2002

# Bankruptcy Professionals, Debtor Dominance, and the Future of Bankruptcy: A Review and a Rhapsody on a Theme

Thomas E. Plank

# Book Review

## BANKRUPTCY PROFESSIONALS, DEBTOR DOMINANCE, AND THE FUTURE OF BANKRUPTCY: A REVIEW AND A RHAPSODY ON A THEME

DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA.
David A. Skeel, Jr., Princeton University Press, 281 pp. (2001)

*Reviewed by*
*Thomas E. Plank**

David Skeel's book, *Debt's Dominion: A History of Bankruptcy Law in America*,[1] ("*Debt's Dominion*") presents the fascinating political history of American bankruptcy law. Applying public choice theory—primarily interest group theory—this book examines the three forces that have shaped bankruptcy law in America: the self interest of debtors, creditors, and bankruptcy professionals. In particular, it presents a detailed analysis of the enactment of the two important pieces of twentieth century bankruptcy legislation: the addition of bankruptcy reorganization to the Bankruptcy Act of

* Associate Professor of Law, University of Tennessee College of Law; A.B., Princeton University (1968); J.D. University of Maryland (1974). Many thanks to George Kuney and Jonathan Lipson for their invaluable comments on this review.

[1] DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA (2001).

1898 during the New Deal years of 1933 through 1938, and the enactment of the Bankruptcy Code of 1978 ("Code").

Happily, *Debt's Dominion* does not overwhelm the reader with economic analysis. *Debt's Dominion* weaves the analysis of the role of these three large interest groups into a coherent description of the contributions of ideology, political parties, regional conflict, the tensions between national and local interests, and specific individuals in shaping the development of bankruptcy law. It is well written; it is highly informative; and it makes a significant contribution to understanding not only the history of bankruptcy law but also the dynamics of bankruptcy law.

*Debt's Dominion* also reveals how the interests of bankruptcy professionals have most recently dominated the bankruptcy system. In my view, this dominance has produced a Code that currently tilts in favor of debtors, especially debtors—or to be more precise, the management of corporate debtors—purporting to reorganize under chapter 11. This pro-debtor slant has allowed a growing use of the bankruptcy process for purposes that have little or nothing to do with resolving the problem of financial or economic distress of debtors unable to repay their creditors. This use has, in turn, produced a growing belief among other non-debtors—prospective borrowers and creditors—that the current Code and its application are both fundamentally unfair and wasteful. This realization has engendered several responses. Some of these, such as the increasingly ambitious efforts of the credit card industry to curb the use of consumer bankruptcy by those with the presumed means of repaying their debts, the book describes well. Other responses follow the basic theme of the development of bankruptcy law described in *Debt's Dominion.* Later this review briefly describes two significant responses: (1) the promulgation and enactment of Revised Article 9, and (2) the dramatic growth of securitization. Both of these developments exhibit the same pattern of development described by *Debt's Dominion.*

## BANKRUPTCY LAW'S PAST

*Debt's Dominion* is neatly organized into eight chapters that alternate between individual and corporate bankruptcy, each of which discusses a discrete part of the history of bankruptcy. The first chapter summarizes the political and economic interests that contributed to the enactment and repeal of the first three American bankruptcy acts. In the first 100 years of the United States, Congress enacted bankruptcy acts, which generally provided for the liquidation of a debtor's assets for distribution to creditors, only in response to severe national economic recessions: the Act of 1800[2] following the recession of 1793;[3] the Act of 1841[4] following the Panic of 1837;[5] and the Act of 1867[6] following the Panic of 1857, which had been interrupted by the Civil War.[7] After these recessions ended, however, none of these Acts survived because of a lack of agreement among creditor and borrower interests and commercial and rural interests over the desirability of federal bankruptcy legislation.[8]

During the nineteenth century, politicians representing creditor interests, in particular creditors from the northeastern part of the United States, wanted a federal bankruptcy act to make national creditor collection efforts more effective.[9] Politicians representing borrower interests and politicians from less commercially developed states feared that a federal bankruptcy act would cause defaulting borrowers to lose their property and would also disadvantage local creditors. Compounding the difficulty of reaching agreement was a three way split among those legislators who wanted no bankruptcy act; those who wanted only a voluntary bankruptcy regime, that is, an act that would allow only the borrower to initiate a bankruptcy case; and those who wanted the

---

2 Act of Apr. 4, 1800, ch. 19, 2 Stat. 19 (repealed 1803).

3 *See* SKEEL, *supra* note 1, at 25.

4 Act of Aug. 19, 1841, ch. 9, 5 Stat. 440 (repealed 1843).

5 *See* SKEEL, *supra* note 1, at 25.

6 Act of Mar. 2, 1867, ch. 176, 14 Stat. 517 (repealed 1878).

7 *See* SKEEL, *supra* note 1, at 25.

8 Although the Act of Apr. 4, 1800, ch. 19, 2 Stat. 19, was to expire in five years, *id.* § 64, 2 Stat. at 36, Congress repealed it after three years because it proved to be so unpopular. Act of Dec. 19, 1803, ch. 6, 2 Stat. 248. *See* Vern Countryman, *A History of American Bankruptcy Law*, 81 COM. L.J. 226, 228 (1976); Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 534 (1996) [hereinafter Plank, *Constitutional Limits*]; Charles J. Tabb, *The History of the Bankruptcy Laws in the United States*, 3 AM. BANKR. INST. L. REV. 5, 15 (1995). The Act of Aug. 19, 1841, ch. 9, 5 Stat. 440, lasted even less time than the Act of 1800; Congress repealed the Act of 1841 after only 18 months. *See* Act of Mar. 3, 1843, ch. 82, 5 Stat. 614. *See* Plank, *Constitutional Limits*, *supra*, at 538; Tabb, *supra*, at 118. The Act of 1867 lasted longer, but it too was repealed in 1878. *See* Act of Sept. 1, 1878, ch. 160, 20 Stat. 99; Plank, *Constitutional Limits*, *supra*, at 538-39.

9 *See* SKEEL, *supra* note 1, at 26.

bankruptcy act to include an involuntary regime that would allow creditors to initiate a proceeding against a borrower.[10]

The enactment of the Bankruptcy Act of 1898 followed the same tortuous path as had the earlier acts, but with one difference: creditor groups emerging during the latter nineteenth century were better organized and more effective at pressuring lawmakers. Nevertheless, procreditor forces had to contend with and make concessions to strong pro-debtor, populist, agrarian, and states' rights sentiments in the Congress, and it took almost seventeen years of negotiation before the Act of 1898 became law.[11]

Interestingly, one of the compromises necessary to obtain enactment of the Act planted the seeds for the ultimate permanence of bankruptcy law in America. To reduce the concerns about federal power over debtors and the high costs of a bankruptcy system, the 1898 Act placed the administration of bankruptcy into the hands of referees paid from the estates being administered.[12] This choice fostered the development of the bankruptcy professionals, judges (the successors to the referees), trustees, practitioners, and academics, who became the third force in shaping twentieth century American bankruptcy law, a force that Professor Skeel describes as "the single most important influence on the development of bankruptcy law" since 1898.[13]

Chapter 1 sets the stage for the remainder of the book: the interplay of pro-creditor interests, pro-debtor interests, and the interests of the bankruptcy professionals. It summarizes 100 years of economic and political history in twenty-five pages. I would have preferred a fuller treatment of the development of the history of bankruptcy law in the nineteenth century. On the other hand, a detailed history of this period may have gotten in the way of the more fascinating story, the role of the bankruptcy professionals, a twentieth century phenomenon. The remainder of the *Debt's Dominion* presents a richer picture, filled with detail, color, and texture. Accordingly, any reader who continues beyond the first chapter is well rewarded.

Chapter 2 steps away from bankruptcy legislation to analyze the rise of the equity receivership during the last half of the nineteenth

---

[10] *See id.* at 28-34.

[11] *See id.* at 35-44.

[12] *See id.* at 40-41, 44-47.

[13] *See id.* at 47.

century. In the absence of any legislative guidance or authority, the railroad managers, their Wall Street investment bankers and lawyers, and federal judges created the equity receivership to resolve the financial and economic distress of railroads.[14] The equity receivership combined two settled legal doctrines—the traditional power of a court of equity to appoint a receiver of assets, and the traditional creditor suit to foreclose a mortgagor's equity of redemption—in an entirely new way. Secured creditors and later the railroad management itself would obtain appointment of a receiver—typically a representative of management—to operate the railroad while management and the investment bankers, who had originally underwritten the railroad's secured debt, negotiated a restructuring of the debt. These underwriters gained control of the negotiations by obtaining the consent of the debt holders to act as their agents. Upon completion of the negotiations and the approval of a reorganization plan, the judge would complete the foreclosure sale of the railroad to a newly reorganized entity that would have the capital structure set forth in the plan. As provided in the plan, the proceeds of the foreclosure sale received by the existing creditors would consist of cash payments or securities of the new entity. For example, secured bondholders of the previously insolvent railroad might receive stock and secured debt of the reorganized entity. Not limiting itself to analyzing the major legal issues in the equity receivership, this chapter describes the motivations of the participants in the process: the managers of the railroad; the investment bankers and their lawyers who looked after the interests of the creditors as well as their own; and the federal judges.

[14] Neither the Bankruptcy Act of 1867 nor the Bankruptcy Act of 1898 contained provisions for the reorganization of large corporations. The 1898 Act contained only limited provisions for an "arrangement." A bankrupt could propose to his creditors a plan for the composition of his debts that would allow the bankrupt to retain the bankrupt's property, and the composition could be confirmed only with the consent of a majority of the creditors whose claims had been allowed (measured by both the number of creditors and the amount of allowed claims). *See* Bankruptcy Act, ch. 541, § 12, 30 Stat. 544, 549-50 (1898) (codified as amended at 11 U.S.C. § 30 (1926) (repealed 1933)). In 1874, Congress amended the Bankruptcy Act of 1867 to allow a debtor to enter into a composition agreement or extension agreement that would allow the debtor to retain her property and that would be binding on all unsecured creditors if a majority in number and 75% in value agreed. Act of June 22, 1874, ch. 390, § 17, 18 Stat. 178, 182-83 (repealed 1878). This extension of bankruptcy law was upheld in *In re Reiman*, 20 F. Cas. 490, 492 (S.D.N.Y. 1874) (No. 11,673), *aff'd*, 20 F. Cas. 500, 501 (C.C.S.D.N.Y. 1875) (No. 11,675). *See* Plank, *Constitutional Limits*, *supra* note 8, at 539-40.

This equity receivership developed before and independent of the enactment of the Bankruptcy Act of 1898. Nevertheless, as we learn later, important features of the equity receivership described in chapter 2 reappear in later bankruptcy law: the belief that reorganization and the alleged preservation of jobs and going concern value is a worthy goal by itself; control of a reorganization by the managers who often use the reorganization process to pursue their own interests; and the enormous personal interest that bankruptcy judges and bankruptcy lawyers have in reorganization.

