

# The Role of the Courts in Shaping American Bankruptcy Law: Review of “Debt’s Dominion — A History of Bankruptcy Law in America”

Douglas G. Smith\*

## INTRODUCTION

In recent years, a renewed emphasis on, and interest in, bankruptcy law has emerged as an increasing number of companies have sought to utilize the bankruptcy system as a means for resolving various problems that have brought them to the brink of financial ruin.<sup>1</sup> Through the efforts of legislators, judges, and practitioners,

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\* Partner, Kirkland & Ellis, Chicago, Ill.; J.D., Northwestern University School of Law; M.B.A., University of Chicago; B.S./B.A., State University of New York at Buffalo. The views expressed in this article are solely those of the author and do not necessarily reflect those of Kirkland & Ellis or its clients. I would like to thank David Skeel for his comments on a prior draft of this article.

<sup>1</sup> See DAVID A. SKEEL, JR., DEBT’S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 4-5 (2001) (“Law students now flock to bankruptcy classes, the nation’s elite law firms have rediscovered bankruptcy practice, and the number and range of personal and business bankruptcies have reached unprecedented levels.”); *id.* at 222 (“The newfound prominence of corporate bankruptcy practice has also been reflected in the academic literature.”); Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors’ Bargain*, 75 VA. L. REV. 155, 155 (1989) (“The developing academic interest in legal theory has spurred a corresponding interest in expanding the theoretical foundations of bankruptcy law as well.”); Robert E. Scott, *Through Bankruptcy with the Creditors’ Rights Bargain Heuristic*, 53 U. CHI. L. REV. 690, 690 (1986) (“It is a commonplace, but nonetheless true: the study of bankruptcy has attained a new respectability in American law schools.”); Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 775 (1987) (“As bankruptcy has flourished in the popular press and in law practice, it enjoys what may be looked back on as a golden age in academe.”).

The numerous recent articles published in the field demonstrate the significant academic interest in bankruptcy law. See, e.g., Barry E. Adler, *The Theory of Corporate Insolvency*, 72 N.Y.U. L. REV. 343 (1997); Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311 (1993); Douglas G. Baird, *Bankruptcy’s Uncontested Axioms*, 108 YALE L.J. 573 (1998); Douglas G. Baird & Robert K. Rasmussen, *Control Rights, Priority Rights, and the Conceptual Foundations of Corporate Reorganizations*, 87 VA. L. REV. 921 (2001); Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043 (1992); Edith H. Jones, *Rough Justice in Mass Future Claims: Should Bankruptcy Courts Direct Tort Reform?*, 76 TEX. L. REV. 1695 (1998); Donald Korobkin, *Contractarianism and the Normative Foundations of Bankruptcy Law*, 71 TEX. L. REV. 541 (1993); Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L.

the bankruptcy system has evolved to accommodate these new and varied needs. This evolutionary process has not occurred overnight. Indeed, the bankruptcy system in the United States has continued to evolve throughout our nation's history.

David Skeel's recent book, *Debt's Dominion: A History of Bankruptcy Law in America* provides a valuable perspective on the historical evolution of bankruptcy law in the United States.<sup>2</sup> Professor Skeel catalogues the history of the bankruptcy system in the United States from its inception, including the early struggles to define the nature of the system as well as major turning points such as the 1898 Bankruptcy Act and the 1978 Bankruptcy Code. *Debt's Dominion*, however, is not merely a historical review; it identifies and analyzes the forces that Professor Skeel believes have been responsible for shaping U.S. bankruptcy law over the last two hundred years.

While Professor Skeel emphasizes the efforts of legislators in shaping our modern bankruptcy system, arguably the efforts of the judiciary have been equally significant. In particular, the frameworks established under the various bankruptcy laws have provided a large degree of latitude for judges to develop creative means for resolving new and challenging problems that have arisen over the years. As our nation has progressed from a largely agrarian society to an industrial power, and now into the information age, our bankruptcy system has been forced to evolve along with our nation's economy. Indeed, the flexibility afforded bankruptcy judges is so great that certain commentators have expressed concern that "bankruptcy decisionmaking may be without rational constraint."<sup>3</sup>

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REV. 597 (1993); Ronald J. Mann, *Bankruptcy and the Entitlements of the Government: Whose Money Is It Anyway?*, 70 N.Y.U. L. REV. 993 (1995); Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 MICH. L. REV. 47 (1997); Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEX. L. REV. 51 (1992); Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 YALE L.J. 437 (1992); Michelle J. White, *Why It Pays to File for Bankruptcy: A Critical Look at the Incentives Under U.S. Personal Bankruptcy Law and a Proposal for Change*, 65 U. CHI. L. REV. 685 (1998).

<sup>2</sup> *Debt's Dominion* is not the first major work providing an overview of bankruptcy law in the United States. Professor Skeel cites a number of influential works, including the following: BRUCE G. CARRUTHERS & TERENCE C. HALLIDAY, *RESCUING BUSINESS: THE MAKING OF CORPORATE BANKRUPTCY LAW IN ENGLAND AND THE UNITED STATES* (1998); PETER J. COLEMAN, *DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND BANKRUPTCY, 1607-1900* (1974); KAREN GROSS, *FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM* (1997); THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY* (1986); CHARLES WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* (1935); ELIZABETH WARREN ET AL., *AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA* (1989).

<sup>3</sup> Donald R. Korobkin, *Value and Rationality in Bankruptcy Decisionmaking*, 33 WM. & MARY L. REV. 333, 334 (1992). Professor Skeel suggests that the Supreme Court's

In his book, Professor Skeel discusses a number of instances in which the courts have developed new procedural mechanisms to address problems relating to debtor insolvency, thereby directly impacting the nature of the bankruptcy system. Such innovations have been necessary to accommodate an ever-changing commercial landscape. In addressing situations that have arisen for the first time, the courts have been forced both to create new rules, and to develop more detailed standards within the contours of established rules.

