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The Facts & Fiction of Bankruptcy Reform

Catherine E. Vance*
and Paige Barr**

The people of this country, not special interest big money, should be the source of all political power. Government must remain the domain of the general citizenry, not a narrow elite . . . This means that the values and preferences of all citizens, not just those who can get our attention by waving large campaign contributions in front of us, must be considered in the political debate. One person, one vote – no more and no less – the most fundamental of democratic principles.  

Senator Paul Wellstone
April 5, 2001

FOREWORD

This article was a work in progress on October 25, 2002, the day Senator Paul Wellstone died in a plane crash.

Through my work, I have been involved with the bankruptcy reform legislation for most of its history and I had become very cynical about

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2. By Ms. Vance.
3. The Bankruptcy Reform Bill was first introduced during the 105th Congress in the House as H.R. 3150 on February 3, 1998. This bill was passed on June 10, 1998. The Senate version, S. 1301 was introduced on October 21, 1997. The Senate passed the companion measure H.R. 3150, in lieu of S. 1301, on September 23, 1998. Ultimately, however Congress was unable to pass bankruptcy reform, and the measure died at the end of the 105th Congress. During the 106th Congress the bill was reintroduced in the House as H.R. 833 on February 24, 1999. On March 16, 1999, the Senate introduced S. 625. H.R. 833 and S. 625 produced a conference report that was rolled into H.R. 2415. H.R. 2415 was subsequently passed on December 7, 2000,
the political process and the people who call themselves “public serv-

ants” (though I do not recall hearing many use that term – they seem to like “public official” better).

Senator Wellstone’s opposition to the bankruptcy legislation was the one aspect of the whole process on which I had pinned my hopes; his willingness to stand alone and oppose a bill that has enjoyed near unanimous support in Congress allowed me to believe that the whole system was not, if fact, corrupt and driven solely by moneyed interests.

I watched the news that night, listening to the many journalists, politicians, and others talk about Senator Wellstone and noting the recurring theme: Senator Wellstone was a man of integrity; he was not afraid to speak his conscious in Congress even if it meant alienating this or that demographic. I knew this about the Senator already, given his unbending insistence that the bankruptcy reform legislation was a rotten bill that would only hurt ordinary Americans. What struck me was how unique this particular quality seemed to be. It was as if Senator Wellstone stood alone in having the kind of character we should be able to expect from all of our elected officials.

but President Clinton pocket vetoed the measure. Then again in the 107th Congress the bill was reintroduced in the House as H.R. 333 on January 1, 2001 and passed on November 15, 2002. The Senate introduced S. 420 on March 1, 2001. A conference report emerged in July 2002, but ultimately, bankruptcy reform failed to make it out of the 107th Congress due to controversial language regarding abortion. Despite the existence of these many bills, this Article will refer to them collectively as “bankruptcy reform” for the sake of convenience.


5. Written less than six months before Senator Wellstone died, an article about his re-election campaign aptly described the Senator:

At a moment when most Democrats are still trying to figure out how to challenge a popular President, the former college wrestler is leaping into the ring. Wellstone is not running for cover; he is running to deliver a message about politics in a state and a nation that he believes to be far more progressive than the readers of political tea leaves in Washington could begin to imagine . . . Paul’s a controversial guy. He’s the little guy who takes on the big guys. That is not something the political process is designed to reward these days. If you take strong stands you put yourself at risk – and Paul takes more strong stands than just about anyone else.

John Nichols, Wellstone and the White House Duke It Out: The Senate’s Most Progressive Member Is in the Fight of His Life, NATION, May 27, 2002, 2002 WL 2210547 (quoting Myron Orfield, whom the article describes as “widely regarded as one of the nation’s top experts in the study of voting patterns”).

6. Underscoring the seeming rarity of such virtues as integrity was Time Magazine’s selection for its 2002 “Persons of the Year,” three ordinary women who all had an “extraordinary” quality in common — the ability and courage to tell the truth. Richard Lacayo & Amanda Ripley, Persons of the Year; Sherron Watkins of Enron Coleen Rowley of the FBI Cynthia Cooper of WorldCom, TIME MAG., Dec. 30, 2002, at 30.
All this talk confirmed what I had believed: my cynical attitude that Congress and the Presidency belong to the wealthy seemed validated. Since the demographic to which I belong restricts my own access to the power brokers, I felt as if I had lost the one voice in Congress that was willing to speak on my behalf. Even if the cause of the average American was ignored in the final product, be it bankruptcy reform or some other legislation, at least our voices would be heard and our concerns stated on the record.

However, there remained the task of this Article. All during the day after Senator Wellstone's death, I drew a complete blank. What I had been attempting seemed hollow, as if I were going through the motions of the writing process without producing anything worthwhile, other than additional reading for those of us who find bankruptcy law to be interesting.

If the sense of loss I felt over Senator Wellstone's death was causing my belief that this Article would ring hollow – which was surely true – then the only thing for me to do was to change the character of the Article. I decided to proceed with a new voice in mind.

Ms. Barr, who began work on this Article as a research assistant, viewed the change in tone with much enthusiasm and willingly took on the role of co-author. I must commend her dedication to this Article, the hard work she contributed, and her contribution to the angry-prophet-renouncing-the-hypocrisy-of-our-times view of Congress and bankruptcy reform.

We intend this Article to give voice to at least some of the concerns Senator Wellstone would have advocated had he not died. We sincerely hope we succeed. As we explain, the bankruptcy reform process is a function of the power structure in Congress and represents a dangerous trend in lawmaking. It is in Senator Wellstone’s memory – and toward his vision – that we proceed.

7. I've taken this line from the Peter Finch character in “Network.” The movie makes for a particularly apt portrayal of corporate power in America. While engaging in his “angry prophet” rhetoric, Finch's character had no idea, because he was actually insane, that the corporate executives, who knew his rantings, were duping him (such as urging viewers to go to their windows and shout, “I'm mad as hell, and I'm not going to take it anymore!”) would get high ratings. It also allowed the corporate-run television network to put on a program that was supposed to be a news program but which, in actuality, was empty entertainment. Network (MGM 1976).
I. INTRODUCTION

We have always known that heedless self-interest was bad morals; we know now that it is bad economics.\(^8\)

‘Reform’ was the premise for a lot of legislative activity in 2002. Corporate and accounting reform,\(^9\) campaign finance reform,\(^10\) and bankruptcy reform,\(^11\) were all before Congress in 2002 and were accompanied by considerable media attention.\(^12\) It is the last of these on which this Article will focus, not because the others are not worthy of comment, but because of the marked distinctions between the origins and perceived need for bankruptcy reform versus other reform efforts. Moreover, a careful examination of the history and substance of bankruptcy reform calls into question the sincerity of Congress in enacting other reform initiatives,\(^13\) as well as the general commitment of our


\(^{9}\) Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745. The stated purpose of this legislation is “[t]o protect investors by improving the accuracy and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes.” Id. Whether Sarbanes-Oxley achieves this goal remains to be seen, as problems in its implementation have already arisen. Id. See infra note 13.

\(^{10}\) Bipartisan Campaign Finance Reform Act of 2002, Pub. L. No. 107-155, 116 Stat. 181. As with Sarbanes-Oxley, the effectiveness of campaign finance reform requires the passage of time, but there are implementation problems here, too. See infra note 12.

\(^{11}\) H.R. 333, 107th Cong. (2002). Although substantially similar bills were also considered in the 105th and 106th Congresses, we refer to all these bills as “bankruptcy reform,” unless otherwise noted, for the sake of simplicity.

\(^{12}\) Bankruptcy reform received little coverage on television, but has been the subject of some comment in the print media. See e.g., David Broder, Unworthy Bankruptcy Bill, The REC.-BERGEN COUNTY, N.J., May 20, 2002, available at 2002 WL 4657895 (stating that the topic has been widely ignored except on the business pages in the press). Of course, even extensive coverage in the print media does not mean that most Americans fully understand bankruptcy reform and its heavy industry support, or its harsh view of individuals’ financial distress. Obviously, most people do not regularly read the many newspapers that have addressed bankruptcy reform. Moreover, studies have shown that the majority of people tend to get their regular news from television, local news programs in particular, rather than the print media. See e.g., Pew Center For Civic Journalism, Straight Talk from Americans – 2000, at http://www.pewcenter.org/doingcj/research/r_ST2000.html (last visited Feb. 15, 2003) (finding 59 percent watch local television news daily compared to 44 percent who read a local daily newspaper).

Also worth noting, although beyond the scope of this Article is the significant and well-deserved criticism that the media does not properly serve its essential role of informing the people because the industry has been concentrated into the hands of a few large corporate interests. See generally DEAN ALGER, MEGAMEDIA: HOW GIANT CORPORATIONS DOMINATE MASS MEDIA, DISTORT COMPETITION, AND ENDANGER DEMOCRACY (Rowman & Littlefield Pub., Inc. (1998).

\(^{13}\) The Administration’s commitment to corporate, accounting, and campaign finance reform is already in doubt. Implementing the Sarbanes-Oxley Act, with respect to the accounting industry, brought about nothing but further controversy that eventually led to SEC Chairman Harvey Pitt’s election night resignation. Mr. Pitt’s Belated Departure, N. Y. TIMES, Nov. 7, 2002, at A30.
elected officials to passing legislation that is in the best interests of the country rather than favored special interest groups.\textsuperscript{14} Corporate and accounting reforms stem, of course, from the scandals that came to the public's attention beginning with the collapse of Enron. There is no need to recount the history of these scandals, for do to so would be redundant of not only substantial news coverage, but scholarly works as well.\textsuperscript{15} However, it is important to note that the problems that Enron came to symbolize significantly predated the collapse of that corporate giant without Congress's decision to take affirmative, corrective action.\textsuperscript{16} Indeed, Congress not only passed leg-

\textsuperscript{14} The final days of the 107th Congress provide an appropriate example. The Homeland Security Bill, which is now law, contained the well-publicized perks for industry. At the same time, Congress failed to extend unemployment benefits. See Zachary Coile & Edward Epstein, Congress Leaves Much Work Undone; No Budget Passed, No Energy Bill, and No Delta Plan, \textit{San Francisco Chron.}, Nov. 21, 2002, at A4.

\textsuperscript{15} Nancy B. Rapoport, \textit{Enron, Titanic, and 'The Perfect Storm,'} \textit{Fordham L. Rev.} (forthcoming 2003) (manuscript at n.6-8, on file with authors) (citing scholarly and popular press articles).

\textsuperscript{16} \textit{See e.g.,} Christopher H. Schmitt \& Paula Dwyer, \textit{Did the Auditors Cross the Line? The SEC Has Tough Questions for Microstrategy and PWC,}, \textit{Bus. Wk.}, Sept. 25, 2000, at 168 (company booked $66 million more in revenue - more than one-fifth of sales total - for 1997-99 period, changing each year's bottom line from profits to losses); John A. Byrne, \textit{Chainsaw Al Dunlap Cuts His Last Deal,} \textit{Bus. Week Online}, Sept. 5, 2002, at http://www.businessweek.com (Sunbeam's true financial state was hidden from investors from 1996 through early 1998, resulting in thousands of lost jobs, $4.4 billion in shareholder losses, and Sunbeam's bankruptcy); Carol J. Loomis, \textit{Hard Time? Hardly,} \textit{Fortune}, Mar. 3, 2002, at 78 (discussing scandals from the 1990s including Cendent, formed in a 1997 merger of CUC International and HFS, Inc.; four months later, "CUC's accounting was exposed as rotten, and Cendant's market value dropped $14 billion in one day"); Clifton Leaf, \textit{Enough Is Enough; White-Collar Criminals: They Lie They Cheat They Steal and They've Been Getting Away With It For Too Long,} \textit{Fortune}, Mar. 18, 2002, at 60 ("Before Enronitis inflamed the public, gigantic white-collar swindles were rolling through the business world and the legal system with their customary regularity."). And we haven't even mentioned the now burst tech bubble. \textit{See e.g.,} Megan Barnett, \textit{Surviving the Stakeout, Industry Standard,} Mar. 5, 2001. A "\textit{Frontline}" report stated that there were more than 700 U.S. companies that had to restate their earnings in the 1990s, all well before Enron. \textit{Bigger Than}
islation that enabled the meteoric rise of WorldCom and Enron, it also expressly declined to remedy the stock options issue that was so critical to the 2002 scandals, and was vigorously opposed to a proposed rule that would prohibit accountants from also acting as consultants.

_Enron_ (PBS television broadcast, 2002), at http://www.pbs.org/wgbh/pages/frontline/shows/regulation/etc/script.html. So, rather than being the year of the corporate scandal, 2002 was, in actuality, merely the year the scandals finally became big (or sexy) enough to warrant extensive media coverage.


WorldCom was only a minor player until the Telecommunications Act of 1996, pushed through Congress by Rep. Newt Gingrich and Sen. Trent Lott and signed into law with the enthusiastic support of corporation-friendly “New Democrat” President Clinton. At the behest of lobbyists for WorldCom – based in Lott’s home state of Mississippi – the senator stuck in an amendment specifically designed to enable WorldCom to grab a huge chunk of the telephone market.

At the time, WorldCom was lagging badly behind the big three long-distance carriers. Lott’s legalese, however, turned this to the company’s advantage by specifying that only companies – such as WorldCom – with 5 percent or less of the long-distance market could enter into joint marketing agreements with local phone service suppliers. The firm was thus free to buy MFS Communications, then the top alternative provider of local phone services, for $12.4 billion and became the first company to provide both local and long distance since deregulation forced the breakup of the Bell system.

...Thus was born the overreaching, out-of-control and fundamentally dishonest corporation that is now in bankruptcy after conceding false accounting of more than $7 billion.

18. According to the “Frontline” report, in 1993, the Financial Accounting Standards Board decided to require that stock options be expensed on a company’s balance sheet, closing a loophole that allowed stock options to remain hidden from ordinary investors. CEOs came from all over the country in a full-steam lobbying effort to prevent the FASB from taking its proposed action. Senator Lieberman, whose home state of Connecticut has a heavy concentration of accountants, led the charge against the FASB’s proposed action, and the Senate passed a non-binding resolution by a vote of 88 to 9 condemning it. Jim Leisenring, who served as Vice Chairman of the FASB at the time and who Frontline interviewed for its report, summarized the battle over the treatment of stock options: “It wasn’t an accounting debate. We switched talking about whether ‘Have we accurately measured the option?’ to things like ‘Western civilization will not exist without stock options,’ or that there won’t be jobs anymore for people without . . . stock options. People tried to take the argument away from the accounting and over to be just plainly a political argument.” _Bigger Than Enron, supra_ note 16. See also, John B. Judis, _What W. Didn’t Learn from Enron, Option Play, New Republic Online,_ Apr. 30, 2002, at http://www.tnr.com/doc.mhtml?id=20020506&s=judis050602 (discussing stock options and failed efforts to address the problems in Congress).

19. According to the Center for Responsive Politics:

In 2000, Arthur Levitt, who was then chairman of the Securities and Exchange Commission, spotted a potential conflict of interest brewing in the accounting industry. The “Big Five” accounting firms (Arthur Andersen, Deloitte & Touche, Ernst & Young, KPMG and PricewaterhouseCoopers) had managed to increase their income by offering consulting services to the same companies they audited. Levitt, concerned that the firms would compromise their credibility when they had to audit their own services, proposed an SEC rule that would bar accountants from also acting as consultants. But
Campaign finance reform, although not stemming from an event of a particular magnitude like the Enron collapse, is nevertheless similar to corporate and accounting reform because it represents a Congressional gesture designed to assure the public that moneyed interests will not completely overrun the interests of the ordinary American. Campaign finance reform attempts to diminish the influence of the powerful, moneyed interests in the political process. As Senator Feingold put it:

The people sent us here to wrestle with some very tough issues. They have vested us with the power to make decisions that have a profound impact on their lives. That is a responsibility that we take very seriously. But today, when we weigh the pros and cons of legislation, many people think we also weigh the size of the contributions we got from interests on both sides of the issue. And when those contributions can be a million dollars, or even more, it seems obvious to most people that we would reward, or at least listen especially carefully to, our biggest donors.20

Bankruptcy reform is a different animal altogether. As this Article will explore, there are problems with the Bankruptcy Code,21 with those that are most troubling arising in business bankruptcies under Chapter 11. Bankruptcy reform, however, addresses none of the real problems arising under the Code or the genuine abuses that the Code presently allows. Instead, bankruptcy reform has since its inception relied on a problem that is, in fact, largely nonexistent, specifically that too many consumer debtors—real ordinary Americans—are abusing the good graces of the Code.