Returning to the development of bankruptcy legislation, chapter 3 of *Debtor's Dominion* tells the remarkable story of the survival of the portion of the bankruptcy bar involved in liquidations under Chapter VII of the 1898 Act. By the beginning of the New Deal, these bankruptcy lawyers had developed an unsavory reputation. Two detailed investigations of bankruptcy practice under the 1898 Act—one conducted by William Donovan for the Association of the Bar of New York, and one directed by former federal judge and then Solicitor General Thomas Thacher—examined the practice of lawyers who were members of the "bankruptcy ring." These lawyers would solicit votes from creditors and use this voting power to arrange for their election as trustee or selection as the trustee's counsel, the principal source of fees in a liquidation. The Thacher report proposed the creation of federal bankruptcy administrators under the United States Attorney General to control the bankruptcy case.[15] This proposal found its way into bankruptcy bills introduced in Congress in 1932. Despite the support of groups representing unsecured creditors, however, the bankruptcy bar derailed these proposals. The bankruptcy reform acts that emerged, while making modest improvements in bankruptcy procedure, left the bankruptcy system as it had developed, in the hands of the bankruptcy professionals.[16]

In contrast to the preservation of the bankruptcy liquidation bar during the New Deal bankruptcy reform, chapter 4 tells the dramatic story of the complete elimination by the Chandler Act of 1938[17] of the role of the Wall Street investment banks and the elite reorganization bar from large corporate reorganization. When Congress first took up the task of bankruptcy reform in 1932, Wall

[15] *See* SKEEL, *supra* note 1, at 78-79.

[16] *See id.* at 89-93.

[17] Act of June 22, 1938, ch. 575, 52 Stat. 840.

Street bankers and their lawyers favored the codification of the equity receivership because of doubts about the federal court's jurisdiction over the reorganization of ordinary corporations that did not have the same aura of public necessity as the railroads. In 1933, Congress added new section 77 to the 1898 Act to govern the reorganization of railroads,[18] and in 1934 Congress added new section 77B to govern the reorganization of corporations.[19] Section 77 interjected the Interstate Commerce Commission into the reorganization of railroads, but Section 77B left general corporate reorganization in the hands of Wall Street bankers and their lawyers.[20]

Soon thereafter, corporate reorganization law changed dramatically under the leadership of William O. Douglas, initially the head of the study mandated by the Securities and Exchange Act of 1934 of the bondholder protective and reorganization committees used in the equity receiverships[21] and later Chairman of the Securities and Exchange Corporation.[22] These efforts produced Chapter X of the 1898 Act, added by the Chandler Act of 1938.[23]

---

[18] *See* Bankruptcy Act, § 77, *added by* Act of Mar. 3, 1933, ch. 204, 47 Stat. 1467. Section 77, codified as amended at 11 U.S.C. § 205 (1976) (repealed 1978), remained in effect until the adoption of the Code.

[19] *See* Bankruptcy Act, § 77B, *added by* Act of June 7, 1934, ch. 424, § 1, 48 Stat. 911 (codified as amended at 11 U.S.C. § 207 (1934) (repealed 1938)).

[20] *See* SKEEL, *supra* note 1, at 107.

[21] *See* Securities and Exchange Act, § 211, *enacted by* Act of June 6, 1934, ch. 404, § 211, 48 Stat. 881, 909.

[22] *See* SKEEL, *supra* note 1, at 107-19.

[23] *See* Bankruptcy Act, §§ 101-276, *as added by* Act of June 22, 1938, ch. 575, 52 Stat. 840, 883-905 (codified as amended at 11 U.S.C. §§ 501-676 (1976) (repealed 1978)). Congress also added Chapter XI for the adjustment of the unsecured debt of smaller businesses; Chapter XII for the adjustment of real estate debt of individuals and partnerships; and Chapter XIII for the adjustment of debts of wage earners. *See* Bankruptcy Act, §§ 301-399 [ch. XI], 401-526 [ch. XII], 601-686 [ch. XIII], *as added by* Act of June 22, 1938, ch. 575, 52 Stat. 840, 905-38 (codified as amended at 11 U.S.C. §§ 701-799 [ch. XI], 801-926 [ch. XII], 1001-1086 [ch. XIII] (1976) (repealed 1978)).

In 1934, Congress had added a Chapter IX dealing with the insolvency of governments and their agencies. *See* Bankruptcy Act, §§ 78-80, *as added by* Act of May 24, 1934, ch. 345, 48 Stat. 798, *as amended by* Act of April 10, 1936, ch. 186, 49 Stat. 1198, and Act of April 11, 1936, ch. 210, 49 Stat. 1203. The Supreme Court declared this Act unconstitutional in *Ashton v. Cameron County Water Improvement Dist. No. One*, 298 U.S. 513, 531-32 (1936). Congress enacted a new Chapter X for insolvent governments in 1937, Bankruptcy Act, §§ 81-84, *as added by* Act of Aug. 16, 1937, ch. 657, 50 Stat. 653, 654 and renumbered this Chapter to Chapter IX in the Chandler Act of 1938, Act of June 22, 1938, ch. 575, § 3(a), 52 Stat. 840, 939. Congress amended this Chapter on several occasions, and in 1976, it was completely revised. *See* Pub. L. No. 94-260, 90 Stat. 315 (codified as amended at 11 U.S.C. §§ 401-418

Chapter X radically altered the method of reorganizing large corporations. In place of retaining the existing management under the equity receivership or a Section 77B reorganization, Chapter X required the appointment of a "disinterested" trustee,[24] precluding participation by existing management, their investment bankers, or the bankers' lawyers.[25] Chapter X also froze out the investment bankers and their lawyers by prohibiting the solicitation of votes from debtholders until *after* a reorganization plan had been approved, in lieu of the earlier practice by which investment banks obtained control of the reorganization by soliciting the votes of debt holders *before* negotiating a plan.[26] Finally, it appointed the SEC as the guardian of the interests of the publicly issued securities in lieu of the investment banks and their lawyers.[27]

Even with the radical change wrought by Chapter X, however, the bankruptcy legislation retained the minimalist approach to government control over bankruptcy, leaving bankruptcy largely in the hands of federal judges and bankruptcy referees, trustees, and practitioners. Thus, although bankruptcy reform was an integral part of the New Deal, the bankruptcy reform differed sharply from the other New Deal reforms that created new federal agencies staffed with federal employees with broad regulatory power. With the exception of the elimination of the high profile Wall Street investment banks and their lawyers (a somewhat insular and, in the climate of the Depression, politically vulnerable group), this ironic

---

(1976) (repealed 1978)).

[24] The bankruptcy judge had discretion not to appoint independent trustees only if the total indebtedness of the debtor were less than $250,000. *See* Bankruptcy Act, § 156, *added by* Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 888 (1938) (codified as amended at 11 U.S.C. § 556 (1976) (repealed 1978)).

[25] The definition of a person who was not "disinterested" was broad: A person was not disinterested if the person was (a) a creditor or stockholder of the debtor; (b) an underwriter of any outstanding securities of the debtor or a person who had during the previous five years been an underwriter of any securities of the debtor; (c) a person who during the previous two years had been an officer, director, or employee of the debtor or underwriter, or an attorney for the debtor or underwriter; or (d) any other person who has an interest materially adverse to the interests of any class of creditors or stockholders. *See* Bankruptcy Act, § 158, *added by* Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 888 (1938) (codified as amended at 11 U.S.C. § 558 (1976) (repealed 1978)).

[26] Professor Skeel also discusses the role of the Trust Indenture Act of 1939 in freezing out the Wall Street bankers by requiring each bondholder to vote on a modification of the principal or interest payments on the bond, and hence preventing such modification through a majority vote of all bondholders. *See* SKEEL, *supra* note 1, at 121.

[27] *See id.* at 119-22.

result flowed directly from the concentrated efforts of the then existing bankruptcy professionals.

Chapters 5 and 6 take us from the New Deal reforms to the enactment of the current Code. The 1950s and the 1960s saw a dramatic growth in consumer bankruptcy, which exposed the need for bankruptcy reform. In 1970, Congress authorized the Commission on the Bankruptcy Laws of the United States to study the 1898 Bankruptcy Act and to recommend reform.[28] In 1973, the Bankruptcy Reform Commission produced its Report[29] that included a proposed bill.[30] In 1978, Congress enacted the Code.[31] Professor Skeel describes these changes in chapter 5.

As Professor Skeel notes, the Commission's Report and the later enactment of the Code followed the same path as the Thacher report and the New Deal revisions in one important respect. Echoing the Thacher report,[32] the Commission's report recommended the creation of a bankruptcy agency in the Executive Branch that would handle much of the administrative aspects of bankruptcy.[33] There would still be a need for bankruptcy judges, but not as many. Under the Commission's proposal, the number of bankruptcy judges would decline from about 220 to about 150, a one-third reduction. Also, the creation of the proposed agency would reduce the demand for consumer bankruptcy lawyers. "Not surprisingly, bankruptcy professionals launched an immediate assault on the proposed agency."[34] The bankruptcy judges produced their own version of a reform bill that, also unsurprisingly, allowed the judges to retain exclusive control over bankruptcy.[35] After

---

28 *See* Bankruptcy Study Commission, Pub. L. No. 91-354, 84 Stat. 468 (1970), *reprinted in* 1970 U.S.C.C.A.N. 545; *see also* Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DEPAUL L. REV. 941, 942-43 (1979) (discussing the formation of the Commission on the Bankruptcy Laws of the United States).

29 COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137 (1973) [hereinafter COMMISSION REPORT].

30 *Id.* pt. 2. The Commission's act was introduced as S. 236, 94th Cong. (1975); H.R. 31, 94th Cong. (1975); S. 4046, 93d Cong. (1974); and H.R. 10792, 93d Cong. (1973). *See generally* Klee, *supra* note 28, at 943-44 (discussing the introduction of the act into the House of Representatives by Congressmen Don Edwards and Charles Wiggins, and into the Senate by Senator Quentin Burdick).

31 11 U.S.C. §§ 101-1330 (1994).

32 *See supra* text accompanying note 15.

33 *See* COMMISSION REPORT, pt. 1, *supra* note 29, at 51-66.

34 *See* SKEEL, *supra* note 1, at 143.

35 The judge's proposed act was introduced as S. 235, 94th Cong. (1975); H.R. 32, 94th Cong. (1975); and H.R. 16643, 93d Cong. (1973). A companion judges' bill was not

extensive hearings[36] during the 94th Congress on both the Commission's and the judges' proposed acts, representatives of the Commission and the judges helped forge a compromise that was introduced in the 95th Congress in a form substantially similar to the current Code.[37] As a classic example of successful defensive lobbying, these bills did not contain the proposed bankruptcy agency and left bankruptcy in the hands of the judges, trustees, practitioners, and debtors.

Further, as an example of the successful use of affirmative lobbying, the revised legislation introduced in 1977 in the House elevated bankruptcy judges to Article III status, that is, appointment by the President for life terms.[38] The revised legislation introduced

---

introduced in the Senate in the 93d Congress. *See generally Hearings on H.R. 31 & H.R. 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong. App. (1975-1976) [hereinafter *Comparison of H.R. 31 & 32*] (comparing the Commission's act, H.R. 31, and the bankruptcy judges bill).

[36] *See Hearings on HR. 31 & H.R. 32 Before the Subcomm. On Civil and Comm. On the Judiciary*, 94[th] Cong. (1975-1976) (spanning four volumes and 2700 pages and covering thirty-five days of testimony, with over 100 witnesses); *Hearings on S. 235 & S. 236 Before the Subcomm. on Improvement in Judiciary Machinery of the Senate Comm. on the Judiciary*, 94th Cong. (1975) [hereinafter *Senate Hearings*] (comprising one volume of 1316 pages and covering 3 days of testimony, with 75 witnesses); *see also* Klee, *supra* note 28, at 944 (noting that in contrast to the 93rd Congress, there was "intensive study of the bankruptcy legislation in both the House and Senate . . . during the 94th Congress").

