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Bankruptcy Policy

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Bankruptcy is a booming business—in practice and in theory. From headlines about LTV's 10,000-page filing to feature stories about bankrupt consumers (usually Joe-and-Ethel-whose-names-have-been-changed-to-protect-their-privacy), bankruptcy has become an increasingly popular news item in the past few years. Both organized labor and the consumer credit industry made concerted efforts to put bankruptcy issues before the public in their recent pushes to amend the new Bankruptcy Code. Lawyers have been drawn to the bright lights. Firms that did not have a single bankruptcy practitioner five years ago now field large bankruptcy sections. Bankruptcy seminars have been sellouts. And—perhaps the most reliable indicator of increased attention and activity—bankruptcy jokes have begun to make the rounds.

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. Law review articles on bankruptcy abound, and enrollments in bankruptcy and related commercial law classes are reported to be on the rise across the country. Uncertainty about how

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the new Bankruptcy Code will be interpreted and dramatic shifts in the strategic use of bankruptcy have prompted reporters to call law professors for in-depth interviews or quotable statements for the evening news. Rumor has it that requests for expert help are on the increase and consultation fees are up for more than a few academics specializing in bankruptcy. All in all, it's not a bad time to know something about bankruptcy.

In the midst of this attention and noise and clamor, however, there is a quiet but persistent question: what function does bankruptcy serve? After the statutory arguments have been exhausted and the cases have been explored, most academic discussions of bankruptcy can be distilled to this question. Currently, the policies endorsed to support bankruptcy pronouncements are wide-ranging and, at the extremes, very much in opposition. Despite the critical importance of different policy presumptions, the policy elements underlying most discourses are asserted only obliquely, and they are rarely challenged directly.[1]

Professor Douglas Baird and I have undertaken to debate in writing the basis of bankruptcy policy.[2] We offer this paired set of essays in the spirit of the old "Point-Counterpoint" segment of television's "Sixty Minutes." While we cannot promise the dripping invective and snarling satire that made that old feature so delightful, we can try to push forward the debate by making direct challenges and responses. In the belief that a good fight is far more interesting than a host of polite compliments and careful hedgings, Professor Baird and I undertake an aggressive and irreverent debate.

In order to join issue more clearly and to narrow the focus of the debate somewhat, Professor Baird and I have agreed to debate

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[1] A recent exception to the practice of ignoring disagreeable policy differences was the debate between Professor Kripke and Professors Jackson and Schwartz. See Homer Kripke, Law and Economics: Measuring the Economic Efficiency of Commercial Law in a Vacuum of Fact, 133 U. Pa. L. Rev. 929 (1985); Thomas H. Jackson and Alan Schwartz, Vacuum of Fact or Vacuous Theory: A Reply to Professor Kripke, 133 U. Pa. L. Rev. 987 (1985).

[2] Professor Baird has coauthored much of his work with Professor Thomas H. Jackson. Although Baird has written the other article in this exchange without Professor Jackson, it seems fairly clear from their jointly authored works as well as from their individual pieces that they are in substantial agreement on the basic policy premise of bankruptcy and the implications of that policy in state-federal conflicts. On the other hand, it seems equally clear that since Professor Baird is the only one participating directly in this exchange, it would be most unfair to refer constantly to Professor Jackson's views as well. Therefore, I refer in this article to Professor Baird as the proponent of the points with which I disagree, without absolving his absent coauthor one whit, and I refer to the opinions expressed in their joint pieces as those of Professor Baird. I expect that my frequent coauthor, Professor Westbrook, may suffer the same fate.

the basis of bankruptcy policy in the context of business bankruptcies. While we both believe that the principles we discuss have significance in a consumer setting as well, we recognize that additional issues should be a part of a discussion about consumer bankruptcy policy and that those issues would make the discussion even more complex.

Professor Baird and I hold very different views of the purpose bankruptcy law serves. I see bankruptcy as an attempt to reckon with a debtor's multiple defaults and to distribute the consequences among a number of different actors.[3] Bankruptcy encompasses a number of competing—and sometimes conflicting—values in this distribution. As I see it, no one value dominates, so that bankruptcy policy becomes a composite of factors that bear on a better answer to the question, "How shall the losses be distributed?"

By contrast, Baird has developed a coherent, unified view of bankruptcy that revolves around a single economic construct. According to Baird, the only goal of bankruptcy is to enhance the collection efforts of creditors with state-defined property rights.[4] He explains that all bankruptcy laws are to be tested by a single measure: whether they enhance or diminish the creditors' collective benefits.[5] With that construct, Baird purports to answer a host of wide-ranging questions and translate his policy into specific statutory recommendations.[6]

As Baird and I begin this debate, I am acutely aware that we disagree not only about what bankruptcy policy should be, but also about how that policy should be derived. Baird begins with hypothetical behavior and ends with firmly fixed answers. I begin with a historical observation about legal structures, I surmise the concerns of the drafters, and I end only with tentative conclusions and

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[3] Readers interested in futher exposition of these views should see, e.g., Elizabeth Warren and Jay Lawrence Westbrook, The Law of Debtors and Creditors: Text, Cases, and Problems 3-7 (discussing the concept of leveraging and how various elements of the collection system interrelate), 219-26 (discussing claims and distribution) (1986) ("Debtors and Creditors").

[4] See, e.g., Douglas G. Baird and Thomas H. Jackson, Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy, 51 U. Chi. L. Rev. 97, 103 (1984) ("Corporate Reorganizations") (bankruptcy law should focus only on the interest of those "who, outside of bankruptcy, have property rights in the assets of the firm").

[5] Id. at 103-04; Douglas G. Baird and Thomas H. Jackson, Cases, Problems and Materials on Bankruptcy 31 (1985) ("Baird and Jackson Casebook").

[6] Corporate Reorganizations at 110 (cited in note 4) (once the idea of collectivism is accepted, "analysis of adequate protection of secured creditors in bankruptcy is straightforward").

more complex questions. Baird presumes that there can be a simple answer to explain all of bankruptcy, and that the relationship between statutory law and modification of the behavior of debtors and creditors is known and can be predicted in new circumstances. I see bankruptcy as a more complex and ultimately less confined process than does Baird.

In this paper I discuss our differing views, explaining first the central policy justification of bankruptcy as I see it. In the second section, I contrast my conception of bankruptcy with Baird's view, and I take up his application of theory to the difficult problem of undersecured creditors. In the spirit of forthright debate, I try to expose my ideas enough to provide a target for Baird, and I take direct and specific aim at his work.

I. The Central Policy Justification of Bankruptcy: Coping with Default in an Integrated System

Discussing the debtor-creditor system is much like focusing a camera. Different elements of the system are always in view, but depending on where the focus is directed, different features of the system take on greater importance. I want to begin the discussion of bankruptcy by looking briefly at the role the debtor-creditor system plays in a much broader pattern of promise enforcement.

A. Default and Contract Enforcement

The debtor-creditor system is itself part of a larger, integrated order of public enforcement of promises between individuals. An analysis of promise enforcement should begin with contract law—the laws enforcing private promises—and come full circle with bankruptcy law—the laws sanctioning default on private promises.[7] Each element of this system balances against the other.

A contract is not a legally enforceable obligation to do a promised thing. Holmes observed that the understanding of contract should always be modified by the statement that the law requires only that the promise be performed or that the money equivalent be paid.[8] A bankruptcy scholar would point out that Holmes's focus is still too narrow: a contract requires a party to do the thing

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[7] Obligations to pay money arise from several sources, including, of course, tort law and property law. Even criminal actions can create payment obligations. When regarded as a separate legal specialty, however, rules about repayment can best be studied in the context of the contract—the prototype for most debtor-creditor relations. For ease of discussion, I use that single example here.

[8] Oliver Wendell Holmes, The Common Law 236 (Mark DeWolfe Howe ed. 1967).

promised or to pay the money equivalent *or* to discharge the promise through the bankruptcy system. That is a positive description—a statement of the law as it is, with contract enforcement and bankruptcy default. I am willing to argue that it is also a normative description—a statement of precisely what the law should be to create a coherent system of promise enforcement.