At its heart, bankruptcy reform is a useful example of the ever-widening gulf between the political leadership of this country and the people whom they are supposed to serve. The impetus for bankruptcy reform was not public shock or outrage, or even media attention focusing on the citizenry's rampant abuse of the bankruptcy system. Instead, bankruptcy reform has been driven by a myopic focus on the banking industry's story of the state of consumer bankruptcies and the

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millions of dollars that this same industry poured into politicians' coffers.\textsuperscript{22}

Moreover, bankruptcy reform implicates issues much larger than those too easily dismissed as the rhetoric of class warfare. In the first place, bankruptcy reform demonstrates the ease with which Congress will overlook the financial condition of average Americans when the glare of the media spotlight is absent. The corporate and accounting reforms, after all, required that Congress act, and act quickly. The public was aware of the scandals, and the allegations of corporate greed and misconduct seemed to be indisputably true. Bankruptcy reform also allows us to question Congress's sincerity in the reform of campaign financing. In the same year that campaign finance reform was enacted, bankruptcy reform, which finds virtually no support outside of the banking industry,\textsuperscript{23} came within a breath of enactment, and ultimately failed only because of a dispute over abortion.\textsuperscript{24} If ever a piece of legislation exemplifies the power of special interests in Washington, surely it is bankruptcy reform. Thus, even assuming that the laws enacted in 2002 reforming campaign financing and corporate and accounting practices are effective,\textsuperscript{25} bankruptcy reform allows us to question the motives behind the enactment of either; that is, is Congress sincerely committed to legislating in the public interest or simply


\textsuperscript{23} Demonstrating the breadth of opposition to bankruptcy reform is an August 23, 2002 letter to Senators Daschle and Lott, and Representatives Hastert and Gephardt, whose signatories included American Association of University Women; American Federation of State, County and Municipal Employees; Association of Community Organizations for Reform Now (ACORN); Center for Community Change; Consumer Federation of America; Consumers Union; The Feminist Majority; International Association of Machinists and Aerospace Workers; International Brotherhood of Boilermakers; International Brotherhood of Teamsters; International Union, UAW; Leadership Conference on Civil Rights; Lutheran Office for Governmental Affairs, ELCA; NAACP; Ralph Nader; National Consumer Law Center; National Organization for Women; NOW Legal Defense and Education Fund; National Partnership for Women and Families; National Women's Law Center; Neighborhood Assistance Corporation of America; Public Citizen; OWL, The Voice of Midlife and Older Women; Religious Action Center of Reform Judaism; Self-Help Credit Union; Transport Workers Union; United Steelworkers of America; and U.S. Public Interest Research Group (Aug. 23, 2002) (on file with the authors).

\textsuperscript{24} One of the provisions of the bill attempts to limit the ability of abortion protestors to use bankruptcy laws to avoid their fines and costs imposed after abortion protests. Anti-abortion groups and their constituents in Congress have vehemently opposed this provision. Philip Shenon, \textit{Anti-abortion Lobbyists Tying Up Bankruptcy – Overhaul Bill}, \textit{N.Y. Times}, Sept. 24, 2002, at 22. Previously, after reaching agreement on this provision, Senator Charles Schumer stated that the resulting bill was a “victory for women.” Philip Shenon, \textit{Negotiators Agree on Bill to Rewrite Bankruptcy Laws}, \textit{N.Y. Times}, Jul. 26, 2002, at 1.

\textsuperscript{25} See supra note 13.
saving individual members' political careers when the polls dictate the necessity of taking action?

This Article proceeds in three parts. Part II briefly discusses some of the policy considerations underlying the Bankruptcy Code. Part III explores two important areas of Chapter 11 bankruptcy that have generated significant criticism: (1) the excessive use of secured transactions; and (2) the excessive power both the Code and the courts grant to bankrupt business debtors in a manner that ultimately harms the most vulnerable of the debtor's creditors, including tort victims, workers and retirees. Part IV examines, and refutes, the premises underlying consumer bankruptcy reform. The ultimate point of this Article is to demonstrate that the true problems with bankruptcy—and the areas in which the potential for abuse are very prominent—remain unaddressed while Congress myopically focuses on the largely untrue assertion that consumers, and only consumers, are abusing the good graces of the Code.

II. BANKRUPTCY POLICY

Let us remember that all reforms are interdependent, and that whatever is done to establish one principle on a solid basis, strengthens all. Reformers who are always compromising, have not yet grasped the idea that truth is the only safe ground to stand upon.26

The problems with bankruptcy, both in its current form and as the reform measures contemplate, require an understanding of the policies underlying bankruptcy and the purposes the Code is intended to serve. Several policies come into play with respect to bankruptcy. One of bankruptcy's underlying purposes serves to:

[r]elieve the honest debtor from the weight of oppressive indebtedness and to permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes. This purpose of the act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.27

Despite the Court's reference to "business misfortunes," this "fresh start for the honest but unfortunate" standard has come to signify the very foundation for individual bankruptcy cases. There is a ring of

27. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (citations omitted).
idealism to this standard that brings to mind the George Bailey\textsuperscript{28} sort of character who, although a person of unwavering integrity, has run into a bad string of luck.\textsuperscript{29} The courts nevertheless make use of the "honest but unfortunate" analysis to this day.\textsuperscript{30} This notion is reflected to some degree in Chapter 11 business cases. For example, plans must be proposed in good faith\textsuperscript{31} and the court may appoint a trustee,\textsuperscript{32} or convert or dismiss a Chapter 11 case,\textsuperscript{33} based on, \textit{inter

\textsuperscript{28} See e.g., Lynn M. LoPucki, Reforming Consumer Bankruptcy Law: Four Proposal: Common Sense Consumer Bankruptcy, 71 Am. Bankr. J. 461 (1997) (challenging the assumption that the current system, in practice, distinguishes between the honest but unfortunate and those whose conduct falls below this idealized standard).

\textsuperscript{29} See, e.g., In re Fretz, 244 F.3d 1323, 1326 (11th Cir. 2001); Carlos J. Cuevas, Public Values and the Bankruptcy Code, 12 Bankr. Dev. J. 645 (1996) (discussing exceptions to discharge expressing public values).


\textsuperscript{31} 11 U.S.C. §1104(a) (2003). Section 1104(a) provides:
(a) At any time after the commencement of the case but before confirmation of a plan, on request of a party in interest or the United States trustee, and after notice and a hearing, the court shall order the appointment of a trustee –
(1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or
(2) if such appointment is in the interest of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor.

\textsuperscript{32} 11 U.S.C. §1112(b) (2003). Under Section 1112(b), the court may dismiss or convert a case for cause, including:
(1) continuing loss to or diminution of the estate and absence of a reasonable likelihood of rehabilitation;
alia, debtor misconduct. Notably, most of these requirements are forward looking; that is, misconduct is measured in the Code in large part by the actions taken after the bankruptcy case has begun in business cases. In some respects, this post-filing perspective makes sense because business bankruptcies involve considerations such as jobs and the ripple effect on other businesses and, perhaps, the community at large, that do not arise in individual cases. Many of the prominent bankruptcies of 2002 serve as useful examples because there have been few intimations of honesty or misfortune, but plenty of evidence of outright misconduct.

(2) inability to effectuate a plan;
(3) unreasonable delay by the debtor that is prejudicial to creditors;
(4) failure to propose a plan under section 1121 of this title within any time fixed by the court;
(5) denial of confirmation of every proposed plan and denial of a request made for additional time for filing another plan or a modification of a plan;
(6) revocation of an order of confirmation under section 1144 of this title, and denial of confirmation of another plan or a modified plan under section 1129 of this title;
(7) inability to effectuate substantial consummation of a confirmed plan;
(8) material default by the debtor with respect to a confirmed plan;
(9) termination of a plan by reason of the occurrence of a condition specified in the plan; or
(10) nonpayment of any fees or charges required under chapter 123 of title 28.

Id.

34. See, e.g., id. But see, e.g., 11 U.S.C. §1104, supra note 31 (allowing appointment of trustee for fraud, dishonest, or gross management before the case is commenced).
35. Compare Chapter 11 to Chapter 7’s section 707(b), 11 U.S.C. §707(b) (2003), which allows dismissal of consumer cases where “substantial abuse,” of the provisions of Chapter 7, exists. Section 707(b) necessarily requires examination of the consumer debtor’s pre-petition motives for seeking relief.
37. The bankruptcies of 2002 were notoriously scandalous. It was painfully clear that they were not prompted by “honest but unfortunate” businesses. When it named three whistle blowers as Persons of the Year in 2002, Time magazine gave an excellent articulation of that year’s corporate fiascos:

Who knew that the swashbuckling economy of the ’90s had produced so many buccaneers? You could laugh about the CEOs in handcuffs and the stock analysts who turned out to be fishier than storefront palm readers, but after a while the laughs came hard. Martha Stewart was dented and scuffed. Tyco was looted by its own executives. Enron and WorldCom turned out to be Twin Towers of false promises. They fell. Their stockholders and employees went down with them. So did a large measure of public faith in big corporations. Each new offense seemed to make the same point: with communism vanquished, capitalism was left with no real enemies but its own worst impulses. It can be undone by its own overreaching players. It can be bitten to pieces by its own alpha dogs.

Day after day, one set of misgivings twined around the other, keeping spooked investors away from the stock market, giving the whole year its undeniable saw-toothed edge. Were we headed for a world where all the towers would fall? All the more reason
In both individual and business cases, bankruptcy functions as a collective process. Under state law, creditors may avail themselves of whatever remedies applicable law permits on an individual basis; if the debtor is in financial distress, creditors will often be in a race with each other in pursuing those remedies and whatever assets may be available. Bankruptcy, aided by the automatic stay, is designed to give debtors a needed reprieve from collections pressures, but protects creditors as well by providing them a single, collective process through which each should expect fair and orderly treatment. As compared with the state law race for available assets, bankruptcy has its advantages:

[Bankruptcy's] collective procedure is considered more advantageous to the creditors as a group than the alternative of allowing the individual creditors who move most quickly to recover in full while others recover little or nothing. Not only is each creditor in the same class paid the same proportion of its entitlement, but the proceeds of the estate, and consequently the proportion of the debt paid, are likely to be higher if the assets are liquidated in a coordinated manner rather than grabbed piecemeal by individual creditors and sold at distress prices.

This collective process is the hallmark of Chapter 7 liquidation cases, in which the trustee collects, liquidates, and distributes the debtor's assets for the benefit of the unsecured creditors. Collective action in Chapter 11 takes a different form. In most cases no trustee is appointed; rather, the debtor continues to operate the business as debtor in possession, carrying with it a fiduciary duty to the bankruptcy estate and its unsecured creditors. In Chapter 11, a creditors'

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Lacayo, supra note 6.


39. As the legislative history to §362 states:

The automatic stay also provides creditor protection. Without it certain creditors would be able to pursue their own remedies against the debtor's property. Those who acted first would obtain payment of the claims in preference to and in detriment of other creditors. Bankruptcy is designed to provide an orderly liquidation procedure under which all creditors are treated equally. A race of diligence by creditors for the debtor's assets prevents that.


41. 11 U.S.C. § 1107(a) (2003). For a discussion of criticisms of the debtor in possession concept, see infra Part II.B.

42. See supra notes 122-124 and accompanying text.
committee entrusts a few select creditors, typically the largest, with the responsibility of protecting the rights and interests of the unsecured creditor body as a whole.\textsuperscript{43}

Moreover, whereas Chapter 7 focuses on the efficient and orderly administration of the estate, Chapter 11 is more of a negotiation process, with the Code providing the framework and the rules for the parties to work toward the ultimate goal - a confirmed plan.\textsuperscript{44} In the best of all possible worlds, the debtor will emerge from bankruptcy as a viable business able to function in the market, and it will pay its prepetition creditors. This result is almost never obtained.\textsuperscript{45} Because the bankruptcy's dual aims of business viability and maximum creditor recovery may be in conflict, competing views on the exact purpose to be served by Chapter 11 have arisen. To state these views as succinctly as possible, one view is that Chapter 11 should serve the single purpose of efficient debt collection.\textsuperscript{46} On the other hand, there are those who recognize "that the financial collapse of a firm presents questions of loss allocation and community interest simply not implicated in individual debtor-creditor disputes," and who believe bank-


\footnote{44. A Chapter 11 plan can be one for reorganization or liquidation of the business. In re Ocean Beach Props., 148 B.R. 494, 497 (Bankr. E.D.Mich. 1992).}

\footnote{45. See, e.g., Ryan B. Minetti, Ordinary Business Terms: Ending the Debate Surrounding §547(c)(2)(C), 16 BANKR. DEV. J. 165, 172 n.42 (1999)(finding that payments to unsecured creditors on account of pre-petition claims in Chapter 11 are rare); Lynn M. LoPucki, The Death of Liability, 106 YALE L.J. 1 (1996) [hereinafter "Death of Liability"]. According to Professor LoPucki:

Early bankruptcy liquidations produced at least some distributions to creditors in the majority of cases. By 1976, the percentage of bankruptcy liquidations in which there was a distribution to unsecured creditors had fallen to twenty percent; by 1991-92 it had sunk to five percent. In 1926-27, unsecured creditors recovered over twenty-seven cents on the dollar in assignment liquidations, over ten cents on the dollar in involuntary bankruptcy liquidations, and about six and one-half cents on the dollar in voluntary bankruptcy cases. By 1976, the average recovery in all bankruptcy cases had fallen to less than one cent on the dollar.

Id. at 18-19.

\footnote{46. Lawrence Ponoroff & F. Stephen Knippenberg, The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy, 85 N.W. U.L. REV. 919, 949-50 (1991). See also Paul B. Lewis, Bankruptcy Thermodynamics, 50 FLA. L. REV. 329, 332 (arguing that the purpose of bankruptcy law is an attempt to reverse the flow of "disorder of certain types of systems-troubled firms- and return them to viability").}
ruptcy "is and should be designed to address a broad range of interests affected by the collapse of a debtor enterprise." 47

This Article is not concerned with weighing the relative merit of these or other views 48 of bankruptcy policy. Whichever academic perspective is correct, the reality is a predominate view that favors rehabilitating financially distressed businesses and allowing them a second chance to compete in the marketplace. Although rehabilitation is not, of itself, a misguided approach – indeed, the Code’s legislative history expresses a preference for it 49 – the rehabilitation policy can be used to such an extreme that enforcing the substance of the Code becomes a matter of secondary importance.

III. Bankruptcy Reality

All animals are equal but some animals are more equal than others. 50

A. The Supremacy of Security

In the discussion of bankruptcy policy above, use of the term “creditors” was oversimplified, making no distinction between those that are secured and those with only unsecured claims. In reality, of course, this distinction is extremely important because secured claims will be paid first and the extent of the secured creditor’s interest in the debtor’s collateral will determine whether and to what extent unsecured creditors will be paid. This general scheme holds true in bankruptcy and under the various states’ laws.

The fairness of separating secured from unsecured creditors and preferring the former is usually justified by arguments that secured credit serves a greater good that produces benefits to unsecured creditors, and the assumption that all affected creditors have consented to their status. The validity of both of these justifications is subject to much academic debate, leading to the fair conclusion that the jury is still out on the issue. Congress, at least through its last major revision of the bankruptcy laws in 1978, attempted to strike some balance be-

47. Ponoroff, supra note 46, at 960-61.
49. The legislative history states that the goal of Chapter 11 is:
[t]o restructure a business’s finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap.
between recognition of the increased acceptance and use of security on the one hand, and the need to protect the interests of the unsecured creditor body in bankruptcy, on the other.\textsuperscript{51} The history of bankruptcy reform reveals that Congress is less interested in striking a fair balance between secured and unsecured creditors than it once might have been; indeed, bankruptcy reform has at no time questioned the supremacy of security and has even expanded the secured creditor’s rights in certain transactions.\textsuperscript{52}

The debate over security’s supremacy is extensive and robust.\textsuperscript{53} Professor Warren offers this summary of the debate:

The rhetoric of the debate over security interests is couched largely in the language of economics. Will a priority scheme make lending more efficient? Will it promote more lending? Will it cause over-investment in risky projects? Will a modified priority scheme encourage greater internalization of risk? Do externalities caused by a full priority scheme undercut any efficiencies it might produce?

\textsuperscript{51} In the past, distribution to unsecured creditors was not so directly dependent upon the extent of security because courts were more hostile toward secured transactions than they are today. See, e.g., G. Ray Warner, The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy, 9 AM. BANKR. INST. L. REV. 3, 6-9 (2001); William J. Woodward, Jr., The Realist and Secured Credit: Grant Gilmore, Common-Law Courts, and the Article 9 Reform Process, 82 CORNELL L. REV. 1511, 1516-20 (1997).