[37] *See* H.R. 6, 95th Cong. (1977) (introduced January 4, 1977). The sponsors revised H.R. 6 and introduced the revision as a successor bill, H.R. 7330, on May 23, 1977. H.R. 7330, 95th Cong. (1977). The sponsors then revised this bill and introduced the revision, H.R. 8200, on July 11, 1977. H.R. 8200, 95th Cong. (1977); *see also* Klee, *supra* note 28, at 945-47 (discussing the legislative history of the Code). The House amended H.R. 8200 several times. The Senate began to work on a companion bill, S. 2266, in October 1977. After H.R. 8200 passed the House and was received in the Senate in February 1978, the Senate revised and adopted S. 2266. Although similar to H.R. 8200, S. 2266, as approved, contained substantial differences. Finally, after approving S. 2266 in September 1978, the Senate amended H.R. 8200, as passed by the House, by striking out the text and substituting all of S. 2266. *See* Klee, *supra* note 28, at 947-53. For practical reasons, the sponsors could not use a conference committee to reconcile the differences between the House and Senate bills. Accordingly, the sponsors in the House and the Senate informally reconciled the differences. Just before final passage of the Code, both the House and the Senate made last minute amendments to H.R. 8200 as passed by the House, and H.R. 8200, as amended by the Senate, to reconcile the differences between them, and both houses accepted the final compromise. Congress enacted these final versions as the Bankruptcy Reform Act of 1978. *See* Klee, *supra* note 28, at 953-56.

[38] *See* H.R. 6, 95th Cong. § 201 (1977); H.R. 7330, 95th Cong. § 201 (1977); H.R. 8200, 95th Cong. § 201 (1977) (as introduced on July 11, 1977).

The Commission's act provided that bankruptcy judges be appointed by the President for fifteen year terms and therefore not have the life tenure required for federal judges under Article III of the Constitution. *See* COMMISSION REPORT, pt. 1, *supra* note 29, at 5-7, 85, 94-6, in the Senate, however, did not accord bankruptcy judges Article III status but provided for appointment by the President for twelve-year terms.[39] As the result of the efforts of a different interest group, federal judges that already enjoyed Article III status and were intent on preserving their elevated position,[40] the final reconciled version of the Code provided for appointment of bankruptcy judges for fourteen-year terms by the President after receiving recommendations from the judicial conference for the related circuit.[41]

Chapter 5 also recounts the successful efforts of reformers to expand the scope of bankruptcy law by expanding the jurisdictional reach of bankruptcy courts and by adopting broader definitions of "property of the estate" and a "claim."[42] It also describes the unsuccessful efforts of different groups to make other significant changes in bankruptcy law:

---

pt. 2, §§ 2-102(a), (b) at 15-6; S. 236, 94th Cong. §§ 2-102(a), (b) (1975); H.R. 31, 94th Cong. §§ 2-102(a), (b) (1975); S. 4026, 93d Cong. §§ 2-102(a), (b) (1973); and H.R. 10792, 93d Cong. §§ 2-102(a), (b) (1973); *see also Comparison of H.R. 31 & H.R. 32*, *supra* note 35, at 27. This was not a surprising result given the presence of federal judges on the Commission and the exclusion of bankruptcy judges from the Commission. *See* SKEEL, *supra* note 1, at 139.

The bankruptcy judges, however, did not seek Article III status in their bill, although they sought to preserve their interests by proposing appointment by the judicial council of their respective circuit for fifteen year terms instead of appointment by the President. *See* S. 235, 94th Cong. §§ 2-102(a), (b) (1975); H.R. 32, 94th Cong. §§ 2-102(a), (b) (1975); and H.R. 16643, 93d Cong. §§ 2-102(a), (b) (1973); *see also Comparison of H.R. 31 & H.R. 32*, *supra* note 35, at 27.

39 *See* S. 2266, 95th Cong. § 201 (1977) (as introduced October 31, 1977); S. 2266, 95th Cong. § 201 (1977) (as reported on August 10, 1978).

40 *See* SKEEL, *supra* note 1, at 157-58.

41 Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 201(a), 92 Stat. 2549, 2657 (1978) (codified as amended at 28 U.S.C. §§ 152, 153 (1976 & Supp. III 1979). In 1984, in response to *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 59-60 (1982) (holding that non-Article III bankruptcy judges could not adjudicate a breach of contract claim by a debtor in possession against a third party who had not filed a claim in the bankruptcy case), Congress provided for appointment of bankruptcy judges by the judges of the United States Courts of Appeal. *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 104(a), 98 Stat. 333, 336 (codified as amended at 11 U.S.C. § 152(a) (1982 and Supp. II 1984)).

42 *See* SKEEL, *supra* note 1, at 148-49. Although I agree that the definition of "claim" under the Code is significantly broader than that under the 1898 Act, I disagree with Professor Skeel's characterization of the new definition of property of the estate as broader than the former definition. The new definition of property of the estate is simpler, but not substantially broader, than the former definition.

the efforts of reformers to impose uniform exemptions on debtors in bankruptcy and the successful efforts of different interest groups to retain state exemptions;[43]

the unsuccessful efforts of consumer advocacy groups to eliminate the fraud exception to discharge and to eliminate reaffirmation of debts by individual debtors; and

the unsuccessful efforts of creditor groups to exclude debtors with the income–the "means"–to repay some or all of their debt from Chapter 7 liquidation and a discharge of debts and to require the use of some of that future income to pay past debts through the new Chapter 13 arrangement for wage earners.

Nevertheless, the result of the necessary compromises gave the consumer advocacy groups mild victories in requiring that reaffirmations be approved by the court and the elimination of the fraud exception to a discharge under a Chapter 13 plan.

Chapter 6 analyzes the development of corporate bankruptcy after the New Deal. The Chandler Act had marked a complete SEC victory over the Wall Street reorganization practice and the elite reorganization bar. This victory did not, however, represent the demise of bankruptcy professionals in reorganizations. Instead, the SEC's victory over Wall Street planted the seeds for the demise of its role in corporate reorganization and the development of a powerful reorganization bar. Not surprisingly, except perhaps to the SEC reformers, the use of Chapter X steadily declined because of the understandable aversion of managers of financially distressed corporations to ceding their jobs to a reorganization trustee.[44] Instead of filing under Chapter X, these managers filed petitions under Chapter XI, despite the statutory limitation that a Chapter XI

---

[43] The compromise was, and remains, truly bizarre. Debtors may chose either the federal exemptions or the state exemptions unless the state specifically provides that debtors may not use the federal exemptions. Over half of the states require individual resident debtors to use only the state law exemptions. *See, e.g.*, NAT'L BANKR. REV. COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 120 (1997); William Houston Brown, *Political and Ethical Considerations of Exemption Limitations: The "Opt-Out" as Child of the First and Parent of the Second*, 71 AM. BANKR. L.J. 149, 151 (1997) (arguing that states should not be allowed to opt out of uniform federal exemptions).

[44] In 1939, there were 577 Chapter X filings, more than five times the average for the remainder of its existence; in 1940 and 1941, there were 291 filing. Thereafter, annual filings ranged from a high of 165 (in 1942) to a low of sixty-one with an average of less than 100. *See* SKEEL, *supra* note 1, at 126.

plan could only address the corporation's unsecured debt.[45] Chapter XI did not require the appointment of a trustee and therefore allowed the managers to control the reorganization process. This use of Chapter XI in turn led to the expansion of the existing non-elite bankruptcy bar into reorganizations. By the 1970s, when Congress took up the question of reforming the Bankruptcy Act of 1898, the bankruptcy professionals—judges, practicing lawyers, and academics—had developed both the expertise and the coherent identity of interests and organizational structures to influence the coming reform of reorganization.

Chapter 6 describes how the reformers replaced the New Deal model of large corporate reorganizations, with the SEC acting as the protector of investor interests, with the Chapter 11 system resembling what largely developed under Chapter XI by the non-elite bankruptcy bar. This system placed reorganization in the hands of managers of troubled corporations and their reorganization attorneys. A concentrated, knowledgeable interest group successfully attacked a system of reorganization that had little interest group support and that was also largely ineffective. In this regard, the new version of corporate reorganization is surely superior to the system that existed under Chapters X, XI, and XII of the Bankruptcy Act.

The Code enacted in 1978 created a more efficient process for adjusting the relationship between insolvent debtors and their creditors, by giving both individual debtors and the managers of troubled corporations greater control over the process. This greater control, however, also allows greater abuse of the bankruptcy process. This opportunity for abuse has increased the awareness of creditors, both secured and unsecured, of the costs of the current bankruptcy system to non-debtors. In the last part of the *Debt's Dominion,* Professor Skeel describes some of the responses of the creditor community to this awareness, and the opposition of the bankruptcy professionals to changes in the system. Chapter 7 discusses the efforts of unsecured creditors, in particular the issuers

[45] *See* Bankruptcy Act, §§ 306(1) (defining "arrangement" to mean a plan relating to unsecured debts), 307 (defining debt as unsecured debt and creditors as persons holding unsecured debts), 356 (providing that a plan shall include provisions for the modification of unsecured debts), 371 (providing that confirmation of an arrangement discharged unsecured debts and liabilities), *as added by* Act of June 22, 1938, ch. 575, § 1, 52 Stat. 840, 910, 912 (codified as amended at 11 U.S.C. §§ 706(1), 707, 756, 771 (1976) (repealed 1978)).

of credit cards, to reduce consumer bankruptcy filings, and chapter 8 discusses the largely ineffective efforts of creditors to cut back on Chapter 11 bankruptcies.

As chapter 7 of *Debt's Dominion* notes, consumer bankruptcy filings exploded under the 1978 Code from 172,000 filings in 1978 to 1.4 million filings in 1998.[46] These filings have followed the growth of the consumer finance industry. The credit card companies blame the Code and the ease with which debtors can file a Chapter 7 petition. Most bankruptcy professionals and consumer advocates, on the other hand, blame the consumer finance industry for inducing debtors to borrower more than they can repay. Professor Skeel describes the maneuvers of each side extremely well: the specific policy issues reflected in current law and proposed changes; the arguments and interests of the different groups; and the political climate in which the debate has occurred.[47]

Under Chapter 7 of the Code, consumer debtors may liquidate their property—which may be small or non-existent—and discharge

---

[46] *See* SKEEL, *supra* note 1, at 136-37. According to a press release by the American Bankruptcy Institute, the year 2001 saw the largest number of bankruptcy filings in history. *See* Press Release, ABIWorld, Bankruptcy Filings Set Record in 2001, *available at* http://www.abiworld.org/release/4q01.html (last visited Feb. 19, 2002) (citing date released by the Administrative Office of the U.S. Courts and noting that the number of new bankruptcies filed during calendar year 2001 rose to a historic high of 1,492,129 cases, a nineteen percent increase from the 1,253,444 cases filed in 2000, that total Chapter 7 filings were 1,054,975, a 23 percent increase from 859,220 in 2000, Chapter 13 filings increased by 11 percent from 383,894 for the same period in 2000 to 425,292 and that Chapter 11 filings rose sixteen percent from 9,884 to 11,424, spurred by a record number of large public company filings).