Default is a distasteful idea, one to which we give as little attention as possible in discussing legal theory and in training young lawyers. One of my dyspeptic joys in introductory commercial law classes is to point out how lofty we contract scholars are (and I am always careful to mention my hope to be counted among the chosen): once we have cleverly proven that a promise is legally enforceable and have even gone so far as to detail the appropriate remedy, we contract scholars strike our colors and retire from the field, satisfied we have completed the serious labor. In our view, there can be little more work requiring the talents of a thoughtful and expensive scholar. Getting the money paid is a matter of course, or of honor, or—if it should come to that—of grubby technical steps.

Notwithstanding these prejudices, it is useful to pause occasionally to reflect that a system of enforceable promises necessarily involves an escape valve—a way to avoid the enforcement of those promises when sufficiently compelling circumstances arise. Contract law today can be relatively coherent as an intellectual scheme in part because of debtor-creditor law.

The enforcement scheme in debtor-creditor law acknowledges values different from those central to contract law. Idiosyncratic factors involved in the changed circumstances of debtors in extreme financial distress become important. Debtors may not be able to meet their obligations for a host of different reasons. Their stupidity, greed, misfortune, bad judgment, or inadequate foresight may leave them unable to pay. They may not be able to pay over the short term or the long term. They may be victims of their own mistakes or of unforeseeable circumstances. Contract law need not take account of the values relevant to sanctioning debtor default, because these values are accounted for in the debtor-creditor collection scheme. Without the refined and balanced system of debtor-creditor law—which includes a well-developed concept of bankruptcy—contract law itself would look very different, and its enforcement would be considerably more constrained.

The definition of an enforceable contract allows some leeway to consider social concerns. Contract principles such as impossibility, mutual mistake, and more recently, duress and unconscionabil-

ity undercut any naive view of "strict" enforcement. But for the point of this paper, it is sufficient to note that once an agreement has been struck, the subsequent inability of a party to pay or the high cost of payment is rarely an overt feature of contract doctrine. Relatively strict enforceability of contract can prevail precisely because the debtor-creditor system instills a measure of temperance, an ability to respond to changed circumstances, a notion that enforcement should not offend deeply held social norms.[9]

Default—or nonpayment—of debt has long been an essential feature of a system of promise enforcement. Centuries before bankruptcy law became an integrated part of the collection scheme, default existed. Biblical jubilees, medieval English debtor sanctuaries, and poorhouses are evidence of society's past attempts to balance rightful demands for payment with some possibility of escape.[10] When organized forgiveness has been unavailing, debtors have devised their own nonpayment plans. Debtors have been known to flee the jurisdiction, to threaten their creditors, or—as an extreme measure—to die.[11] Even today, with corporate debtors and risk-spreading creditors, a significant feature of the debt collection system is the possibility of escape from payment through a variety of maneuvers, both legal and extralegal. Anyone who ever extends credit faces the possibility that repayment will not be forthcoming. Interest is structured, among other things, to pay the creditor for assuming the risk of nonpayment.

B. Default and the Collection System

The current debt collection system has two primary responses

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[9] For a fuller discussion of bankruptcy as an exercise in moral ambiguity, in which policymakers hold conflicting and vaguely articulated views of appropriate bankruptcy policy, see Teresa A. Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, As We Forgive Our Debtors (forthcoming 1987); Teresa A. Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, The Use of Empirical Data in Formulating Bankruptcy Policy, 50 L. & Contemp. Prob. 195, 198, 235 (1987) ("Use of Empirical Data"); Teresa A. Sullivan, Elizabeth Warren, and Jay Lawrence Westbrook, Folklore and Facts: A Preliminary Report From the Consumer Bankruptcy Project, 60 Amer. Bankr. L. J. 293, 312 (1986).

[10] See, e.g., The Bible, Deuteronomy ch. 15, verses 1-18 (on jubilees); W. S. Holdsworth, 3 A History of English Law 303-07 (3d ed. 1923) (on sanctuaries); Peter J. Coleman, Debtors and Creditors in America: Insolvency, Imprisonment for Debt, and Bankruptcy, 1607-1900 at 4-5 n.1 (1974) (on poorhouses).

[11] See, e.g., Joseph W. McKnight, Protection of the Family Home from Seizure by Creditors: The Sources and Evolution of a Legal Principle, 86 S.W. Hist. Quart. 369, 393 (1983); Man Killed While Trying to Collect Debt, St. Louis Post-Dispatch 4A, col. 4 (Oct. 24, 1984); Barry Siegel, A Tragic Dilemma: Woman's Stand, Death Sparks Debate Over Lien Laws, Dallas Times Herald 2A, col. 2 (Nov. 18, 1984); Charlotte Grimes, Cheated by Life, Lien Victim Found Revenge in Death, St. Louis Post-Dispatch 1A, col. 1 (Aug. 26, 1984).

to a debtor's default: state collection law and federal bankruptcy law. When discussing the two collection schemes, it is important to bear in mind that property and contract rights are not synonymous with collection rights. Bankruptcy is only a collection scheme; it necessarily depends on other legal rules for the determination of substantive rights underlying bankruptcy claims.[12] Whether a contract is enforceable, a tort has been committed, or an owner has clear title to a piece of land are issues of substantive state or federal law. Similarly, state collection law is different from the underlying substantive law. State collection law presupposes the enforceability of an underlying claim (as does bankruptcy) and focuses on the rights of a creditor to extract the payment owed (as does bankruptcy). State collection law is about judgments, statutory liens, voluntary security interests, exemptions, garnishment, prejudgment remedies, and so on. The state system and the bankruptcy system are both only collection systems.

Although this distinction between substantive rights and collection rules might seem obvious, it is important to the policy debate, which often centers on the degree to which bankruptcy law should "rely" on underlying state law. The answer depends on which underlying state law is under discussion. The real issue is not whether bankruptcy law—or state collection law, for that matter—relies on state law for the definition of substantive rights. The issue is whether the state collection and distribution scheme presumptively should be the federal scheme. That bankruptcy builds on state substantive law does not require it to build on state collection law.

It would, of course, be possible to create a single, fully integrated debt collection scheme rather than the separate state and federal schemes now in effect. But even a unified scheme would have to consider two prototypes of default: first, the single default where only one creditor complains about repayment and the remaining creditors are evidently (even if only temporarily) content with their repayment prospects; and second, the debtor's widespread default and collapse in which every creditor's prospects for repayment are sharply diminished. These two kinds of default involve some overlapping issues about appropriate collection rights, and a factual continuum from a single default to complete collapse better describes the world that includes the two extremes. None-

[12] There are, of course, substantive rights created by federal law as well. The language is less burdensome if "state law rights" is read to encompass all substantive rights other than those created in federal bankruptcy.

theless, the policy issues involved in the two exemplary circumstances differ importantly, and they must be addressed separately whether they are part of one collection system or two.

The current debt collection system treats these issues in different fora: state collection laws cope with a wide spectrum of limited defaults, while the bankruptcy scheme concentrates on default in the context of the debtor's imminent collapse. The state collection scheme occasionally deals with complete collapse, but overall it is rationalized in order to serve a wide variety of collection needs. The federal bankruptcy scheme, by contrast, reckons with a much more limited factual context, and with very different legal devices such as discharge of debt and distribution of unavoidable losses. The different factual contexts change the focus of the policymaking decisions of state collection law and bankruptcy.

C. Default and State Collection Law

A central purpose of state debt collection law is to provide a means for collection of a single unpaid debt. State collection law swings into action on the complaint of a single creditor, and it provides that creditor an avenue to pursue payment of the obligation owed to it. In enforcing the rights of one creditor, state collection law does not address the possible consequence that the collection will render the debtor unable to pay its remaining creditors.

Notwithstanding how much law professors and newspapers focus on complete collapse, a state system that specializes in the collection of single debts makes a great deal of sense. When one creditor demands payment through the state law system, other creditors are not necessarily affected. Many collection lawsuits are brought because a debtor denies liability on a debt or because the debtor has other disputes with the creditor. Sometimes the debtor is simply slow to pay, or irrationally stubborn, or downright vindictive. State collection law is a system in which one creditor can isolate the debtor's default and enforce repayment. A complex factual inquiry into the consequences for others of the collection of the single debt need not be a part of every collection lawsuit.

Of course, paying one creditor may affect the debtor's ability to repay other creditors. In the race of the diligent, the slower creditor always runs the risk that by the time it arrives, the assets will be depleted. Moreover, the state law system permits enhanced collection rights for certain creditors, which increases the likelihood that the unfavored creditors will find the debtor's bones bare. Article 9 of the Uniform Commercial Code (UCC) and the state law of liens create priority arrangements that permit a creditor to

isolate certain property and to ensure that it will be used to pay that creditor before it is sold or seized to profit anyone else. These state law priority systems create what sometimes turn out to be effective rank-orderings of collection rights.

