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Some Reflections on Bankruptcy

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Some reflections on BANKRUPTCY

THE BANKRUPTCY BENCH AND THE BANKRUPTCY BAR

Congress is considering a bill to amend the 1978 Bankruptcy Code. According to Professor Frank R. Kennedy's historical view of bankruptcy, this reform effort is about 20 years too early. "Curiously, major overhauls have come at 40-year intervals — in 1898, 1938 and 1978," he says. Here, Kennedy shares an insider's view of the 1978 reform and the development of the bankruptcy bar and bench before and since. This article is adapted from a speech he gave at the American College of Bankruptcy induction ceremony at the U.S. Supreme Court in 1991.

— BY FRANK R. KENNEDY

BANKRUPTCY DISPLACES GRAB LAW by providing for orderly liquidation of debtors' estates. Historically and in many countries, that is its only role. In its origins and for many years, bankruptcy was quasi-criminal, and stigmatization of the bankrupt was one of bankruptcy's distinctive characteristics. In this country, to a far greater extent than in other countries, bankruptcy embraces the fresh start principle. Today, American bankruptcy exhibits a compassionate countenance.

Contrary to a widely-held opinion, I had no role in the drafting of the Bankruptcy Act of 1898 or the General Orders in Bankruptcy promulgated in that year by the Supreme Court. Rather, I encountered bankruptcy as a law student in 1938, the year of the enactment of the Chandler Act, the first overhaul of the Act of 1898.

Although I have always found bankruptcy an intriguing subject of study and field in which to work, the years from 1940 to 1970 were not exciting for bankruptcy buffs. I learned to my dismay that the bankruptcy practice and bankruptcy bar were not generally held in the high esteem to which I was wont to accord them.

Of course, bankruptcy business underwent a severe depression during World War II and for some time thereafter. Referees in bankruptcy, as they were called, had to derive their compensation and expenses from fees collected in the cases, and tenure for a referee was two years. A referee could be reappointed by the district judge or judges who made the original appointment, but the general perception was that a referee was so beholden to the district judge who would have the power of reappointment that confidence in the independence of the referee's judgment was often impaired.

Recall that in those days the referees had no law clerks, opinions of referees were rarely seen, and district judges' opinions in bankruptcy cases were not frequent. I think I can detect some murmurs of yearning for a return to that state of affairs. It is easy to sympathize with that point of view, and I have been importuned to lead or support an effort to place limits on the number and length of bankruptcy court opinions. I must confess that while I wish some bankruptcy judges would be less generous with their contributions to the new bankruptcy jurisprudence, I am disinclined to silence them or to deprive them of research assistance. I am of the opinion that the benefits of the present system outweigh the costs.

By the mid-'40s, bankruptcy referees' offices became so impoverished that the bankruptcy system was severely crippled. In 1946, Congress recognized the referees' plight and enacted the Referees' Salary Act of 1946, extending referees' tenure to six years and removing the basis for a constitutional challenge that their compensation was tied to their decisions in particular cases.

COMPREHENSIVE REFORM

Through the '50s and '60s, consumer bankruptcies increased at an alarming rate, and consumer advocates became increasingly active and successful in obtaining amendments of the Bankruptcy Act that enhanced the benefits obtainable by consumer debtors. Meanwhile, Senator Quentin Burdick of North Dakota, while sitting on the Senate Judiciary Committee, had come to the conclusion that the piecemeal legislation chipping away at the Bankruptcy Act was uncoordinated and unintelligent. In 1968, he filed a bill to create a Congressional commission to undertake a comprehensive study of the Bankruptcy Act and make recommendations for amendment if needed. Hearings were held and witnesses were unanimous that such a study and amendments were needed.

The bill to create the Commission on Bankruptcy Laws of the United States passed in1970, and the commission was given a two-year life, with $400,000 to do the job. There were to be nine members — three appointed by the President, two by the President of the Senate, two by the Speaker of the House, and two by the Chief Justice. Due largely to the Chief Justice's delay in naming the two representatives of the judiciary, only 13 months remained in the commission's original two-year term when the small staff moved into its quarters and began its work. The commission spent considerable time and energy during the first year convincing Congress that an extension was needed — an awkward burden when no track record had been made. It was not clear that the effort would succeed until near the end of the original two-year period.