\textsuperscript{52} Lien-stripping in Chapter 13, for example, is limited under bankruptcy reform. The Code requires Chapter 13 debtors to pay in full the value of collateral, but any deficiency is treated as a general unsecured claim. Bankruptcy reform requires payment at the contract rate for any collateral acquired within a year before the bankruptcy was filed and, if the collateral is a motor vehicle, the lookback period is two and one-half years. For a general discussion of this change, see Scott F. Norberg, Consumer Bankruptcy’s New Clothes: An Empirical Study of Discharge and Debt Collection in Chapter 13, 7 AM. BANKR. INST. L. REV. 415 (1999), but note that Norberg’s discussion addresses this lien-stripping provision when the lookback period was five years for all types of collateral, which was shortened in the 107th Congress.

\textsuperscript{53} For a comprehensive collection of authority on the security debate, see, e.g., Lucian Arye Bebchuk & Jesse M. Fried, The Uneasy Case for the Priority of Secured Claims in Bankruptcy, 105 YALE L.J. 857, 934 n.22-23 (1996); Steven L. Schwarcz, The Easy Case for the Priority of Secured Claims in Bankruptcy, 47 DUKJ L.J. 425 (1997) (arguing security creates benefits for unsecured creditors by increasing liquidity, allowing the financially distressed debtor to avoid bankruptcy, and increasing distribution to unsecured creditors in the event of bankruptcy); Lopucki, Unsecured Creditor’s Bargain, 80 VA. L. REV. 1887, 1963 (1994) (arguing that “[article 9 artificially and unjustifiably advantages the institution of security over unsecurity.”); Robert E. Scott, The Truth About Secured Financing, 82 CORNELL L. REV. 1436 (1997); Warner, supra note 51, at 81; (arguing revised Article 9 is designed to allow secured lenders to escape burdens of the Code); Charles W. Hendricks, Offering Tort Victims Some Solace: Why States Should Incorporate a 20% Set-Aside into Their Versions of Article 9, 104 COM. L.J. 265 (1999); Robert E. Scott, The Politics of Article 9, 80 VA. L. REV. 1783, 1788 n.13 (1994) (collections of citations on efficiency debate) [hereinafter Politics of Article 9]; Steven L. Harris & Charles W. Mooney, Jr., Measuring the Social Costs and Benefits and Identifying the Victims Subordinating Security Interests in Bankruptcy, 82 CORNELL L. REV. 1349, 1371 (arguments of “unfairness” find no support); Woodward, 82 CORNELL L. REV.1511 (1997); Julia Patterson Forrester, Bankruptcy Takings, 51 FLA. L. REV. 851 (1999) (arguing the security debate does not properly take account of constitutional issues under the Takings Clause).
There can be no doubt that economic analysis provides a valuable tool in analyzing the implications of any rule in commercial law, including a rule regarding the priority of secured debt. . .

Debates over priority are not new. Professor Schwartz revived an old debate in the newly discovered language of law and economics by asking whether secured debt is efficient. In quick order, a cottage industry of articles rising to the challenge of disputing its basic assumptions arose.

* * *

Professor LoPucki noted that economists spend a great deal of time explaining why any rule that aims to redistribute wealth to the underdog would actually reduce wealth to everyone. These economists explain the need for banks to be able to seize all the assets of a business while the tort victims limp away with nothing, as based on allocative efficiency. LoPucki comments: "Ah, to be exquisitely cruel but at the same time efficient – what more could an economist ask of an institution?"

The conflict between efficient outcomes and distributive consequences goes well beyond the Article 9 debates, with warring camps looking at their opposing numbers with sneers of derision. The special contribution of Professor LoPucki, Professor Bebchuk, and Mr. Fried has been to establish that the theoretical debate needed a much larger framework than simply figuring out why secured credit was efficient and why it should therefore always take precedence over distributional concerns. They forcefully point out that the heralded efficiencies of secured credit might themselves be suspect. Indeed, they push the point further, noting that there might be serious inefficiencies created by a full priority scheme for secured creditors. Their scholarship sets the stage for a heretical question: If the secured credit system might be both inefficient and distributionally suspect, perhaps the time has come to revisit its premier place in the commercial world.54

Professor Warren captures the dual nature of the security debate; whether security is efficient in the first place and, even assuming it is, whether Article 9 should nevertheless incorporate some measure of normative considerations. The latter is a question of procedural fairness and a challenge to the notion that an efficient system is superior to all others.55


55. That efficiency can and should give way to normative considerations is hardly a novel concept. Our criminal justice system is inefficient, but we accept that the inefficiency is necessary to ensure justice is properly done. More to the point of this Article, Chapter 11 is, at least conceptually, a normative construct, as reflected in the policy that Chapter 11’s primary goal is to give financially troubled businesses a chance to recover. Notwithstanding its unimpressive success rate, even the most strident free-market thinkers support Chapter 11 and its rehabilitation policy. In a Washington Times editorial, for example, Daniel Mitchell, the McKenna fellow
The normative challenge to security looks at the consequences of permitting debtors to redistribute their wealth, transferring value away from unsecured creditors, especially involuntary creditors, such as tort claimants,\textsuperscript{56} as well as "reluctant"\textsuperscript{57} creditors, who are least able to protect themselves, to "lenders who are entirely voluntary, best able to protect their rights, and best able to spread their risks among numerous projects."\textsuperscript{58} Put another way:

A borrower may distribute dangerous products that cause injury, fail to pay its employees, or fail to make required payments into the employees' pension funds. That business's secured lender, though, provided it followed the rules, will be paid from the borrower's assets before the tort claimants or employees get anything.\textsuperscript{59}

In the worst cases, debtors can render themselves judgment proof, insulating themselves from liability while continuing to operate.\textsuperscript{60}

The consequences that this system requires tort victims, employees, and other involuntary creditors to bear cannot be understated. The state law secured financing regime places these creditors at a distinct disadvantage in terms of recovery, a disadvantage that the Bankruptcy

\textsuperscript{56.} Other claimants who would be classed as involuntary would include former spouses and children who are owed domestic support, governmental agencies including taxing authorities, utility companies, defrauded creditors, or victims of antitrust violations, unfair competition, and patent, trademark and copyright infringement. LoPucki, supra note 53 at 1896-97 (1994).

\textsuperscript{57.} Id. at 1896. Professor LoPucki divides the voluntary unsecured creditors into two camps, the "asset-based" unsecured lender and the "cash-flow surfers." He argues that the asset-based unsecured creditor is typically large and sophisticated, dealing with debtors of comparable size and sophistication, and, as such, is protected largely to the same extent as the secured lender. Id. at 1924-30. The more common cash-flow surfers, "expect to be paid in the ordinary course of business from the secured creditor's collateral, particularly the debtor's usually fully encumbered bank account." Id. at 1938. The secured creditor can interrupt this cash flow "at its whim," by enforcing an agreement between it and the debtor, an agreement to which the unsecured creditor was not a party. Id. at 1939. These creditors are also referred to as "occasional" creditors, Politics of Article 9, supra note 53, at 1794, "nonadjusting creditors," Bebchuk, supra note 53 (including involuntary creditors within the term, or similar self-describing types of terms).

\textsuperscript{58.} Warren, supra note 54, at 1389.


\textsuperscript{60.} Death of Liability, supra n. 45 at 4. Lynn M. LoPucki, The Death of Liability, 106 YALE L.J. 1, 4 (1996).
Code fully recognizes. Once a bankruptcy is filed, the reluctant and involuntary creditors’ dilemma is often exacerbated, despite any protections the Code is supposed to provide. Any action these creditors could have taken outside of bankruptcy will be automatically stayed and, as will be discussed below, the debtor’s management can so control the outcome of the bankruptcy case that these claimants have little ability to assert their rights. This is no small matter because there are literally thousands of involuntary creditors with claims in pending bankruptcy cases right now, including individuals injured by defective products and the employees, retirees and investors caught up in the record breaking – and, as with Enron, WorldCom and their ilk, scandal-ridden – business bankruptcy cases.

Although efficiency alone is insufficient to justify Article 9 and secured transactions among academics, it is the cornerstone of Article 9 itself. The original drafters wanted “to provide a simple and unified structure within which the immense variety of present-day secured financing transactions can go forward with less cost and with greater certainty.” Indeed, it is because of Article 9’s emphasis on efficiency and simplicity that issues concerning distributional consequences have arisen.

Yet, despite the debate and compelling arguments challenging the supremacy of security, the recent revision to Article 9, which has been adopted in every state, actually expands the secured creditor’s power

61. See infra, note 88 and accompanying text.
62. See infra section II.B.
63. There is no doubt that the Enrons and WorldComs of the 2002 bankruptcy saga have caused thousands of claims for employees and retirees. Asbestos cases, as well, have produced thousands of claims. For instance, when Owens Corning, producer of asbestos-containing high-temperature pipe coating, filed for bankruptcy with the numbers of asbestos claims growing and the funds becoming inadequate. The asbestos containing material was present in 90% of American homes. Fiberglass Information Network, Owens Corning Declares Bankruptcy, available at http://www.sustainableenterprises.com/fin/News/bankrupt.htm. Of course, homeowners may never even realize that they have claims against Owens Corning or any other company producing asbestos or using it in its products. In 2002, when the Environmental Protection Agency was ready to make a public announcement to the American people that the insulation in their attics may be contaminated by asbestos, the White House intervened and the warning was never made. Andrew Schneider, White House Thwarted EPA’s Asbestos Insulation Warning, SEATTLE TIMES, Dec. 29, 2002, seattletimes.com.
64. See, e.g., Dena Aubin, Fraud Figures Heavily as Bankruptcies Soar, THE SAN DIEGO UNION-TRIB. Dec. 31, 2002, at C-3. To put 2002 in better perspective, the Kmart case, filed in early 2002, was the sixth largest when filed; by year-end, it was no longer even in the top ten. Michael Arndt, The Bankruptcy Run Isn’t Slowing, BUS. WEEK, Jan. 13, 2003, at 36. Even more eye-popping is that the assets of bankrupt companies in 2001-02 exceed the combined assets of every business bankruptcy in the previous decade. The Year of the Falling Companies, HOUS. CHRON., Jan. 2, 2003, at 1.
65. LoPucki, Death of Liability, supra note 45 60, at18.
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over the debtor's assets. Moreover, certain provisions of revised Article 9 appear designed specifically to defeat Code sections that actually do disadvantage secured creditors. As Professor Warner has speculated, revised Article 9 produces several general themes, all of which work to the detriment of unsecured creditors in bankruptcy:

First, revised Article 9 rejects the notion that any assets should be "carved out" of the reach of secured credit in order to preserve some free assets to either fund a reorganization effort or to insure some minimum recovery for unsecured creditors. Second, the revision drastically curtails the trustee's ability to use the bankruptcy strong-arm power to avoid security interests. Third, with respect to income producing assets, the revision provides a mechanism for opting out of the bankruptcy regime entirely. Fourth, the revision diverts the enterprise's reorganization value to the secured creditor. Finally, the revision hampers the debtor's ability to reorganize by giving greater control over that process to the secured creditor.

A question that should immediately spring to mind is how security could have been so expanded under revised Article 9 in the face of legitimate scholarly debate regarding the supremacy of secured credit. The answer lies, at least in part, in the process by which uniform laws like Article 9 are created, revised and enacted.

66. See, e.g., Larry T. Garvin, The Changed (and Changing?) Uniform Commercial Code, 26 Fla. St. U. L. Rev. 285, 344-46 (1999), which summarizes Article 9's revisions as follows:
Even more important [than a disparity among classes of creditors in transitional costs], though, is the tendency of revised Article 9 to favor secured lenders over trade creditors and other unsecured creditors. The original U.C.C. moved far in that direction, in part by unifying a messy and complex field of law, in part by abrogating the pre-Code rights of unsecured creditors, and in part by making possible the ready use of floating liens and blanket liens. The new Article 9 pushes further that way. It expands the possible scope of security interests to include, among other things, deposit accounts, payment intangibles, commercial tort claims, health care receivables, and most consignments. It eases perfection rules. It lowers costs by doing away with most occasions for multiple filings. It clarifies the rules about filing locations, thus reducing the number of multistate filings.
Just as important are the things it does not do. It makes only modest improvements in the lot of the consumer-debtor, rolling back some helpful changes in earlier drafts. Though a good many commentators of a wide range of political stances have urged that involuntary tort claimants be given enhanced priority, this was not done. The Article 9 committee also lobbied for the reversal of a proposed change in Article 2, which would have improved the status of a reclaiming seller; the Article 2 committee acceded.

67. See generally, Warner, supra note 51.
68. Id. "[T]he extent to which the changes in revised Article 9 will have these effects turns on a number of factors," notably judicial construction of the revised Article's language. Id. at 24.
69. Indeed, when the "carve-out" was proposed, it was greeted with hostility and unanimously rejected. Woodward, supra note 51.
70. Warner, supra note 51, at 24.
71. See Politics of Article 9, supra note 53, at 1803-07 (providing a description of this process).
tion as a "pure" process\textsuperscript{72} that relies on experienced practitioners and academics with particular expertise on a given subject, special interests nevertheless tend to heavily influence the final product.\textsuperscript{73} Indeed, this influence partly derives from the very structure – reliance on experts – that gives the U.C.C. its perceived intellectual superiority.\textsuperscript{74} In his examination of the Article 9 Study Group,\textsuperscript{75} Dean Scott observed:

\begin{quote}

a year-round clearinghouse for business-friendly legislation. Its nine task forces, each composed of legislators and representatives from private industry, sit down together to draft model bills on issues ranging from agriculture to school vouchers, which are then introduced in state legislatures across the country.

Though it calls itself "the nation's largest bipartisan, individual membership association of state legislators," ALEC might better be described as one of the nation's most powerful — and least known — corporate lobbies. While other lobbyists focus on the federal government, ALEC gives business a direct hand in writing bills that are considered in state assemblies nationwide. Funded primarily by large corporations, industry groups, and conservative foundations — including R.J. Reynolds, Koch Industries, and the American Petroleum Institute — the group takes a chain-restaurant approach to public policy, supplying precooked McBills to state lawmakers. Since most legislators are in session only part of the year and often have no staff to do independent research, they're quick to swallow what ALEC serves up. In 2000, according to the council, members introduced more than 3,100 bills based on its models, passing 450 into law. As Jones points out, ALEC's critics justifiably charge the group with an unacceptable attempt at stealthy involvement: legislation drafted by corporate interests, reaching various areas including deregulation of utilities, limitations on class actions and tort liability, and reducing or eliminating the minimum wage, is introduced without ALEC's fingerprints. Enron was among ALEC's past corporate donors, and its membership "includes speakers, presidents, and majority and minority leaders in 22 senates and 30 houses" across the country.


\textsuperscript{73} Politics of Article 9, supra note 53, at 1828 ("the distributional effects [of Article 9's choice of law provisions] clearly favor those classes of secured creditors – general financiers, and other primary lenders – who have and continue to exercise the greatest influence over the Article 9 revision process"). See also, Woodward, supra note 51(describing hostile response and uniform rejection of Professor Warren's suggestion of a 20% carve-out).

\textsuperscript{74} See e.g., James J. White, *Ex Proprio Vigore*, 89 Mich. L. Rev. 2096, 2097 (1991) ("The principal argument that the Commissioners can make on behalf of a uniform law when it is considered by a state legislature is its technical and substantive superiority over a law born in the back room of a state legislature and sired by a lobbying organization.").

\textsuperscript{75} A study group is appointed if the Permanent Editorial Board for the Code and the American Law Institute's Director ex officio agree to prepare a report for revisions of the Code. Here Dean Scott explains the nature and make up of the study groups:

Study groups tend to have academics serving as chief reporters, with other academics and practitioners serving as members. In addition, study groups seek out advice from groups or individuals who have some interest or stake in the revisions at hand. The
The principal currency in the Study Group, therefore, is technical expertise. Moreover, all expertise is not equally valued. Although academic insights into the structure and social effects of Article 9 are recognized as important, encyclopedic knowledge of how the rules have been interpreted by different courts is valued more highly, and the greatest asset is knowledge of how the rules "really work" in practice. This hierarchy of expertise is not irrational, given the operating assumption of the ALI and NCCUSL approach.  

* * *

On the other hand, the privileged status of "hands on" working knowledge of Article 9 rules has dramatic effects on the dynamics of Study Group deliberations. Most significantly, in-house counsel for banks and finance companies and private commercial lawyers whose practice involves representation of those interests provide the most important source of expertise concerning the nature and effects of proposed revisions to Article 9.