In some cases, then, state collection laws will resolve the relative collection rights of parties when a debtor collapses. But it does not follow that the state system is well-suited to the circumstances of debtor collapse. I submit that the state law system is *not* well-suited to those circumstances precisely because it necessarily must consider too broad a range of possible debtor-creditor relationships and follow collection principles inconsistent with those raised in the circumstances of complete collapse.

State collection laws are many and varied. To pick a single example from UCC Article 9, the consequences of delay in filing a security interest involve very different considerations depending on whether the delay takes place in the context of single-debt collection or complete collapse. In Article 9, only a purchase money creditor attempting to beat a previously perfected security interest needs to worry about the time elapsed between the debtor's receipt of the property and the time the creditor files its notice. All other creditors can delay as they wish, risking only that another creditor will file on the same property ahead of them. Public notice is an option creditors can exercise at any time, but their security interests are enforceable against debtors and others who are aware of the security interest even if the creditor avoids the public notice system.[13] In the context of bankruptcy, however, a creditor who delays during the 90 days preceding bankruptcy will find that its security interest is invalid.[14] The Article 9 provisions are drafted with a concern for the creditor's costs and inefficiencies, and for the possibility that the debtor and creditor may wish to keep their deal private. In the context of complete collapse, however, the policy interests shift: the risk of collusion between the debtor and a favored creditor and the possibility that fraudulent schemes may be imposed on the remaining creditors outweigh the advantages of letting the parties keep the security interest secret.

There are many other examples of policy differences between

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[13] UCC § 9-312(3), (4) (purchase money security interest, if filed within specified time limits, has priority over previously perfected security interest in same collateral); id. § 9-312(5) (if no exception applies, the first creditor to file wins); id. § 9-501(2) (creditor with security interest has rights and remedies outlined in Article 9; no reference to any need for the creditor to file to make these rights enforceable against the debtor).

[14] 11 U.S.C. § 547(b) (1982).

state law debt collection and bankruptcy. In Article 9 alone, there are special repossession rights that vary from one set of circumstances to another, different perfection rules depending on the type of collateral, and priority schemes that depend on who is demanding what interest in the collateral. All these options give secured creditors different bundles of rights if the debtor defaults, and all wrestle with a wide variety of possible circumstances of the debtor, the creditor, the property, and parties ancillary to the transaction.

This is not the place for an extended discussion of the balancing of numerous interests behind various state collection law rules. My point is simply that it is naive to think that these interests, and the appropriate balance among them when a single creditor is asserting a claim against a debtor, are also optimal legal rules when a debtor faces collapse. The impact of repossession rights when a debtor faces collapse requires specialized analysis—best undertaken in the context of a comprehensive system designed to deal with just that circumstance. But, because state collection law must balance debtor and creditor rights in a variety of factual circumstances, state priority systems do not automatically fit the bill.[15]

State collection law and bankruptcy law also differ in their central policy considerations because they rest on fundamentally different collective premises. The two systems make very different adjustments for the survival of creditors' unpaid claims. Although it is an obvious point, it is worth noting that the premise of state law rank-ordering is that no claim is extinguished. Nothing in state law discharges the lawful claim of a creditor who is unable to collect. A creditor seeking collection may face a debtor with insufficient assets to pay a debt, but the state system merely streamlines the collection operation to ensure that the creditor can be the first to collect if the debtor's circumstances improve. Similarly, a creditor may face a debtor whose assets are tied up by Article 9 security interests, but just as the state system puts the Article 9 creditor at the head of the collection line, state law finds a place in line for every other creditor.[16] And state law carefully establishes proce-

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[15] There are, of course, some state law actions designed specifically to deal with collapse and the multiple creditors who may be affected. Receiverships and assignments for the benefit of creditors are collective actions. They are, however, often little more than burdensome state law versions of bankruptcy that have become outmoded and are seldom used if federal bankruptcy is available.

[16] UCC § 9-301(4) develops the process by which lien creditors can secure their next-in-line position, limiting the first creditor's future advances under the original security agreement.

dures by which the diligent creditor can make a judgment survive in perpetuity.[17] State law promises that if the creditor is persistent, the corporate debtor can escape payment only through death: the corporation must cease operations and return its charter to the state. Nothing in state law allows a corporation to continue to operate while denying the enforceability of a lawful debt.[18]

To structure collection rules and priorities in the context of inextinguishable claims is to create one kind of system. To graft that set of collection rules and priorities onto a system that discharges debt is to create a very different collection system—one that should be evaluated separately and not accepted simply because some of the rules make sense in a different, state law scheme.

D. Default and Bankruptcy

By contrast with state law, which sees only one default, bankruptcy begins with a presumption of default on every obligation the debtor owes.[19] Although some debtors are able to repay all their debts in bankruptcy, the statutory scheme presumes that some creditors will not enjoy repayment in full. Bankruptcy law aims first to conserve and divide an estate that cannot meet all its obligations, and second to terminate the rights of unpaid creditors. Unlike state law, which considers innumerable circumstances of default, bankruptcy law is sharply focused on the consequences of a debtor's imminent collapse.

The difference from state collection law is fundamental. Bankruptcy disputes do not share the debtor-versus-creditor orientation of state collection law. In bankruptcy, with an inadequate pie to divide and the looming discharge of unpaid debts, the disputes center on who is entitled to shares of the debtor's assets and how these shares are to be divided. Distribution among creditors is not incidental to other concerns; it is the center of the bankruptcy scheme. Accordingly, bankruptcy disputes are better characterized as creditor-versus-creditor, with competing creditors struggling to push the losses of default onto others. The Bankruptcy Code reflects this orientation: a significant part of its distributional

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[17] See Debtors and Creditors at 43-44 (cited in note 3) for a discussion of dormancy and revivor actions.

[18] This rule is of particular significance in the case of corporations, since they have no exempt assets with which to continue operations. If a creditor is sufficiently motivated to pursue its claims, a corporation cannot escape payment and survive.

[19] See, e.g., In re Hoffman, 51 Bankr. 42, 46 (W.D. Ark. 1985) ("the filing of a bankruptcy acts to accelerate the maturity of all debts"); In re Manville Forest Products Corp., 43 Bankr. 293, 297 (S.D.N.Y. 1984) (bankruptcy accelerates all claims).

scheme is oriented toward establishing priorities among creditors.

The battle between secured and unsecured creditors has commanded much interest, but the Bankruptcy Code tackles a wide variety of other distributional issues as well. Some rights are destroyed in bankruptcy, and some are preserved. Priority distributions reorder the competing interests of employees, taxing authorities, fishermen, and farmers. Landlords and business partners receive special treatment. Parties to executory contracts hold an identified place in the bankruptcy pecking order. The beneficiaries of state statutory liens find their rights reordered in bankruptcy. Ordinary course creditors and creditors making contemporaneous exchanges discover that their positions differ from other unsecured creditors. Creditors lending to consumers are distinguished from creditors lending to businesses. Banks with setoff rights are treated differently from banks not in a setoff position. This list is suggestive rather than definitive, but it serves to show that the Bankruptcy Code is concerned with making hard choices about which creditors belong where in a financial hierarchy.[20] These are choices about distribution and redistribution, and they are not controlled by state law.

The distributional design of the Code is even more thorough than the straightforward state law's rank-ordering of easily identified creditors such as fishermen and farmers. The bankruptcy system goes so far as to anticipate the consequences of default on a host of potential creditors, including, for example, future tort claimants who have not yet discovered their injuries or their legal rights and a government agency that might uncover toxic wastes and demand that a debtor clean them up. Bankruptcy law recognizes these rights even though they may not be mature under state law at the time of the bankruptcy filing. In the state law system, these creditors would simply wait until they discovered the injuries and then would sue one at a time for the appropriate remedy.[21] They would take their debtors—tortfeasors or toxic polluters—as they found them when their claims matured, whether the debtors were fat with profits or stripped to a hollow shell after earlier creditors had concluded other disputes.

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[20] These various provisions of the Bankruptcy Code can be found at 11 U.S.C. §§ 507, 365(d)(3)-(4), 303(d), 365(a)-(c), 545, 547(c)(1), (2), (7), 553 (1982 & 1985 Supp.).