Moreover, it is apparent from reading *Debt's Dominion* that the courts have had a more indirect effect in shaping the bankruptcy system as well. While not the focus of his study, Professor Skeel's book demonstrates that legislative changes in the bankruptcy laws often have been preceded by judicial innovations designed to resolve problems not explicitly addressed by the legislative branch. Indeed, it may be fair to characterize many of the major changes in the bankruptcy laws as mere "codifications," or at least adaptations of well-established bankruptcy practice. As a result, the judiciary itself has acted as perhaps one of the most powerful interest groups involved in shaping legislation in that it has paved the way in developing new mechanisms for addressing problems within the bankruptcy system.

By addressing changing circumstances as they arise, the courts have shaped the terms of the debate before the legislature. As Professor Skeel's book demonstrates, from the determination of whether issues relating to insolvency are within the scope of congressional bankruptcy powers, to the use of those powers in large-scale corporate reorganizations, to the development of procedural mechanisms necessary to address liability resulting from mass torts, the courts consistently have played a leading role in framing the terms of the legislative debate.

This review first provides an overview of the themes expressed in *Debt's Dominion*, including Professor Skeel's thesis that the bankruptcy laws have been shaped by three primary forces: creditors, pro-debtor and other populist interests, and bankruptcy professionals. It then provides certain additional observations concerning the history that Professor Skeel outlines. In particular, Professor Skeel catalogues a

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approach to interpreting the Bankruptcy Code in many of its more recent decisions may be at odds with such judicial flexibility and could in some cases stifle further judicial innovation. See Letter from David Skeel to Douglas Smith, Partner, Kirkland & Ellis (May 13, 2002) (on file with author). Faithful adherence to the understanding of the text, however, does not necessarily constitute a restraint on judicial latitude. A strict construction of the text may reveal a legislative intent to confer broad authority upon the courts.

number of instances in which alterations in the bankruptcy system have been the direct result of judicial innovation, rather than legislative change. Moreover, it appears that in addition to the factors Professor Skeel emphasizes, in fashioning creative solutions to bankruptcy problems the courts have had a significant influence on the legislature's enactment of various bankruptcy reforms.

### I. PROFESSOR SKEEL'S THESIS

Professor Skeel divides the history of bankruptcy law in the United States into "three general eras." The first he describes as "culminat[ing] in the enactment of the 1898 [Bankruptcy] Act, and the perfection of the equity receivership technique for large-scale reorganizations." Before Congress passed the 1898 Act, there were numerous laws that Congress enacted in response to economic downturns, which were then repealed when the economy recovered. As Professor Skeel observes: "All told . . . Congress passed three federal bankruptcy laws prior to 1898: the Bankruptcy Acts of 1800, 1841, and 1867. Together, the acts lasted a total of sixteen years."<sup>4</sup> As a result of competing forces, during this period there was an "inability to reach a stable outcome on federal bankruptcy legislation."<sup>5</sup>

All of this changed, however, toward the end of the nineteenth century with the passage of the 1898 Bankruptcy Act, which "set up an adversarial, judicial process as the American model for bankruptcy" that was more "sympathetic to debtors' interests."<sup>6</sup> Accompanying this newly-created adversarial process, according to Skeel, was a rise in the importance and influence of the bankruptcy

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<sup>4</sup> SKEEL, *supra* note 1, at 25; see also Susan Block-Lieb, *Congress' Temptation to Defect: A Political and Economic Theory of Legislative Resolutions to Financial Common Pool Problems*, 39 ARIZ. L. REV. 801, 854-55 (1997) ("Congress enacted federal bankruptcy laws in 1800, 1841 and 1867. Each of these early Acts was enacted amid political controversy among organized interests and in reaction to national economic crises. Each was short-lived—repealed within a brief time after enactment.") (footnotes omitted); Richard C. Sauer, *Bankruptcy Law and the Maturing of American Capitalism*, 55 OHIO ST. L.J. 291, 291 (1994) ("Before finally implementing a permanent regimen of bankruptcy relief in 1898, Congress generated three abortive systems from a debate as heated and philosophically far-reaching as those addressing monetary policy, the tariff, or the two Banks of the United States, in the process tracing with unequaled precision the nation's basic political faultlines.").

<sup>5</sup> SKEEL, *supra* note 1, at 30.

<sup>6</sup> *Id.* at 43; see also Douglass G. Boshkoff, *Fresh Start, False Start, or Head Start?*, 70 IND. L.J. 549, 550 (1995) (observing that "[t]he Bankruptcy Act of 1898 was the product of a prolonged legislative struggle between agrarian interests which wanted only voluntary (debtor-initiated) proceedings and banking interests which fought for a creditor-controlled involuntary system").

bar. Indeed, Skeel concludes that “[s]ince 1898, bankruptcy professionals have been the single most important influence on the development of bankruptcy law.”<sup>7</sup>

It was also during this time that the courts began to develop the law governing corporate reorganization. After reviewing the history concerning these early judicially-sanctioned reorganizations, Professor Skeel concludes that “[i]n a very real sense, the history of corporate reorganization is the history of nineteenth-century railroad failure. The periodic collapse of the railroads led to the first reorganizations — which were called equity receiverships.”<sup>8</sup> Initially there was some question as to whether corporations could take advantage of the bankruptcy laws at all — not to mention whether they could do so to reorganize, rather than liquidate, their assets.<sup>9</sup> When, however, large railroads began to fail during the nineteenth century, the courts devised novel solutions such as the equity receivership to allow large-scale corporate reorganizations that were not expressly provided for under existing bankruptcy law.<sup>10</sup> Such innovations were necessary given that it made no sense to liquidate a railroad and the massive infrastructure necessary for such operations: it was eminently more reasonable to maintain such a company as a going concern. As a result of the need to respond to such novel circumstances, significant innovation in the nation’s bankruptcy laws marked the end of this first era.

The second era Skeel discusses encompasses the Great Depression and the New Deal. According to Skeel, the rise of populism that accompanied the Great Depression led to the enactment of bankruptcy laws that were far less friendly to large corporate interests.<sup>11</sup> Accordingly, the SEC was afforded a much larger role in regulating corporate reorganization, “injecting pervasive governmental oversight into a practice that previously had consisted largely of private arrangements.”<sup>12</sup> Thus, to some extent

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<sup>7</sup> SKEEL, *supra* note 1, at 47; *see also* Adler, *Financial and Political Theories of American Corporate Bankruptcy*, *supra* note 1, at 343 (“Members of the bankruptcy and corporate bars are direct beneficiaries of the current bankruptcy regime and the commercial and corporate laws supporting it.”).