Industry bias is even more pronounced with respect to enacting the final product, and "wide enactment of uniform laws often requires industry support, and is impossible to accomplish in the face of industry opposition." The need to create text that is capable of being enacted in the various states is the uniform law process's most constraining feature. Since the Uniform Commercial Code, by definition, requires uniformity of enactment, controversial proposals, or those involving sweeping changes to the status quo, are disfavored. Affected industries that view a draft as unfavorable can successfully exercise their influence by threatening to mount a concerted effort in opposition in only a few key states.

In the end, of course, efficiency and the belief in the inherent goodness of Article 9 prevailed over normative considerations, and the revision was enacted in almost every state by the hoped-for effective date of July 1, 2001, and the few dilatory states soon followed suit.

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study group as a whole has the final say as to the draft report's contents. After completing their reports, study groups, which tend to meet two to three times a year, send their products on to both the ALI [American Law Institute] and the NCCUSL [National Conference of Commissioners of Uniform State Laws].

Politics of Article 9, supra note 53, at 1804-05.

76. Here, Dean Scott refers to the American Law Institute ("ALI") and the National Conference of Commissioners on Uniform State Laws ("NCCUSL"), both of which "believe that their function is to deal with technical problems that can be resolved by legal expertise and to avoid issues whose resolution requires controversial value choices." Id. at 1805-06.

77. Id. at 1808-09. Dean Scott cautions, however, against sole reliance on impressionistic observations. Id. at 1809.

78. Id. at 1820.


80. Id. at 1521-26.

All through the process, bankruptcy reform was pending before Congress. Despite having once attempted to ameliorate the effect of security on the collective process in bankruptcy, Congress has largely ignored any problem revised Article 9 might create in bankruptcy, including the extent to which security precludes distribution to unsecured creditors, or the manner in which specific Code protections are rendered effectively superfluous.

Distribution to unsecured creditors depends almost entirely on the existence of unencumbered assets. Indeed, it is not unusual that security is so all-encompassing that no distribution is possible. In these cases, the Code's protections for unsecured creditors are, quite simply, meaningless. For example, § 507(a) of the Code acknowledges the particular vulnerability of involuntary creditors and requires that certain classes of these creditors be paid before general unsecured creditors receive any distribution. Of course, if the debtor's assets are fully collateralized, the priority status accorded these creditors is of no value at all.

Moreover, as is discussed next, even where there are unencumbered assets, it is far from a foregone conclusion that creditors will receive meaningful distribution, or even fair treatment, once the bankruptcy case has been commenced.

82. In Connecticut, the revision was effective October 1, 2001, and in Alabama, Florida and Mississippi, the revision took effect on January 1, 2002. Jul. 1 Press Release, supra note 81.

83. See supra note 51.

84. Even if Congress showed an inclination to consider the effect of revised Article 9 in bankruptcy as part of its overall effort to reform the Code, "financial institutions no doubt would argue before Congress that sound policy (including distributional policy) was already set by national experts in the Article 9 process and it would be wasteful to revisit the issues." Woodward, supra note 51, at 1531 n.99.

85. See e.g., LoPucki, supra note 60, at 18-19. Compounding this situation is the fact that even where a debtor enters bankruptcy with unencumbered assets; unsecured creditors are deprived of the value of those assets when the debtor's post-petition financer requires that a security interest be granted as a condition to providing funds. 11 U.S.C. § 364(c) (2003).

86. 11 U.S.C. § 507(a) (2003). Among the types of debt afforded priority under § 507(a) are past due wages, certain retirement benefits, consumer deposits, alimony and child support, and taxes. Plainly, none of these debts would arise from a normal debtor-creditor transaction in which the creditor voluntarily extends credit in exchange for even nominal consideration.
B. Concentrated Control in the Hands of the Debtor

A chief criticism of Chapter 11 business cases is that too much power over the reorganization process is vested in the debtor, resulting in delay, excessive costs, and other problems. As discussed above, the ease with which the debtor can transfer wealth to preferred lenders through security can make the bankruptcy itself a meaningless endeavor from the unsecured creditors’ vantage point. In addition to wealth transfer through securitization, debtors are armed with significant express powers that put them in the driver’s seat at the earliest and most critical stages of the bankruptcy.

Indeed, debtor control begins even before commencement of the case because it is the debtor who determines where the bankruptcy case will be filed. Section 1408 of title 28 permits the debtor to file its bankruptcy case where its principal assets or principal place of business are located, or in the debtor’s state of residence or domicile. Because “residence or domicile” has been interpreted to include the debtor’s state of incorporation, the case can proceed in a state where the debtor has no physical presence, other than the documents that created it. The affiliate rule expands debtor choice even further. Under this rule the bankruptcy of an eligible subsidiary can first be filed in the desired district and, based on that debtor’s properly

88. Excessive security can also make bankruptcy impossible for the debtor. Because Chapter 11 is funded through unencumbered assets, which includes compensation of the debtor’s attorney and other professionals, “even a viable debtor may find it impossible to obtain the professional services necessary to reorganize.” LoPucki, supra note 87, at 579
89. This statement assumes the bankruptcy is voluntarily filed, as is true for the majority of bankruptcies. Even if creditors file an involuntary petition, the debtor may move to transfer venue in the interests of justice or for the convenience of the parties. See 28 U.S.C. § 1412 (2003), FED. R. BANKR. P. 1014(a).
90. 28 U.S.C. § 1408 (2003). The statute provides:
   Except as provided in section 1410 of this title [venue of cases ancillary to foreign proceedings], a case under title 11 may be commenced in the district court for the district —
   (1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement, or for a longer portion of such one-hundred-and-eighty-day period than the domicile, residence, or principal place of business, in the United States, or principal assets in the United States, of such person were located in any other district; or
   (2) in which there is pending a case under title 11 concerning such person’s affiliate, general partner, or partnership.
venued case, the parent’s bankruptcy petition can be filed in the same district.\textsuperscript{93} Used strategically, the affiliate rule not only allows a case to proceed in a state with which the debtor has no connection, other than corporate affiliation, but can also destroy a healthy company\textsuperscript{94} for the sake of obtaining the preferred venue.\textsuperscript{95}

The venue choices available to debtors, of course, can easily lead to an impermissible degree of forum shopping. Theoretically, bankruptcy law should be uniformly applied throughout the nation’s bankruptcy courts, but in practice, courts differ in their interpretations of the Code. Selecting a court strategically to exploit those differences “can have an important effect on the distribution of the losses emanating from a bankruptcy reorganization.”\textsuperscript{96} For example, a debtor facing mass tort liability to which the debtor’s officers and directors may also be exposed would likely seek to avoid judicial districts in which so-called third party releases as components of the reorganization plan are prohibited.\textsuperscript{97} Strategic use of venue selection in this regard would allow non-debtors to evade their liability to injured tort claimants, even where egregiously wrongful conduct is involved.\textsuperscript{98}

A debtor may also strategically select a court that places considerable distance between it and significant numbers of its creditors. That

\footnotesize{93. Theodore Eisenberg & Lynn M. LoPucki, Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations, 84 CORNELL L. REV. 967, 985 n.52 (1999). A good example is the Enron bankruptcy, which involved 28 affiliated debtors in what we refer to collectively as “Enron’s bankruptcy” was filed. The first petition was filed by an entity known as Enron Metals & Commodity Corp., which, although incorporated in Delaware, had its principal place of business and most of its employees in New York. \textit{Id.} Through the affiliate rule, the remaining 27 petitions could be filed in New York as well, despite the fact that 26 of them, including parent Enron Corp., had their principal place of business, principal assets, executives and officers, and (unshredded) business records in Houston, Texas. \textit{In re Enron Corp.}, 274 B.R. 327, 338-39 (Bankr. S.D. N.Y. 2002). \textit{Id.}


95. A prominent example of the use of the affiliate rule is Eastern Airlines. Eastern, a Miami based corporation, filed for bankruptcy in the Southern District of New York through the use of one of its subsidiaries, Ionsphere Clubs. Ionsphere was insolvent when it filed and represented only a tiny fraction of Eastern’s assets (it ran Eastern’s hospitality suites for its frequent flers). Robert K. Rasmussen & Randall S. Thomas, Timing Matters: Promoting Forum Shopping by Insolvent Corporations, 94 N.W. U. L. REV. 1357, 1365 (2000).


97. \textit{See infra} note 145-49 and accompanying text.

98. \textit{Id.} at 149.
distance serves to disadvantage creditors, especially employees, consumers, or small trade creditors who lack the resources to fully vindicate their rights. In large, complex cases, this argument loses some of its force because the disadvantage by distance argument would be present wherever the case is ultimately sited for all but the largest institutional creditors.99

In other cases, however, the debtor's venue choice is so far removed from its operations that an inference of abuse, or at least impropriety, arises.100 For example, in the fall of 1998, Sun TV, an electronics and appliance retailer, filed a voluntary Chapter 11 petition in Delaware. Other than having incorporated in Delaware, Sun TV had no nexus with that state. Instead, its headquarters, real estate, and the majority of its operations were in Ohio. Two months after filing its Chapter 11 petition, the Sun TV case was converted to Chapter 7, and the company was liquidated. In the meantime, customers of Sun TV had a difficult time getting answers, let alone property they had purchased or money on their claims, from Sun TV.101 In the end, Sun TV's secured creditors ended up with the money consumers used to pay for goods, and the goods many of those consumers purchased.102 As unsecured creditors, affected consumers got nothing even though the Code blessed them with priority status,103 and, as the successful bidder

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99. In the Enron case, supra note 93, Houston appears to be a more logical venue because of the location of the companies' assets, employees and documents. However, even if the bankruptcy proceeded in Houston, creditors, including workers, retirees, and small trade creditors, would still be disadvantaged.

100. A party in interest can object to the debtor's chosen venue and move for a transfer of the case under §1404 of title 28. 28 U.S.C. §1404 (2003). However, as discussed below, the factors courts use to determine whether a case should be transferred tend to tilt in favor of the debtor's chosen venue. See infra n. 105-10 and accompanying text.


102. Id. We can only speculate, but Sun TV's secured creditors probably had security interests in both proceeds and inventory.

103. 11 U.S.C. § 507(a)(6) (2003). This section grants priority status to:

allowed unsecured claims of individuals, to the extent of $2,100 for each such individual, arising from the deposit, before the commencement of the case, of money in connection with the purchase, lease, or rental of property, or the purchase of services, for the personal, family, or household use of such individuals, that were not delivered or provided.

Id. By its plain language, this priority would encompass the goods Sun TV's customers purchased but which were not delivered, and may also encompass the extended warranties many of Sun TV's consumer creditors had purchased. See e.g., In reTart's T.V. Furniture & Appliance Co., 165 B.R. 171 (Bankr. E.D.N.C. 1991).
in an auction of Sun TV's assets, the company's founder was able to reclaim a number of its stores.\footnote{104}

A properly venued case can, of course, be transferred to another venue in the interest of justice or for the convenience of the parties,\footnote{105} but the courts' standards for considering such motions make transfer unlikely. Unlike the liberal choices granted the debtor under the venue statute,\footnote{106} courts approach motions to transfer with great caution.\footnote{107} In addition, among the various factors courts consider when determining whether to transfer venue,\footnote{108} the economic and efficient administration of the estate is held to be of paramount concern,\footnote{109} and this includes a court's investment of resources in the case at its earliest stages. Where a debtor files along with its bankruptcy petition any number of "first day" and emergency motions, which is not uncommon, the debtor's court of choice necessarily becomes invested in the case before all but the largest of creditors have even received their official notification that the case has commenced.\footnote{110} Thus, just as the initial choice of venue may be a strategic one for the debtor, so, too, can be its conduct once the case is commenced in ensuring the case remains in the debtor's preferred court.


\footnote{106} Note that the liberality of interpreting the venue statute does not extend to consumer cases where the debtor's place of employment may be his preferred district for filing. In \textit{In re McDonald}, 219 B.R. 804 (Bankr. W.D. Tenn. 1998), for example, the court transferred a case from the Western District of Tennessee because the debtor resided in Arkansas. However, the debtor worked in Tennessee, and his chosen venue was only a short distance for both the debtor and his counsel, while the Arkansas bankruptcy court required more than an hour's drive time. Siding with the majority of courts, the \textit{McDonald} court held the debtor's place of employment does not equate to the "place of business" for venue purposes. \textit{Id.} at 805. \textit{See also In re Berryhill}, 182 B.R. 29, 30 (Bankr. W.D. Tenn 1995) (citing cases).

\footnote{107} \textit{See, e.g., In re Enron}, 274 B.R. at 342 (motions to transfer venue are "not to be taken lightly" and the "debtor's choice of forum is entitled to great weight if venue is proper").

\footnote{108} \textit{In re Commonwealth Oil Refining Co.}, 596 F.2d 1239, 1247 (5th Cir. 1979). The court here held the general considerations for transfer of venue are the interest of justice and the convenience of the parties. Under the "convenience of the parties" the factors to be considered are:

1) The proximity of creditors of every kind to the court;
2) The proximity of the bankrupt (debtor) to the court;
3) The proximity of the witnesses necessary to the administration of the estate;
4) The location of the assets;
5) The economic administration of the estate;
6) The necessity of ancillary administration if bankruptcy should result.

\footnote{109} \textit{Id.} \textit{See In re Enron}, 274 B.R. at 348.

Once a case is filed, various Code provisions combine to allow debtors to chart the course of their bankruptcies, which may not be consistent with the best interests of their creditors. Unlike other national bankruptcy systems, the American Code permits the debtor's prepetition management to continue operating the business as debtor in possession in Chapter 11. As with venue, there is a presumption favoring continued debtor in possession operation and, although trustees may be appointed, courts have shown reluctance in doing so. The theory behind the debtor in possession is that those most familiar with the business should continue its operation.

As this part will show, the debtor in possession concept is replete with criticism. In the first place, there is no mechanism in Chapter 11 to weed out cases in which poor management caused the financial distress, and poor management, alone, is insufficient to warrant appointment of a trustee. Studies have shown that the Chapter 11 process takes longer when the debtor in possession continues to operate the business, and management can strategically use delay to extract concessions from creditors.

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111. See, e.g., Theodore Eisenberg & Stefan Sundgren, Is Chapter 11 Too Favorable to Debtors? Evidence From Abroad, 82 Cornell L. Rev. 1532, 1534 ("The United States is probably the only developed nation that leaves the debtor in unsupervised possession of the estate during a reorganization") (quoting Lynn M. LoPucki, Chapter 11: An Agenda for Basic Reform, 69 AM. BANKR. L.J. 573, 576-77 (1995)) (providing criticism of debtor in possession concept).

112. In re La Sherene, Inc., 3 B.R. 169, 174 (Bankr. Ga. 1980) ("The presumption arises from a belief that the debtor and current management are generally best suited to orchestrate the process of rehabilitation for the benefit for creditors and other interests of the estate.").

113. See e.g., Lynn M. LoPucki, The Debtor In Full Control – Systems Failure Under Chapter 11 of the Bankruptcy Code? Second Installment, 57 AM. BANKR. L.J. 247 (1983) [hereinafter Systems Failure]; Harvey R. Miller, The Changing Face of Chapter 11: A Reemergence of the Bankruptcy Judge as Producer, Director, and Sometimes Star of the Reorganization Passion Play, 69 AM. BANKR. L.J. 431 (1995) (presenting and analyzing the following criticisms: that the existing officers and management caused the very financial distress that precipitated the bankruptcy case, the concept that the management of some public corporations is not always a significant owner of the capital stock of the corporation and will be indifferent to the interests of stockholders, and that the concept is of the debtor in possession is flawed because there is no independent party responsible for advancing the reorganization on an expeditious basis, thus the debtor in possession carries too many duties to be effective); Edward S. Adams, Governance in Chapter 11 Reorganizations: Reducing Costs, Improving Results, 73 B.U. L. Rev. 581, 583 (1993) (criticizing the Code for inadequately constraining debtor in possession indiscretions with respect to Fundamental Bankruptcy Decisions); George G. Triantis, A Theory of the Regulation of Debtor-in-Possession Financing, 46 VAND. L. Rev. 901 (1993) (arguing that no coherent theory informs judicial determinations over debtor-in-possession financing).

114. Systems Failure, supra note 113, at 263 ("There is a broad consensus among students of business failure that the large majority of businesses which fail do so because of poor management.").