[21] Of course, some claimants join class action suits, but even these suits have a one-at-a-time quality: the class sues on behalf of all the victims of a particular wrong, but the class still lines up with other creditors trying to reach the debtor for payment of other obligations.

But because bankruptcy recognizes that the pre-bankrupt debtor will not survive to be sued another day, its distributional scheme necessarily focuses on how to deal with future claimants. Several alternatives are possible. Bankruptcy's distributional scheme could leave future claimants to bear their losses in full, refusing to compensate them at all and effectively barring their future claims. If, instead, their rights to compensation continue notwithstanding the bankruptcy, the distributional consequences of bankruptcy will depend on whether the debtor succeeds or fails in any reorganization attempt. Still a third distributional scheme is created if the future claimants are participants in a distribution plan and provisions are made for their eventual—if limited—recovery.

The Bankruptcy Code clearly rejects the alternative of leaving future claimants uncompensated. It defines "claim" broadly to pull future creditors into the debtor's distribution plan and to require participation by anticipated claimants.[22] The Code does not specifically address how to establish funds to pay future claimants and determine appropriate payout priorities, and as a result, the courts must take on the difficult task of devising workable plans.[23] Nonetheless, it is clear that dealing with the effects of default on future claimants was intended to be a significant feature of bankruptcy's distributional scheme.

The Bankruptcy Code accomplishes other distributional ends less directly. By providing for impairment of state law collection rights in a court-supervised reorganization, Chapter 11 of the Bankruptcy Code gives bankrupt businesses another opportunity to succeed. The opportunity may not often result in genuine success, but the reports of Toys-Я-Us, Wickes, Continental Airlines, Evans Home Products, and a host of other bankruptcy success stories serve as a reminder that at least some Chapter 11 reorganizations conserve and maximize the wealth of the debtor's estate for the benefit of all claimants—an important objective of bankruptcy.

But the revival of an otherwise failing business also serves the distributional interests of many who are not technically "creditors" but who have an interest in a business's continued existence. Older employees who could not have retrained for other jobs, customers

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[22] 11 U.S.C. § 101(4) (1982).

[23] See, e.g., In re Johns-Manville Corp., 36 Bankr. 743, rearg. denied, 39 Bankr. 234 (S.D.N.Y. 1984). Professor Roe wrestles with the problem at a more conceptual level than have the courts, and suggests creative approaches to compensating mass torts victims. See Mark J. Roe, Bankruptcy and Mass Tort, 84 Colum. L. Rev. 846 (1984).

who would have to resort to less attractive, alternative suppliers of goods and services, suppliers who would have lost current customers, nearby property owners who would have suffered declining property values, and states or municipalities that would have faced shrinking tax bases benefit from the reorganization's success. By giving the debtor business an opportunity to reorganize, the bankruptcy scheme acknowledges the losses of those who have depended on the business and redistributes some of the risk of loss from the default. Even if dissolution is inevitable, the bankruptcy process allows for delay, which in turn gives time for all those relying on a business to accommodate the coming change.

Congressional comments on the Bankruptcy Code are liberally sprinkled with discussions of policies to "protect the investing public, protect jobs, and help save troubled businesses,"[24] of concern about the community impact of bankruptcy,[25] and of "the public interest" beyond the interests of the disputing parties.[26] These comments serve as reminders that Congress intended bankruptcy law to address concerns broader than the immediate problems of debtors and their identified creditors; they indicate clear recognition of the larger implications of a debtor's widespread default and the consequences of permitting a few creditors to force a business to close.

These comments are also a reminder that, while the broader effects of business failure can be elusive to measure, they are nonetheless very real. Congress—whether out of a crass concern about reelection or a superior view of the deeper social implications of business failure in a highly integrated society—accepted the idea that bankruptcy serves to protect interests that have no other protection. The older employee, the regular customer, the dependent supplier, and the local community are important; and bankruptcy attends to many of their concerns, regardless of whether they have rights recognized at state law.

Bankruptcy does not, of course, offer complete protection to all those who might be affected by the outcome of a bankruptcy

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[24] 124 Cong. Rec. 32392 (Sept. 28, 1978) (statement of Rep. Edwards).

[25] Bankruptcy Reform Act of 1978, Report of the Committee on the Judiciary, H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 53-62 (Sept. 8, 1977), reprinted in 1978 U.S. Code, Cong. & Admin. News 6014-23 (letter from Judge Conrad Cyr responding to congressional request for information about cases with special community impact). See also, e.g., Report of the Commission on the Bankruptcy Laws of the United States, Part I, H.R. Doc. No. 93-197, 93rd Cong., 1st Sess. 72 (Sept. 6, 1973) (discussion of the "overriding community goals and values" in bankruptcy).

[26] 124 Cong. Rec. 33990 (Oct. 5, 1978) (statement of Sen. DeConcini).

dispute. Businesses can still sell off their assets, dismantle their corporations, and flee the state or even the country, leaving a wake of disappointed expectations. For those decisions, the businesses are left largely to their own self-interested decisions. To recast it in economic lingo, the *debtor* is always free to redeploy the firm's assets. But the creditors in a bankruptcy proceeding are not.

Chapter 11 offers only limited protection against the *creditors'* making the decision to dissolve the business.[27] The creditors must defer some collection rights in Chapter 11 in order to give the debtor an opportunity to continue as a viable business. But Chapter 11 is not a license for the old management to continue the same old business; in order to get a second chance, the debtor business may have to be restructured and slimmed down to become newly competitive. And even with radical changes, the business may fail. Chapter 11 bankruptcy is only a chance, available in limited circumstances and offering limited help. But it is a valuable, deliberately created chance nonetheless.

E. Distributive Rationales in Bankruptcy

By definition, the distributional issues arising in bankruptcy involve costs to some and benefits to others. Enforcing the state law collection rights of secured creditors often comes at the cost of defeating the state law collection rights of unsecured creditors whose claims are discharged without payment. A priority payment to one unsecured creditor necessarily leaves less for the remaining creditors. The debtor's estate—and thus its creditors—profits from assigning a favorable lease, but this costs the landlord whose lease specifically provided for no assignments. The benefits reaped by the employees or suppliers relying on the continuation of a business are purchased at the expense of every creditor who gives up valuable state collection rights as part of the plan to allow the debtor business a second chance at success.

It might be reasonable to ask about the legitimacy of forcing losses on those with lawful expectations of repayment. The difficulty with this question, however, is that it posits that bankruptcy is the "cause" of the cost. Bankruptcy is not the cause of the

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[27] The debtor is left with decisions such as whether to move or terminate the business, but the creditors, with less information and less at stake, are restricted in their ability to force a dissolution that the debtor does not want. If one were so inclined, one could restate this argument in the terms of economic analysis, noting that the law permits the entity with superior information and a greater stake in the business to make these critical decisions regarding deployment of the business's assets.

cost—it is merely the distributor of the cost. The cost of default is occasioned by the debtor's inability to repay.

Without a bankruptcy system, someone would still bear the costs of default. Perhaps, under the state law collection system, those costs would be borne entirely by unsecured creditors or employees or suppliers or landlords or creditors with loans secured by inventory that is difficult to monitor. But speculation on what would happen at state law is nothing more than the substitution of a different distributional scheme—one created indirectly by focus on the collection of a single debt rather than one created deliberately with an overriding attention to widespread default.

Even if there were no legal scheme to distribute the costs of default, the losses would be distributed by some method. The distribution of losses might be determined by creditor speed (who first backs up to the warehouse with big trucks) or strength (who can carry away the most while others look on) or by debtor favoritism (who gets the first call when the debtor decides to give up). Indeed, outside bankruptcy, it is not clear as an empirical matter whether losses are distributed according to the state law scheme or according to creditor strength, debtor favoritism, or some other factor. But the point is that the costs must be distributed in some manner. Bankruptcy is simply a federal scheme designed to distribute the costs among those at risk.

On what basis does bankruptcy law distribute these costs? Below are some of the important features for ordering distributional priorities. The list is only partial, but it identifies some of the key issues.

