, to control the judicial outcome."[222] Courts have recognized this reality, and have hesitated to extend deference to such actions.[223] In the context of preemption determinations, for example, the "prospect of agency bias" in a decision "weighs against the application of *Chevron* deference."[224] Other scholars have noted that deference should be limited when the agency offers its position as a litigant.[225] An agency's motivation for financial benefit—as suggested here in the veil-piercing and *Second Thursday* shapeshifting contexts—has also led to calls for a reduction in the deference afforded to these kinds of agency shapeshifting decisions.[226]

833 (2001) (comparing the strength of deference under *Skidmore* and *Chevron* doctrines); Eric M. Braun, Note, *Coring the Seedless Grape: A Reinterpretation of* Chevron U.S.A. Inc. v. NRDC, 87 COLUM. L. REV. 986, 1005 (1987) (finding deference less appropriate "where an agency interpretation shapes a statute's core meaning or an agency has a *substantial interest* in its interpretation" (emphasis added)).

221. *See* Timothy K. Armstrong, Chevron *Deference and Agency Self-Interest*, 13 CORNELL J.L. & PUB. POL'Y 203, 206 (2004) ("Principles rooted in notions of due process weigh against according *Chevron* deference to interpretations implicating the self-interest of the issuing agency."); Criddle, *supra* note 209, at 156 ("Due process prohibits courts from granting deference to an administrative agency's judgment if there is a possibility that idiosyncratic institutional interests could compromise the agency's impartiality."); Cass R. Sunstein, *Law and Administration After* Chevron, 90 COLUM. L. REV. 2071, 2076 (1990) ("Perhaps . . . an agency view will not warrant deference when its self-interest is conspicuously at stake.").

222. Robert A. Anthony, *Which Agency Interpretations Should Bind Citizens and the Courts?*, 7 YALE J. ON REG. 1, 60 (1990).

223. *See, e.g.*, Gutierrez de Martinez v. Lamango, 515 U.S. 417 (1995) (remanding for de novo review due to U.S. Attorney's overwhelming motivation to certify for purposes of the Federal Tort Claims Act); Nat'l Fuel Gas Supply Corp. v. FERC, 811 F.2d 1563, 1571 (D.C. Cir. 1987), *cert. denied*, 484 U.S. 869 (1987) ("Deference might lead a court to endorse self-serving views that an agency might offer in a post hoc reinterpretation of its contract.").

224. Nina A. Mendelson, Chevron *and Preemption*, 102 MICH. L. REV. 737, 794 (2004); *see also* William N. Eskridge, Jr., *Vetogates*, Chevron, *Preemption*, 83 NOTRE DAME L. REV. 1441, 1478 (2008) ("Consistent with the federalism-protective constitutional structure, there is concern among scholars that federal agencies harbor a turf-grabbing or turf-protecting bias that would over-preempt state law if the Court followed their lead routinely, and there is a constituency within the Court for this concern.").

225. *See* Bresgal v. Brock, 833 F.2d 763, 768 (9th Cir. 1987) (arguing that the Secretary of State should not be entitled to more deference that any party involved in the suit); Sharon Hritz, Beck v. Pace International Union*: A Mask of Unanimity to Conceal Disagreement and Confusion*, 28 J. NAT'L ASS'N ADMIN. L. JUDICIARY 673, 691 (2008) ("The debate on deference to an agency's interpretation presented in litigation has been joined by several circuit courts, with the general consensus that no deference is due [to] such interpretations presented in litigation.").