117. Unproposed Solution, supra note 94, at 136.
Chapter 11 incentives are also skewed against creditors:

Arguably, in a capitalist system the market should provide the function of disciplining management without the need for legislation. However, a corporation which files for relief under Chapter 11 is shielded from the effects of the market. Furthermore, under Chapter 11, a corporation can seek such protection from the market irrespective of its financial status and may extend such protection indefinitely. Thus, corporate management is able to take unnecessary risks with the assets of a corporation. When those risks are successful they inure to the benefit of management, but when the risks are unsuccessful they are spread among the creditor body.\(^{118}\)

Indeed, it may be difficult for parties in interest to even assess the risks undertaken by management. Not only are courts hesitant to interfere with the day-to-day business decision-making,\(^{119}\) but there may also be obstacles to obtaining the information necessary to assess the decisions actually being made.\(^{120}\) The debtor in possession may be reluctant to share certain information, requiring either creditor concessions\(^{121}\) or costly judicial intervention.

Moreover, even though the debtor in possession serves in a fiduciary capacity with respect to the bankruptcy estate and its creditors, the fiduciary obligations imposed on management provide illusory protection because of inherent conflicts with management’s duty to shareholders,\(^{122}\) or its own self-serving interest.\(^{123}\) Worse still, at least one commentator has argued that management control of the reorganiza-

118. Id. at 145-46.
119. Id. at n.222.
120. Professors Betkar, Ferris and Lawless noted the decrease in available information resulting from a bankruptcy filing:

A bankruptcy filing exacerbates the normal information asymmetries that exist between management and the firm’s external claimants. Market valuations often disappear as stock exchanges delist bankrupt firms’ stock or the market trades the stock thinly. Firms in bankruptcy often cease reporting audited financial statements and instead offer unaudited reports generated by management. Also, the management of a firm in bankruptcy even may delay the filing of mandated SEC reports or the holding of periodic shareholders’ meetings.

Periodic financial reporting required by the Code does not come close to solving the information asymmetries. There generally is no requirement that these reports be certified as accurate by a third party such as an auditor. Hence, these reports are no more credible than the managers standing behind them. As an example, Professors Weiss and Wruck studied Eastern Airlines bankruptcy and concluded that lack of credible information was one of the reasons creditors were not able to identify the downward spiral of Eastern Airlines during its Chapter 11. The result was a loss of two billion dollars or almost 50% of Eastern’s prebankruptcy value.


121. See, e.g., Picker, supra note 94, at 523 (discussing unsecured creditors’ access to information regarding the debtor’s secured indebtedness).
tion process may allow insiders to engage in post-confirmation self-dealing, which, because of jurisdictional concerns, is beyond the authority of the bankruptcy courts to redress.124

Other checks on the debtor in possession's control – the participation of unsecured creditors committees, appointment of trustees or examiners, or conversion or dismissal of the Chapter 11 case – may also prove ineffective. Creditors' committees, for example, are a good theoretical idea, but practical problems stand in the way of their effectiveness. First, such committees are not formed in all cases.125 If formed, the individual committee members likely will not possess the financial and legal skills necessary to navigate the committee through the case,126 but if there are no unencumbered assets, no funds will be available to pay for needed professionals.127 Moreover, the committee itself may not adequately represent the interests of all creditors. For example, a committee composed of banks with general unsecured claims has no incentive to advance the interests of, say, consumers with priority claims.128 To do so would only diminish the members' ultimate recovery, as would appointment of a separate committee for the consumer claims because of the increased cost.129

Of equally limited value in reigning in the power of the debtor in possession are Code provisions allowing for the appointment of a trustee or examiner and dismissal or conversion of the case. The limitations on the creditors' committee discussed above diminish the value of these provisions; an unformed, inactive, or unfunded committee is not likely to file motions for such relief, especially since they are not likely to be granted.130

To its credit, Congress has seen the need to limit debtor control in one respect: bankruptcy reform provides a change in the "exclusivity period," which currently precludes any party other than the debtor from filing a plan of reorganization for a specified period of time.

125. Id. at 120.
126. Systems Failure, supra note 113, at 252; Cuevas, supra note 123, at 395.
127. The debtor can ensure that no funds are available to the committee through the effective use of security. See supra, Part II.A. The same result can be obtained through postpetition financing.
129. See, e.g., Systems Failure, supra note 113, at 251-252.
130. Cuevas, supra note 123, at 400.
Under current law, exclusivity lasts 120 days, but is routinely extended under the lenient "for cause" standard.\textsuperscript{131}

Otherwise, however, Congress has left the Code largely intact as it concerns debtor control in large business bankruptcies, despite the clear indications that the Code's attempt to strike a balance between the Chapter 11 debtor and its creditor body have failed. Moreover, Congress has likewise failed to address bankruptcy jurisprudence that, toward the goal of fostering rehabilitation, actually conflicts with the Code itself.

Nowhere is this point more clear than with the "doctrine of necessity." The doctrine of necessity, also called the "critical vendor doctrine," involves the debtor's request to pay the prepetition claims of specific vendors, suppliers, or other creditors whose goods or services are essential to the debtor's operations. Satisfaction of these critical vendor claims can take many forms,\textsuperscript{132} but the justification for them is largely the same - if the prepetition claim is not satisfied, the vendor will not deal with the debtor postpetition, and the debtor will have no viable shot at reorganizing.

The "doctrine of necessity" dates back many years in bankruptcy practice, growing out of the separate but related doctrines of the "six months rule" and the "necessity of payment rule." The first of these stems from railroad reorganizations in the 19th century in which the appointed receiver was allowed to pay certain prepetition debts for labor, supplies, and equipment. Equitable in nature, the rule "only applied to expenses necessary for the continued operation of the railroad that arose immediately preceding the petition."\textsuperscript{133} This rule is now codified at § 1171(b) of the Code, but remains applicable only to railroads.

The necessity of payment rule "developed to allow trustees to pay pre-petition debts under threats of creditors in order to obtain continued supplies or services essential to the continued operation of the debtor's business."\textsuperscript{134} Also originally applied in railroad reorganization cases, the rule was extended, quite logically, to airline cases, and grew into the current doctrine of necessity.\textsuperscript{135} Under the modern formulation, the type of business involved is no longer terribly relevant;

\begin{itemize}
\item \textsuperscript{131} 11 U.S.C. § 1121 (2003).
\item \textsuperscript{133} \textit{In re CoServ}, L.L.C., 273 B.R. 487, 493 n.7 (Bankr. N.D. Tex. 2002).
\item \textsuperscript{134} \textit{Id.}
\item \textsuperscript{135} \textit{Id.}
\end{itemize}
rather, the cases emphasize the “paramount consideration of Chapter 11, that of continued operation and rehabilitation of the debtor.”¹³⁶

However, this “paramount consideration” fails to take the Code itself into account. As noted above, only in railroad cases are these sorts of payments explicitly permitted. It is a well-settled rule of statutory interpretation that where the legislation specifically addresses an issue, its silence elsewhere demonstrates intent to limit application of the rule. Moreover, the Code prescribes in no uncertain terms the order in which creditors are to be paid. After satisfaction of valid liens, the Code requires that § 507(a) priority claims be satisfied before general unsecured creditors may receive anything. To pay the prepetition claim of a so-called critical vendor, whose claim is nearly always a general unsecured claim, is to accord to that creditor a preferred status that the language of the Code simply does not permit.

Courts have relied on a variety of Code provisions to justify deviation from the mandated payment scheme.¹³⁷ Some courts, remarkably, do not even address the effect of their decisions on § 507(a);¹³⁸ those that do tend to downplay the importance of § 507(a) when compared with the need to foster rehabilitation. As one court stated:

A rigid application of the priorities of § 507 would be inconsistent with the fundamental purpose of reorganization and of the Act’s grant of equity powers to bankruptcy courts, which is to create a flexible mechanism that will permit the greatest likelihood of survival of the debtor and payment of creditors in full or at least proportionately.¹³⁹

Too often overlooked, however, are the types of creditors holding § 507(a) priority claims, including workers and consumers. Indeed, if the claim for a necessity payment is not for the benefit of an on-going business concern, it will likely be denied despite evidence of actual benefit to the estate, which, in turn, would foster rehabilitation. This was the case in Official Committee of Equity Security Holders v. Ma-

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¹³⁶  Id.

¹³⁷  According to the CoServ court, critical vendor payments have been authorized under § 363(b)(1), which authorizes use of estate property outside the ordinary course of the debtor’s business, the debtor in possession’s general powers under § 1107(a), “and even the Court’s power under 11 U.S.C. § 549 to reverse a post petition transfer.”  Id. at 392-93. Other courts have determined that the general equitable powers under § 105(a) permit critical vendor payments.  See In re Just for Feet, Inc., 242 B.R. 821, 826 (D. Del. 1999) (citing In re Fin. News Network Inc., 134 B.R. 732, 736 (Bankr. S.D. N.Y. 1991), In re NVR L.P., 147 B.R. 126, 128 (Bankr. E.D. Va. 1992) (holding that “proponent of the payment must show substantial necessity”), In re Eagle-Picher Indus. Inc., 124 B.R. 1021, 1023 (Bankr. S.D. Ohio 1991) (stating that payment must be “necessary to avert a serious threat to the chapter 11 process”)).

¹³⁸  In re Just for Feet Inc., 242 B.R. 821.

where, despite clear evidence that an emergency fund to provide medical services to tort claimants would actually diminish the total amount of claims against the estate, the Fourth Circuit held the lower court was without authority to allow payment outside of a confirmed plan.\footnote{832 F.2d 299 (4th Cir. 1987).}

Tort claimants have found themselves on the losing end of interpretive decisions in other areas as well, again in ways that run contrary to the Code. The Code expressly provides a co-debtor stay in Chapter 12\footnote{11 U.S.C. § 1201 (2003).} and Chapter 13\footnote{11 U.S.C. § 1301 (2003).} cases, but not in Chapter 11. Yet, many courts have extended the automatic stay in Chapter 11 to protect the corporate debtor’s officers, directors, and insurers, even where those parties’ conduct give rise to causes of action independent of those asserted against the debtor.\footnote{A.H. Robins Co., 788 F.2d at 999; Lomas Fin. Corp. v. N. Trust (In re Lomas), 117 B.R. 64, 68 (S.D. N.Y. 1990) See generally Elizabeth H. Winchester, Note, Expanding the Bankruptcy Code: The Use of Section 362 and Section 105 to Protect Solvent Executives of Debtor Corporations, 58 BROOK. L. REV. 929 (1992).}

However, extending the automatic stay to nondebtors is only a temporary solution, but the protection is often made permanent through the use of third party releases in plans of reorganization. The Code does not authorize third party releases, which forever bar actions against parties not in bankruptcy who may also be liable to the debtor’s creditors,\footnote{There are three general premises on which justifications for third party releases rest: (1) a claim against a non-debtor is tantamount to a claim against the debtor where the non-debtor will have a claim of indemnification or contribution against the debtor either through the operation of surety law, the debtor-company’s charter, state corporation laws, or by way of agreement between the debtor and the non-debtor; (2) a non-debtor contributing to the reorganization will not contribute funds if claims against the non-debtor are not enjoined, thereby adversely affecting the reorganization; and (3) suits against a third party who has a role in restructuring the debtor, but who has incurred personal liability to a creditor, may adversely affect the reorganization because the third party’s attention may be distracted from the reorganization efforts or the third party will have no incentive to continue its efforts if claims against it or others are not enjoined. Peter M. Boyle, Note, Non-Debtor Liability in Chapter 11: Validity of Third-Party Discharge in Bankruptcy, 61 FORDHAM L. REV. 421, 430-31 (1992).} but neither are they expressly forbidden. The problem lies in the language of § 524(e), which provides that the “dis-
charge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt." Some courts hold that this language is an outright prohibition on third party releases, while other courts take a more flexible approach, stating that § 524(e) merely describes the effect of the discharge without prohibiting the courts from broadening its reach.

To be sure, third party releases may serve as a valuable aspect of a plan of reorganization, such as when a creditor agrees to temporarily forego its right to pursue payment from a nondebtor guarantor, so long as plan payments are made and the debt will be paid in full. In other cases, however, such third party releases simply cannot be squared with public policy because the released parties are not only relieved from the consequences of the wrongs they have committed against the public, but they also retain the fortunes amassed as a result of their wrongdoing. Such cases as these are not only relying on

147. For a thorough discussion of the allowance of third party releases among the circuits, see Barbara J. Houser & Douglas Wade Carvell, A New Twist on Third Party Plan Protections (2001) (on file with authors).

Subsequent to the Houser & Carvell piece, the Sixth Circuit expressly approved of third party releases even as to nonconsenting creditors in Class Five Nev. Claimants v. Dow Corning Corp. (In re Dow Corning Corp.), 280 F.3d 648 (6th Cir. 2002) cert. denied, 123 S. Ct. 85 (2002).
148. Id. See Peter E. Meltzer, Getting Out of Jail Free: Can the Bankruptcy Plan Process Be Used to Release Nondebtor Parties?, 71 AM. BANKR. L.J. 1 (1997) (providing a detailed interpretive analysis of the language of § 524(e)). Statutory interpretation alone, however, may not provide an appropriate answer to whether third party releases are permissible as part of a bankruptcy plan. One commentator describes the debate over § 524(e) as a "red herring," arguing instead that:

A proper understanding of the reach of bankruptcy courts' jurisdiction and accompanying injunctive powers leads to the conclusion that nondebtor releases are not an appropriate extension of the historical injunctive powers of federal bankruptcy courts. In the absence of express congressional authorization, the courts have no jurisdictional authority to approve nondebtor releases.

149. No better example of the use of third party releases for the benefit of nondebtor wrongdoers exists than the bankruptcy of the A.H. Robins Company, which produced the infamous Dalkon Shield, an intrauterine birth control device. An excellent and comprehensive description of the Robins bankruptcy is found in Richard B. Sobol, Bending the Law: The Story of the Dalkon Shield Bankruptcy. The Robins case is shocking in virtually all respects. As Sobol recounts, [In prebankruptcy tort litigation] Robins was opposed by highly skilled litigators who, over the company's determined and, it has been suggested, improper resistance, succeeded in proving that Robins had marketed the Dalkon Shield without investigating its safety and that, after they learned of the propensity of the device to cause life-threatening pelvic infections, company officials had withheld and even destroyed this information while the Dalkon Shield was still being sold and used.

Sobol, supra note 40 at x. Through the third party release provision of the Robins plan, these same company officials were completely relieved of any personal liability for their wrongful
questionable statutory and jurisdictional authority, they also set a troubling precedent. It is difficult indeed to justify the rehabilitation of a business where tortious or fraudulent conduct has created the company’s financial woes, and allowing wrongdoers to evade their responsibility to their victims diminishes the incentive for businesses generally to ensure they deal fairly and honestly with their customers and the public.

The combination of Chapter 11’s business-friendly statutes and jurisprudence\textsuperscript{150} raises a critical question similar to that posed with respect to security’s supremacy: In the face of extensive scholarly criticism and calls for change, how is it that Chapter 11 has remained largely unchanged throughout the bankruptcy reform efforts in Congress?

One possibility is that America’s captains of industry, including the banking sector, like the system as it is currently constructed – why wouldn’t this be the case? Executive compensation is generous, despite the troubled financial condition of the company.\textsuperscript{151} Decision-making continues in much the same manner as before the filing, but with the added benefit that the automatic stay will hold creditors at

\textsuperscript{150} Conduct. They also profited handsomely when the plan was confirmed: The acquisition of Robins by American Home Products “resulted in the issuance of $916 million of American Home Products stock. Of this amount, $385 million went to the Robins family. . . . As an exchange of stock, the transaction was tax-free.” Id. at 286. A similar result occurred in the bankruptcy of Drexel Burnham Lambert Group, Inc. The confirmed plan in that case released about 200 individuals from substantial securities fraud liability and allowed those same individuals to retain the vast fortunes amassed as a result of the fraud. Brubaker, supra note 148 at 4 n.11 and accompanying text. Fortunately, under the Sarbanes-Oxley Act, releases relating to securities fraud may no longer be approvable. According to the Sixth Circuit, third party releases are permissible only if they are not otherwise inconsistent with the Code. See Dow Corning, supra n. 147 at 656. The Sarbanes-Oxley Act makes certain debts related to securities law violations nondischargeable in bankruptcy. Thus, releasing an individual who would be subject to this new nondischargeability provision creates the sort of inconsistency the Sixth Circuit describes as impermissible. More recently, but as yet unresolved, evidence has emerged that the W.R. Grace Company, a producer of asbestos and asbestos-related products that is now in bankruptcy, falsely marketed a product called Monokote as being free of asbestos, which W.R. Grace knew was not true. Michael Moss & Adrienne Appel, Protecting the Product: A Special Report; Company’s Silence Countered Safety Fears About Asbestos, N.Y. TIMES, Jul. 9, 2001, at A1. According to the Times report, W.R. Grace pursued a “strategy of silence,” choosing to avoid disclosure of Monokote’s asbestos content in order to keep the product on the market. Id.