1. *Relative ability to bear the costs of default.* Some creditors are not likely to have anticipated the risks of termination of the business, and others may face especially acute difficulties in absorbing the costs of a debtor's default. For example, a debtor's employees may be particularly ill-suited to bear the costs of default. Employees are among the creditors least likely to have spread the risks of default. They seldom are able to contract with several different employers, and losing a paycheck will quickly deplete modest savings. The Bankruptcy Code reflects a concern for these creditors, granting a priority to limited employee wage and retirement fund payments.[28]

2. *Incentive effects on pre-bankruptcy transactions.* The Bankruptcy Code also requires creditors to disgorge payments re-

[28] 11 U.S.C. § 507(a)(3)-(4) (1982). Code provisions regarding consumers' deposits with businesses also reflect these principles. Id. § 507(a)(6).

ceived from the debtor in the days preceding bankruptcy.[29] Protecting these payments would encourage aggressive collection efforts when debtors' financial positions are obviously deteriorating—perhaps rewarding those whose demands needlessly forced into bankruptcy a debtor who otherwise could have escaped complete collapse. This rule has exceptions for creditors whose transactions do not immediately worsen the debtor's pre-bankruptcy position. For instance, the Code exempts the contemporaneous exchange creditor, the secured purchase money lender, and the ordinary course creditor from having their pre-bankruptcy transactions unraveled.[30] Such transactions facilitate continued operation of a tottering business, and they are essential if the business is to have a chance to avoid bankruptcy.[31]

3. *Similarities among creditors.* The Code's treatment of the debtor's executory contracts illustrates another distributional objective of bankruptcy: treating like creditors alike. Before the bankruptcy filing, the debtor may abrogate a contract at the cost of incurring damage liability to the aggrieved party. A subsequent bankruptcy filing gives the party an unsecured damage claim. The debtor in bankruptcy also may abrogate an executory contract, giving the aggrieved party a similar unsecured damage claim.[32] Were the debtor in bankruptcy unable to abrogate its contracts, some contract creditors might be able to jump the priority queue and extract payments in excess of their unsecured claims by forcing performance on economically infeasible obligations.[33] Instead, all contract partners face the same bankruptcy risk. The requirement that unsecured creditors be classified together and receive pro rata distributions is another attempt to treat creditors with similar

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[29] Id. § 547(b)(4).

[30] Id. § 547(c)(1)-(3).

[31] Secured credit may also be essential to weak businesses and, accordingly, the effects of bankruptcy laws on the role secured credit plays in nonbankruptcy transactions is another important distributional concern. To the extent that pre-bankruptcy security interests are enforced in the bankruptcy scheme, the Code encourages their nonbankruptcy use. But to the extent that security interests do not give unfettered collection rights in bankruptcy, secured creditors are discouraged from relying solely on their security interests for complete protection. The "unreliability" of a security interest in a bankruptcy creates pressure on secured creditors to minimize the likelihood that the debtor is driven to complete collapse and a bankruptcy filing.

[32] 11 U.S.C. § 365(a) (1982 & 1985 Supp.).

[33] Sometimes, however, a technical distinction can make an enormous difference in abrogating executory contracts. For instance, the landlord who declares a default before the debtor files bankruptcy will find herself in a very different position from the landlord who attempts to declare a default just minutes after the filing. See id. § 365(c)(3).

characteristics alike.[34]

4. *Owners bear the loss when a business fails.* An almost axiomatic principle of business law is that, because equity owners stand to gain the most when a business succeeds, they should absorb the costs of the business's collapse—up to the full amount of their investment. The Code provides that the equity owners participate in distributions or maintain ownership interests following reorganization only if the creditors have been paid in full or if the creditors consent to their continued ownership.[35] Moreover, by incorporating equitable subordination principles into bankruptcy, the bankruptcy scheme forces the same last-place distribution on those who are nominally listed as creditors but who nonetheless exercise ownership control.[36]

5. *Benefit to the bankruptcy estate.* In some cases, a creditor's nonbankruptcy rights can be impaired, forcing it to share in the losses of bankruptcy, in order to give the failing business a chance to survive. For example, the Bankruptcy Code refuses to honor a landlord's "default on bankruptcy clause."[37] This benefits the bankruptcy estate if the lease is profitable for the debtor. If the lease is unprofitable, the debtor can choose instead to reject the lease and to limit the resulting damages according to bankruptcy rules rather than the terms of the agreement. The Code's treatment of labor contracts even more acutely highlights the concern for maximizing the bankrupt debtor's estate. By requiring that a "balance of the equities" dictate the status of a labor contract, the Code suggests that the distributional aim of bankruptcy should be tailored to the facts of the case—permitting impairment of labor contracts if it is essential for a successful reorganization and rejecting it if it is not.[38] Thus, even though Congress is other-

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[34] Id. § 544(a).

[35] Notwithstanding this statement, I have no illusions about the absolute priority rule as it has worked its way through the courts. The courts have attempted to fashion a workable principle out of an unflinching rule; they must face the reality that the current owner is essential to the success of the reformed business and his continuing participation in the business may come at the price of equity participation. See, e.g., In re Ahlers, 794 F.2d 388, 402-03 (8th Cir. 1986) (farmer's contribution of labor sufficient to permit continuing equity ownership); In re Star City Rebuilders, 62 Bankr. 983, 988-89 (W.D. Va. 1986) (stockholder-president of debtor corporation could keep "worthless" stock even over objections of impaired creditors).

[36] Equitable subordination has been developed by the courts and incorporated by reference into 11 U.S.C. § 510(c) (1982). See, e.g., Matter of Pancho's Intern., Inc., 26 Bankr. 5, 8 (M.D. Fla. 1982).

[37] 11 U.S.C. § 365(b)(2)(A)-(C) (1982 & 1985 Supp.).

[38] Id. § 1113(c)(3). Just how seriously the courts take that balancing is indicated by Wheeling-Pittsburgh Steel v. United Steelworkers, 791 F.2d 1074, 1085 (3d Cir. 1986), where

wise solicitous of the peculiarly vulnerable position of employees, some losses may be thrust upon them in order to permit the business to survive.

The list offered here is preliminary at best, and any example given undoubtedly could be explained by several distributional rationales. The point of this paper, however, is not to explore every value weighed in bankruptcy's distributional scheme, but to establish that such values exist, that Congress gives them credence, and that collectively they have a significant impact on the bankruptcy process.

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I have only identified normative considerations that may drive legislative and judicial decisions.

For a hard-nosed commercial lawyer (once again, I aspire to be among the chosen), the obvious question is: what good is it to identify the premises of bankruptcy law if they won't yield any specific answers? Aside from the fact that debating these issues is good, clean fun, what does it accomplish?

Even if it does not compel specific answers to hard questions, identifying the premise of bankruptcy has a very real impact on how those questions are answered. If the central policy justification is nothing more than a single economic construct, specific conclusions with systemwide impact follow neatly from an abstract principle.[43] But if the justification for bankruptcy is also distributional, the relevant inquiry is necessarily larger: what are the values to be protected in the distributional scheme, and is the implementation scheme effective? The questions become more difficult, and the answers, while less certain, take into account many more of the considerations important to a reasonable decision.

A policy that focuses on the values to be protected in a bankruptcy distribution scheme and on the effective implementation of these values assists the decision-making process even if it does not dictate specific answers. This approach illuminates the critical questions. The distributional objectives of bankruptcy cannot be considered without inquiries into many issues, including who may be hurt by a business failure, how they may be hurt, whether the hurt can be avoided, at what cost it can be avoided, who is helped by the business failure, whether aid to those helped offsets the injury to those hurt, who can efficiently evaluate the risks of business failure, who may have contributed to the business failure, how they may have contributed, whether the contribution to failure serves other useful goals, who can best bear the costs of business failure, and who expected to bear the costs of business failure—just to name a few. These questions are normative, and each contains essential empirical questions as well.[44]

Bankruptcy policy has always rested on an unarticulated

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[43] Baird describes as "straightforward" the process by which he reasons from collectivism to how undersecured creditors should be able to collect for pendency interest. Corporate Reorganizations at 110 (cited in note 4).