<sup>8</sup> SKEEL, *supra* note 1, at 48.

<sup>9</sup> *Id.*

<sup>10</sup> *Id.*

<sup>11</sup> *See id.* at 98-99.

<sup>12</sup> *Id.* at 119; *see also id.* at 131 (“In corporate bankruptcy the New Deal injected sweeping governmental controls into a regime that had previously relied on contract and private negotiations . . . .”); *cf.* Posner, *supra* note 1, at 60 (“[A]s Mark Roe shows, the ideology of populism — characterized by a suspicion of concentrated economic and political power — accounts at least partly for the laws that fragment ownership

this second era was marked by attempts to impose a more rigid and inflexible framework on the bankruptcy process—at least with respect to corporate reorganization.

However, all of this soon changed. The third and final era delineated by Skeel, which included the enactment of the 1978 Bankruptcy Code, involved “a repudiation of the New Deal vision for reorganizing large corporations.”<sup>13</sup> While a dramatic increase in the number of personal bankruptcies<sup>14</sup> precipitated the hearings preceding the enactment of the Code, the result of the new legislation was a dramatic change in the law governing corporate reorganization.<sup>15</sup> As a result, under the 1978 Bankruptcy Code, there was a “resurgence of large-scale corporate reorganizations.”<sup>16</sup> In particular, Chapter 11 of the Code “has proven far more attractive to troubled firms than prior law because it permits a debtor’s current managers to continue running the firm in bankruptcy.”<sup>17</sup> For this reason, Skeel concludes that the Code involved a “repudiation” of the heavy government oversight inherent in the New Deal legislation.<sup>18</sup>

Nonetheless, while the 1978 Code seems to have wrought the changes in corporate bankruptcy that Congress intended,<sup>19</sup> it has not stemmed the flow of consumer bankruptcies that prompted consideration of such legislation. Since the enactment of the 1978 Code there has been an even greater increase in the rate of consumer bankruptcy filings.<sup>20</sup> This dramatic increase has resulted in repeated calls for reform, and the recent history of the bankruptcy debate has

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of public corporations. If populism has influenced corporate law, it seems likely that it also has influenced bankruptcy law.”) (footnote omitted).

<sup>13</sup> SKEEL, *supra* note 1, at 5.

<sup>14</sup> *See id.* at 136.

<sup>15</sup> *See id.* at 161 (“Although the passage of Chapter 11 was by far the most important corporate law reform, several other changes also have contributed to the flourishing of corporate reorganization since 1978.”).

<sup>16</sup> *Id.* at 20.

<sup>17</sup> *Id.*

<sup>18</sup> *Id.* at 19.

<sup>19</sup> *See* Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 372 (1993) (observing that “[t]he new Code — Chapter 11 in particular — was designed with an avowed intention to make bankruptcy more attractive to businesses in trouble”).

<sup>20</sup> *See, e.g.*, Ted Janger, *Crystals and Mud in Bankruptcy Law: Judicial Competence and Statutory Design*, 43 ARIZ. L. REV. 559, 615 (2001) (“[I]n the year 2000, with the economy in its eighth year of recovery, personal bankruptcy filings are above one million and have been at that level for the last few years, notwithstanding the booming economy.”); David A. Moss & Gibbs A. Johnson, *The Rise of Consumer Bankruptcy: Evolution, Revolution, or Both?*, 73 AM. BANKR. L.J. 311 (1999) (discussing reasons for the increase in consumer bankruptcy filings).

been marked by a “fierce struggle over the future of consumer bankruptcy in the United States.”<sup>21</sup> While creditors have vigorously advocated a tightening of the bankruptcy laws, “bankruptcy professionals, consumer advocates, and academics . . . have formed a tight, ongoing defense” against such efforts.<sup>22</sup> To date, these forces seem to have won the day: congressional efforts to reform the bankruptcy laws to stem the abuse of consumer bankruptcy have failed.<sup>23</sup> Nonetheless, as Professor Skeel observes, such efforts continue, given the proponents’ view that it is critical that some measure of rationality be imposed upon consumer bankruptcies in the United States.<sup>24</sup>

Throughout his discussion of the history of our nation’s bankruptcy system, Skeel identifies three primary forces as being responsible for the evolution of bankruptcy law in the United States: creditor groups, pro-debtor and other populist interests, and bankruptcy professionals.<sup>25</sup> For example, he observes that “populist ideology featured prominently in the nineteenth-century bankruptcy debates.”<sup>26</sup> Similarly, he notes that “[i]n their role as bankruptcy

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<sup>21</sup> SKEEL, *supra* note 1, at 187 (“Creditors point to the unprecedented number of bankruptcy filings and call for restrictions, while the bankruptcy bar points its finger at creditors as the source of the problem.”).

<sup>22</sup> *Id.* at 195.

<sup>23</sup> *See id.* at 187-89.

<sup>24</sup> *See id.* at 210-11.

<sup>25</sup> *Id.* at 16. Skeel further comments that:

[p]artisan politics have also figured prominently in bankruptcy history. Much of creditors’ influence has been in the Republican Party, whereas most pro-debtor lawmakers have been Democrats. The political divide was especially pronounced in the nineteenth century, but the interaction of the three principal forces in U.S. bankruptcy law and the two political parties continues to be an important theme, even today.

*Id.* Similarly, concerns about federalism have also animated the debates over this nation’s bankruptcy laws. Although the Constitution provides an express congressional power to enact “uniform laws on the subject of bankruptcies,” *id.* at 23, an ever present debate concerning the proper role of the states in the bankruptcy system continues today. Finally, geographical differences also played a role in shaping parties’ views regarding federal bankruptcy laws. As Skeel observes, during the early years of the nation:

Because southerners feared that northern creditors would use bankruptcy law as a collection device to displace southern farmers from their homesteads, the strongest opposition to federal bankruptcy came from the South. Many western lawmakers opposed bankruptcy legislation for similar reasons. Lawmakers from the commercial northeastern states, by contrast, were much more likely to view federal bankruptcy legislation as essential to the promotion of commercial enterprise.