Only by the wonder-working of Commission Chairman Harold Marsh, Deputy Director Gerald K. Smith and other members of the small staff was it possible for the commission to complete its work. We also were aided by generous dollops of assistance by committees and members of the National Bankruptcy Conference, the National Conference of Bankruptcy Judges, the Commercial Law League, the National Association of Credit Men, the Securities and Exchange

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Commission, and other organizations and agencies.

Three bound volumes were published, but only two were important; the first contained an exposition of findings and recommendations, and the second contained a draft of a completely new Bankruptcy Act, designated the Bankruptcy Act of 1973. The National Conference of Bankruptcy Judges, disagreeing with the commission's decision to combine all the reorganization provisions into a single chapter, filed an alternative set of proposals. Both sets of proposals were embodied in bills introduced in both houses, but Congress was diverted by the crisis created by the break-in at Watergate, which had occurred while the commission staff was slaving over its perverse Xerox machine. Extensive hearings on the bankruptcy bills were nevertheless held.

THE NITTY GRITTY

There was unanimity of opinion in 1970 favorable to Congressional overhaul of the Bankruptcy Act, but the unanimity ended as soon as the harsh truth — the nitty gritty — of specifying the reforms to be enacted was confronted. Activity on the part of those involved in perfecting the proposed bankruptcy bills during 1977 and 1978 can only be described as feverish. In view of the objections of the Chief Justice, not to mention some members of the Commission on Bankruptcy Laws and representatives of various interest groups, the miracle of miracles occurred on Nov. 8, 1978, when President Carter signed the bill before it expired.

One aspect of the operation of the bankruptcy system under the Bankruptcy Reform Act that has been the focus of criticism is that debtors increasingly resort to relief under the act for reasons of business strategy rather than liquidation or reduction and/or extension of an overwhelming debt load. The *Manville, Robins, Continental Airlines* and *Texaco* cases have been most frequently mentioned as illustrative of an abuse of the law. Typically, it is argued that the elimination of the requirement that a debtor be insolvent to be eligible for or amenable to administration under the bankruptcy laws caused this form of abuse. In response to this criticism, I have argued that the bankruptcy court is the best forum for resolving conflicting claims against a debtor in a manner that affords all the interests the best assurance of fair treatment. The development of confirmable plans for dealing with the future as well as the existing claims in the *Manville* and *UNR* cases, notwithstanding formidable obstacles in the form of statutory and procedural limitations and hostile opposition at every crossroad, is a monumental achievement that is a tribute to the lawyers and judges and other participants in the process.

NO SCARLET LETTER

Shortly after the commission began its work in 1972, it received an unexplained barrage of correspondence from Shelbyville, Ind. with the theme, "The first thing you should do is to restore the stigma to bankruptcy." Instead, the commission removed the stigmatizing noun "bankrupt" from its proposed Bankruptcy Act. The Bankruptcy Reform Act of 1978, drafted in large part by Richard Levin and Kenneth Klee of the House Judiciary Committee staff with assistance from Robert Fiedler and Harry Dixon of the Senate Judiciary Committee staff, followed the commission's recommendation. The last time I checked, the rule substituting "debtor" for "bankrupt" has not been violated in any subsequent amendments of the code.

More than a hundred years ago, the President of the American Bar Association remarked on the tendency of American laws governing creditors' rights to intervene for the protection of debtors, thus attesting to "the higher, purer, more beneficent morality of our day and people." So, when critics foment against bankruptcy reform and against the tidal wave of rhetoric about debtors' rights to a fresh start, they ignore or are ignorant of the development of bankruptcy law that has roots extending back for two hundred years. And it is anachronistic to say, as a recent commentator did, that: "Twenty years ago bankruptcy had a scarlet letter, but not today."