[44] The implementation issues in bankruptcy also put a premium on trying to identify the likely effects of a particular proposal. Any inquiry into whether distributional objectives can be met through the current bankruptcy scheme necessarily requires a pause to consider the empirical elements of the inquiry. See Use of Empirical Data at 196-202 (cited in note 9).

blend of empirical assumptions and normative conclusions.[45] The approach I describe denies that the uncomfortable normative issues can be avoided by playing a narrow game of logic. My approach also exposes and highlights the empirical assumptions underlying specific bankruptcy policy decisions. Even if few academics are moved to explore more empirical bankruptcy questions,[46] the inquiry at least suggests caution as to decisions that depend critically on empirical considerations when the decision maker is unarmed with facts.[47]

My approach does not assume that current bankruptcy policy is unfailingly rational, either normatively or empirically. In the current distributional scheme, some creditors may enjoy preferences over others who, according to the distributional values articulated earlier, are more deserving. Or, the current scheme may thwart well-considered distributional objectives because the implementation is faulty and too few interested parties are able to invoke the bankruptcy process. The current system may be flawed, but the point of this analysis is to highlight the questions appropriate to exploring bankruptcy's functions, and to caution that normative considerations and empirical evidence are critical to evaluating any bankruptcy rule.

The difficulty of the process does not mean that the considerations amount to fuzzy "do equity" preachments of the hopelessly confused, who leave good results to good people and assume that ideas and analysis have no content. Instead, the questions are tough and specific. The distributional premise of bankruptcy is implemented through a difficult and complex tapestry of empirical presumptions interwoven with normative concerns, some of which I have tried to identify here. The process yields better, but never complete, answers to specific bankruptcy questions. There are easier solutions and easier solutions are seductive. A focus on the difficulty of the appropriate questions helps stiffen the spine against easy answers and makes the task of imperfect search for the illusive answer a little more tolerable.

II. Baird's Approach: Collectivism Alone

Professor Baird's view of the bankruptcy world is much neater than mine. He explains that there is a single justification for bank-

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[45] Id. at 198-99.

[46] My pessimism is explained in id. at 217-22.

[47] See id. at 233-35.

ruptcy: enhancing the collective return to the creditors. He also explains that there is only one interest to be protected: the interest of those "who, outside of bankruptcy, have property rights in the assets of the firm filing a petition."[48] Baird has rejected the notion that any values other than collectivism may be important in fashioning bankruptcy policy. As the following passage indicates, he at times recognizes the questions that lead eventually to a complex, multifactored analysis:

> Consider the "rehabilitation" goal of a Chapter 11 proceeding. No one, to our knowledge, argues that keeping a firm intact is *always* a good thing. Yet as soon as one concedes that a reorganization may not always be desirable, one is faced with the problem of understanding and articulating *why* reorganizations are favored in the first place and *how much* should be given up to facilitate them.[49]

Yet Baird evidently sees the questions he poses as either unanswerable or too silly to answer, for, having identified them, he says no more. He simply observes:

> The economy of an entire town can be disrupted when a large factory closes. Many employees may be put out of work. The failure of one firm may lead to the failure of those who supplied it with raw materials and those who acquired its finished products. Some believe that preventing such consequences is worth the costs of trying to keep the firm running and justifies placing burdens on a firm's secured creditors.
>
> We think that this view is, as a matter of bankruptcy policy, fundamentally wrong.[50]

Without further discussion, Baird concludes that such attempts are "beyond the competence of a bankruptcy court."[51]

Baird makes a point he can defeat by making it too big. Because bankruptcy will not *always* save a company, and because *sometimes* the cost of saving the company is too high, this must *never* be a goal of any bankruptcy policy. Baird refuses to acknowledge the possibility that bankruptcy might give a corporation a limited opportunity to succeed—an opportunity that balances the cost of trying to the creditors against the likelihood of eventual

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[48] Corporate Reorganizations at 103 (cited in note 4).
[49] Id. at 99-100 (original emphasis, footnote omitted).
[50] Id. at 101-02 (footnote omitted).
[51] Id. at 102.

success. He acknowledges neither the potential benefit of a second chance nor the possibility that bankruptcy policy might aim toward a broad balance between the competing interests of the debtor, the creditors, and the many others who may be injured by the debtor's collapse.

Baird also considers the role of other distributional issues in bankruptcy and concludes that they should play none. He explains, for example, that the question of whether secured creditors should be paid ahead of anyone else "is not one peculiar to bankruptcy law" and then does little more than assert that the arguments for or against favoring the payment rights of secured creditors

> would apply with equal force to any group given favored treatment under nonbankruptcy law. The desirability of secured credit—or other nonbankruptcy property rights—is ultimately not a bankruptcy question and attempting to transform it into one creates incentives that are perverse and counterproductive.[52]

Thus, the distributional issues involved in determining the creditors' legal pecking order are, according to Baird, the same whether the debtor is in default on a single obligation or in a state of complete collapse.

Having dispensed with any other policy considerations, Baird is ready to turn to his single justification for bankruptcy: enhancing the collective return for creditors who have identified property rights.[53] Here Baird purports to use only careful logic to answer some of the most intractable bankruptcy problems, all the while avoiding any discussion of the distributional consequences of his work. The difficulty with Baird's approach is that collectivism alone won't get him where he is going. He necessarily uses—even if he does not discuss—distributional principles. Moreover, Baird endorses the wholesale use of the state law distributional scheme, but he does not defend the distributional rationale of that scheme, nor does he address the possibility that the state scheme was designed

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[52] Id. at 129, 130.

[53] Baird describes collectivism as the "unique function of bankruptcy" and explains that "at its core" bankruptcy is designed only to further collectivism. Id. at 105, 100. Equally important, in his articles on corporate reorganization and on toxic wastes in bankruptcy, Baird nowhere suggests that any other value or rationale might be a part of the bankruptcy system. See, e.g., Douglas G. Baird, The Uneasy Case for Corporate Reorganizations, 15 J. Legal Stud. 127 (1986); Douglas G. Baird and Thomas H. Jackson, *Kovacs* and Toxic Wastes in Bankruptcy, 36 Stan. L. Rev. 1199 (1984).

to resolve questions significantly different from those to which he applies it.

Baird is engaged in a game of pulling rabbits from other hats. He may actually have a distributional principle to defend; he could argue that state law better distributes risks between secured and unsecured creditors than does current bankruptcy law. We could debate that conclusion, but even that debate would accept the premise that bankruptcy is designed to resolve difficult distributional choices. Instead, Baird purports to avoid distributional concerns—and the attendant normative and empirical issues—by discussing only the "neutral" principle of collectivism. I believe Baird only diverts the debate from the central issues.

A. Collectivism: The Test that Isn't

Collectivism provides a useful way to examine some bankruptcy problems. Baird shows how the need for collectivism can explain why the bankruptcy system substitutes a single, lower-cost action for expensive, multiple individual actions.[54] His analogy between state collection law and the wild car races of "It's a Mad, Mad, Mad, Mad World"[55] makes a delightful story that helps explain a very important function of bankruptcy: bankruptcy calls a halt to the superaggressive, wasteful, and potentially damaging creditor activity permitted by state law.

My dispute with Baird centers instead upon his attempts to use collectivism not only to explain significant features of the bankruptcy system, but also to justify the entire system and to provide answers to specific, complex questions. Baird sees collectivism as something of an intellectual yardstick, a tool that he can use to determine whether a particular bankruptcy proposal is good or bad—solely by measuring whether it promotes or impairs collectivism.[56] Yet Baird ultimately uses collectivism, once a useful theme in a more complex bankruptcy system, to obscure a very different analysis.

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[54] Baird and Jackson Casebook at 33-34 (cited in note 5).

[55] Douglas G. Baird and Thomas H. Jackson, Teacher's Manual: Cases, Problems and Materials on Bankruptcy 12-13 (1985).

[56] Baird describes as follows the process for justifying any deviation from state law:

> [W]e examine the protection afforded to secured creditors in bankruptcy, asking, first, what exactly the secured creditors' nonbankruptcy rights are and, second, whether any modification of those rights is necessary in order to preserve or enhance the firm's assets for the general benefit of the investor group.

Corporate Reorganizations at 101 (cited in note 4).