*Id.* at 26.

<sup>26</sup> SKEEL, *supra* note 1, at 81.

experts . . . bankruptcy lawyers have an ongoing opportunity to influence the legislative process. In hearing after hearing, one sees bankruptcy professionals testifying before the Judiciary Committee on bankruptcy-related issues.”<sup>27</sup> Skeel traces the role of these three forces in shaping the major changes in the legal framework established by Congress as a basis for the bankruptcy system, and argues persuasively for their significant impact on bankruptcy law throughout our nation’s history.<sup>28</sup>

## II. THE ROLE OF THE COURTS

There are, however, additional significant factors that have shaped American bankruptcy law, which jump out at the reader. Throughout the history of American bankruptcy law, as catalogued by Skeel, the role of the courts in crafting novel solutions to problems that have arisen in the context of bankruptcy is readily apparent. Skeel discusses numerous instances in which the courts have come up with innovative solutions that later served as a framework, if not a model, for legislative changes in the bankruptcy system. As a result, besides directly creating rules within the flexible framework established by Congress, the bankruptcy courts themselves have represented an important influence in shaping bankruptcy legislation.<sup>29</sup>

### A. *A History of Innovation*

One of the examples that Professor Skeel discusses at length in his book is the utilization of equity receiverships during the nineteenth century as a prototypical means of achieving corporate reorganizations.<sup>30</sup> While the bankruptcy laws did not expressly provide a mechanism for large-scale corporate reorganizations,<sup>31</sup>

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<sup>27</sup> *Id.* at 87; *see also id.* at 88 (“Given their participation in every phase of the legislative process, bankruptcy professionals have an enormous influence on the shape of any proposed legislation.”). Skeel concludes that “[b]ankruptcy lawyers have repeatedly lobbied to expand the bankruptcy process, and they have opposed amendments that might diminish the use of bankruptcy.” *Id.* at 93.

<sup>28</sup> *See id.* at 80-100.

<sup>29</sup> In earlier writings, Professor Skeel has included bankruptcy judges among the “bankruptcy professionals” he cites as one of the three forces shaping bankruptcy legislation. *See, e.g.,* David A. Skeel, Jr., *Bankruptcy Lawyers and the Shape of American Bankruptcy Law*, 67 *FORDHAM L. REV.* 497, 510 (1998).

<sup>30</sup> *See, e.g.,* SKEEL, *supra* note 1, at 4, 48, 52, 56-69.

<sup>31</sup> Explaining the lack of a provision for corporate reorganization under the bankruptcy laws, Professor Skeel observes that “[i]n the early and middle decades of the nineteenth century, there was heated debate whether the Bankruptcy Clause gave Congress the power to regulate troubled corporations, rather than just

courts came up with novel mechanisms to accomplish this task when faced with the large-scale railroad bankruptcies in the late 1800s:

With a pervasive legislative response unlikely, and no adequate common-law precedents, reorganizers and courts cobbled together a new device from two powers that did have an established common-law pedigree: courts' equitable authority to appoint receivers to preserve the value of a debtor's property; and the right of a mortgage holder to foreclose on mortgaged property if the debtor defaults.<sup>32</sup>

Thus, the courts developed new procedural mechanisms to address a novel problem that they had not faced before—the bankruptcy of a company that it made no sense to liquidate. In doing so, the courts themselves significantly, and directly, altered the face of the bankruptcy system.

Moreover, as Skeel acknowledges, these judicial innovations had a significant impact on subsequent bankruptcy legislation: “When Congress finally added a meaningful corporate reorganization option to the Bankruptcy Act in the 1930s, it took all of its cues from the railroad receivership techniques that had long been used in the courts.”<sup>33</sup> Thus, these judicial innovations had an indirect effect in spurring Congress to attempt to codify a mechanism for addressing corporate reorganization. In doing so, Congress was largely following the lead of the courts.

A second example involves the procedures developed by the courts during the latter half of the twentieth century for addressing the mass tort bankruptcies filed by debtors such as Johns-Manville, A.H. Robins and Dow Corning, which involved “thousands of actual and potential tort victims.”<sup>34</sup> Skeel attributes the rise in such filings to the “expanded definition of claim” under the 1978 Bankruptcy Code.<sup>35</sup> Nonetheless, in addressing these cases, courts developed

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individuals. . . . In the early decades of the nineteenth century, when corporations were closely tied to their domicile states, the argument was quite powerful.” SKEEL, *supra* note 1, at 52-54.

<sup>32</sup> *Id.* at 57.

<sup>33</sup> *Id.* at 48; *see also* Charles W. Adams, *An Economic Justification for Corporate Reorganizations*, 20 HOFSTRA L. REV. 117, 131 (1991) (observing that “the equity receivership . . . was the forerunner of the business reorganization proceeding in Chapter 11 of the Bankruptcy Code”).

<sup>34</sup> SKEEL, *supra* note 1, at 217.

<sup>35</sup> *Id.*; *see also* 1 REPORT OF THE NATIONAL BANKRUPTCY REVIEW COMMISSION 315 (Oct. 20, 1997) [hereinafter NBRC REPORT] (“Parties have found that traditional individual tort or contract litigation for mass tort or mass contract is unwieldy and too expensive for all parties, and has forced them to seek more efficient alternatives. The bankruptcy system offers a structured system to manage multiple liabilities and has provided a forum for companies with massive liabilities to attempt to do so.”).

procedures, which were not expressly codified in existing bankruptcy laws, to resolve problems found in this new breed of bankruptcy case. In the Johns-Manville bankruptcy, for example, a post-confirmation trust was established to pay for asbestos-related tort claims.<sup>36</sup> The court issued an injunction channeling all tort claims to the trust and away from the reorganized debtor.<sup>37</sup> In this manner, the court established a mechanism for addressing both present and future claims.<sup>38</sup>

Although such procedures have now become commonplace, they have not remained static. Courts facing asbestos and other mass tort claims within the bankruptcy system have developed innovative solutions to address such claims within the framework of a debtor's reorganization.<sup>39</sup> As a result, Professor Skeel concludes that bankruptcy is now "the forum of choice for resolving the modern dilemma of mass tort liability."<sup>40</sup> Other commentators agree, noting that this is "[o]ne of the most cost-effective uses of bankruptcy . . ."<sup>41</sup>

These procedures have in turn significantly influenced the legislature. As Professor Skeel observes, after the successful

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<sup>36</sup> SKEEL, *supra* note 1, at 217.