[47] The only part of this story that threw me off was his discussion of the "moral confusion" surrounding Chapter 13 for individuals with regular income. Professor Skeel describes the use of various "bribes" to induce individuals to file for Chapter 13, including a discharge of fraudulent debts that is not available to individuals receiving a discharge under Chapter 7. Consumer advocates had long charged that the consumer credit industry would ignore misleading information provided by the borrower at the time of the initial application for a loan and then use this misleading information as a way to exclude the loan from discharge under the exception for fraud. The fuller discharge under Chapter 13 was a compromise on this issue. *See* SKEEL, *supra* note 1, at 155. Later, in a section entitled "The Moral Confusion in U.S. Consumer Bankruptcy," Professor Skeel suggests that bankruptcy reform should reduce the strategic use of bankruptcy and "move toward a morally coherent approach to consumer bankruptcy." *See id.* at 211. This suggestion, however, seems out of place in this analysis of the contest between interest groups. Any such movement "toward a morally coherent approach to bankruptcy" would require a definition of the "moral" component in the debtor-creditor relationship, a subject outside the basic theme of the book: the clash of self interested groups, a clash that, however "selfish" it might appear, produces in the long run a "fairer" or more "moral" resolution of the competing interests.

almost all of their debts, freeing their post petition income from the claims of creditors. Another alternative, Chapter 13 of the Code, allows individual debtors to retain their property and dedicate their future income to the repayment of a portion of their debts under a plan that they devise. One of the long-standing proposals of the consumer credit industry requires that those debtors with the ability to repay some or all of the debts from their future income do so, primarily by denying those with the "means" to repay more of their debts the alternative of liquidation under Chapter 7.

The consumer credit industry has been unsuccessful to date in requiring "means testing" for Chapter 7. It did achieve a modest step in this direction in 1984 when Congress authorized bankruptcy judges to dismiss chapter 7 petitions for "substantial abuse."[48] Presumably, debtors denied relief under Chapter 7 would file under Chapter 13. This modest achievement turned out perhaps to be nothing more than a fig leaf in reality as bankruptcy judges have been reluctant to use this power in ways that provide much assistance to the consumer finance industry.

The consumer credit industry, however, almost achieved a more explicit form of means testing in the bankruptcy reform legislation of the last few years. Indeed, Congress passed the Bankruptcy Reform Act of 2000,[49] only to see it pocket vetoed by President Clinton on December 19, 2000. The bill that passed in 2000 was reintroduced in Congress in 2001,[50] but the House and Senate passed somewhat different versions of the bills. These bills are still hung up in a conference committee.

Returning to corporate bankruptcy, chapter 8 of *Debt's Dominion* analyzes the development of reorganizations under the Code through the end of the twentieth century. It covers the key and interesting developments: the explosion of corporate bankruptcy after the takeover boom of the 1980s; the use of bankruptcy by

---

[48] *See* Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 312, 98 Stat. 333, 355, amending 11 U.S.C. § 707 (1982 and Supp. II 1984).

[49] *See* H.R. 2415, 106th Cong. § 1 (2000) (providing for enactment into law of the provisions of S. 3186 of the 106th Congress, as introduced on October 11, 2000 by the conference committee for the House and Senate bills) (passed December 7, 2000) (Pocket Vetoed by President Clinton December 19, 2000). The text of S. 3186 is included in the H.R. 2415 conference report: H.R. REP. NO. 106-970 (2000).

[50] *See* Bankruptcy Reform Act of 2001, S. 220, 107th Cong. (Placed on the Calendar in the Senate January 31, 2001; Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. (Passed by the House March 31, 2001).

debtors to solve their mass-tort liabilities; the return of the elite Wall Street law firms to large corporate reorganizations; the support of progressive bankruptcy scholars for a reorganization regime that repudiates the New Deal vision of reorganization and that incorporates important features of the pre-New Deal equity receivership; and the rise of law and economics theory questioning the current process under Chapter 11 of the Code. The chapter also describes important current issues in reorganizations and the role of managers of debtors and bankruptcy professionals in these debates: the largely unsuccessful use of bankruptcy waivers and the more successful use of pre-packaged bankruptcies as a partial avoidance of bankruptcy, the growing prominence of Delaware as a venue for large corporate bankruptcies, the continuing debate over absolute priority and the new value exception (by which the owners of a corporate debtor attempt to retain some interest in the debtor over the objection of creditors who have not been paid in full), and the development of international insolvency regimes. Despite these controversies, Professor Skeel predicts that, given the preferences of the bankruptcy professionals, "it is difficult to imagine a set of circumstances that would lead to serious alteration of the current reorganization framework. . . . The expansion of U.S. corporate reorganization is likely to continue as new crises arise, and there is no obvious end in sight."[51]

THE FUTURE OF BANKRUPTCY LAW

*Debt's Dominion* explains why, once the Bankruptcy Act of 1898 had survived its infancy, bankruptcy professionals obtained more influence over the shape of bankruptcy law than either the creditor or debtor interests. To be sure, on specific issues, creditor interests resisted proposed changes. For example, banks had consistently and successfully defeated attempts to eliminate their right of set-off.[52] But, as a general rule, secured and unsecured creditors are too diffuse to focus on the technical aspects of bankruptcy law, and in any event, they can adjust their prices to reflect the allocations of risks and losses created by any bankruptcy law. Similarly, borrowers in general are too diffuse to lobby Congress for changes in

[51] *See* SKEEL, *supra* note 1, at 236-37.

[52] *See id.* at 182-83.

bankruptcy law, and most do not anticipate becoming debtors under the Code.

Bankruptcy professionals, on the other hand, have a direct interest in the shape of bankruptcy law, they have an unmatched expertise in the subject, and they are a much more concentrated group. Accordingly, they have been able to influence the shape of bankruptcy law. Much of this influence is undoubtedly good. The very existence of the bankruptcy professionals of the early twentieth century reversed the "boom and bust" cycle of bankruptcy legislation of the nineteenth century described by Professor Skeel. The successful efforts of bankruptcy judges, formerly known as referees until 1973, along with those of bankruptcy lawyers and practitioners, to elevate the status of bankruptcy judges has produced a system of adjudication of remarkably high efficiency and quality. The expansion of bankruptcy jurisdiction from the summary jurisdiction under Chapter VII of the Bankruptcy Act of 1989 to the fuller, nationwide jurisdiction under the Code has eliminated much needless waste.

On the other hand, the influence of bankruptcy professionals has contributed to the growth of an increasingly pro-debtor bankruptcy system, and especially a bankruptcy system that favors managers of a corporate debtor in Chapter 11. Although there is no evidence that the benefits of this pro-debtor/pro-management tendency outweigh the costs to society, there is no question that this pro-debtor growth has benefitted bankruptcy professionals. Nevertheless, those who pay the costs for the pro-debtor tilt of the Code are beginning to respond. This response is seen in several different manifestations, and is, not surprisingly, led by other interest groups who see themselves benefitting from the response. Professor Skeel analyzes the response of one group, the credit card industry. I will briefly discuss two other groups–of which I am substantially, but not exclusively, a member:[53] 1) secured lenders

[53] Before becoming a full time law professor in 1994, I practiced law for nineteen years, of which about fourteen years were spent serving as issuer's, bankruptcy, and underwriter's counsel for the issuance of mortgage-backed and asset-backed securities and tax-exempt housing bonds; counsel for purchasers, sellers, and servicers of mortgage loans and other loans; lender's counsel in direct real estate and commercial lending; and owner's counsel in selling, leasing, and financing real estate. Since 1994, I have continued to serve as a consultant for Kutak Rock LLP, of which I was a partner from 1986 through 1994, and since June 2001 have been Of Counsel to McKee Nelson, LLP, in both cases providing advice on bankruptcy and security interest matters in securitizations and other real estate, commercial,

and their lawyers, and 2) the investment bankers and their lawyers involved in securitization.

*Secured Creditors and Revised Article 9*

After a more then ten-year odyssey,[54] the latest revision of Article 9 has taken effect in all fifty states and the District of Columbia.[55] Some of the changes clarify issues under former Article 9 on which courts had disagreed.[56] Other changes expand the scope of Revised Article 9 to include additional transactions[57] and property

---

and public finance transactions. I have also served as an expert witness in two federal court cases involving securitizations, including serving as the expert witness for Abbey National Treasury Services PLC, on the true sale of trade receivables and the proper structuring of the LTV trade receivables securitization in *In re LTV Steel Co., Inc.*, No. 00-43866 (Bankr. N.D. Ohio 2000) *discussed infra* at text accompanying notes 84-94. I have derived substantial economic and non-economic benefits from the existence of secured credit and securitization and from my participation in these activities.

[54] In 1990, the Permanent Editorial Board for the UCC established a committee to study Article 9 of the UCC. The Article 9 study group recommended that a drafting committee be formed to draft amendments to Article 9, and it made many recommendations for changes. *See* PERMANENT EDITORIAL BD. FOR THE UNIF. COMMERCIAL CODE, PEB STUDY GROUP UNIF. COMMERCIAL CODE ARTICLE 9 REPORT (December 1, 1992). A drafting committee was formed in 1993, and its draft of Revised Article 9 was approved by the its sponsors, The American Law Institute and the National Conference of Commissioners on Uniform State Laws, in 1998. *See* U.C.C. § 9-101 cmt. 2 (2001); Steven L. Harris & Charles W. Mooney, Jr., *The Article 9 Study Committee Report: Strong Signals and Hard Choices*, 29 IDAHO L. REV. 561, 562 n.2 (1993). *Symposium on Revised UCC Article 9*, 74 CHI-KENT L. REV. 857 (1999). Additional minor amendments were adopted in 1999, 2000, and 2001. *See Uniform State Laws Scorecard*, COM. L. NEWSL. (ABA Section of Business Law/Unif. Com. Code & Fin. Serv. Comm.), Mar. 2002, at 17-18 & n.1.

[55] *See* UCC RPT. SERV. STATE UCC VARIATIONS, *Table of Enactments of 1999 Amendments* at xxv-xxvi (Sept. 2001); *Uniform State Laws Scorecard*, COM. L. NEWSL. (ABA Section of Business Law/Unif. Com. Code & Fin. Serv. Comm.), Mar. 2002, at 17-18 & n.1.

[56] *See, e.g.* U.C.C. §§ 9-102(a)(3) & cmt. 13.a (providing a broader definition of "proceeds" that rejects the holding of *FDIC v. Hastie* (*In re Hastie*), 2 F.3d 1042 (10th Cir. 1993) that postpetition cash dividends on stock subject to a prepetition pledge are not "proceeds"); *id.* §§ 9-103 & cmt. 7.a (approving what some cases have called the "dual- status" rule, under which a security interest may be a purchase-money security interest to some extent and a non-purchase-money security interest to some extent and rejecting the "transformation" rule adopted by some cases, under which any cross-collateralization, refinancing, or the like destroys the purchase-money status entirely).