* * *

Even if that single value were accepted, Baird isn't home free. He quietly works distributional elements into his economic example, all the while denying a distributional consequence. For example, by arguing that the only way to ensure that reorganization values exceed liquidation values is to give all secured creditors interest on their claims, Baird makes a distributional decision as well.[65] Indeed, it is simply not possible to avoid a distributional decision. To destroy the special, pre-bankruptcy rights of some creditors is to make a distributional decision. To enforce those rights is to make a different distributional decision. Baird does not want to discuss distributional objectives, but he cannot avoid them by pretending they are not there.[66]

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[65] Id. at, e.g., 101. Baird comes dangerously close to recognizing the distributional aspects of his analysis when he asserts that he will demand interest for secured creditors but that he will force them to give up their repossession rights. He explains that secured creditors cannot be allowed to retain repossession rights in bankruptcy because "to permit a secured creditor the full exercise of his rights may hinder efforts to preserve the going-concern value of the business." Id. at 117 (footnote omitted). This argument is overtly distributional. If the estate cannot pay enough to delay repossession through a voluntary transaction, in light of the full risks at issue, why should the secured creditor be forced to accept a judicially determined interest that is unlikely to reflect the market rate for the kind of transaction involved? Baird could explain that the secured creditor is a monopolist with power to extort excessive payments. This is a conventional economic argument, but it is also a distributional argument. Baird ultimately argues that the secured creditor has too much power, and the Bankruptcy Code should diminish that power in order to accomplish other objectives—which, in fact, are distributional.

[66] Baird evidently has mixed feelings about the distributional issues in bankruptcy. On the one hand he explains that "someone must decide not only how best to deploy the assets, but also how to split up the returns from those assets." Id. at 105 (footnote omitted). On the other hand, he resists the notion that he is making a distributional argument when he gives undersecured creditors their interest claims. He explains that bankruptcy law "should aim to keep the asset-deployment question separate from the distributional question, and to have the deployment question answered as a single owner would answer it"—that is, according to collectivist principles. Id. at 108 (footnote omitted). He then treats the payments to undersecured creditors as "asset-deployment" issues, not distributional issues. But "asset deployment" need only involve ensuring that the estate makes the economically rational choice between liquidation and reorganization—not ensuring that any particular creditor receive any particular distribution.

Baird's distributional consequence is not compelled, as he asserts, by collectivism alone. The interest payments he requires in the name of efficiency could, for example, be paid into a fund for *all* creditors—secured and unsecured. If all the creditors—not just the secured creditors—shared the assets of the estate, their incentives to maximize the return on the estate would converge. But Baird doesn't bother to consider this or any other alternative to paying the secured creditors.

In fact, Baird ignores the most effective way to make certain that the structure of bankruptcy promotes collectivism: recognize no security interests in bankruptcy. If no class of creditors were superior to any other class of creditors and all creditors in bankruptcy stood to lose or gain on a pro rata basis, then the issue of what to do with the collateral would be simple. The creditors, collectively, would either keep the collateral or sell it, whichever brought the most money. No one would have any interest except maximizing the return to the estate, because no one would profit except by such maximization.

To obliterate all creditor differences in bankruptcy would, of course, impose costs elsewhere in the debtor-creditor system. The values encompassed in bankruptcy's current distributional scheme—such as permitting enhanced collection opportunities for employees, consumers, and a host of others—would be destroyed. The ramifications for the nonbankruptcy behavior of different parties would likely be profound and, at our current understanding of the credit system, unpredictable. In sum, were we to adopt Baird's collectivism truly untempered by any other values, it would threaten significant disruption to the debtor-creditor system.

Ultimately, Baird rounds out collectivism with additional objectives. His earlier work does not illuminate those objectives, but in his response to this article he asserts that he is concerned about the pre-bankruptcy maneuverings of creditors about to go into bankruptcy that would result if bankruptcy and nonbankruptcy fora gave creditors different rights. Baird argues that a single state law scheme is needed to preclude such presumptively evil maneuvers. The implications of strategic planning pose yet another debate Baird and I might have, but my point here is made: collectivism alone doesn't go so far as Baird always claims. He needs to incorporate other values into his tight, "neutral" scheme in order to justify adoption of a specific plan.

B. Collectivism and Bankruptcy Judges

The coincidence that Baird's solution to the economic disin-

should get no less inside bankruptcy than they would get outside of it. But he fails to supply the policy analysis necessary to support a normative claim. Even if the courts undercompensate secured creditors, Baird must explain why full compensation of these and only these creditors is essential. But that debate is one that will focus squarely on the distributional objectives of bankruptcy. Baird cannot avoid that debate by invoking "neutral" collectivist principles and then requiring payments to undersecured creditors because judges are too dumb to make reasonable economic decisions.

C. Collectivism and State Law

In discussing bankruptcy policy, Baird assumes away the very thing I think we should discuss: how to distribute the losses occasioned by the debtor's widespread default. It is important to understand exactly how he avoids this central issue. To Baird, distributional issues are the same in and out of bankruptcy.[76] Baird seems to believe that this presumption not only permits him to support a single-issue bankruptcy policy, but that it also permits him to ignore any distributional consequences of the policies he embraces. By announcing that he is merely enforcing nonbankruptcy rights, and declaring, in effect, that he is changing nothing, Baird seeks to build a presumption into bankruptcy—a presumption that it will always follow the state-determined collection scheme—without ever defending that scheme. State law, as Baird explains it, is merely "our baseline," from which any bankruptcy "modification" must be justified.[77]

Baird cannot assert that he is offering *no* distributional scheme simply because he accepts the scheme that exists in state collection law. Any scheme distributes, whether Baird chooses to discuss it or not. If he proposes to adopt state collection law as the baseline for federal bankruptcy, he is obligated to offer some rationale for this choice and to make some examination of the consequences of using state distribution within the very specialized context of bankruptcy.

Baird ignores the fact that the way state collection law operates outside of bankruptcy is fundamentally different from the way it operates when grafted onto a bankruptcy system. There is in this respect a delicious irony in Baird's relentless defense of the se-

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[76] Corporate Reorganizations at 129-30 (cited in note 4).

[77] Id. at 103, 101.

cured creditor's demand for its "nonbankruptcy rights." At state law, the secured creditor was promised repossession rights if the debtor defaulted on its loan obligations. But, as anyone who has practiced a little collections law will readily acknowledge, there is many a slip twixt default and cash from the sale of collateral. The collateral may be hard to find. Some of it may be in another jurisdiction. The debtor may resist the creditor's self-help repossession, requiring the creditor to file a lawsuit. Some debtors seek restraining orders to prevent court-ordered repossession. State courts can be quick to restrain repossession and excruciatingly slow to give final effect to repo orders. As a strategic move to hold off creditor foreclosure, some debtors have turned to lender liability suits.[78] Notwithstanding any contractual agreements, the debtor may sell the collateral or give it to another creditor to satisfy loan obligations. The list goes on, and, to the frustrated creditor, it may seem endless.

Life is no bed of roses for the secured creditor drawn into a bankruptcy: the bankrupt debtor may still resist payment, and for some creditors the delays of bankruptcy simply follow the delays of the state court process. But a few things may improve in bankruptcy. In one stroke, all the lawsuits are in a single forum.[79] The bankruptcy court, unlike many state courts, recognizes the importance of time and the likelihood that the debtor will use court processes for delay. Several critical bankruptcy rules require that the court act quickly, often within thirty days. The debtor cannot seek temporary restraining orders to avoid enforcement of court orders or file harassing lawsuits in other courts. The creditor gets nationwide service of process regardless of where the collateral is located. The court monitors the debtor's behavior, restricting the debtor's control over the disposition of assets. No other creditor

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[78] Suits against the lender have become a newly popular device to stave off state foreclosure attempts. The Hunts put themselves back in the news again recently—in typically grand style—with a $14 billion suit against twenty-three banks. A Fort Worth lawyer explained that such suits are an attempt to "buy time" to forestall foreclosure. Kenn McGill, Hunts File an Appeal Over Order, Fort Worth Star-Telegram, business sec. 1, col. 5 (Sept. 9, 1986). See also Suit Against Lenders Seen As Possible Landmark Case, Wall St. J. 35, col. 3 (Sept. 15, 1986).

[79] I could make that statement with more confidence before the 1984 amendments to the Code. Today, some cases can go back to state court, but the run-of-the-mill collection cases seem to stay in bankruptcy court. See 28 U.S.C. § 157 (1982 & 1985 Supp.). See also Debtors and Creditors at 709-11, 714-15 (cited in note 3) (discussing the effect of the 1984 amendments); Elizabeth S. Gibson, Removal of Claims Related to Bankruptcy Cases: What is a "Claim or Cause of Action"?, 34 U.C.L.A. L. Rev. 1 (1987) (arguing for a narrow view of when bankruptcy claims can be removed to federal district court for adjudication).

may slip away with the debtor's assets. The bankruptcy court uses its contempt power to back up its rules for monitoring and conserving the property. And, perhaps most importantly for the secured creditor, the debtor in bankruptcy is the one that didn't close up in the middle of the night, shipping out its assets in a rented truck.