<sup>37</sup> Sheldon S. Toll, *Bankruptcy and Mass Torts: The Commission's Proposal*, 5 AM. BANKR. INST. L. REV. 363, 375-76 (1997).

<sup>38</sup> *See id.* ("The channeling device, first used in Manville, diverts future claimants from the reorganized debtor to a trust or a pool of assets from which they will receive compensation. Channeling injunctions have also been used to protect insurers of the debtor and other third parties. As a result, channeling injunctions are critical to any scheme to resolve mass future claims.") (footnotes omitted); *cf.* NBRC REPORT, *supra* note 35, at 346 ("Channeling injunctions serve an appropriate and beneficial role in the equitable treatment of mass future claimants. The channeling injunction reinforces the effect of the discharge while it clearly directs claimants toward a specific fund."); Warren, *supra* note 19, at 359 (observing that bankruptcy law "may resolve both present and future claims at once, giving comparable outcomes to those with similar legal rights, but different timetables for reaching the courthouse").

<sup>39</sup> SKEEL, *supra* note 1, at 218-21.

<sup>40</sup> *Id.* at 221.

<sup>41</sup> Warren, *supra* note 19, at 348 n.28 ("One of the most cost-effective uses of bankruptcy may be to bring a number of similar lawsuits against a debtor — such as those from the tort claimants in A.H. Robins or Johns-Manville — into a single forum for much less costly resolution than the case-by-case adjudication that would have taken place at state law."); *see also* John C. Coffee, Jr., *Class Wars: The Dilemma of the Mass Tort Class Action*, 95 COLUM. L. REV. 1343, 1355 (1995) (concluding in comparing class actions and bankruptcy that "[i]n terms of both its fairness to creditors and its ability to rehabilitate a financially strained debtor, the latter wins on all counts—except its ability to preserve management in control"); Mark J. Roe, *Bankruptcy and Mass Tort*, 84 COLUM. L. REV. 846, 855 (1984); Alex Raskolnikov, Note, *Is There a Future for Future Claimants After Amchem Products, Inc. v. Windsor?*, 107 YALE L. J. 2545, 2547 (1998) ("[M]any have argued that bankruptcy is a better remedy for mass torts than class actions like *Ahearn* and *Georgine*").

reorganization of Johns-Manville, “[i]n 1994, bankruptcy professionals and the managers of Manville itself persuaded Congress to give its explicit imprimatur on the Manville solution to the question of how to bind future claimants.”<sup>42</sup> Once again, much as it had in the case of the equity receiverships and early corporate reorganizations, Congress sought to codify procedures that had long been employed by the courts and had become well-established.<sup>43</sup>

*B. The Continuing Need for Innovative Solutions*

The development of innovative procedural techniques for resolving novel problems arising in bankruptcy continues to this day.<sup>44</sup> Indeed, given the fierce political forces that have blocked recent proposed bankruptcy reforms, the role of the courts in crafting solutions to problems arising in bankruptcy may become even more important. In particular, the wide latitude afforded the courts in fashioning creative solutions can be used to remedy certain

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<sup>42</sup> SKEEL, *supra* note 1, at 220; *see also* Toll, *supra* note 37, at 364 (“As part of the Bankruptcy Reform Act of 1994, Congress enacted legislation, codified in section 524(g) of the Bankruptcy Code, to deal with asbestos mass tort claims in Chapter 11 reorganizations.”) (footnote omitted).

<sup>43</sup> In its 1997 report, the National Bankruptcy Review Commission proposed further codification of the procedures that had been developed by courts for addressing mass tort claims. *See* NBRC REPORT, *supra* note 35, at 315-50; SKEEL, *supra* note 1, at 220 (“In keeping with its general enthusiasm for existing practice, the 1997 Bankruptcy Commission report proposed to expand the reach of bankruptcy still further, by applying a similar approach to all firms, including those outside the asbestos industry.”); Jones, *supra* note 1, at 1695 (noting that the NBRC report “proposes codifying authority in bankruptcy courts to reorganize or liquidate companies exposed to mass future claims”); Toll, *supra* note 37, at 364.

<sup>44</sup> *See, e.g.*, Korobkin, *supra* note 3, at 364 (“[T]he rule of equity has an essential role in bankruptcy decisionmaking. It allows a court to respond to an inescapable clash between strongly held values by mediating their relationship in the context of a particular bankruptcy case. This kind of flexibility creates a possibility that a normative constraint definitively ranking the aims would have foreclosed: the court may develop a creative solution that accommodates a range of divergent demands.”); Lawrence Ponoroff & F. Stephen Knippenberg, *The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 NW. U. L. REV. 919, 968 (1991) (“[W]hether by default or caprice, the institution of bankruptcy has become a medium for relieving the pressure which inevitably builds in a commercial economy for solutions to new and unprecedented societal problems. . . . While it is always open to argument whether bankruptcy is the best or most efficient forum in which to respond to any particular problem, its role as a problem-solver in the broad sense has been unequivocally established.”); *cf.* Scott, *supra* note 1, at 691 (“[T]here has been increasing resort to the bankruptcy process to resolve vexing conflicts between the societal interest in reducing the costs of business failure and the allegedly overriding interests in preserving collective bargaining agreements, compensating victims of defective products, and insuring the removal of toxic waste and other environmental hazards.”) (footnotes omitted).

perceived defects in the current system that are in need of immediate redress.