\textsuperscript{151} Other than the doctrine of necessity and third party releases, which we have discussed herein, there are certainly other issues in which the courts have tilted the balance in favor of the debtor. See, e.g., J. Ronald Trost et al., Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification, SD24 A.L.I.-A.B.A. CONTINUING LEGAL EDUC. 401 (1998).

\textsuperscript{151} Matt Miller, When Failure Pays, DAILY DEAL (N.Y.), Feb. 27, 2003 (“Since the late 1990s, bankrupt companies have routinely offered their top officers rich pay packages to stay on, even though many of these executives helped shepherd their companies into Chapter 11 in the first place.”).
bay indefinitely, especially pesky tort claimants (or their estate representatives) who claim the company has caused them harm. On the whole, Chapter 11 is roughly akin to those “country club prisons” (or “Club Feds”) like that in which the fictional Murphy Brown once spent time for refusing to reveal a news source—no one really wants to end up there, but the perquisites make the stay alarmingly tolerable.

Although there is no direct evidence on this point, Congressional history, coupled with a deafening silence from the corporate and finance worlds, lends some plausible support to this conclusion. First, consider the banking industry, which is, after all, the reason Congress decided an overhaul of the Code was necessary in the first place. Despite its call for sweeping changes in the Code’s treatment of consumer cases, from all appearances the banking industry seems to have no interest in changing Chapter 11. The reason for the industry’s silence is a matter of conjecture. Perhaps they are true believers that the rehabilitation policy is their best chance of getting paid. Banks, of course, are the creditors who may look to the debtors’ assets for satisfaction of debt through security agreements, but they may nevertheless have unsecured claims as well. Even so, the current regime offers an opportunity to transform an unsecured claim into one secured by the debtor’s assets through post-petition financing that is cross collateralized, offering another plausible reason for the lack of vocal opposition to the current Chapter 11 process. Indeed, providing debtor in possession financing can be a lucrative endeavor. On a more cynical note, the current regime may help those banks that were involved in the pre-petition mismanagement or misdeeds of their debt-

152. “Murphy Brown” was, of course, the popular television series in which Candace Bergen portrayed the hard-nosed and liberal-leaning reporter for a local news program. Murphy, relishing somewhat in the prospect of doing time for refusing to reveal a news source, was horrified by the comforts of her incarceration, including planned recreational activities and surroundings that resembled a retreat more than a jail. Just how comfortable or pleasant minimum-security incarceration is in reality is both beyond the scope of this Article and beside the point because their portrayal in popular lore is sufficient to make our point. However, we do note that when there is public outcry over prison amenities, it is typically directed at facilities with heightened security and housing street criminals rather than those who committed white-collar crimes.

153. See generally Tabb, supra note 132.

ors avoid exposure. This was certainly the case with Enron, but few cases receive that sort of scrutiny or attention.

As with the banking industry, the corporate world generally has also been silent on bankruptcy reform, insofar as Chapter 11 is concerned. There are isolated exceptions within specific industries, such as when a spokesperson within the telecommunications industry complained that the number of companies in bankruptcy was hurting those who tried to make good on their debts and remain out of bankruptcy courts.

On a broader level, however, to fundamentally alter the character of Chapter 11 would be a 180-degree shift in the policy that Congress and the judiciary have exhibited toward business over the past 20 years or so. It is not difficult to imagine the outcry that would follow any Congressional attempt to wrest control from a corporate debtor's management in Chapter 11, despite evidence that such a move may be warranted or that it could prove beneficial to the varied interests in a corporate bankruptcy case. As we noted earlier, proposals to change the way stock options are treated in corporate records and to sever the conflicted roles of accountants serving as both auditors and consultants met with heated industry opposition and insurmountable resistance in Congress.

The corporate fraud and accounting problems are just isolated examples of the myriad ways in which national policy, both legislatively and judicially, has skewed the balance of power in favor of the largest of business interests and against those who ultimately depend on them. Legislation enacted under the guise of deregulating business and fostering competition has instead permitted extraordinary con-

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156. Little attention was paid to Polaroid’s bankruptcy, for example, despite allegations that the company intentionally misstated its financial health and, in concert with its secured creditors, controlled the auction process in a way that effectively locked unsecured creditors out. A venture capital arm of Bank One bought the company’s assets at what some believe was an artificially low price. The case resulted in significant job loss, and the company discontinued both severance payments for some terminated employees as well as retiree health benefits. Kris Frieswick, What's Wrong with This Picture: Polaroid’s Passage Through Chapter 11 Exposes How Bankruptcy Can Give Debtors Too Much Power, CFO MAG., Jan. 1, 2003. An examiner has been appointed to investigate the matter. Jeffrey Krasner, Examiner to Probe Polaroid, BOSTON GLOBE, Jan. 17, 2003, at D3.


158. See supra note 19.
centrations of power in industries that are vital to the American people, the media included.\footnote{159} At the same time, Congress and the courts will save corporations and their owners and managers from the consequences of their own misdeeds by making litigation regarding securities fraud, products liability, civil rights violations, and other matters of public importance difficult,\footnote{160} if not impossible.\footnote{161}

\footnote{159} See generally ALGER, supra note 12.


Professor Thornburg's observations are particularly apt:

It is not surprising that organized forces have united to argue in favor of cutbacks in discovery. By limiting discovery, they do not merely strive to decrease disliked litigation costs. More importantly, their efforts to limit discovery are intimately tied to efforts to circumscribe enforcement of disliked substantive law. "Court reform" becomes part of the package with "tort reform." This group consists in large part of repeat corporate defendants and their insurers. Casting their pleas as arguments for "efficiency," and even defenses of American productivity, these organizations have lobbied the Advisory Committee for further restrictions on discovery. Perhaps more significantly, they have threatened to go to Congress for relief, circumventing the usual rules amendment process and further politicizing the entire world of federal civil procedure.

\footnote{161} For the poor who rely on state or federally funded legal representation, access to the courts is effectively denied in a variety of contexts. The Brennan Center for Justice did a seven-part report on the politics and reality of legal aid, with particular emphasis on the budget cuts and prohibitions on representation in specific legal matters in the mid 1990s. Some activities which were banned in 1996 included initiation of or participation in class action suits, representation of aliens and incarcerated persons, certain evictions from public housing if the client was, among other things, charged with the illegal sale or distribution of drugs, abortion litigation, welfare reform, redistricting, political advocacy, and lobbying. Brennan Center For Justice, Restricting Legal Services: How Congress Left the Poor with Only Half a Lawyer (2000), available at http://www.brennancenter.org/programs/downloads/Article2.pdf (last visited Feb. 20, 2003). Former Representative George Gekas, a principle sponsor of bankruptcy reform, wanted even
Against this backdrop, it is hardly surprising that Chapter 11 functions as it currently does. A Congress that has consistently focused on reducing or eliminating governmental interference with big business generally is hardly likely to do so in the specific context of Chapter 11. Even if it did, such an effort would no doubt be strenuously opposed. If these assumptions are correct, then Chapter 11, and bankruptcy reform generally, may be exposed for what it truly is – a representation of what the powerful, moneyed interests believe is in their own best interests. Given the ease with which businesses may, first, transfer their wealth to one or a few preferred lenders (most of whom have significant political clout) and, second, control the outcome of any bankruptcy through both express Code provisions and rehabilitation jurisprudence, bankruptcy may be part of a general business strategy rather than a last resort for the financially troubled. However, where there are no political contributions there is no debate, no nostalgic yearning for the days when businesses viewed bankruptcy as a moral failure as much as a financial one, no contrived ‘bankruptcy tax’ quantifying the costs of corporate failure on society as a whole, especially when that corporation is solvent and able to repay its debts. Instead, such laments are confined to the consumer bankruptcy context, pushed singularly and solely by the financial services industry and its campaign dollars.


These restrictions . . . decrease the accountability of executive and legislative actions. Instead of stripping the courts’ power to hear cases involving the rights of poor people, Congress simply stripped advocates for the poor of the power to bring cases. You don’t have to regard the restrictions on legal services lawyers as a form of political repression in order to recognize it as another way of immunizing elected officials and bureaucrats from constitutional limitations on their behavior.


At the state level, too, the poor can be denied legal redress. Consider the case of the Tulane Law Clinic, which represented the poor, and largely minority, community of Convent, Louisiana. A large plastics manufacturer, Shintech, sought to build a new plant in Convent, but citizens were opposed because of dangers to the public health, and the Clinic represented the community. Business interests lobbied hard and won a change to rules governing the Clinic so as to effectively preclude continued representation of Convent’s citizens and similar future actions. See Kim Erickson, Backlash on the Bayou; Tulane University’s Environmental Law Clinic Successfully Opposes Shintech PVC Plant in Convent, Louisiana, EARTH ACTION NETWORK, INC., Nov. 1, 1999, at 22.
IV. Bankruptcy Reform

“Now watch what you say or they’ll be calling you a radical, liberal, fanatic, criminal.”

While the banks may lay an ever-widening claim to assets through security interests, and inept, sometimes corrupt, corporate managers may continue to operate their bankrupt companies, Congress has chosen to focus on the ordinary consumer debtor as the root of all evil under the Code. Representative Moran fairly well summarizes why proponents of bankruptcy reform believe such action is necessary:

The time-honored principle of moral responsibility and personal obligation to pay one’s debts has been eroded by the convenience and ease with which one can discharge his or her obligations. What was once the option of last resort has too often become the preferred option of choice. A legislative fix is vital to distinguish between those who truly need a “fresh start” and those capable of assuming greater responsibility and making good on at least some of what they owe.

On the other hand, Congressional supporters of bankruptcy reform did not rely on mere rhetoric; they said they had facts to support their claims. When bankruptcy reform was first introduced, the economy was robust, unemployment was low, and disposable personal income


163. Bankruptcy reform also creates a “fast track” Chapter 11 mechanism for small businesses in the belief that too many of these debtors languish in bankruptcy without real hope of reorganizing. Just as with consumer bankruptcies, there are faulty assumptions underlying the efficacy of these small business provisions, but they are beyond the scope of this article. In any event, a review of the small business provisions does not leave the reader with the sense that Congress believes most small businesses to be immoral, irresponsible and abusive of bankruptcy, as do the consumer provisions.

164. Bankruptcy Reform Act of 1998: Prepared Statement of James P. Moran Before the House Judiciary Committee Subcommittee on Commercial and Administrative Law, 105th Cong. (1998). Acting as a model citizen, Representative Moran upheld his “moral responsibility” and “personal obligation to pay his debts” without utilizing the “convenience and ease” that have eroded the system. One month before signing onto the bill as the lead Democratic supporter, Representative Moran simply obtained a $447,500 loan to alleviate his financial problems. Like ninety percent of bankruptcies which are caused by medical bills, loss of employment, or divorce, Representative Moran’s financial problems were a product of high credit card debts, stock market losses and paying for the cancer treatment of his daughter. Fortunately for Representative Moran, MBNA Corp., the world’s largest independent credit-card agency and a major supporter of the Bankruptcy Reform Bill, generously gave him this loan at a significantly below industry standard interest rate. Molly Ivins, Bankrolling Political Credit, Chi. Trib., Sept. 19, 2002, at 25, 2002 WL 100518954. The House Ethics Committee also felt that Representative Moran upheld his “moral responsibility.” The Committee declined to open a formal investigation on the matter and found that there was no connection between the loan Representative Moran received and his support of the Bankruptcy Reform Bill. Spencer S. Hsu, Moran Says Ethics Panel Won’t Probe 1998 Loan, The Wash. Post, Feb. 6, 2003, at B07, 2003 WL 10895903.
was on the rise, but at the same time there was a significant rise in consumer bankruptcy filings. The Congressional conclusion that something was amiss was further bolstered by a study at the time that found roughly 15 percent of all consumer filings were “abusive” because debtors, despite being able to repay some of their debt through Chapter 13 plans, instead chose to rather cavalierly discharge them in Chapter 7. As a result of the abuse, banks were losing around $40 billion a year. The study also concluded that the American public bore the banks’ loss in the form of an annual bankruptcy tax of around $400 for every American family.

The Congressional response was an effort to restrict access to Chapter 7 for consumer debtors, essentially requiring all such debtors to prove their honesty and misfortune as a condition precedent to bankruptcy relief. Although bankruptcy reform works myriad changes in consumer bankruptcy law, its most salient feature is its “means test,” which closes the courtroom doors to any consumer debtor who cannot demonstrate a dire financial need for Chapter 7 relief.

The philosophical underpinnings of bankruptcy reform and the means test could be justified if there were something other than the financial support of the banking industry backing them up. In reality, however, the means test is an overreaching and fundamentally flawed method for weeding out those debtors who truly do abuse the good graces of the Code. More generally, lamentations over the problems with consumer bankruptcy are exceedingly difficult to justify and, in light of the scandalous conduct in America’s corporations, accounting firms, and financial institutions over the last few years, combined with an undisputed downturn in the economy, continued Congressional focus on consumer bankruptcies is downright baffling.

A. The Means Test in a Nutshell

Bankruptcy reform’s “means test” implements an elaborate measurement of income and expenses to determine whether there are sufficient funds available to the debtor on a monthly basis to warrant prohibiting that debtor from receiving Chapter 7 relief and instead requiring a Chapter 13 payment plan or precluding bankruptcy relief altogether. Such debtors are deemed “abusers” of Chapter 7, a term

166. Id.
167. Id.
168. Id. See supra n. 27-37 and accompanying text.
169. Id.
that normally connotes some actual impropriety,\textsuperscript{170} based on nothing more than an inability to meet the rigid and unworkable calculations imposed under the means test.

Bankruptcy reform's means test broadly defines "income" as the monthly average of virtually every last penny that has come into the debtor's hands within the six months prior to the filing of the petition.\textsuperscript{171} The few exceptions, payments to "victims of war crimes or crimes against humanity" and those related to international terrorism, for example, are unlikely to arise in the vast majority of cases. Notably, the definition of income provides no exclusion for amounts the debtor acquired by sheer happenstance, such as a lucky lottery ticket for a few hundred dollars, or amounts contributed by others, such as family members, over which the debtor has no control. This latter example is expressly included in the bankruptcy reform bill, even though the contributor can discontinue the funds at any time for any reason. The result in many cases will be an artificially inflated measure of the debtor's monthly income.\textsuperscript{172}

In contrast, bankruptcy reform's determination of the debtor's monthly expenses produces an artificially deflated figure. Under the bill, most expenses have nothing to do with what the debtor actually pays; rather, bankruptcy reform allows only the amounts for food, clothing, and other day-to-day needs specified under guidelines that the Internal Revenue Service uses when it is negotiating workout agreements with taxpayers.\textsuperscript{173} There are a handful of additional al-

\textsuperscript{170} "Abuse" is defined as a corrupt practice or custom or improper use or treatment. To abuse is to deceive or to put to a wrong or improper use. \textsc{Webster's New World Dictionary} 3 (college ed. 1959).

\textsuperscript{171} More specifically, bankruptcy reform defines "income" as:

[T]he average monthly income from all sources which the debtor receives (or, in a joint case, the debtor and the debtor's spouse receive) without regard to whether the income is taxable income, derived during the 6-month period preceding the date of determination, which shall be the date which is the last day of the calendar month immediately preceding the date of the bankruptcy filing. If the debtor is providing the debtor's current monthly income at the time of the filing and otherwise the date of determination shall be such date on which the debtor's current monthly income is determined by the court for the purposes of this Act; and [the definition] includes any amount paid by any entity other than the debtor (or, in a joint case, the debtor and the debtor's spouse), on a regular basis for the household expenses of the debtor or the debtor's dependents (and, in a joint case, the debtor's spouse if not otherwise a dependent), but excludes benefits received under the Social Security Act and payments to victims of war crimes or crimes against humanity on account of their status as victims of such crimes.


\textsuperscript{172} See infra note 182.

\textsuperscript{173} Internal Revenue Service, \textit{Collection Financial Standards}, available at http://www.irs.gov/individuals/article/0,,id=96543,00.html. It is interesting to note that the IRS itself refers to these
allowable expenses, but these, too, are tied to the Internal Revenue Service's guidelines or will require the debtor to incur litigation costs to determine whether such additional expenses are reasonable and necessary.\textsuperscript{174} Any general deviation from the means test's expense standards is similarly formidable for the debtor because of the burden, documentary requirements,\textsuperscript{175} and the necessity of counsel's assistance.\textsuperscript{176}

Bankruptcy reform also specifies how secured and priority debts will be expensed to determine the debtor's disposable monthly income. Generally speaking, for each type of debt the monthly payment amount is the total due divided by 60, although the total for secured debt is limited to that actually due over five years.