Without giving up any of these benefits, the creditor whose debtor has filed bankruptcy pleads unblushingly that it "just wants what was promised at state law." The secured creditors want all the court supervision and control, national jurisdiction, protection against other creditors, and speedy trials of bankruptcy. Then they want the foreclosure rights (or the equivalent interest value) of state law. Baird may find that cry moving; I find it disingenuous.

In short, once the debtor is in bankruptcy, no one gets "just what was promised at state law"—neither secured nor unsecured creditors. The sort of "forum shopping" Baird claims he wants to avoid may lead secured creditors as well as unsecured creditors to conclude that bankruptcy is a better deal than state collection proceedings. With its debtor in bankruptcy, every creditor gets something more by way of control over the debtor and the competing creditors, and something less by way of curtailed collection rights. The secured creditor can claim it has given up too much, and we can debate that issue. But the simple claim that the secured creditor wants only what it had at state law adds nothing to the debate. Once the debtor is in bankruptcy, it is no longer possible to give any party to the dispute its state law rights.

Whether the "baseline" for creditor rights in bankruptcy is state collection law or some other collection scheme, once the dispute enters the federal bankruptcy forum changes are made and a new collection system is created. The starting points have little to do with whether the system, in the end, accomplishes reasonable distributional objectives. Those objectives cannot be ignored, and the special consequences of how they will play out in the context of widespread default in bankruptcy cannot be wished away. The distributional issues of bankruptcy must be resolved at every step in determining bankruptcy policy. There is no way to escape them.

My view is that the central job of bankruptcy is to apportion the losses of the debtor's default, and that a variety of factors impinge on the difficult policy decision of where to let those losses fall. It may be ironic, but I am willing to concede that Baird's concern for secured creditors may be well-founded. If his charge against the current system is proper, and the balance in apportioning bankruptcy losses does favor debtors and some creditors too

greatly, then let that round of debates begin. But let's not hammer out the appropriate system balances in a debate by proxy over collectivism.

My disagreement with Baird might come down to a question of who bears which burdens. Baird simply starts with a state law "baseline," offering not a single insight into why any particular policy has been adopted or should be followed. Baird takes the position that if it exists in the state law scheme, it should be followed. If he wants to defend the state law collection system—or any other system—then he needs to come up with something more. Otherwise, he offers nothing.

Conclusion

I have offered a dirty, complex, elastic, interconnected view of bankruptcy from which I can neither predict outcomes nor even necessarily fully articulate all the factors relevant to a policy decision. Baird has offered a rational, clean approach in which he claims few factors are relevant and solitary conclusions are always compelled. Baird's view of bankruptcy is more chic than mine, but I believe my view is more realistic and more likely to yield useful analysis.

Baird and I disagree about the fundamental purpose of bankruptcy law. But the differences Baird and I nurture run deeper. Baird believes in a method of policymaking that will ineluctably yield a single right answer. I believe in an approach that only asks better questions, focuses on better evidence, yields closer approximations, and offers increasingly better, but still tentative, answers.

Professor Robert Scott has declared that Professor Baird and his coauthor Professor Jackson have, with their single-issue economic analysis of bankruptcy, "set the terms of the scholarly debate for the next decade."[80] The economic analysis of bankruptcy has enjoyed a central position in the discussion of bankruptcy policy, and according to Professor Scott, it will grow in intellectual dominion. The increasing number of scholarly articles that wrestle with difficult bankruptcy problems and eventually bring them to

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[80] Robert E. Scott, Through Bankruptcy with the Creditors' Bargain Heuristic, 53 U. Chi. L. Rev. 690, 692 (1986), reviewing Baird and Jackson Casebook. To be fair to Professor Scott, I should note that what he endorses is the heuristic device of asking a single question over and over throughout a casebook. Even Scott expresses hesitation about the accuracy of Baird and Jackson's analysis, but he nonetheless approves what amounts to teaching students everything about bankruptcy through a narrow question that hammers home an unrelenting economic analysis.

heel with a single, deft stab of economic analysis gives credence to Scott's point.

The attractions of an abstract economic analysis such as Baird's are many. A simple economic analysis of bankruptcy is clear, straightforward, and always promises to yield firm answers to hard questions.[81] The fact that the economic analysis is utterly self-referential also spares the proponent from nasty hours searching out empirical evidence or trying to learn about what happens in real borrowing and lending decisions. The business of writing articles and advising courts about the proper path of bankruptcy policy can proceed apace when all conclusions flow from just one or two easily identified assumptions. And the assumptions themselves are garbed in neutral terms, lending an aura of fairness to the development of policy. The economic analysis Baird practices is seductive.

Mine is not an entertaining (or, I suspect, popular) position for an academic. I cannot claim that bankruptcy, at its heart, is an intellectual construct or that I can reason to a meaningful conclusion by doing nothing more than thinking hard about logical consequences derived from a handful of untested assumptions. I would like to endorse something that requires only library time and yellow legal pads to uncover ideal solutions to legal problems. The trouble is that I can't do it.

But I do not think Baird can do it either. The certainty of Baird's position is a fiction. Although he purports to avoid difficult normative questions and he ignores empirical issues, Baird's conclusions are nonetheless driven by normative values and empirical assumptions. By hiding these values and assumptions, Baird simply makes the debate a shadow game that offers little real illumination.

Ultimately, I disagree not so much with what Baird argues as with how he argues. Baird makes an excellent point about the competition between unsecured and secured creditors. He may be right that unsecured creditors will push for any wild scheme that risks assets of the estate in order to get some shot at repayment. The factors Baird identifies are important, and his economic analysis of pressures that might influence the behavior of debtors and credi-

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[81] The emphasis of my protest is on the "simple" in "simple economic analysis." There are economic models that are not easy and that do not pretend to yield ineluctable answers. There are those that clearly expose their empirical and normative presumptions. Economic analysis is a powerful tool with a great deal to offer. I complain when models become too simple and the assumptions are concealed, so that the tool is used perversely.

tors is insightful. The economic analysis Baird offers could rightly enrich the inquiry about the effective implementation of a distributional scheme. But Baird uses his economic analysis to limit the inquiry—and there is the final rub.

Economic analysis can be used to further the inquiry into what happens in bankruptcy, or it can be used to close it off. Baird begins with an artificial construct of behavior, applies a few immutable principles, and jumps directly to specific statutory recommendations. Nowhere is there room to consider other factors that should be part of the decision-making process, or to make empirical observations that will indicate whether the model conforms sufficiently to reality to be useful. If Baird wants to add his questions to all the others that should be considered in making distributional decisions, then I will readily endorse his work. But so long as he explains his analysis in terms of the *sole* issue involved, the *single* question to be answered, and the *only* parties to be protected, I contend that his approach gives answers that are both illusory and dangerous.

I readily admit that I do not offer a single rule that will resolve all disputes. Instead, I call attention to the difficult distributional issues in bankruptcy, and I identify factors that influence how those distributional issues are resolved. Perhaps more importantly, I advocate a process of framing and refining questions, considering both their normative and empirical elements, to give content to the bankruptcy debate. Slick economic analyses give quick answers, but only by sliding past the troublesome issues that pervade the resolution of real problems.

Baird's single, unified theory of bankruptcy is more fun for academic games than is a complex view of bankruptcy that constantly reminds the player how little she knows about the empirical assumptions that underlie the game or whether other elusive values influence the balance among competing interests. His theory also runs an extraordinary risk of providing answers that are quite sensible within a confined, abstract scheme but that will not work in a complex reality. If the only test for acceptance of a specific statutory rule of law is whether the rule conforms to a logical—but possibly incomplete—concept, then grievous mistakes will go unchecked.

I undoubtedly overstate the risk that any abstract analysis could become the basis for an overhaul of the bankruptcy system and that significant changes could be made with little consideration of any implications other than a select few. Academics do not make these decisions anyway. Final decisions are in the hands of

politicians and judges, who may be much better at remembering to weigh the consequences of any rule than are the scholars who are tied to a single talisman. But if we academics take ourselves seriously, we should put single-issue theories into a somewhat less exalted position in order to minimize the harm we can do. And we should get about the business of asking harder questions, looking for better evidence, and approximating better answers.