### 1. Consumer Bankruptcy

For example, a number of commentators (including Professor Skeel) have cited the dramatic increase in the number of consumer bankruptcy filings in recent years,<sup>45</sup> many of which seem designed to unfairly take advantage of the system at the expense of creditors. “[S]ince 1978 bankruptcy rates have skyrocketed to over one million per year.”<sup>46</sup> As a result, “[m]any commentators worry about the rapid growth of consumer bankruptcies.”<sup>47</sup>

The reason that such increases have been possible is apparent. As Professor Skeel observes, “U.S. bankruptcy law is far more sympathetic to debtors than are the laws of other nations.”<sup>48</sup> This sympathy, however, has arguably led to abuse, as debtors who are able to pay their debts take advantage of the system to wipe the slate clean—particularly as the social stigma associated with bankruptcy has declined.<sup>49</sup>

By utilizing powers that they already possess, however, bankruptcy courts may impose barriers to such abuse. The courts could develop rules in applying their equitable powers to ensure that “undeserving” consumer debtors cannot receive an inequitable discharge of their debts.<sup>50</sup> The rules governing bankruptcy should

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<sup>45</sup> SKEEL, *supra* note 1, at 187-89; *see also* Posner, *supra* note 1, at 121-22.

<sup>46</sup> Posner, *supra* note 1, at 121.

<sup>47</sup> *Id.* at 122.

<sup>48</sup> SKEEL, *supra* note 1, at 1; *see also* White, *supra* note 1, at 685 (“The United States is extremely unusual among industrialized nations for its very pro-debtor bankruptcy laws.”); Charles G. Hallinan, *The “Fresh Start” Policy in Consumer Bankruptcy: A Historical and an Interpretive Theory*, 21 U. RICH. L. REV. 49, 52 (1986) (“In the context of consumer bankruptcies, the Code is most notable for its significant expansion of the protection afforded to bankrupt debtors.”).

<sup>49</sup> *See, e.g.*, Todd J. Zywicki, *Bankruptcy Law As Social Legislation*, 5 TEX. REV. L. & POL. 393, 405 (2001) (“It is generally accepted that one of the factors driving the upward trend in bankruptcy filing rates in recent decades has been a general decline in the social stigma associated with filing bankruptcy.”).

<sup>50</sup> As one commentator has observed:

[T]he right to a discharge is not now, and never has been, absolute.

The difficulty lies in determining what the parameters of the fresh start policy should be. The question is of increasing importance as nonbusiness bankruptcy filings continue to skyrocket, exceeding half a million filings in each of the last two years.

Charles Jordan Tabb, *The Scope of the Fresh Start in Bankruptcy: Collateral Conversions and the Dischargeability Debate*, 59 GEO. WASH. L. REV. 56, 57 (1990); *see also* Boshkoff, *supra* note 6, at 551 (“[N]ot every debtor receives a discharge. The statute directs the court to deny a discharge to an individual debtor in a variety of situations. Debtor

encourage socially beneficial outcomes while discouraging those that are socially undesirable. As Professor Zywicki has observed, “bankruptcy is at least as much a moral and cultural issue as an economic issue. The modern bankruptcy system mocks traditional values of thrift, personal responsibility, and maintaining promises.”<sup>51</sup> Bankruptcy should not reward undesirable behavior or impose a burden on creditors where certain consequences were avoidable through reasonable actions on the part of the debtor. Accordingly, rules should be developed that prevent such abuses.

For example, where debtors are faced with insolvency as the result of circumstances that are truly not their fault, such as unexpected medical costs for which the debtor had no opportunity to insure, the case for allowing the debtor to take full advantage of the bankruptcy system to obtain a fresh start is much stronger.<sup>52</sup> On the other hand, where consumer debtors seek merely to take advantage of the system and avoid debts that they are fully capable of paying, bankruptcy courts may adopt rules that prevent such socially undesirable conduct. Indeed, certain commentators have observed that “the Bankruptcy Code, as currently drafted, contains a fairly sophisticated deployment of open-textured rules predicated on the idea of competent judges who are able to detect abuse.”<sup>53</sup> As the wave of consumer bankruptcies amply demonstrates, there is an urgent need for the courts to fully exercise their latitude to put in place rules that will stem the current abuses.

In fact, courts in certain instances have already begun to employ the tools available to them under the Code to prevent such

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misconduct—typically some improper activity which is prejudicial to creditors holding present claims against the debtor—is an element of almost every case in which the discharge is withheld.”).

<sup>51</sup> Zywicki, *supra* note 49, at 408; *see also id.* at 427 (“The current American bankruptcy system is . . . unique in the legal systems of the world—it provides powerful economic incentives to file bankruptcy and places few limitations on opportunistic use of bankruptcy.”); Lawrence Ponoroff & F. Stephen Knippenberg, *Debtors Who Convert Their Assets on the Eve of Bankruptcy: Villains or Victims of the Fresh Start?*, 70 N.Y.U. L. REV. 235, 241 (1995) (“[T]here is something instinctively unsettling in abiding a debtor with significant unencumbered assets who purposefully converts those assets into exempt form, thereby placing them beyond the reach of creditors, and then seeks absolution from her unpaid debts by means of the bankruptcy discharge.”); *cf.* Warren, *supra* note 19, at 348 (“Strategic, and often wasteful, action is a persistent problem in collection systems. Under any system, both debtors and creditors can be counted on to press whatever advantages they may have.”).

<sup>52</sup> *See* SKEEL, *supra* note 1, at 242-43 (noting one study that found that “almost twenty percent of the debtors . . . listed medical complications as a reason for their bankruptcy filing”).

<sup>53</sup> Janger, *supra* note 20, at 595.

undesirable results. One of the mechanisms debtors often attempt to utilize to shield their assets from creditors is the conversion of assets that would be subject to division among creditors to assets that fall within one of the “exemptions” created by state law and recognized under the Bankruptcy Code. A notorious example is the homestead exemption, which in certain states allows debtors to shield their homes from division among their creditors.<sup>54</sup> By converting nonexempt assets to exempt assets, debtors who may otherwise be able to pay their creditors are allowed to forego payment.