[57] For example, Revised Article 9 now applies to the sale of payment intangibles and promissory notes. *See* U.C.C. §§ 9-109(a)(3). *See generally* U.C.C. §§ 9-101 cmt. 4 (providing a general summary of the revisions made in former Article 9). Revised Article 9 also allows for a limited security interest in certain general intangibles that are otherwise non-assignable. *See* U.C.C. 9-408; Thomas E. Plank, *The Limited Security Interest in Non-Assignable Collateral Under Revised Article 9*, 9 AM. BANKR. INST. L. REV. 323 (2001).

types.[58] Still other changes simplify the process of creating, perfecting, or discovering security interests.[59]

In the context of the entire system of personal property security interest, revised Article 9 represents, in my view, only a modest expansion of secured credit. This expansion slightly benefits secured lenders and their paying borrowers and arguably the paying borrowers' unsecured creditors to the possible detriment of those relatively few borrowers who become debtors under the Code and their unsecured creditors.[60] Because most borrowers who become debtors under the Code are insolvent, more protection for the secured creditor might lead to less recovery for the unsecured creditors of such debtors. On the other hand, although protection against the trustee in bankruptcy and the unsecured creditors is an important purpose of taking a security interest, it is not the only purpose. Perhaps the most important role of a security interest for any one creditor is the exclusivity that the secured creditor retains against the property subject to the security interest. In other words, if creditor *A* gets a security interest in a property item to secure a $100 debt, no other creditor can get the same security interest in that property item.

Nevertheless, the modest expansion of secured credit has produced strong criticism from several members of one group of bankruptcy professionals, the academics. Professor G. Ray Warner calls Revised Article 9 the "anti-bankruptcy act."[61] He asserts that the "Article 9 revisions will result in significant changes in bankruptcy law."[62] He believes that Revised Article 9 will leave the debtor with fewer assets to distribute to unsecured creditors or to finance the

[58] For example, Revised Article 9 now allows for the creation of security interests in deposit accounts, health care receivables, electronic chattel paper, and commercial tort claims. *See* U.C.C. § 9-109(a)(3). *See generally* U.C.C. §§ 9-101 cmt. 4 (providing a general summary of the revisions made in former Article 9).

[59] *See, e.g.*, U.C.C. § 9-502 & cmt. 3 (eliminating the requirement that the debtor sign a financing statement); *id.* § 9-301(1) & cmt. 4 (providing that local law of the jurisdiction of the debtor governs the perfection of a nonpossessory security interest in most goods and other tangible property, in place of the former rule that the local law of the jurisdiction in which most tangible property was located); *id.* § 9-307(e) & cmt. 4 (providing that the location of corporations and other "registered organizations" is the law of incorporation or other registration and not the place of business).

[60] All of the lawyers, however, benefit.

[61] G. Ray Warner, *The Anti-Bankruptcy Act: Revised Article 9 and Bankruptcy*, 9 AM. BANKR. INST. L. REV. 3, 3-6 (2001).

[62] *Id.* at 4.

reorganization effort and make it harder for debtors to reorganize without the cooperation of secured creditors.[63] Other bankruptcy scholars have also been critical of the expansion of secured credit by Revised Article 9.[64] Some, including Professor Warner, have also criticized the process by which Revised Article 9 was drafted and enacted as favoring the secured credit industry.[65]

Whatever the merits of these criticisms—I strongly disagree with much of Professor Warner's article characterizing Revised Article 9 as the "anti-bankruptcy act"—the effort to strengthen Article 9 in light of the pro-debtor tilt of the Code is no surprise. Secured creditors have attempted to redress the balance of power through amendments of the Code targeted to specialized creditors or circumstances.[66] Indeed, the current Bankruptcy Reform Act of

---

[63] *See id.* at 5-6.

[64] *See, e.g.* Lois R. Lupica, *Revised Article 9, Securitization Transactions and the Bankruptcy Dynamic*, 9 AM. BANKR. INST. L. REV. 287, 312-15 (2001) [hereinafter *Securitization and Bankruptcy*] (arguing that securitization has the potential to pose a greater risk to a debtor's unsecured creditors in bankruptcy than ordinary secured credit transactions and therefore questioning the wisdom of Revised Article 9's facilitation of securitization); Lois R. Lupica, *Circumvention of the Bankruptcy Process: The Statutory Institutionalization of Securitization*, 33 CONN. L. REV. 199, 200-02 (2000) [hereinafter *Statutory Institutionalization of Securitization*] (criticizing Revised Article 9's putative facilitation of securitizations); Julian B. McDonnell, *Is Revised Article 9 a Little Greedy?*, 104 COM. L.J. 241, 242-43 (1999) (stating that the "U.C.C. specialists who prepared Revised Article 9 decided to grab as much technical terrain as they possibly could for the secured creditor."). There is also a large body of scholarly literature questioning the desirability of secured credit. *See, e.g.*, Symposium, *The Priority of Secured Credit*, 82 CORNELL L. REV. 1279 (1997).

[65] *See* Warner, *supra* note 61, at 16-18; *see also* Edward J. Janger, *Predicting When the Uniform Law Process Will Fail: Article 9, Capture, and the Race to the Bottom*, 83 IOWA L. REV 569, 618, 625 (1998) (arguing that the process by which Revised Article 9 was drafted and enacted, requiring a uniform and enactable draft, contributed significantly to the failure to address the presumed distributive consequences of Revised Article 9); William J. Woodward, Jr., *The Realist and Secured Credit: Grant Gilmore, Common-Law Courts, and the Article 9 Reform Process*, 82 CORNELL L. REV. 1511, 1511 (1997) (lamenting the inability, in Professor Woodward's view, of the Article 9 enactment process to address desirability of secured credit).

[66] *See, e.g.*, SKEEL, *supra* note 1, at 234-35 (describing additional grounds for relief from the automatic stay for single asset real estate cases pursuant to 11 U.S.C. § 362(d)(3)). Many of these amendments added exceptions to the automatic stay. *See, e.g.*, *id.* § 362(b)(7) , *as added by* the Bankruptcy Amendments and Federal Judgeship Act of 1984, Pub. L. No. 98-353, § 392(b)(1), 98 Stat. 333, 365 (1984) (excepting the setoff by a repo participant of any mutual debt under certain repurchase agreements); *id.* §§ 362(b)(12)-(13), *as added by* Pub. L. No. 99-509, § 5001(a), 100 Stat. 1874, 1911-12 (1986) (excepting certain actions involving a Chapter 11 debtor brought by the Secretary of Transportation or the Secretary of Commerce to foreclose certain preferred ship or fleet mortgages or security interests); *id.* § 362(b)(9), *as added by* the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 116, 108 Stat. 4106, 4119 (1994) (excepting tax audits, demands for returns, and assessments); § 362(b)(17), *as added by* Pub. L. No. 101-311, § 102(3), 104 Stat. 267, 267 (1990) *as renumbered by* the Bankruptcy

2001 contains several attempts by particular groups of secured lenders to obtain better treatment in bankruptcy.[67] Revised Article 9 is another quite natural response by this one interest group—secured creditors and their lawyers—to a perceived imbalance of power in favor of other interest groups—principally managers of borrowers who become debtors and their lawyers—who benefit from a robust reorganization regime. The struggle between those interest groups favoring the full voluntary use of security and those seeking to reduce the impact of security interests in bankruptcy will no doubt exhibit the dynamics described by Professor Skeel. It is unlikely, however, that the pro-secured credit crowd will cede much ground.

Either through their own experience with bankruptcy or through the education from their lawyers on the effects of a bankruptcy of their borrower, many secured creditors have become more aware of the extent to which the Code deprives secured creditors of the benefit of their nonbankruptcy entitlements.[68] This awareness undoubtedly affects how they price credit, how much credit they extend, and to whom they extend credit. The decisions that secured creditors make on these issues in turn affect potential borrowers. The accumulation of these effects may be sufficient

---

Reform Act of 1994, Pub. L. No. 103-394, § 501(c), 108 Stat. 4106, 4144 (1994) (excepting the setoff by a swap participant of any mutual debt under a swap agreement).

In addition, in 1994, Congress apparently eased the mortgagee's ability to perfect a security interest in rents by allowing perfection by notice as a substitute for perfection by seizure or commencing an action. *See* 11 U.S.C. § 546(b)(2) (1994), *as added by* the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, sect. 204, § 546(b)(2), 108 Stat. 4106, 4122 (1994). Congress also revised § 552(b)(2) apparently to allow the continuation of security interests in rents but the statutory language is literally incompatible with revised § 546(b)(2). *See* 11 U.S.C. § 546(b)(2) (1994), *as added by* the Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, sect. 214, § 552(b)(2), 108 Stat. 4106, 4126 (1994); *see also* David Gray Carlson, *Rents in Bankruptcy*, 46 S.C. L. REV. 1075, 1145-46 (1995) (describing the interplay between § 552(b)(2) and § 546(b)(2)).

[67] *See, e.g.*, Bankruptcy Reform Act of 2001, S. 220, 107th Cong. § 1201 (2001) (expanding the provisions for relief from the automatic stay for single asset real estate by, among others things, eliminating the $4 million cap on the amount of secured debt for such real estate); Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. § 1201 (2001) (same).

[68] On the other hand, my colleague Professor George Kuney, an experienced Chapter 11 practitioner, has advised me that some secured creditors in bankruptcy have become adept at deriving large benefits from the reorganization procedure. He is currently working on an article tentatively entitled *The Hijacking of Chapter 11: Secured Creditors Have Climbed the Learning Curve*, in which he argues that in appropriate cases secured creditors have used a large number of techniques to turn a Chapter 11 case to their advantage.

incentive to mount a significant challenge to the legal status quo. It need not be the only impetus, however. Another incentive may be a growing competitive disadvantage for significant portions of the credit industry arising out of the dramatic growth of securitization.

*Securitization and the Avoidance of Most of the Bankruptcy Tax on Secured Credit*

Securitization is the transformation of loans—residential or commercial mortgage loans, automobile loans, credit card receivables, equipment leases and loans, student loans, trade receivables, and other receivables—into securities that can be sold in the capital markets.[69] One of the principal benefits of securitization is that, despite the higher transaction costs of a securitization, it saves money for the originators of loans[70] and their borrowers.[71] Much of the savings created by securitization derives from the unbundling of the risk associated with the assets being

---

[69] *See generally* SECURITIZATION OF FINANCIAL ASSETS (Jason H.P. Kravitt ed., 2d ed. 1996 and Supp. 2001); TAMAR FRANKEL, SECURITIZATION: STRUCTURED FINANCING, FINANCIAL ASSET POOLS, AND ASSET-BACKED SECURITIES (Little Brown & Co., Law & Business 1991); STEVEN L. SCHWARCZ, STRUCTURED FINANCE: A GUIDE TO THE PRINCIPLES OF ASSET SECURITIZATION (Practicing Law Institute, 2d ed. 1993); Committee on Bankruptcy and Corporate Reorganization, Association of the City of New York, *Structured Financing Techniques*, 50 BUS. LAW 527 (1995); Stephen I. Glover, *Structured Finance Goes Chapter 11: Asset Securitization by Reorganizing Companies*, 47 BUS. LAW 611, 613-14 (1992); Charles E. Harrell & Mark D. Folk, *Financing American Health Security: The Securitization of Healthcare Receivables*, 50 BUS. LAW 47 (1994); Charles E. Harrell et al., *Securitization of Oil, Gas, and Other Natural Resource Assets: Emerging Financing Techniques*, 52 BUS. LAW 885 (1997); Steven L. Schwarcz, *The Alchemy of Asset Securitization*, 1 STAN. J.L. BUS. & FIN. 133 (1994); Steven L. Schwarcz, *The Parts are Greater Than the Whole: How Securitization of Divisible Interests Can Revolutionize Structured Finance and Open the Capital Markets to Middle-Market Companies*, 1993 COLUM. BUS. L. REV. 139 (1993); Joseph C. Shenker & Anthony J. Colletta, *Asset Securitization: Evolution, Current Issues and New Frontiers*, 69 TEX. L. REV. 1369 (1991).

