Symposium on Bankruptcy

Stefan A. Riesenfeld

VANDERBILT LAW REVIEW

VOLUME 38 | MAY 1985 | NUMBER 4

Symposium on Bankruptcy

Foreword

*Stefan A. Riesenfeld**

The Bankruptcy Reform Act of 1978, a.k.a. The Code, has now been in operation for more than a quinquenniun. Thus, it is old enough to be the subject of a symposium, even if that expression is used in its original meaning of drinking party or festivity. The editors of the *Vanderbilt Law Review* deserve high praise for having observed that opportunity and gathered an illustrious panel of guest-participants. Special commendations are due for the hosts' success in enlisting in their offerings the cooperation of the celebrated Triple-K-Trio[1] to regale the readership with their now almost classical performing style. Equally gratifying is the fact that they have reserved spots for the Novae on the academic skies. Thus, the sprinkling of Posnerites are able to go through the almost inevitable Posner rites and others less distinct but of no lesser distinction are called to display their individual acts or idiosyncrasies.

I conceive my own role in this gala neither as that of an M.C. nor as that of a Beckmesser who is installed to grade the merits of

* Emanuel S. Heller Professor of Law Emeritus, University of California, Berkeley; Professor of Law, University of California, Hastings College of the Law. L.L.B. University of California, Berkeley; S.J.D. Harvard Law School.

1. Kennedy, King and Kountryman.

the Mastersingers, as in Wagner's opera. Rather I am content with the humble part of a stagehand preparing the artists' entrance.

The Code, as is well known, had its birth after a long gestation period, which commenced with the appointment in 1970 of a Commission on the Bankruptcy Laws of the United States[2] and terminated with the passage in 1978 of H.R. 8200.[3] In this case the mountainous labors defied the classical Aesopian fable[4] and brought forth more than a ridiculous little mouse.

The Code introduced a number of bold and far-reaching changes:

1. establishment of bankruptcy courts with comprehensive jurisdiction over all cases and civil proceedings arising in, or relating to, cases under the Code;[5]

2. upgrading and clarifying the judicial status of the judges of the bankruptcy courts;[6]

3. institution of an official trustee system as a pilot project;[7]

4. consolidation of Chapters X and XI and the provisions on railroad reorganizations into a single Chapter 11, entitled reorganization;[8]

5. broadening the scope of former Chapter XIII relating to wage-earner plans to cover debt adjustment proceedings available to individuals with regular income;[9]

6. insertion of a new subchapter on commodity broker liquidation;[10]

7. modification of the rules governing the formation and scope of the bankrupt estate, including community property;[11]

8. reform of the exemption system including an optional system of bankruptcy exemptions;[12]

9. revision of the voiding powers of the trustee in particular in relation to preferential transfers and recognition of broad voiding powers in the debtor to protect the unimpaired enjoyment of ex-

2. Pub. L. No. 91-354, 84 Stat. 468 (1970).
3. Pub. L. No. 95-598, 92 Stat. 2549 (codified at 11 U.S.C. § 101-151326 (1982).
4. As retold by Horace, *Epistles: Parturiunt montes nascetur ridiculus mus.*
5. 28 U.S.C. § 151 (1982); 28 U.S.C. §§ 1471-1482 (1982).
6. 28 U.S.C. §§ 151(b), (c) - 160 (1982).
7. 11 U.S.C. §§ 1501-151326 (1982).
8. 11 U.S.C. §§ 1101-1174 (1982).
9. 11 U.S.C. §§ 1301-1330 (1982).
10. 11 U.S.C. §§ 761-766 (1982).
11. 11 U.S.C. § 541 (1982).
12. 11 U.S.C. § 522 (1982).

empt property.[13]

10. abolition of the distinction between provability and allowability of claims and restructuring the proof and status of secured claims;[14]

11. codification in the statute of the rules governing the automatic stay;[15]

12. modernization of the provisions governing discharge and dischargeability and design of special rules on that subject applicable to community claims;[16]

13. abolition of the "acts of bankruptcy" and of insolvency as defined in the balance sheet test as prerequisite for involuntary proceedings;[17]

14. recognition of foreign insolvency proceedings and of foreign representatives appointed in such proceedings.[18]

The Code was not received with unanimous enthusiasm. It soon became apparent that the new legislation was marred by a number of defects in draftsmanship, ambiguities, and inconsistencies. Moreover, certain business interests found it difficult to operate under the Code. In addition, experience under the Code caused vociferous complaints by the credit industry claiming that the combination of the exemption and discharge provisions of the Code and the unlimited access to both Chapter 7 and Chapter 13 cases by individuals led to an abuse of the system. As a result, cries for remedial legislation multiplied.