The Bankruptcy Code, however, contains mechanisms for preventing such abuse. For example, under Section 523, specific debts that are incurred under false pretenses are not subject to discharge.<sup>55</sup> Under this section, courts may uphold “objections to a debtor’s claim of exemption based on the last-minute conversion of non-exempt property to exempt form.”<sup>56</sup> Courts, however, have gone even further, completely denying debtors any discharge of their debts under Section 727(a)(2) of the Code<sup>57</sup> based on “pre-bankruptcy conversion of nonexempt property to exempt property” on the grounds that such conversion constituted “intentional concealment of assets.”<sup>58</sup> Accordingly, under such precedents, “the use of nonexempt assets to create more exempt assets can itself be grounds for denial of discharge.”<sup>59</sup>

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<sup>54</sup> SKEEL, *supra* note 1, at 209.

<sup>55</sup> 11 U.S.C. § 523(a)(2) (2002) (“A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt . . . for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by . . . false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor’s or an insider’s financial condition.”).

<sup>56</sup> Ponoroff & Knippenberg, *supra* note 51, at 281 (citing *Hanson v. First National Bank*, 848 F.2d 866 (8th Cir. 1988)) (footnote omitted).

<sup>57</sup> 11 U.S.C. § 727(a)(2) (2002) (“The court shall grant the debtor a discharge, unless . . . the debtor, with the intent to hinder, delay, or defraud a creditor or an officer of the estate charged with custody of property under this title, has transferred, removed, destroyed, mutilated, or concealed, or has permitted to be transferred, removed, destroyed, mutilated, or concealed . . . property of the debtor, within one year before the date of the filing of the petition.”).

<sup>58</sup> Ponoroff & Knippenberg, *supra* note 51, at 269 (citing *In re Reed*, 700 F.2d 986 (5th Cir. 1983); *Northwest Bank Nebraska v. Tveten*, 848 F.2d 871 (8th Cir. 1988); and *In re Smiley*, 864 F.2d 562 (7th Cir. 1989)); see also Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393, 1442 (1985) (“[B]ankruptcy discharge does seem like a natural starting place for lawmakers designing penalties for certain fraudulent activities. The relation between the activities covered by section 727 and creditors’ collection efforts may be so close as to justify presumptively denying discharge to a debtor who engages in such activities — in addition to imposing whatever other penalties he might deserve.”).

<sup>59</sup> Ponoroff & Knippenberg, *supra* note 51, at 278; see also *id.* at 293 (“[T]he

Other potential mechanisms exist that may be employed to prevent consumer bankruptcy abuse. For example, courts have developed a doctrine under which a debtor's bankruptcy petition may be dismissed if it is filed in "bad faith."<sup>60</sup> This doctrine arguably may be applied to ensure that consumer debtors who are capable of paying their debts and are merely filing for strategic purposes will not be allowed to use the bankruptcy system to escape their debts. Thus, as the foregoing discussion makes clear, a number of tools exist for imposing rational constraints on the wave of consumer bankruptcies flooding the system.

## 2. Mass Torts

A second area in which further judicial innovation may be desirable is in the context of corporate reorganization involving mass torts. Here, there is a pressing need for bankruptcy courts to ensure that only deserving claims receive compensation. Numerous commentators, for example, have recognized that the filing of thousands of dubious claims have plagued asbestos litigation.<sup>61</sup>

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conversion of nonexempt assets to exempt form on the eve of bankruptcy has come to be regarded as behavior at odds with the image of the honest but unfortunate debtor, a normative ideal widely held as a general matter if nowhere defined with rigorous particularity."); Jackson, *supra* note 58, at 1443 ("[C]onsider whether a debtor should be denied discharge for converting his nonexempt assets to exemptions on the eve of bankruptcy in order to maximize his exemptions in an anticipated bankruptcy proceeding. Despite a legislative statement suggesting that the Bankruptcy Code does not reach acts of this kind, courts frequently treat such intentional conversions as falling under the ban of section 727(a)(2).").

<sup>60</sup> See Ponoroff & Knippenberg, *supra* note 51, at 296 ("[A] debtor may . . . be dismissed from the bankruptcy process for having filed in bad faith. There is, as already observed, no statutory requirement that a debtor file in 'good faith'; rather, the requirement has been introduced into doctrine through the case law.") (footnote omitted); Ponoroff & Knippenberg, *supra* note 44, at 944 (noting "the widespread acceptance of a good faith filing prerequisite" but also observing that "the standards by which good faith is to be judged remain ill defined and obscure").

<sup>61</sup> See, e.g., Lester Brickman, *The Asbestos Litigation Crisis: Is There a Need for an Administrative Alternative?*, 13 CARDOZO L. REV. 1819, 1826-27 (1992) ("The more successful courts became in devising ways to more quickly and assuredly compensate the meritorious, the larger the number of unmeritorious claims that were able to enter the system."); Christopher F. Edley, Jr. & Paul C. Weiler, *Asbestos: A Multi-Billion-Dollar Crisis*, 30 HARV. J. ON LEGIS. 383, 384 (1993) ("Tens of thousands of [asbestos] claims have been made, many successfully, by individuals who are understandably worried about their exposure to asbestos but who are not now and never will be afflicted with disease."); Debora R. Hensler, *Fashioning a National Resolution of Asbestos Personal Injury Litigation: A Reply to Professor Brickman*, 13 CARDOZO L. REV. 1967, 1974 (1992) ("Cases with minor injuries, or no current impairment at all, are producing payment for some individuals while other individuals, with serious impairment or fatal illness, are unable to obtain timely compensation."); Victor E. Schwartz & Leah Lorber, *A Letter to the Nation's Trial Judges: How the Focus on Efficiency*

Indeed, the Supreme Court has recently observed that asbestos litigation is “a disaster of major proportions to both the victims and the producers of asbestos products” alike, with baseless claims receiving compensation at the expense of more deserving claimants.<sup>62</sup> As a result, “[m]ost commentators agree that tort litigation today is a highly unsatisfactory system for resolving claims arising out of workers’ exposure to asbestos.”<sup>63</sup> By eliminating those claims that lack merit, bankruptcy courts can ensure that only deserving claimants receive compensation.<sup>64</sup> Stringent judicial “gatekeeping” can be used to weed out “weak and frivolous claims.”<sup>65</sup> The bankruptcy courts enjoy wide latitude to ensure that only deserving claimants receive compensation through their power to disallow