[70] In 1986, for example, General Motors Acceptance Corporation (GMAC) securitized over $4 billion of automobile loans. A study found that this securitization saved GMAC an annual amount equal to 1.3% on these securities in comparison with GMAC's costs of raising money through traditional debt financing. *See* James A. Rosenthal & Juan M. Ocampo, *Analyzing the Economic Benefits of Securitized Credit*, 1 J. APPLIED CORP. FIN. 32, 36-40 (1988). This annual rate of savings translates roughly, over the life of the deal, into between $80 and $100 million in cost savings.

[71] Several studies have shown that securitization has lowered mortgage rates. *See, e.g.*, Steven K. Todd, *The Effects of Securitization on Consumer Mortgage Costs* (2000) (unpublished dissertation, Loyola University of Chicago), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_I=223585 (last visited May 6, 2000) (finding that in 1993 securitization of mortgage loans saved consumers more than $2 billion in mortgage origination fees, but criticizing the methodology of other studies all finding a lowering of interest rates).

securitized from all of the other risks of the operations of the entity originating the loans.

An originator of loans must raise money to finance its operations. It can sell the loans or it can borrow money and grant the loans as security for the debt. If it borrows money, the secured lender takes both the risk associated with the assets and all other risks associated with the originator's operations. If the originator becomes a debtor under the Code for reasons unrelated to the assets, the secured lender still suffers all of the disabilities that the Code imposes on secured creditors. The most significant detriment is the imposition of the automatic stay, which prevents any payments to the lender.[72] Other detriments include the ability of the trustee in bankruptcy (including the originator as debtor in possession) to use the collateral, including the cash generated by the loans,[73] to force a creditor possessing the underlying loans to return the loans to the trustee,[74] and to give a new lender a security interest in the existing secured creditor's collateral that has priority over the secured creditor.[75] These provisions of the Code essentially allow for the transfer of some of the value to which the secured creditor would be entitled outside of bankruptcy to the debtor in bankruptcy. This transfer imposes additional costs on the secured creditor, which can be appropriately characterized as a bankruptcy surcharge or bankruptcy tax.

The originator can also securitize the loans. By doing so, it can either obtain a higher price for the loans or obtain lower financing costs while retaining an indirect interest in the residual value of the loans. Typically, the originator will create a bankruptcy remote, special purpose entity ("SPE"), such as a corporation and sell the

---

[72] *See* 11 U.S.C. § 362(a)(6) (2000) (staying any act to collect a claim).

[73] *See id.* §§ 363(a)-(c).

[74] *See id.* § 542(a), *interpreted by* United States v. Whiting Pools, Inc., 462 U.S. 198,211 (1983). *But see* Thomas E. Plank, *The Creditor in Possession Under the Bankruptcy Code: History, Text, and Policy*, 59 MD. L. REV. 253, 255-58, 301-05, 310-11, 339-44 (2000) (criticizing the Court's failure to follow the statutory language of the Code, its use of weak legislative history and its ignorance of direct, contrary legislative history and its too general policy analysis); Thomas E. Plank, *The Outer Boundaries of the Bankruptcy Estate*, 47 EMORY L.J. 1193, 1196-97, 1234-63 (1998) (critiquing the Court's analysis in *Whiting Pools* and its effect on the interpretation of property of the estate under § 541(a)(1) and explaining why it should no longer be considered good law).

[75] *See* 11 U.S.C. § 364(d)(1) (2000).

loans to the SPE. The SPE will then issue debt securities secured by and payable from the loans.[76]

The transaction is structured to isolate the loans from the risk of the bankruptcy of the originator. The sale from the originator to the SPE must be a "true sale", and hence the loans would not be part of the originator's bankruptcy estate if the originator became a debtor under the Code. The organizational documents for the SPE limit its activities to acquiring the loans and issuing the debt securities to minimize the risk that the SPE would file a bankruptcy petition for reasons unrelated to the performance of the loans. The SPE will also be structured—by a requirement for a director independent of the parent and detailed "separateness covenants" in the SPE's articles of incorporation or other organizational document—to operate as a separate legal person to ensure that it would not be substantively consolidated with its parent, typically the originator, if the parent became a debtor under the Code.

---

[76] The consideration for the sale will be the proceeds from the sale of the securities and the stock in the newly created SPE. If the SPE has already been established, then the SPE must pay cash or other property for the loans for the full purchase price.

By selling loans to an SPE that the originator owns, the originator can retain, indirectly, the residual value in the underlying loans that it originated. The SPE owns the loans, which is now subject to a security interest to secure the debt securities that it issued, and hence it retains the residual value in the loans remaining after payment of the debt. This residual value, less the general expenses and liabilities of the SPE, is the value of the stock of the SPE owned by the originator as parent of the SPE.

Securitizations can also use a "pass-through" structure. The originator can sell the loans to a trustee and issue pass-through certificates representing 100% of the beneficial interest in the underlying loans. The trustee has legal title to the loans and passes through the payments on the loans to the certificate holders in accordance with the operative document, usually referred to as a pooling and servicing agreement. In the simplest pass-through structure, there would be no SPE. Many pass-through structures, however, also use an SPE. In these structures, there will be multiple classes of certificates in which the most senior classes receive the highest priority of payment of the available cash flow from the loans and the most junior classes absorb any losses on the loans. For example, if there were four classes of certificates, classes *A* through *D*, cash would go first to *Class A*, then to *Class B*, then to *Class C*, and then to *Class D*, to the extent available, either to pay interest in the order specified and then to pay principal in that order, or all cash to pay both principal and interest in that order. From the perspective of a lawyer structuring the transaction to avoid the consequences of bankruptcy, the senior certificates represent debt, although they may not be debt for other purposes, and the most junior certificates represent the residual value of the loans. Accordingly, because a bankruptcy court might view the owner of these residual certificates as the "owner" of the loans, these residual certificates would be transferred to and held by an SPE. Hence, from a bankruptcy structuring perspective, multiple class pass-through certificates are essentially the same of pure debt securities.

By acquiring the loans and issuing debt secured by the loans, the SPE and its secured creditors, the debt holders, assume the risk that the loans will not perform as expected and that the debt will not be repaid. The SPE and its secured creditors, however, will not assume the other risks normally associated with an operating company like the originator of the loans. By eliminating these other risks, the SPE and the secured creditors can more easily predict the risks associated with the loans themselves and the amount of additional credit support usually required to ensure the repayment of the secured debt. By structuring the cash flows from the loans to provide the necessary credit support, the SPE can issue securities that will receive an investment grade rating from a rating agency that then facilitates the sale of the securities in the capital markets.[77]

Securitization does not circumvent the Code. If the loans owned by the SPE do not generate sufficient cash flow to repay the secured debt, the secured creditors may attempt to foreclose on the loans. The expected response is a bankruptcy filing by the SPE. Securitization, however, avoids the risks associated with an *originator* bankruptcy. Accordingly, an SPE that owns the loans and pledges them as security for the debt securities can receive an investment grade rating on its debt securities that an originator who owned and pledged the loans could not achieve. Similarly, the SPE who owned and pledged the loans could achieve an interest rate on its secured debt lower than the interest rate on the secured debt of an originator who owned and pledged the loans.[78] By separating the risks associated with the assets from the other risks of the operating company, securitization avoids the costs imposed on secured

---

[77] Generally, the credit support for the securities must come from the loans themselves and not from a guarantee from the parent of the SPE. The simplest form of credit support is over collateralization. For example, a pool of receivables in the amount of $100 million might provide sufficient cash flow, even after assuming levels of default several times higher than historical loss, to support $90 million of securities with a AAA rating, the highest. Other sources of credit support are financial guarantee policies, but the issuers of these policies base their policies on the underlying loans and seek reimbursement for any payments only out of the loans themselves.

[78] Securitization is used by many originators who are too small or who do not have sufficient equity to achieve an investment-grade rating for their debt securities. Originators who are rated also use securitization to save costs. For example, when General Motor Acceptance Corporation ("GMAC") securitized $4 billion of automobile loans, its traditional debt securities had a AA rating. The securities backed solely by the loans received a AAA rating. The cost saving for GMAC, however, resulted not from the difference in interest rates but from the cost of maintaining the amount of equity required for GMAC to achieve a AA rating on its own debt securities. *See* Rosenthal & Ocampo, *supra* note 70, at 32.

creditors who lend to operating companies like an originator of loans.

Securitization has become tremendously important in the economy, and it continues to be one of the fastest growing forms of capital formation. For example, the total debt owed by issuers of asset backed securities—excluding mortgages—increased 183% from $713 billion as of the end of 1995 to $2.02 trillion as of the end of September 2001.[79] In contrast, outstanding corporate bonds of issuers in the non-financial sector increased ninety-two percent during the same period from $1.3 trillion as of the end of 1995, about twice the outstanding debt of asset back issuers, to $2.48 trillion as of the end of September 2001.[80] In addition, as of the end of 2000, there were about $5.32 trillion of single family mortgage loans outstanding, of which about $2.93 trillion, or about fifty-five percent, had been securitized.[81] Further, as of the end of October 2001, there were approximately $1.63 trillion of consumer credit loans outstanding, of which $560 billion, or about thirty-four percent, had been securitized.[82]

A few scholars have criticized securitization as detrimental to the unsecured creditors of the originator.[83] Although I do not agree that securitization is detrimental to unsecured creditors, underlying the concern about the effect of securitization on unsecured creditors of bankrupt originators is the fear that securitization could reduce the amount of the bankruptcy tax that the debtor can collect from secured creditors and that the debtor could use to finance its reorganization efforts. Hence, securitization is seen as a threat to managers of reorganizing debtors and the bankruptcy professionals who benefit from reorganization efforts, regardless of how futile they may be. Because of its dramatic success, however, securitization

[79] *See* Board of Gov. of Fed. Res. System, *Domestic Financial Statistics*, 88 FED. RES. BULL. No. 2, A40, tbl. 1.59, 1.47 (Feb. 2002) [hereinafter *2002 Statistics*]; Board of Gov. of Fed. Res. System, *Domestic Financial Statistics*, 86 FED. RES. BULL. No. 12, A40, tbl. 1.59, line 47 (Dec. 2000) [hereinafter *2000 Statistics*].

[80] *See* 2002 *Statistics*, A40, tbl. 1.59, l. 8; 2000 *Statistics*, A40, tbl. 1.59, line 8.

[81] *See* 2002 *Statistics*, A35, tbl. 1.54, lines 2, 55, 58, 61, 69. Of this amount, $500 billion held in private pools and $2.43 trillion acquired from private industry and held by government agencies and government sponsored enterprises. *See id.* at A35, tbl. 1.54, lines 55, 58, 61, 69.

[82] *See* 2002 *Statistics* at A36, tbl. 1.55, lines 4, 10 (not seasonably adjusted figures).