Once these amounts have been calculated, a debtor is deemed to have abused the provisions of Chapter 7, and the case must be dismissed or converted to Chapter 13, if "the debtor's current monthly figures as "guidelines" while bankruptcy reform imposes them as an inflexible, and quite likely inaccurate, hard and fast rule.

\textsuperscript{174} Under the Bill, additional expenses may be allowed, in reasonable circumstances for the following reasons: to maintain the safety of the debtor and his family from family violence; for food and clothing, of up to 5 percent of the food and clothing categories as specified by the National Standards issued by the Internal Revenue Service; for the continuation of actual expenses paid by the debtor for care and support of an elderly, chronically ill, or disabled household member or member of the debtor's immediate family, who is not a dependent and who is unable to pay for such expenses; for a debtor eligible for chapter 13, the actual administrative expenses of administering a chapter 13 plan for the district in which the debtor resides, up to an amount of 10 percent of the projected plan payments, as determined under schedules issued by the Executive Office for United States Trustees; for actual expenses for each dependent child under the age of 18 years, up to $1,500 per year per child to attend a private or public elementary or secondary school; for housing and utilities, in excess of the allowance specified by the Local Standards for housing and utilities issued by the International Revenue Service, based on the actual expenses for home energy costs, if the debtor provides documentation of such expenses.

H.R. REP. No. 107-617.

\textsuperscript{175} The Bill states:

\begin{enumerate}
  \item [(B)(i)] In any proceeding brought under this subsection, the presumption of abuse may only be rebutted by demonstrating special circumstances that justify additional expenses or adjustments of current monthly income for which there is no reasonable alternative.
  \item [(ii)] In order to establish special circumstances, the debtor shall be required to itemize each additional expense or adjustment of income and to provide –
  \begin{enumerate}
    \item documentation for such expense or adjustment to income; and
    \item a detailed explanation of the special circumstances that make such expenses or adjustment to income necessary and reasonable.
  \end{enumerate}
  \item [(iii)] The debtor shall attest under oath to the accuracy of any information provided to demonstrate that additional expenses or adjustments to income are required.
\end{enumerate}

H.R. REP. No. 107-617.

\textsuperscript{176} The availability of counsel is also severely undermined by bankruptcy reform, which not only provides for sanctions against debtors' counsel under the means test, but also seeks to actually regulate the manner in which debtors' attorney represent their clients.
income . . . when multiplied by 60 is not less than the lesser of 25 percent of the debtor's non-priority unsecured claims, or $6,000, whichever is greater, or $10,000."177

As so constructed, the means test is inherently flawed, producing faulty results and misguided incentives. As we discussed above, bankruptcy reform creates the potential for both artificially inflated income and deflated expenses. However, one must also consider the calculation of priority debts. Because these debts – which include alimony and child support – are taken into account before arriving at the determinative disposable monthly income, debtors who are more seriously delinquent in their support obligations are less likely to be tagged as “abusers,” because they are more likely to qualify for Chapter 7 under the means test. Moreover, the calculation of priority debts actually gives debtors an incentive to forego making alimony or child support payments, whether in collusion with the recipient or without regard to the consequences on the recipient of nonpayment.

The calculation of payments on secured indebtedness is equally flawed, but for a different reason. First, it draws an arbitrary distinction between owners versus lessees of property. For example, transportation expenses are included in the Internal Revenue Service guidelines – for the owner of a car, there is a double deduction, one under the guidelines and another for payment of secured debt. Bankruptcy reform provides no such allowance for the lessee's actual lease payments. The same anomaly exists for homeowners versus their counterparts who rent their homes.

In addition, the means test’s use of a five-year repayment forecast across the board to determine the debtor’s average monthly payments produces anomalous results.178 For example, consider three similarly situated debtors, each of which has a $300 per month car payment. One debtor has five years left to pay his loan, the second debtor has three years, and the third debtor has one year. The means test distorts how much the second and third debtor will contribute to secured debt. In reality only the first debtor’s payments are actually reflected in the means test; he must pay $300 per month for a period of five years. The second debtor will show a $180 monthly obligation ($10,800 total due divided by 60), and the third debtor’s means tested car payment is a paltry $60 ($3,600 total due divided by 60). Thus, the means test assumes that the second and third debtors have far greater monthly disposable income than they actually do have, and assuming the exis-

177. H.R. REP. No. 107-617.
tence of funds these debtors never have the opportunity to enjoy may thrust the ‘abusive filer’ tag on them.

Yet another example of the means test’s problematic nature is its failure to account for demographic distinctions among classes of debtors, the elderly for example. The means test does not account for the fact that the elderly demonstrate many important differences from the population as a whole. They are more prone to increased future expenditures and reduced future incomes. These variables will ultimately affect the success of their repayment plans. Furthermore, the premises of the bankruptcy reform policy carried out through the means test are undermined when applied to the elderly. For example, the promise of a fresh start through Chapter 13 is virtually useless to an older debtor; the majority of our elderly population is not composed of able-bodied debtors, who are capable of earning an income that would allow them to live comfortably and still make payments to their creditors.

Unexpected expenses that are not allotted for by the means test also frequently burden the elderly. An estimated 19 million of our nation’s elderly have little or no prescription drug coverage, which may sometimes force them to incur large credit card balances in order to obtain the necessary medication. Furthermore, the recent corporate scandals and the fall of many corporate giants have left many

179. The elderly are likely to have more medical bills, receive less pay, suffer job reduction or loss, or live on fixed pensions that do not increase with the rate of inflation. Robyn L. Meadows, Bankruptcy Reform and the Elderly: The Effect of Means-Testing on Older Debtors, 36 Idaho L. Rev. 227, 237 (2000).

180. Id.

181. In order to obtain a fresh start under the means test, an elderly debtor would have to give up most of his remaining economically productive years. Consider the following example of the remaining lives of debtors aged 40, 50, 60, and 65.

Assuming each worked until the age of 70 and used a repayment plan of five years... [as the legislation proposes] the 40 year old would pay on the plan for one-sixth of his remaining working years (5/30), the 50 year old would for one-quarter (5/20), the 60 year old one-half (5/10) and the 65 year old for his entire (5/5) remaining working years. There would be little reason for these debtors to attempt repayment plans. If means testing forecloses liquidation as an option, these debtors will be left with no meaningful bankruptcy protection available.

Id. at 238.

182. Since the means test is not limited to wage earners, the elderly who may not be able bodied or may be relying on a pension or another source of fixed income or assets, are included, even if the inclusion is unintentional. Id.

183. News at Deadline, Hosp. & Health Networks, Dec. 5, 1998, at 75. While frequently plaguing the elderly, these unexpected and, under the means test, unaccounted for, expenses, may be encountered by a member of any demographic.
employees, those planning retirement and those already retired, without their promised pensions or 401(k)'s.\textsuperscript{184}

Adding insult to injury, just as the elderly population faces unique hardship from limited incomes and unexpected hardships, they are also particularly vulnerable to financial scams. For example, in 1948, when the Arizona Baptist Foundation ("ABF") was formed as a non-profit to raise money for Baptist churches and ministries, while at the same time paying returns to investors, it seemed like a safe and sound investment for many elderly investors.\textsuperscript{185} However, in 1999, after years of hiding losses and financial misrepresentations, aided by the accounting services of Arthur Andersen, ABF declared one of the largest non-profit bankruptcies in history, resulting in losses totaling over $570 million for nearly 11,000 elderly investors.\textsuperscript{186}

\textbf{B. Empirical Evidence of Abuse}

Bankruptcy reform was based in part on the results of studies conducted on debtors who file for bankruptcy under Chapter 7 and the estimated percentage of such debtors who could repay a "substantial portion of their debts." An October 1997 study, which the Credit Research Center ("CRC") conducted and the credit card industry funded,\textsuperscript{187} found that an estimated 30 percent of chapter 7 debtors could repay at least 21 percent of their "‘non-housing, non-priority debts,’ such as car loans and credit card debts, over a five-year period."\textsuperscript{188} The study concluded, "Our results imply that the bankruptcy system itself is contributing to these rising costs by offering the opportunity to wipe out debt with a single signature to many borrowers that have the ability to repay."\textsuperscript{189} Another study in March 1998, which Ernst & Young conducted, found 15 percent of the Chapter 7 debtors

\textsuperscript{184} For example, Enron employees experienced losses ranging from $60,000 to $1,000,000,000 in retirement plans and 401(k)s. Thomas Frank, \textit{Shocked, Shocked! Enronian Myths Exposed}, \textit{Nation}, Apr. 8, 2002, at 17; William J. Angelo, \textit{Scandals Unleash 401(k) Woes}, \textit{Eng’g News-Rec.}, Feb. 25, 2002 at 47.


\textsuperscript{186} Id.

\textsuperscript{187} The study issued by Georgetown University’s Credit Research Center was produced with a $100,000 grant from Visa U.S.A. and MasterCard International Inc. Robert Cwiklik, \textit{Education: Ivory Tower Inc.: When Research and Lobbying Mesh}, \textit{Wall St. J.}, June 9, 1998, at B1, 1998 WL-WSJ 3497148.


\textsuperscript{189} Donald L. Barlett \& James B. Steele, \textit{Souked by Congress, Lavished with Campaign Cash, Lawmakers are “Reforming” Bankruptcy – Punishing the Downtrodden To Catch A Few Cheats}, \textit{Time}, May 15, 2000.
studied could repay all of their non-housing secured debts, all of their
unsecured priority debts, and at least 20 percent of their unsecured
non-priority debts over a five-year period.190

However, a third study, conducted in March 1999 and funded by the
non-partisan American Bankruptcy Institute (ABI), found that 3.6
percent of Chapter 7 debtors, could repay the same debts repayable
under the Ernst & Young study.191 Concluding with a strikingly dif-
ferent assertion than the CRC, the ABI’s researchers found:

The vast majority [of those filing for chapter 7] belong in that chap-
ter. They have too little income after necessary expenses to repay
unsecured debt. It is vital, therefore, that no undue burdens be
thrust on that needy majority in order to flush out a small minority
of abusers. The amount that might be collected: less than $1
billion.192

Thus, this later study stood in stark comparison to those that the
credit industry conducted, creating a significant difference of opinion
among researchers, academia, interest groups, and members of
Congress.

There are many possible explanations for why the studies produced
such varying results. For example, in its review of all three studies, the
General Accounting Office suggested:

These differences include different (1) groupings of the types of
debts that could be repaid, (2) gross income thresholds to identify
those debtors whose repayment capacity was analyzed, (3) assump-
tions about debtors’ allowable living expenses, (4) treatment of stu-
dent loans that debtors had categorized as unsecured priority debts,
(5) assumptions about the administrative expenses that would ac-
company a debtor repayment plan. It is also possible that differ-
ences in the sampling methods and time periods each report used to
select the debtors for analysis could have contributed to different
results.193

A far more critical distinction, however, arises from the source of
funding. It is hardly surprising that the study directly and richly
funded by Visa and Mastercard produced the direst statistics indicat-
ing debtor abuse.194 Not only does the provision of funding allow for
the production of self-serving studies that have the appearance of
credibility, such studies are merely the first step in a public relations

190. GAO Report, supra note 188.
191. Id.
192. Barlett, supra note 189.
193. Barlett, supra note 189. See generally, Marianne B. Culhane & Michaela M. White, Tak-
ing the New Consumer Bankruptcy Model for a Test Drive: Means-Testing Real Chapter 7 Debt-
194. See supra note 188 and accompanying text.
process called "impropaganda." Here is how the process worked in bankruptcy reform:

Lobbyists for banks and credit card companies seized on the [Credit Research Center] study as they lobbied Congress for changes in federal law that would make it harder for consumers to file for bankruptcy relief. Former U.S. Treasury Secretary Lloyd Bentsen cited the study in a *Washington Times* opinion column, offering Georgetown's academic imprimatur as evidence of the need for "bankruptcy reform." What Bentsen failed to mention was that the Credit Research Center is funded in its entirety by credit card companies, banks, retailers, and others in the credit industry. . . . Bentsen also failed to mention that he himself had been hired to work as a credit-industry lobbyist.\footnote{Center for Media & Democracy, *What Is Impropaganda?*, available at http://www.prwatch.org/improp/impropaganda.html.}

Thus, by paying for both the study and for Bentsen's services, the finance industry was able to more fully circulate the study's results without serious questions about its propriety being raised. Sadly, this approach to public policy is far from uncommon and not limited to bankruptcy reform.\footnote{See generally People for the American Way, *Buying a Movement*, available at http://www.pfaw.org/pfaw/general/default.aspx?oid=2055.} Equally troubling is that Congress seems to have completely disregarded the one study that undermined the very validity of the need for a means test.\footnote{See GAO Report, *supra* note 188.}

However, even if the Credit Research Center's gloomy findings are taken as true, has the case for bankruptcy reform actually been made? Recall that the study concluded some 30 percent of Chapter 7 debtors could afford to repay about one-fifth of their general unsecured debt. Are those numbers sufficient to justify revamping the entire consumer bankruptcy system in a manner that will undoubtedly harm many individuals, especially the 70 percent who, as the study implies, cannot afford to repay anything? Congress, through bankruptcy reform, has steadfastly refused to answer this question.

At the same time, Congress has struggled to find a remedy for a very real bankruptcy abuse, the homestead exemption. A form of abuse that is most readily available to the wealthiest of debtors, the homestead exemption permits a debtor to discharge his debts while retaining sometimes lavish estates. The only requirement for such favored treatment is for the debtor to establish residence in a state such as Florida\footnote{WorldCom's former chief financial officer, Scott Sullivan, is currently building a mansion in Florida valued at over $15 million. Shawn Young, *Without a Net: In Bankruptcy, Getting Laid Off Hurts Even Worse*, WALL ST. J., Sept. 30, 2002, at A1.} or Texas,\footnote{See supra note 188.} which allow debtors to shield significant
amounts, if not all, of the equity in their homes from creditors. Deeply offensive to most ordinary Americans and obvious in its inherent unfairness, this aspect of bankruptcy reform has proven to be one of the most controversial.200

Other questions Congress has also conveniently ignored, which are the focus of the discussion below, concern just how robust the economy truly was in the late 1990s and how it has unquestionably changed since, the inappropriate and inequitably applied notions that Americans should be shamed away from bankruptcy relief, and the credit industry’s very own culpability.

C. The Economy

Even if the means test is a proper way to determine debtor abuse and the credit industry produced an accurate study of the extent of the abuse, the economic premises underlying bankruptcy reform simply no longer exist. First, not everyone benefited from growth in the 1990s. Second, the robust nature of the economic conditions in the late 1990s is not altogether true because, as is now known, some of America’s largest corporations were misstating their earnings. Third, even if neither of the above is true, the economy now is most assuredly worse than it was just a few years ago.