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*is Hurting You and Innocent Victims in Asbestos Liability Cases*, 24 AM. J. TRIAL ADVOC. 247, 250-51 (2000) (observing that “[t]he push toward efficiency has encouraged the filing of baseless claims on behalf of unimpaired claimants” and that, indeed, “[t]he bulk of the new claims are filed by people who have not been impaired by asbestos”); John A. Siliciano, *Mass Torts and the Rhetoric of Crisis*, 80 CORNELL L. REV. 990, 1010 (1995) (observing that there has been a “parasitic fusion of strong and weak cases”); Jack B. Weinstein, *Ethical Dilemmas in Mass Tort Litigation*, 88 NW. U. L. REV. 469, 521 (1994) (“Some attorneys . . . will take almost any case without regard to its merit, hoping for a global settlement.”).

<sup>62</sup> *Ortiz v. Fibreboard Corp.*, 527 U.S. 815, 821 (1999).

<sup>63</sup> Peter H. Schuck, *The Worst Should Go First: Deferral Registries in Asbestos Litigation*, 15 HARV. J.L. & PUB. POL’Y 541 (1992); see generally REPORT OF THE JUDICIAL CONFERENCE AD HOC COMMITTEE ON ASBESTOS LITIGATION 2 (Mar. 1991) (describing asbestos litigation as a “disaster of major proportions to both the victims and the producers of asbestos products”).

<sup>64</sup> Commentators have noted procedural problems and strategic behavior by the plaintiffs’ bar in the Manville reorganization that arguably led to a failure to impose such requirements, resulting in depletion of the assets available to pay valid claims. See NBRC REPORT, *supra* note 35, at 344 (“[T]he Johns-Manville trust faced procedural problems that affected its adequacy. Parties ‘jumped the queue’ and proceeded to litigation, while group settlements to avoid litigation multiplied, forcing the trust to litigate on several fronts at once, and not surprisingly, these problems undermined the trust’s ability to devote its resources to equitable compensation of asbestos claimants.”); Frank Macchiarola, *The Manville Personal Injury Settlement Trust: Lessons for the Future*, 17 CARDOZO L. REV. 583, 602-03 (1996) (“The Trust mechanism was poorly designed and highly vulnerable to litigation . . . . The Trust did little to effectively apportion its funding among all possible claimants because their settlements were docket driven.”).

<sup>65</sup> *Castano v. American Tobacco Co.*, 84 F.3d 734, 747 n.24 (5th Cir. 1996). As Judge Jones recently observed:

For nearly two decades, as waves of product liability litigation have assaulted civil courts, the same questions have continued to arise and yet defy solution. Even the question of the defendants’ liability, which should be a critical matter in the fashioning of a just solution, becomes submerged beneath the overwhelming volume of claims and the huge transactional costs of defending them. In mass litigation, it is difficult to distinguish valid claims from frivolous or false ones.

Jones, *supra* note 1, at 1696-97.

invalid claims, and in fact courts have used these powers to disallow invalid tort claims.<sup>66</sup> Such procedures are consistent with the “policies of flexibility and equity built into Chapter 11 of the Bankruptcy Code”<sup>67</sup> and preserve debtor assets to ensure an equitable distribution.

As these examples show, as in the past, the courts can make a valuable contribution in solving problems currently facing the bankruptcy system. While legislative solutions to such problems may be desirable, they may not always be feasible given the prevailing political climate. Moreover, in many instances Congress seems to have waited for the courts to address a problem before acting, merely codifying procedures that have already been put in place. Irrespective of whether the legislature chooses to act, however, judicial problem-solving can function as a valuable tool for correcting many of the problems currently plaguing our bankruptcy system.

#### CONCLUSION

*Debt's Dominion* makes a valuable contribution to our understanding of the forces influencing the nation's bankruptcy laws over the last two hundred years. While Professor Skeel focuses on the evolution of legislation governing the bankruptcy system in the United States, the courts have had a significant role in shaping the bankruptcy framework. That role has manifested itself in two ways. First, and most obviously, the courts have established innovative mechanisms for addressing novel problems arising in bankruptcy. Where there has been an urgent need to address new problems that have arisen as the result of an ever-changing commercial landscape, courts have not failed to act. Second, as is clear from Professor Skeel's discussion of the historical evolution of our nation's bankruptcy laws, the innovative mechanisms adopted by the courts

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<sup>66</sup> See, e.g., *In re The Babcock & Wilcox Co.*, No. 00-0558, 2000 WL 422372, at \*4 (E.D. La. Apr. 17, 2000) (withdrawing the reference to determine “the validity of claims based on unreliable scientific evidence of disease and/or causation”); *In re Dow Corning Corp.*, 215 B.R. 526, 529 (Bankr. E.D. Mich. 1997) (applying *Daubert* standards in determining the validity of breast implant tort claims); *In re Dow Corning Corp.*, 215 B.R. 346, 360 (Bankr. E.D. Mich. 1997) (“Summary judgment will serve to weed out those claims which do not present a genuine issue of material fact, and for which the debtor is entitled to judgment as a matter of law.”); *In re Standard Insulations, Inc.*, 138 B.R. 947, 954 (Bankr. W.D. Mo. 1992) (“Summary judgment is similar to the claims allowance process in that one purpose is to isolate and dispose of factually unsupported claims.”); Toll, *supra* note 37, at 369 (“Dow Corning contests its liability for silicone-related claims and is using bankruptcy as a massive class action-type device to litigate its liability issues in a single forum.”).

<sup>67</sup> *NLRB v. Bildisco & Bildisco*, 465 U.S. 513, 525 (1984).

often have formed the basis for substantive legislative changes. Thus, in a very real sense, the courts have had a significant role in shaping the system that exists today. This role becomes even more critical during periods of rapid change in the commercial landscape, which are often accompanied by unique problems calling for an immediate response, or during periods in which opposing political forces block meaningful legislative reform, leaving pressing needs unaddressed.