The New York Times, The Wall Street Journal, The National Law Journal, the networks — all the media are proclaiming that bankruptcy and bankruptcy practice are no longer embarrassed by an ill-favored image. Rather, the reports from the bankruptcy front for the last three years have been upbeat if not euphoric: Bankruptcy business is booming, and bankruptcy is the hot area of practice. Bankruptcy lawyers are no longer the Rodney Dangerfields of the profession. Not surprisingly, there are other views and voices. Bankruptcy has been trashed by such works as Sol Stein's *A Feast for Lawyers,* which trumpets eleven lies about Chapter 11 and faults the system for the high rate of failures of Chapter 11 petitioners.

To me, however, it is a gratifying phenomenon that a many knowledgeable critics and defenders with diverse perspectives are constructively criticizing

the bankruptcy system. A comprehensive Critique of the First Decade Under the Bankruptcy Code with an Agenda for Reform was organized and presented at Williamsburg in October of 1988. Since that time the National Bankruptcy Conference, an organization devoted to the improvement of bankruptcy law and administration with which I have worked for more than 40 years, has engaged in an examination of problems that require legislative attention.

The American Bankruptcy Institute has launched a project looking toward the establishment of a Congressional Commission on Bankruptcy comparable to the commission of 1972 and 1973. The Bankruptcy Committees of the Business Law Section of the American Bar Association have studies under way that contemplate legislative reform, and I am confident without being informed that the National Conference of Bankruptcy Judges, the Commercial Law League and other organizations that conferred with and assisted the Commission on Bankruptcy Laws in the early '70s are seriously studying the function of bankruptcy laws with a view to supporting changes that will improve them.

The American College of Bankruptcy is an ideal conception and force to support the laudable effort to improve bankruptcy law and administration by recognizing and enlisting as participants the leaders of the bench and bar and related professions and activities.

THE CASE FOR FUTURE REFORM

There are numerous, enormous challenges awaiting those willing to confront the problems facing bankruptcy reformers: solving conflicts between the demands of the environmental law advocates and the principles of bankruptcy law (*i.e.*, fairness and equality of distribution and provision of a fresh start); the treatment of victims of mass torts, including those whose injuries are not manifested until after the estates of the liable parties have been administered; the administration of claims for retirement, health, and welfare benefits owed by insolvent enterprises; the unwinding of leveraged buyouts. There are troubling signs that insurance companies and financial institutions may be heading toward conditions that will precipitate a need for application of the experience and expertise developed under the bankruptcy laws.

Professor Morris Shanker of Case Western Reserve University Law School recently presented a persuasive argument that bankruptcy should be a required course in law school. His argument emphasized its intersections with every other area of law, its toughness as a subject of study and its importance in focusing on the necessity of planning for all legal transactions. In their study of consumer bankruptcy, *As We Forgive Our Debtors*, Professors Elizabeth Warren of the University of Pennsylvania and Theresa Sullivan and Jay Westbrook of the University of Texas emphasized the uniqueness of American bankruptcy law, not only in its protection of the fresh start but in its highly individualistic character and minimization of the role of government regulation of the process.

A lively debate has developed, however, regarding bankruptcy policy. Dean Thomas Jackson of Virginia and Professor Douglas Baird of the University of Chicago, both espousing the law-and-economics approach, have been questioning the justification for bankruptcy laws. They argue that these laws fall short of meeting tests of economic accounting and efficiency. There are, however, many voices in opposition to the "economic account;" they argue that many values in addition to efficiency must be considered in appraising the adequacy of the bankruptcy system and in formulating reform measures. There are exciting times ahead for bankruptcy buffs.

I conclude these reflections by acknowledging that while there have been disappointments and setbacks in the development of bankruptcy law, practice, and administration during the last 48 years, my conclusion is that there has been dramatic improvement. Moreover, there is reason to believe that notwithstanding the challenges and difficulties ahead, the improvement will continue. A principal reason for this optimism is the increase in the number of laborers in the vineyard, who have lent their energy, interest, intelligence and experience to improving bankruptcy administration.

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