Supporters of bankruptcy reform may have been seeing the “good times” of America from a slightly skewed vantage point because they looked at the economic conditions in the 1990s in isolation, without considering long-term trends. Inequality has been rapidly encroaching on America over the last few decades, and the robust economy of the 1990s did not curb the climb of this inequality.201 In the 1990s the inflation-adjusted incomes of the poor were flat, and middle class incomes grew only two percent. However, the average income of the upper five percent of Americans grew by 27 percent.202 From 1985 to 2001, workers’ pay rose by 63 percent, while CEOs’ pay rose by 866 percent.203 To put it simply, there has been an “explosion of income,” but, for the most part, only at the top of the income scale, which may


202. Id.

have masked the reality of the times in 1998, when bankruptcy reform first arose in Congress.\textsuperscript{204}

From the 1930s through today there have been significant shifts in the equality and inequality of wages among America’s rich, middle class, and poor. Before 1930, a small number of very rich people controlled most of the nation’s wealth.\textsuperscript{205} Then, in the period following the New Deal and World War II, a dominant middle-class society emerged in America.\textsuperscript{206} In the decades following World War II the income gaps slowly began to close,\textsuperscript{207} but then around the 1980s the lower economic segments began to lose ground.\textsuperscript{208} While there was a narrowing of the gaps during the 1990s, this was merely a step in the right direction. The improvement could in no way account for the losses suffered during the preceding twenty years.\textsuperscript{209} Moreover, the slight gains of the 1990s are quickly vanishing as income disparities continue to widen.\textsuperscript{210} The earnings of high-wage workers are continuing to grow faster than those of middle- and low-wage workers, consequently laying the same tracks of history that the nation experienced before the 1930s.\textsuperscript{211}

Furthermore, unknown to the public during the 1990s, a flurry of corporate wrongdoings and scandals was robbing the nation of its economic future. As one journalist appropriately described the now apparent atmosphere of the 1990s:

Americans seem generally to have believed that they lived in a world where the depictions of the business press were fairly accurate, where pundits argued for things because they believed in them, where accountants and stock analysts spoke truthfully, where politicians represented their constituents and not just those with money, where the stock market had been cleansed of crooks and was now safe enough for little old ladies from Beardstown. The Enron story

\begin{flushleft}
\textsuperscript{205} Id.
\textsuperscript{206} Id.
\textsuperscript{207} Of course this is a generalization that does not account for the disparities encountered by gender, race, or other forms of discrimination.
\textsuperscript{208} American business policies since the 1960’s may have contributed to the rising inequality gap. In the 1960’s corporations behaved like “socialist republics [rather] than cutthroat capitalist enterprises” and the CEO’s behaved like “public spirited bureaucrats [rather than] captains of industry.” However, since the 1980’s there has been a focus on “personal” leadership. However, since the 1980’s there has been a focus on “personal” leadership. Krugman, \textit{supra} note 205.
\textsuperscript{211} Id.
\end{flushleft}
has flattened each of these faiths simultaneously. It’s a perfect ideological reversal, a narrative that was supposed to prove the goodness of the New Economic Order and that has instead discredited it in every respect.\(^{212}\)

The past two years have produced record setting bankruptcies,\(^{213}\) many of which were plagued by fraud.\(^{214}\) These bankruptcies have rippling effects throughout the economy: “The effects are bleeding into everyday life as Kmart closes stores, United Airlines weighs more layoffs and cuts in air service, communities see tax bases shrink, and lenders get less than 20 cents back on every $1 of bad telecom loans.”\(^{215}\)

When large companies file for bankruptcy, the logical result is that many employees lose their jobs. The ten largest companies filing for bankruptcy in 2001 reported employing about 140,500 people.\(^{216}\) The top ten in 2002 had 444,600.\(^{217}\) Not surprisingly, loss of employment is a major cause of consumer bankruptcy.\(^{218}\)

It is quite apparent that the American economy has endured its fair share of hardships in the past few years. Threats of war and terrorism, corporate scandals and CEO criminal wrongdoing, shrinking 401(k)s, record setting bankruptcies, rising unemployment, massive wage cuts and sinking consumer confidence have all contributed to a bleak economy which is struggling to keep its head above water. The perceived “economic boom” of the 1990s is long gone,\(^{219}\) and with it went any of the purported justifications for bankruptcy reform.\(^{220}\)

In sum, the economic arguments in support of bankruptcy reform are as untrue as the means test is unsound. The downturn of the American economy has long been eroding the very premises that motivated members of Congress to introduce bankruptcy reform. While

\(^{212}\) Frank, infra note 184.

\(^{213}\) Eight of the top 12 largest bankruptcy cases among publicly traded companies have been filed in the past 13 months. Matt Krantz, Consecos Adds to Record Bankruptcy Filings, USA TODAY, Dec. 22, 2002, www.usatoday.com.

\(^{214}\) See infra note 230.

\(^{215}\) Krantz, supra note 213.

\(^{216}\) Young, infra note 198.

\(^{217}\) Id.


\(^{219}\) See supra note 216 and accompanying text.

\(^{220}\) Consider the example of United Airlines, who filed for bankruptcy in December 2002. They blamed their unions for the airlines financial difficulties. In response, the pilots underwent a 29% pay cut. Mary Wisniewski, United Pilots Set to Take 29% Pay Cut, CHI. SUN TIMES, Dec. 29, 2002, at 10. When considering actions of this kind under the bankruptcy reform bill, it is a wonder if the banks will give these pilots a 29% discount on their mortgages, since their income is now much less than before.
the economy may have been thriving in the early days of the bill the underlying reality of the very people touched by the bill were not, and are still not. The economy has fallen into a recession, which places even more burdens on those already struggling for resources.221

D. The Fallacy of ‘The Lost Moral Stigma’

Supporters of the bankruptcy reform are concerned that filing for bankruptcy has lost its moral stigma. While admitting this phenomenon cannot be proved directly, supporters feel that it may be indirectly inferred. They believe that many social factors today encourage filing. Examples that have been cited include; non-delinquent borrowers are filing at increasing rates; an increase in Hollywood celebrities and other wealthy prominent citizens filing in the 1990s; increased advertisements in which lawyers portray bankruptcy as an easy solution for overextended debtors; and a general decline in moral values.222 As Senator Grassley stated, “[W]e have had a general lack of shame or personal responsibility that used to be associated with paying bills or not paying bills and the filing of bankruptcy.”223

However research has demonstrated that consumers do not take advantage of more favorable bankruptcy laws; instead economic factors drive bankruptcy filings.224 A study of current economic activity demonstrates that economic factors are a significant influence on bankruptcy filings, to a much greater extent than the alleged effect of other influences of dubious importance, like celebrities.225

While politicians lament the loss of moral stigma in consumer bankruptcies, surprisingly, the loss of moral stigma in other areas does not

221. Eric Gillin, Events Conspire Against Bankruptcy Reform; Recession and the Fallout from Sept. 11 Have All but Killed a Measure that Looked Inevitable in Washington, THESTREET.COM, Jan. 10, 2002, 2002 WL 10629832. Some opponents of the bill argue that its passage would prevent the United States from recovering from the recession. As one journalist stated:

Japan has antiquated bankruptcy laws and millions are hopelessly in debt. Every penny goes to servicing debt. That's why their economy remains moribund. (citations omitted). 'This law would make us like them, preventing America from bouncing back from recessionary times.'

Id. (citation omitted).


[If] debt “causes” bankruptcy, it is only because overspending and an unwillingness to live within one's means “causes” debt. In short, one can re-characterize the “debt causes bankruptcy” thesis as “overspending causes bankruptcy.”

Id. at 224.

223. Barlett, supra note 190.


225. See supra Part IV.C.
seem to be of great concern. When one company, Halliburton, Inc., sold one of its divisions it declared that its employees had "resigned," allowing it to confiscate their pensions.\textsuperscript{226} Yet this company did exactly the opposite when its former CEO resigned, changing the terms of his $8.5 million charge against earnings to reflect the cost of its parting gift to him\textsuperscript{227} – that man is United States Vice President, Dick Cheney.\textsuperscript{228}

Also, in a number of the top bankruptcies filed in the last 13 months, the companies’ former top executives have been criminally investigated for illegal practices that led to their companies’ bankruptcies.\textsuperscript{229} These top executives, who conveniently had first hand knowledge of the companies’ troubles, were able to escape the effects of bankruptcy. Enron’s top executives made off with $1 billion before the company announced its bankruptcy.\textsuperscript{230} Maintaining an illusion of success allowed insiders to sell their stock at good prices to naive vic-

\textsuperscript{226} After Halliburton’s Dresser Industries unit sold its majority stake in Dresser-Rand to Ingersoll-Rand, Halliburton stopped covering 440 salaried employees under Dresser’s pension plan because they were no longer Dresser employees. Three hundred of the workers who were under 55 and had been eligible for an enhanced early retirement benefit lost that privilege when the unit was sold. Thus, Halliburton treated these employees as if they had “resigned.” Dana Milbank, Democrats Urge Cheney to Aid Ex-Employees, \textit{WASH. Post}, Sept. 11, 2002, at A03; Paul Krugman, Cronies in Arms, \textit{N.Y. Times}, Sept. 17, 2002, at A29.

\textsuperscript{227} Coincidently, Thomas White, appointed by Mr. Cheney as secretary of the army, was one of the insiders at Enron, who made away with $1 billion before the company collapsed. Krugman, \textit{supra} note 226.

\textsuperscript{228} \textit{Id.}

\textsuperscript{229} Two top executives at WorldCom (the largest filing to date) have been criminally charged. Bernard Ebbers was indicted for securities fraud related to an alleged scheme to falsify WorldCom’s books. While Ebbers has since resigned, he was rewarded with a $1.5 million yearly pension and is paying back $408 million in loans from the company at an impressive rate of 2.8%. While the other chief executive, Scott Sullivan, was fired without severance, he wisely put a $10 million dollar bonus in 2000 to good use. \textit{See supra} note 199. Andrew S. Fastow, Enron Corp.’s former chief financial officer was charged with “78 federal counts alleging that he masterminded schemes to artificially inflate the company’s profits and skim millions of dollars at stockholders’ expense.” Randi F. Marshall, \textit{World and Nation: October Was Treat, not Trick for Stocks}, \textit{Newsday} (N.Y., N.Y.), Nov. 1, 2002, at A59. Another company, Tyco, recently filed for bankruptcy and has had criminal charges brought against its former CEO as well. Dennis Kozlowski, Tyco’s former CEO, may be charged with corruption and grand larceny. Tyco is aiming to recover the millions in unauthorized expenses made by the chief-executive: a $17 million Fifth Avenue apartment, a $5 million Nantucket home and a $30 million compound in Florida, as well as the millions he spent on extravagant purchases, including a $6,000 shower curtain, a $15,000 umbrella stand, $97,000 worth of flowers, a $6,300 sewing basket, a $445 pin cushion and $2,900 of coat hangers. \textit{CNBC TV Special Report: SquawkBack Poll: CEO Largesse} (CNBC television broadcast, Nov. 5, 2002), available at http://moneycentral.msn.com/content/CNBCTV/Promos (last visited Dec. 1, 2002).

\textsuperscript{230} Krugman, \textit{supra} note 226.
While economic factors are clearly a significant cause of bankruptcy filings, rather than the loss of the moral stigma involved with the process, it is also true that there is still a negative connotation involved with filing. Filing can harm a person's reputation and can make it more difficult to gain access to credit in the future. Federal law allows credit bureaus to report a bankruptcy filing in the person's credit report for up to ten years after the filing. A recent study, conducted by David Musto, showed that reporting restricts one's access to credit. Musto's study found that having the red flag of bankruptcy was a constraint on an individual's ability to get credit. Furthermore, filing for bankruptcy when an individual or family is experiencing financial troubles "makes the utmost economic sense for local communities and the nation as a whole. Crushing families through a harsh bankruptcy law means more people on welfare rolls, off tax rolls and dependent on already hard pressed local charities." 

E. Credit Industry's Culpability

While pursing bankruptcy reform, not only has Congress overlooked abuse in the business sector, they have overlooked the credit industry's abuse. Many bankruptcy scholars have argued that the rise in personal bankruptcies is largely attributable to the credit card industry. The combination of the industry's indiscriminate extensions of credit and its failure to take precautionary measures to ensure that they are only lending to creditworthy individuals has branded the industry as culpable.

231. Other victims were the Florida state workers whose pension fund invested $300 million in Enron during the company's final months. *Id.* The California Public Employees Retirement System estimated its losses from WorldCom's fall at $565 million, and New York's state retirement system's estimated loss was $300 million. James P. Miller, "House Panel Summons WorldCom CEO," Chicago Tribune, June 27, 2002.

232. *See supra* Part IV.C.

233. Loretta J. Mester, *Is the Personal Bankruptcy System Bankruptcy System Bankrupt?*, BUS. REV. (FED. RES. BANK OF PHILA.), Jan. 1, 2002, 2002 WL 20777433. Mr. Musto used credit-file data from 1994-97 which showed that when the bankruptcy flag was removed from the report, the more creditworthy past filers initiated new credit relationships, especially - high limit credit cards, at a much faster rate than normal. *Id.*


236. *Id.* As one journalist stated: "[T]he rise in personal bankruptcies was never simply a case of Americans turning shiftless and irresponsible. It was a case of credit providers getting care-
The industry has worked hard over the past decade to make credit card borrowing a way of life for most Americans. In 2001, credit card companies sent out 5 billion solicitations, and their efforts have paid off, in more ways than one. Today the average American has multiple credit cards and the credit card companies are making enormous profits off the interest rates. In 1990 there were 213 million outstanding bank credit cards; in 2000, there were an estimated 458 million. "Outstanding credit card debt, the kind that tends to just sit there running up interest, was $154 billion in 1990." In 2000, it was around $486 billion. Also, between 1997 and 2001, the number of active sub-prime or risky accounts tripled.

While the financial services industry pleads innocent, they blame the consumers for being irresponsible with their money. However, the industry fails to recognize that 90 percent of those individuals filing for bankruptcy are forced to do so because of employment loss, high medical bills, or divorce. The industry also fails to recognize that its very own practices have driven many others into bankruptcy. The credit card companies lure in needy consumers with introductory offers at a low interest rate, and then quickly convert that rate into "double digit" charges added to a list of mounting fees. The companies do not hesitate to raise the debtor’s credit limits, as the cardholder falls further into debt. Eventually, some debtors find themselves owing more than they expected when they accepted the credit, due to the extremely low required minimum payments. Also, some lenders have taken “advantage of consumers’ ignorance by actually replacing low-rate mortgages with higher rate mortgages, and adding pre-payment penalties to trap borrowers in the loans.”

238. Reno, supra note 237.
239. Id.
240. Id.
242. Ivins, supra note 164.
244. Nader, supra note 235.
245. Id.
246. Ivins, supra note 164.
Not surprisingly, proposals to stop predatory second mortgage lending, to prohibit solicitations to college students, or to require credit card companies to provide consumers with a notice on their billing statement with information about the cost and length of time it would take to pay off balances at minimum payment rates have been virtually eliminated from the proposed reform legislation.\textsuperscript{248}

Payday loans are another example of the culture that seems to encourage practices that lead to bankruptcy. As research by the American Association of Retired Persons found: “[C]oupled with the decline in the availability of small, unsecured loans from banks and finance companies, many consumers, particularly those with modest incomes or impaired credit, find that payday loans represent their only source for small-sum, short term credit.”\textsuperscript{249} Payday loan operations make short-term loans until the borrower’s next paycheck. The standards required to qualify for the loans are not difficult to meet. Inquiries regarding the consumer’s ability to repay and credit checks are not usually performed.\textsuperscript{250} High annual interest rates become “utterly indefensible” for borrowers.\textsuperscript{251} One survey reported that the average payday loan annual percentage rate was 474 percent.\textsuperscript{252}

Weak consumer protection laws and the industry’s deceptive veiling allow these operations to continue in existence and persist in preying on low-income Americans.\textsuperscript{253} While states have small loans statutes, the payday lenders can claim that their operations are not really a loan in the eyes of the law and circumvent these laws.\textsuperscript{254} Thus, the lenders are free to operate without regulation and free to prey on low-income individuals who cannot defend themselves against the high interest rates and cannot survive without another loan.

Financial services giant, MBNA Corp., stated that bankruptcies accounted for 40 percent of its losses, which last year totaled $4 billion.\textsuperscript{255} However, what the banks fail to reveal is that, even if the bankruptcies did not occur, it is unlikely that they would be receiving this lost money. Many of these debts are not collectable even outside

\textsuperscript{248} Blondin, supra note 219.  
\textsuperscript{250} Generally, consumers only need to demonstrate that they have a personal checking account and that they have been employed for a specified period with their current employer to qualify. \textit{Id.}  
\textsuperscript{252} AARP Research, supra note 250.  
\textsuperscript{253} Payday Loans Fuel Bankruptcy Surge, supra note 252.  
\textsuperscript{254} Id.  
\textsuperscript{255} Heady, supra note 244.
of bankruptcy. The examples of predatory lending and payday loans on behalf of the credit industry demonstrate the double standard that the lending industry has created. Banks have made irresponsible lending decisions and are now turning to Congress for relief of their self-imposed consequences, through the bankruptcy reform bill.

V. Conclusion

The authors of this Article candidly acknowledge that the foregoing discussion has been long on criticism, yet short on answers. However, the purpose is to propose a more appropriate framework of analysis for the future of bankruptcy reform legislation. Effective bankruptcy reform legislation requires an understanding of “abuse,” which, at a minimum, requires careful examination of why consumer filings are at record levels, and, also, that the rhetoric of reform has equal, perhaps even greater, applicability in the corporate bankruptcy context. Sound public policy demands that Congress broaden its perspective on bankruptcy reform to include more than financial service industry’s self-serving version of reality and cease ignoring arguments that are not accompanied by campaign contributions. Only then can Congress fulfill its duty to “remain the domain of general citizenry”\(^{256}\) and enact laws that are reasoned, considered, and above all else, just.