226. Braun, *supra* note 220, at 1006 ("Agency aggrandizement is also at issue where an agency has a substantial and obvious institutional interest in its interpretation. In some

Due to the strong potential for self-aggrandizement where an agency is an unsecured creditor in a corporation's bankruptcy, I suggest that shapeshifting behavior should be uniformly found not to pass the so-called "*Chevron* Step Zero" analysis.[227] Instead, Chapter 11 shapeshifters should be afforded only *Skidmore* deference.[228] Further, such agency action should be subject to de novo review on appeal.[229] This proposal does not break new ground; rather, numerous scholars have suggested similar adjustments in cases of agency self-interest.[230] Some suggest that the Supreme Court itself has taken this position.[231] However, the case for adjusted deference is particularly strong in shapeshifting scenarios due to the multiple-principal relationships at play. As attention has not yet been cast upon agency shapeshifting behavior in bankruptcy, this Article aims to bring focus to yet another instance where deference adjustment is merited, if not critically necessary.

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situations the agency interest is monetary."); Kristin E. Hickman, *The Need for* Mead*: Rejecting Tax Exceptionalism in Judicial Deference*, 90 MINN. L. REV. 1537, 1597 (2006) ("Many agencies . . . have been known to test the boundaries of the statutes they administer . . . for reasons as base as financial self-interest.").

227. Cass R. Sunstein, Chevron *Step Zero*, 92 VA. L. REV. 187 (2006) (discussing the *Chevron* step zero analysis). This analysis eliminates deference from agency decisions that do not have the "force of law." *See* United States v. Mead Corp., 533 U.S. 218, 221 (2001); Christensen v. Harris Cty., 529 U.S. 576 (2000).

228. Skidmore v. Swift & Co., 323 U.S. 134, 140 (1944) (giving weight to an agency view based on "all those factors which give it power to persuade, if lacking power to control").

229. The de novo standard breaks down the preference given to agencies and provides the same review that would be given "in a statutory or regulatory interpretation case not involving agency action." Armstrong, *supra* note 221, at 207.

230. *See, e.g.*, Sunstein, *supra* note 227, at 209–10. As Sunstein noted:

> But when an agency's self-interest is so conspicuously at stake, Congress should not be taken to have implicitly delegated law-interpreting power to the agency . . . . It is not all that complicated to offer an amended understanding of *Chevron*'s reach: *Whenever an agency makes an interpretation of a statute that it administers, that interpretation falls under the* Chevron *framework, unless the agency's self-interest is so conspicuously at stake that it is implausible to infer a congressional delegation of law-interpreting power.*

*Id.*; *see also* Armstrong, *supra* note 221, at 207. As Armstrong stated:

> The courts have correctly refused to defer to agency legal interpretations that implicate the interpreting agency's self-interest . . . . The preferable analytical approach would be to evaluate claims that an agency has acted in a self-aggrandizing manner entirely outside the scope of the Chevron doctrine.

*Id.*

231. *See* Note, *The SEC Is Not an Independent Agency*, 126 HARV. L. REV. 781, 797 n.123 (2013) (discussing New Process Steel, L.P. v. NLRB, 560 U.S. 674, 687–88 (2010)) (supporting an extra-*Chevron* position because the Supreme Court "rejected the NLRB's self-interested interpretation of its quorum requirement without even addressing *Chevron*").

## CONCLUSION

This Article brings attention to a previously unaddressed category of problematic agency behavior that threatens a core protection of the Bankruptcy Code. The forms of shapeshifting described above are a threat to the debtor's various stakeholders, the integrity of the bankruptcy process, and more broadly, the perceived justification for expansive regulatory deference. The modest solutions I suggest are not the only options to remedy and prevent shapeshifting behavior, neither is adoption of any single modification likely to remedy the issues such behavior creates. Further, relying upon traditional separation of powers checks turns a blind eye to the core complexity of shapeshifting agency action. As illustrated by the principal–agent comparison, administrative agencies act in an entangled network of relationships. Perhaps with additional scrutiny and evaluation, a collaborative solution can be formulated to deter agency shapeshifting behavior in bankruptcy and beyond. Agency expertise is only valuable if it is used responsibly and can be trusted. Similarly, the bankruptcy system's ability to discharge debt relies on public trust that the process will protect value and equitably distribute assets. By correcting one ongoing misstep in both systems, this Article attempts to move toward that goal.