The need for further Congressional action became undeniable in 1982 when the Supreme Court in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*[19] held that the broad jurisdiction granted in 28 U.S.C. § 1471, as amended by section 241(a) of the Bankruptcy Reform Act of 1978, violated article III of the Constitution and required curative action. Although the decision was made prospective so as to "afford Congress an opportunity to reconstitute the bankruptcy courts or to adopt other valid means of

13. 11 U.S.C. §§ 522(f)-(j), 544-551 (1982).

14. 11 U.S.C. §§ 501, 502, 506, 507 (1982).

15. 11 U.S.C. § 362 (1982).

16. 11 U.S.C. §§ 523, 524, 525, 725, 1141(d), 1328 (1982).

17. 11 U.S.C. § 303 (1982).

18. 11 U.S.C. §§ 303(b)(4), 304, 508(a) (1982). For recent discussions of these provisions, see Morales & Deutsch, *Bankruptcy Code Section 304 and U.S. Recognition of Foreign Bankruptcies: The Tyranny of Comity*, 39 Bus. Law. 1573 (1984); Note, *Section 304 of the Bankruptcy Code: Has it Fostered the Development of an "International Bankruptcy System"?*, 22 Colum. J. Transnat'l L. 541 (1984).

19. 458 U.S. 50 (1982).

adjudication," Congress was unable to act before the expiration of the deadline and interim rules were adopted by the courts.[20] Ultimately, however, a new jurisdictional system was worked out by Congress and put into operation by legislation of 1984, entitled the Bankruptcy Amendments and Federal Judgeship Act of 1984.[21]

While the 1984 Act's *raison d'être* was the need for a legislative solution of the allocation of bankruptcy jurisdiction between judges possessing article III status and nonarticle III judges — after the decision to deny that status to the bankruptcy judges had been made[22]—the Act contained other measures of varying degrees of urgency designed to remedy perceived shortcomings of the Code. Undoubtedly the other most pressing problem was created by the Supreme Court's holding in *NLRB v. Bildisco & Bildisco*[23] which, according to influential legislators, called for immediate curative action.

Since the Congressional leadership had resolved not to make any substantive amendments until the bankruptcy court system was settled, the agreement on that issue cleared the way for other amendments which were pending in Congress. As a result a Title III was included in the bill that distributed an array of substantive changes over subtitles numbered A to J (with the omission of I) to which a subtitle H containing so-called technical amendments was added. Subtitles E and K deal with fiscal matters and the entry into force.

The subtitles adopting substantive amendments deal with:

A. Consumer Credit Amendments;
B. Grain Storage Facility Bankruptcy;
C. Leasehold Management Amendment;
D. Discharge of Intoxicated Drivers;
E. Repo-Amendments;
G. Time Share Consumer Protection; and
J. Collective Bargaining Agreements.

Subtitle H contains a number of stylistic and other corrections

20. The text of the interim rule is reproduced as an appendix to White Motor Corp. v. Citibank, N.A., 704 F.2d 254, 265 (6th Cir. 1983), upholding the validity of the rule and discussing its genesis. For a detailed story of the background of the Emergency Rule and its acceptance by the courts, see Countryman, *Scrambling to Define Bankruptcy Jurisdiction: The Chief Justice, the Judicial Conference, and the Legislative Process*, 22 HARV. J. ON LEGIS. 1, 19 (1985).