[83] *See, e.g.*, Christopher W. Frost, *Asset Securitization and Corporate Risk Allocation*, 72 TUL. L. REV. 101, 102 (1997); Lois R. Lupica, *Asset Securitization: The Unsecured Creditor's Perspective*, 76 TEX. L. REV. 595 (1998).

has created strong countervailing interest groups—Wall Street investment bankers and the securitization lawyers. The struggle war between these two sets of interest groups has already begun, and the dynamics resemble the earlier struggles between interest groups described by *Debt's Dominion.*

The debtor camp—primarily the promoters of the interests of the managers of debtors—led an assault on securitization with the bankruptcy filing of The LTV Corporation ("LTV"). LTV and forty-eight of its subsidiaries who produce and sell steel products had established a securitization in 1994 to securitize the trade receivables generated from the sale of their steel products. LTV created an SPE, and its affiliated sellers entered into a revolving sale agreement agreeing to sell their receivables to the SPE.[84] The SPE then entered into a revolving credit agreement providing for the issuance to investors of highly rated notes secured by the receivables.[85] On December 29, 2000, LTV and its affiliates other than the SPE filed for bankruptcy.[86] Alleging that they required liquid assets to fund their reorganization efforts, the debtors sought to repudiate the trade receivables securitization and recapture the receivables. That same day the debtors immediately moved for an order allowing them to obtain and use the trade receivables that had been sold on the grounds that (i) the securitization was nothing other than a disguised secured transaction and (ii) the inability to use the trade receivables would cause the demise of the debtors and

[84] *See* Receivable Purchase and Sale Agreement, dated as of October 12, 1994, among the LTV Corporation, the Sellers Named Herein, LTV Steel Company, Inc., as the Servicer and LTV Sales Finance Company, as the Purchaser, attached as Exhibit B to the Affirmation of Michael Friedman [hereinafter the Friedman Affirmation], *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 100 filed January 9, 2001). The Friedman Affirmation, as well as the other pleadings in the LTV case, is available at http://216.205.189.186/pdf/100.pdf (last visited May 6, 2002), but the documents attached to the Friedman are not. As of May 6, 2002 the docket for the LTV case and the pleadings files can be found at http://216.205.189.186. Attachments not available can be ordered from the source referenced at that web site. This site also be accessed through the LTV Corporation web site at http://www.ltvsteel.com, which has a link to the "Bankruptcy Docket". Use http://www.ltvsteel.com in lieu of numbered address (last visited and valid May 6, 2002).

[85] *See* Revolving Credit Agreement Dated as of October 12, 1994, among LTV Sales Finance Company the Financial Institutions Parties Hereto as Banks, the Issuing Banks, and the Facility Agent and Collateral Agent, *attached as Exhibit A* to the Friedman Affirmation, *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 100 filed Jan. 9, 2001).

[86] *See, e.g.*, Voluntary Petition of LTV Steel Co., Inc., *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 1 filed Dec. 29, 2000).

the loss of 17,500 jobs.[87] On that very same day, the court entered an interim order permitting the temporary use of the receivables and setting a hearing on the allegations raised by the LTV.[88]

The investor moved for modification of the interim order, which the court denied.[89] After discovery, the filing of briefs and an expert report by the investor,[90] and the filing of amici briefs on behalf of the securitization industry,[91] the debtor and the investor

---

[87] *See* Emergency Motion for (1) Order Granting Interim Authority to Use Cash Collateral and (2) Scheduling and Establishing Deadlines Relating to a Final Hearing; Memorandum and Points and Authorities at 1-4, *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 28 filed December 29, 2000) [hereinafter Debtor's Emergency Motion].

[88] Interim Order (1) Authorizing Debtors to Obtain Post-Petition Financing or Use Cash Collateral Pursuant to 11 U.S.C. §§ 105, 361, 363, 364(c)(1), 364(c)(2), 364(c)(3), and 507(b) and (2) Granting Adequate Protection to Pre-Petition Parties, *In re* LTV Corp., No. 00-43866, at 1-5 (Bankr. N.D. Ohio) (doc. no. 41 filed December 29, 2000). In my view, the LTV case was substantially affected by an "inventory securitzation" that LTV entered into in 1998. In this transaction, LTV's steel producers sold their inventory of raw material to an SPE and hired an LTV affiliate to process the raw material into steel products that the SPE then sold. The "inventory" securitization used the techniques of securitization, but it is not properly speaking a "securitization" in that it does not securitize financial assets but instead attempts to securitize operations. Hence, it is more accurately characterized as a sale and consignment arrangement. Standard and Poor's Ratings Group refers to these types of transactions as "hybrid" transactions. *See* STANDARD & POOR'S RATING SERVICES, LEGAL ISSUES IN RATING STRUCTURED FINANCE TRANSACTIONS 115-19 (2000). If there had been no inventory securitization, I believe that it would have been much more difficult for the debtors to get an interim order allowing them to repudiate the receivables securitization. Most of the allegations that the LTV securitizations were disguised secured transactions focused on the inventory securitization and the fact that the investor in that securitization depended so heavily on the operations of the LTV affiliate "servicing" the raw material by turning it into steel products. *See, e.g.*, Debtor's Emergency Motion, *supra* note 87, at 7-9, 14-16.

[89] *See* Emergency Motion by Abbey National Treasury Services PLC for Modification of Interim Order Entered on December 29, 2000 and Objection to such Order, *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 98 filed January 9, 2001); Order and Memorandum Opinion [denying the Emergency Motion], *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 366 filed February 5, 2001).

[90] *See* Notice of Abbey National Treasury Services PLC of Filing Its Supplemental Memorandum in Opposition to Debtors' Emergency Motion for Final Order Granting Authority to Use Cash Collateral Under Seal, *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 524 filed February 20, 2001); Expert Report Witness of Thomas E. Plank Filed Under Seal, *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 584 filed March 2, 2001).

[91] Motion for Leave to File a Memorandum on Behalf of Amici Curiae in Opposition to the Debtors' Emergency Motion for an Order Granting Interim and Final Authority to Use Cash Collateral, *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 500 filed February 20, 2001) [hereinafter Motion of Securitization Amici]; Memorandum of Securitization Amici Curiae In Opposition to Debtors' Emergency Motion for (1) Order Granting Interim and Final Authority to Use Cash Collateral, *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 502 filed February 20, 2001) [hereinafter, Memorandum of Securitization Amici]; Brief of The New York Clearing House Association L.L.C. as Amicus

entered into a settlement agreement by which the investor, among others, agreed to provide debtor in possession financing, the sellers repurchased the receivables sold to the SPE, and the debtor conceded that the sale of the receivables had been a true sale.[92] On March 20, 2001, the court entered an order approving the terms of the settlement and specifically finding that the sale of the receivables to the SPE had been a true sale of the receivables.[93] Undoubtedly, a significant factor in the settlement was the fact that LTV's attempt to repudiate a properly structured securitization to save 17,500 jobs would destroy an industry that provided trillions of dollars of lower cost financing to many borrowers, including LTV.[94] This result suggests that, despite the aversion of some bankruptcy professionals to securitization, the economic importance of the securitization industry will successfully thwart efforts by prodebtor groups to eliminate or reduce true securitizations.

On the other hand, the securitization industry does not appear strong enough to extend legislatively the benefits of securitization to transactions that do not entail a true sale of assets to an SPE. In the bankruptcy legislation that has been percolating in Congress the last several years, the securitization industry had succeeded in inserting a section, § 912 of the current bill, that would modify § 541 of the Code to exclude assets that had been "transferred" in a "securitization."[95] So long as the securities were rated at least

Curiae In Opposition to Debtors' Emergency Motion for (1) Order Granting Interim Authority to Use Cash Collateral, *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 507 filed February 20, 2001) [hereinafter Brief of New York Clearing House Association].

[92] Final Order Authorizing Debtors Pursuant to 11 U.S.C. §§ 105, 361, 362, 363, 364(c)(1), 364(c)(2), and 364(c)(3) to (A) Obtain Post-Petition Financing and (B) Repurchase Certain Inventory, Accounts Receivable and Adequate Protection Claims, ¶5 at 7-8, ¶11, at 11, *In re* LTV Corp., No. 00-43866 (Bankr. N.D. Ohio) (doc. no. 734 filed March 20, 2001).

[93] *Id.* ¶11, at 11.

[94] Motion of Securitization Amici, *supra* note 91, at 1-2 (identifying as the "Securitization Amici" several steel companies who sell asset-backed securities to fund their operations, issuers of asset-backed securities, trade associations, investors, and underwriters); Memorandum of Securitization Amici, *supra* note 91, at 17, 18, 20 (stating that accepting "LTV's extreme legal arguments and disregarding the structure of the LTV transactions could cause a seismic disruption in the capital markets" and LTV's motion "is an attack on a major funding technique that benefits manufacturers, consumers, investor, and creditors alike"); Brief of The New York Clearing House Association, *supra* note 91, at 4 (noting that LTV's motion would sacrifice the form of financing that successfully aided its earlier rehabilitation and adversely affect thousands of companies with millions of employees as well as millions of investors).

[95] *See* Bankruptcy Reform Act of 2001, S. 420 107th Cong. § 912 (2001), entitled

"Asset-Backed Securitizations":

Section 541 of title 11, United States Code, as amended—

(1) in subsection (b), by inserting after paragraph (7), as added by this Act, the following:

(8) any eligible asset (or proceeds thereof), to the extent that such eligible asset was transferred by the debtor, before the date of commencement of the case, to an eligible entity in connection with an asset-backed securitization, except to the extent such asset (or proceeds or value thereof) may be recovered by the trustee under section 550 by virtue of avoidance under section 548(a); and

(2) by adding at the end the following new subsection:

(f) For purposes of this section—

(1) the term 'asset-backed securitization' means a transaction in which eligible assets transferred to an eligible entity are used as the source of payment on securities, including, without limitation, all securities issued by governmental units, at least one class or tranche of which was rated investment grade by one or more nationally recognized securities rating organizations, when the securities were initially issued by an issuer;

(2) the term 'eligible asset' means—

(A) financial assets (including interests therein and proceeds thereof), either fixed or revolving, whether or not the same are in existence as of the date of the transfer, including residential and commercial mortgage loans, consumer receivables, trade receivables, assets of governmental units, including payment obligations relating to taxes, receipts, fines, tickets, and other sources of revenue, and lease receivables, that, by their terms, convert into cash within a finite time period, plus any residual interest in property subject to receivables included in such financial assets plus any rights or other assets designed to assure the servicing or timely distribution of proceeds to security holders;

(B) cash; and

(C) securities, including without limitation, all securities issued by governmental units;

(3) the term 'eligible entity' means—

(A) an issuer; or

(B) a trust, corporation, partnership, governmental unit, limited liability company (including a single member limited liability company), or other entity engaged exclusively in the business of acquiring and transferring eligible assets directly or indirectly to an issuer and taking actions ancillary thereto;

(4) the term 'issuer' means a trust, corporation, partnership, or other entity engaged exclusively in the business of acquiring and holding eligible assets, issuing securities backed by eligible assets, and taking actions ancillary thereto; and

(5) the term 'transferred' means the debtor, under a written agreement, represented and warranted that eligible assets were sold, contributed, or otherwise conveyed with the intention of removing them from the estate of the debtor pursuant to subsection (b)(8) (whether or not reference is made to this title or any section hereof), irrespective and without limitation of—

(A) whether the debtor directly or indirectly obtained or held an investment grade, the assets would be considered "transferred" if the debtor in a written agreement represented and warranted that the assets were sold with the intention of removing them from the estate of the debtor.[96] Hence, § 912 appears to allow an originator to remove from the property of its potential bankruptcy estate assets that were not truly sold. In essence, investors in securities who obtained an investment grade rating secured by such eligible assets still owned by the debtor would no longer have to pay the bankruptcy tax that would fund the reorganization efforts of the debtor.

Although I am skeptical that the effects of § 912 would be as beneficial as its sponsors hope or as harmful as its critics fear, § 912 drew the ire of some bankruptcy academics.[97] Nevertheless, the fate of § 912 seemed to be tied up in the fate of the larger Bankruptcy Reform Act of 2001, although there has been the possibility of enacting § 912 as part of smaller bill dealing with financial markets.[98] The apparent fate of § 912 changed dramatically, however, following the collapse and bankruptcy filing of Enron Corp. Several bankruptcy academics wrote a letter to Congress on January 23, 2002 opposing § 912 for a variety of reasons, including a charge that § 912 would permit future Enrons[99] and that it would "render impossible untold corporate reorganizations that would save jobs and would give most creditors a much higher return from

---

> interest in the issuer or in any securities issued by the issuer;
>
> (B) whether the debtor had an obligation to repurchase or to service or supervise the servicing of all or any portion of such eligible assets; or
>
> (C) the characterization of such sale, contribution, or other conveyance for tax, accounting, regulatory reporting, or other purposes.

Section 912 of the house bill is identical. *See* Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. § 912 (2001).

96 *See id.*

97 *See, e.g.*, Lupica, *Statutory Institutionalization of Securitization*, *supra* note 64.

98 *See* Financial Contract Netting Improvement Act of 2000, H.R. 1161, 107th Cong. § 13 (introduced in the House January 3, 2001) (using language almost identical to § 912). The predecessor for this provision in the previous Congress was the Financial Contract Netting Improvement Act of 1999, H.R. 1161, 106th Cong. § 13 (introduced in the House March 17, 1999).

99 *See* Letter from Alan Axelrod, Professor Emeritus, Rutgers School of Law, Newark, et al. to Senator Patrick Leahy and Congressman F. James Sensenbrenner, dated January 23, 2002, *reproduced in* 21 AM. BANKR. INST. J. no. 2, Mar. 2002, at 6 *available at* www.abiworld.org/resources/research/letter1.html [hereinafter Law Professors' Letter] (arguing that § 912 "would institutionalize and encourage one of the practices that has led to Enron's failure and its harsh consequences").

a company in financial trouble."[100] Other academics also wrote, criticizing § 912,[101] and the Bond Market Association wrote a spirited defense.[102]

The fate of § 912 is unclear. In an effort to move the Bankruptcy Reform Act through the conference committee, House Republicans offered to delete § 912.[103] I would be delighted to see the demise of § 912, but for reasons much different than most bankruptcy academics. Contrary to the assertions of the Bond Market Association in its letter defending § 912,[104] and some bankruptcy academics and practitioners,[105] I believe that the legal foundations for true securitizations are very firm.[106] Therefore, as the law professors' letter of January 23, 2002, correctly acknowledges,[107] true securitizations do not need § 912. To the extent that § 912 is to remove secured transactions from the reach of the Code, this change should not be limited to only those secured transactions involving financial assets securing securities with an investment grade rating and should be made available to all secured

---

[100] *See id.*, *reproduced in* 21 AM. BANKR. INST. J. no. 2, March 2002 at 38.

[101] *See* Letter from Edward J. Janger, Associate Professor, Brooklyn Law School, et al. to Senator Patrick Leahy and Congressman F. James Sensenbrenner, dated January 28, 2002 [hereinafter Janger Letter], *available at* www.abiworld.org/resources/research/letter1.html; Letter from Kenneth J. Kettering, Associate Professor, New York Law School, et al. to Senator Patrick Leahy and Congressman F. James Sensenbrenner, dated February 5, [hereinafter Kettering Letter], *available at* www.abiworld.org/resources/research/ letter1.html. Both of these letters present good reasons why Congress should jettison § 912.

[102] Letter from John R. Vogt, Executive Vice President, Bond Market Association, to Senator Patrick Leahy and Congressman F. James Sensenbrenner, dated January 30, 2002 [hereinafter BMA Letter], *available at* http://www.bondmarkets.com/regulatory/ ABSO13002.pdf.

[103] *See* F. James Sensenbrenner, Chairman, House Judiciary Committee, Remarks to Credit Union National Association, February 27, 2002 (available at http://www.house.gov/judiciary/sensenbrenner022702.htm) (reporting that on February 26, 2002, House staff submitted a compromise on bankruptcy reform legislation to the Senate that included a proposal to strip the asset-securitization provision from the legislation at the request of the Senate); *see also* Jonathan C. Lipson, Enron, Asset Securitization and Bankruptcy Reform: Dead or Dormant?, 11 J. Bankr. L. & Prac. January/February 2002 (criticizing several unjustified aspects of § 912 and suggesting that it might be resurrected).

[104] *See* BMA Letter, *supra* note 102.

[105] *See, e.g.*, David Gray Carlson, *The Rotten Foundations of Securitization*, 39 WM. & MARY L. REV. 1055 (1998); Kettering Letter, *supra* note 101.

[106] This topic is the subject of one of my works in process, tentatively entitled "*The Secure Foundations of Securitization.*"

[107] *See* Law Professors' Letter, *reproduced in* 21 AM. BANKR. INST. J. no. 2, March 2002 at 36 (noting that the "deliberate asset securitization is booming under current law" and that not every asset securitization is a disguised loan).

transactions. In any event, it would be ironic indeed if a victory on the part of the bankruptcy academics on § 912 led to the enactment of the Bankruptcy Reform Act, which contains many other provisions of much greater impact on individual debtors that have been heavily and rightly criticized.[108]

If securitization is, as I believe, efficient,[109] then it does not adversely affect unsecured creditors. It might, however, adversely affect bankruptcy professionals in another way. If securitization is efficient, the tremendous cost savings that it generates by avoiding a significant portion of the bankruptcy tax on secured credit provides substantial real evidence of the inefficiency of the current bankruptcy regime. This evidence, coupled with doubts about the success rates for reorganizations[110] and the lack of any empirical

---

[108] *See, e.g.*, Jean Braucher, *Means Testing Consumer Bankruptcy; The Problem of Means*, 7 FORDHAM J. CORP. L. (forthcoming 2002) (arguing that the pending 2002 consumer bankruptcy legislation adopting a complicated means testing procedure would impose greater burdens on the innocent, but unfortunate, individual debtor without any significant reduction in the few abusers of the current bankruptcy process or increase of collections in bankruptcy);Jean Braucher, *Increasing Uniformity in Consumer Bankruptcy: Means Testing as a Distraction and the National Bankruptcy Review Commission's Proposals as a Starting Point*, 6 AM. BANKR. INST. L. REV. 1 (1998) (criticizing means testing in several bills introduced in Congress in 1998); Melissa B Jacoby, *Collecting Debts From The Ill And Injured: The Rhetorical Significance, But Practical Irrelevance, Of Culpability And Ability To Pay*, 51 AM. U. L. REV. 229, 253-62 (2001); Ted Janger, *Crystals And Mud In Bankruptcy Law: Judicial Competence And Statutory Design*, 43 ARIZ. L. REV. 559, 615-19 (2001) (explaining why the current proposals for means testing create "a rule that is likely to accomplish virtually none of the stated goals of its drafters"); Zachary Price, *The Bankruptcy Abuse Prevention and Consumer Protection Act*, 39 HARV. J. LEGIS. 237 (2002) (criticizing the current version of the bankruptcy reform pending in the 107th Congress); Charles Jordan Tabb, *The Death Of Consumer Bankruptcy In The United States?*, 18 BANKR. DEV. J. 1 (2001).

[109] This topic is also subject of another of my works in process, tentatively entitled *The Efficiency of Securitization: The Inefficiency of Bankruptcy*. Securitization entails an asset transfer for fair value. The sale of assets itself does not harm unsecured creditors of the originator. The unsecured creditors are harmed if the originator uses the proceeds of the sale unwisely or absconds with the proceeds.

[110] *See* NATIONAL BANKR. REV. COMM'N, FINAL REPORT BANKRUPTCY: THE NEXT TWENTY YEARS 610-14 (1997) (noting that "only a small fraction of the Chapter 11 cases filed nation-wide end in confirmation of a plan of reorganization" (citations omitted)); *see also* Steven H. Ancel & Bruce A. Markell, *Hope in the Heartland: Chapter 11 Dispositions in Indiana and Southern Illinois, 1990-1996*, 50 S.C. L. REV. 343, 348-49 (1999) (noting that out of 2,393 Chapter 11 petitions filed in Region 10 of the United States Trustee system [about 1% of all petitions, or half the national rate] during 1990 through 1996, only 913, or 38%, ended in confirmed plans; 62% converted to Chapter 7 or were dismissed, and a few were left still open); Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate? The Results of a Study and an Analysis of the Law*, 97 COM. L.J. 297, 318-19, 324-25, 327 (1992) (finding that only 17% of 260 Chapter 11 petitions filed in the Bankruptcy Court for the Southern District of New York in Poughkeepsie resulted in confirmed plans, a rate comparable to that found in a national

basis for the belief that reorganization actually saves jobs, might produce a strong impetus for curtailing reorganizations under Chapter 11. Limiting reorganizations under Chapter 11 could have a dramatic effect on some of the interest groups that benefit from reorganization.[111] It remains to be seen whether these elements would be sufficient to overcome the formidable strength of the bankruptcy professionals, whose growth is described so well by Professor Skeel's book.

## CONCLUSION

Professor Skeel has produced a masterful account of how the self interests of bankruptcy professionals has shaped bankruptcy law through their dominance of both the legislative and judicial arenas. Nevertheless, as *Debt's Dominion* describes, underlying the legislative and judicial development of bankruptcy law are the economic forces of a constantly changing economic system. The ever-evolving economy creates new interest groups or transforms existing interest groups who use the then existing law for their ends. The growth and financial distress of railroads created the equity receivership and the role of investment banks and the elite reorganization bar. The Chandler Act destroyed the particular role of those interest groups, but they have reappeared in corporate bankruptcy. The growth of the consumer economy fueled the growth of the consumer creditor industry, the growth of consumer bankruptcy, and the growth of consumer advocacy. Similarly, competitive pressures have induced borrowers, investment bankers, and their

---

study; only 6.5% resulted in consummated plans and rehabilitated debtors; and the average time to confirmation was more than 18 months); Grant W. Newton, *A Need to Determine Business Viability*, 4 AM. BANKR. INST. L. REV. 536, 536 (1996) (noting that most of the large number of Chapter 11 petitions filed by small, nonviable business are simply dilatory tactics, that the assets of the debtors are used by the debtor or its professionals, and that the creditors receive very little, if any, distribution).

Elizabeth Warren and Jay Westbrook suggest that the reported low rate of success for reorganization may be somewhat misleading. *See* Elizabeth Warren & Jay Westbrook, *Financial Characteristics of Business in Bankruptcy*, 73 AM. BANKR. L.J. 499, 523-24, 566 (1999) (reporting that a large number of Chapter 11 filings may in fact be liquidations, and hence the actual success rate for true reorganizations may be higher than the reported rates).

[111] I actually do not think that lawyers suffer much harm if their immediate clients have less business. Lawyers generally have a great capacity to adjust the nature of their practice as the economy changes. Much of the resistance of lawyers to change, I believe, derives from a sincere defense of their clients' interests and also from a natural desire not to have to change their practice.

lawyers to create a new economic and legal tool—securitization—that in turn feeds a new set of interest groups that will protect their interests. Hence, the market will create new economic and legal structures, like securitization, that will have a dramatic effect on the future of bankruptcy in which bankruptcy professionals will undoubtedly play a major role. The story of this future development of bankruptcy law will be another fascinating history to write. Professor Skeel's *Debt's Dominion* is an essential starting point for that future history.