21. Pub. L. No. 98-353, 98 Stat. 333.

22. For the legislative bistory of that determination, see Countryman, *supra* note 20, at 29-31.

23. 104 S. Ct. 1188 (1984).

which reproduce many of the items included in the Technical Amendments proposals of S. 863.[24]

Despite the efforts of the members of the staff, the 1984 Act bristles with defects in draftsmanship and inconsistencies[25] and is itself the subject of a further technical amendments bill.[26]

Undoubtedly the Consumer Credit Amendments are the most significant substantive changes made by the 1984 Act, consisting formally in amendments of sections 109, 342, 349, 521, 522, 523, 524, 547, 704, 707, 1301, 1322, 1325 and 1326 of the Code. The preeminent innovations consist in: (a) the denial of relief under Chapter 7 to individual debtors whose debts are primarily consumer debts, if the court finds that such relief would be a substantial abuse of Chapter 7[27] and (b) the requirement that upon objection of a creditor a court may not approve a Chapter 13 plan unless it applies all of the debtor's disposable earnings during the three-year period beginning with the first payment to the payments under the plan.[28] Other credit industry inspired changes are the curbs on the stacking of federal and state exemptions in jointly administered cases,[29] the reduction of the renter's exemption to $3750,[30] the aggregate limitation to $4000 on the exemption of household goods under the special federal exemption system,[31] the limitation on petitions within 180 days following dismissal of a prior case[32] and the nondischargeability of spending spree purchases.[33]

There can be no surprise that despite the attention to the draftsmanship of the Code, its many far-reaching and often revolutionary changes have created a host of difficult and complex problems for practitioners and courts. The published opinions of

---

24. 97th Cong., 1st Sess. (1981). The bill was passed by the Senate on July 17, 1981, but was not agreed upon by the House.

25. *See* Countryman, *supra* note 20, at 42.

26. S. 529, 99th Cong., 1st Sess. (1985).

27. Pub. L. No. 98-353, § 312(2) (1984) (to be codified as added at 11 U.S.C. § 1325(b)).

28. Pub. L. No. 98-353, § 317 (1984) (to be codified as added at 11 U.S.C. § 1325(b)).

29. Pub. L. No. 98-353, § 306(a) (1984) (to be codified as amended at 11 U.S.C. § 522(b)).

30. Pub. L. No. 98-353, § 306(c) (1984) (to be codified as amended at 11 U.S.C. § 522(d)(5)).

31. Pub. L. No. 98-353, § 306(b) (1984) (to be codified as amended at 11 U.S.C. § 522(d)(3)).

32. Pub. L. No. 98-353, § 301 (1984) (to be codified as amended at 11 U.S.C. § 109(f)).

33. Pub. L. No. 98-353, § 307(a)(3) (1984), (to be codified as amended at 11 U.S.C. § 523(a)(2)).

the bankruptcy judges and other courts reveal the countless difficulties in interpretation and application.

The contributors to this Symposium have addressed a goodly number of the problems but it cannot be denied that the total coverage of the discussions leaves the greater part of the minefield uncleared and unmarked.

Of course, any reader would immediately look for an exegesis of the new jurisdictional provisions of the Bankruptcy Amendments and Federal Judgeship Act especially the amendments of 28 U.S.C. §§ 1334, 1411, and 157. Luckily there will be no disappointment because Dean King's article treats that subject with his usual expertise and clarity.

When it comes to the substantive aspects of bankruptcy the Symposium becomes much more selective and stratified. In part the difference in scope of treatment may be due to the organization of the Code itself, whose Chapters 1, 3, and 5 apply to the most important types of cases, that is, cases under Chapters 7, 11, and 13.[34]

It is regrettable that section 362 in conjunction with sections 105 and 108, and sections 522 and 541 which deal with the formation, composition, and protection of the estate did not find comprehensive and in-depth treatment. But the Symposium focuses on a broad range of issues.

Professor Countryman's massive disquisition on the law of preferences simply deserves Kenneth Klee's classical title "All You Ever Wanted to Know About"[35] that subject. He painstakingly traces the vagaries of that concept from the English origins through the prior United States bankruptcy legislation to the reforms of the Code. The reader will find a detailed treatment of the elements of preferential transfer as specified in section 547(b)(1)-(7). Since the absence or presence of three of the elements depends on certain "dating" rules, a considerable portion of the discussion deals with the application of the appropriate criteria,[36] including those for dating transfers via checks.[37] Professor Countryman deserves the gratitude of the other surviving members

34. 11 U.S.C. § 103(a) (1982).

35. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133 (1979).

36. *See* Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 759 (1985).

37. *Id.* at 760; *see also In re* Sider Ventures & Services Corp., 47 Bankr. 406 (S.D.N.Y. 1985).

of the Gilmore Committee[38] for giving the long overdue credit to its labors to find a workable and balanced[39] solution of the problems created by contemporary case law. Perhaps one of the most important but least heralded changes in the law of preferences is the new definition of the preferential effect test.[40] Professor Countryman justly devotes a considerable amount of attention to the new order. Strangely, though, he nowhere indicates, let alone discusses, the fact that the new formulation also had the purpose and effect of implementing the recommendation of the Bankruptcy Laws Commission that exempt property should be a possible object of a preferential transfer,[41] although — except under particular circumstances, if ever — it would not be that of a fraudulent transfer.[42] As a result, a voluntary preferential transfer of exempt property by the debtor might be recovered by the estate,[43] free from any subsequent exemption claims by the debtor.[44] It is perhaps also regrettable that Professor Countryman does not give his views on the thorny problem of the draw-down of a letter of credit.[45]

---

38. Countryman, *supra* note 36, at 767. Members of tbe Gilmore Committee were Messrs. Anderson, Coogan, Forman, Marsh, Triester, and Whitehurst and Professors Countryman, Gilmore, Kennedy, and Riesenfeld.

39. A particularly sensitive and debated issue was the improvement-of-position test. One author noted certain changes in the Gilmore Committee's proposed drafts. Kronman, *The Treatment of Security Interests in After-Acquired Property Under the Proposed Bankruptcy Act*, 124 U. PA. L. REV. 110, 150 (1975). While the author consulted Professor Gilmore for the reasons, he never consulted the other members of the Committee. *Id.* at 150 n.142. Professor Kripke's letter was never endorsed hy the Committee, because some members considered his interpretation of the suggested "at the expense" limitation as too unfavorable to the other creditors. The Compromise was the replacement of "at the expense" with "to the prejudice" in § 547(c)(5). *See* S. RIESENFELD, CREDITORS' REMEDIES AND DEBTORS' PROTECTION 658 (3d ed. 1979).

40. 11 U.S.C. § 547(b)5(A)-(C) (1982)

41. *Report of the Commission on the Bankruptcy Laws of the United States, Part* II at 170, H. R. Doc. No. 137, 93 Cong., 1st Sess. (1973).

42. *Cf. In re* Reed, 700 F.2d 986 (5th Cir. 1983).

43. *Accord* 4 COLLIER ON BANKRUPTCY, § 547.24 (L. King 15th ed. 1985). Although under the Code exempt property becomes part of the estate, the subsequent exemptability renders it rather dubious that a transfer of exempt property results in a diminution of the estate. In my opinion the continued vitality of that requirement is much over-played by the commentators.

44. Section 522(g)-(h). Recovery of an involuntary preferential transfer of exempt property by the estate entitles the debtor to her or his exemption. Deel Rent-A-Car v. Levine, 721 F.2d 750 (11th Cir. 1983).

45. *In re* W. L. Mead, Inc., 42 Bankr. 57 (Bankr. N.D. Ohio 1984); *In re* Formed Tubes, Inc., 41 Bankr. 819 (Bankr. E.D. Mich. 1984); *In re* Price Chopper Supermarkets, Inc., 40 Bankr. 816 (Bankr. S.D. Calif. 1984).

The amendment of the definition of transfer in 1984[46] by the addition of the words "and foreclosure of the debtor's equity of redemption" seem to render it undeniable that an execution creditor, mortgagee, or beneficiary under a trust deed who buys the property at the forced sale under its lien for less than the fair value of the property minus the remaining lien receives an involuntary preference to the extent that the fair value of the equity sold exceeds the amount of the lien under which the sale is made.[47] As a result, such sale is voidable by the trustee or the debtor, regardless of the absence or expiration of a statutory right to redeem.

The additional amendment of 1984 which inserted words "voluntarily or involuntarily" in section 548(a)'s first sentence[48] seems to have given additional strength to the prevailing case law, following the *Durrett* doctrine.[49] Professors Baird and Jackson, in their contribution, make a strong plea against the propriety of the extension of the fraudulent conveyance idea to such transfers. Their arguments, however, now would seem to apply more *de lege prenda* than *de lege lata.* Certainly, outside bankruptcy there exists little reason to introduce "de facto redemption rights"[50] via amendments to the Uniform Fraudulent Conveyance Act. Actually a number of states, among them California and New York, have recently curtailed or abolished statutory redemption rights because of their chilling effects on bidding, a factor justly stressed by the authors. The proposed amendments of the Uniform Fraudulent Conveyance Act unduly ignore this trend. Moreover, outside bankruptcy, avoidance of a fraudulent transfer usually replaces the avoided transfer with a preference for the diligent creditor. True, in a bankruptcy situation the latter concern is eliminated, yet

46. Pub. L. No. 98-353, § 421(i) (1984) (to be codified as amended at 11 U.S.C. § 101(44)).

47. The statement to the contrary in *In re* Madrid, 725 F.2d 1197, 1201 n.2 (9th Cir. 1984) is simply no longer correct.

48. Pub. L. No. 98-353, § 463 (1984) (to be codified as amended at 11 U.S.C. § 548(a)).

49. Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980) held that a debtor-in-possession under Ch. XI of the Bankruptcy Act of 1898 could avoid, as fraudulent under § 67d(1), a prepetition nonjudicial foreclosure sale under a deed of trust, when the purchaser bid the amount owing under trust deed and thereby acquired property for approximately 57.7% of its fair market value. The holding of the case was followed under the Bankruptcy Code in cases involving judicial foreclosures and execution sales. *In re* Hulm, 738 F.2d 323 (8th Cir. 1984) (judicial foreclosure and expiration of redemption period); *In re* Frank, 39 Bankr. 166 (Bankr. E.D.N.Y. 1984) (execution sale to third party); *In re* Richard, 26 Bankr. 560 (Bankr. D.R.I. 1983) (execution sale); *In re* Smith, 21 Bankr. 345 (Bankr. M.D. Fla. 1982) (execution sale).

50. *In re* Madrid, 725 F.2d 1197, 1202 (9th Cir. 1984).

there still remains the policy question why creditors, via the trustee, should be able to undo a result which they could have prevented. In distinction to the avoidance under the preference section, the applicability of section 548 would reach sales outside the preference period and transfers to purchasers other than creditors.

The other contributors to the Symposium deal with more limited issues. Professor Kennedy, the spiritual father of the new provisions relating to partnerships, presents a detailed and thorough analysis of the application of the Code's provisions relating to discharge and dischargeability to partnerships and partners. While the subject is intricate it is relatively free from undue complications or major controversies. Professor Kennedy's careful discussion of the available case law adds to the value of his exposition.

Professor Epstein and Mr. Fuller compare the application of identical or identically worded provisions of the Code to parallel problems in Chapter 11 and Chapter 13 cases and investigate whether, nevertheless, the different characteristics of these chapters call for resort to different criteria. Their focus is placed on three problems of that type: the requisite "value as of the effective date of the plan" for deferred cash payments under sections 1129 and 1325 of the Code, the grounds for relief from the automatic stay in Chapters 11 and 13, and the permissibility of a classification of unsecured claims in Chapter 11 and Chapter 13 plans. While the authors do not explicitly say so, they seem to disagree — and in my opinion justly so — with Judge Norton's view[51] that section 1122(b) and other provisions of Chapter 11 bar the placement of trade creditors in a separate class.

Professor Eisenberg's piece analyzes one particular provision of the Bankruptcy Code, section 1111(b). This subsection permits undersecured creditors the election to be treated "as if" they were recourse creditors. As other "as if" rules,[52] this one also has prompted many and usually adverse comments. Professor Eisenberg adds to that list, but does so in a far-reaching and deep-searching manner, exploring the legitimate role of security interests in reorganizations. For Professor Eisenberg section 1111(b) "does not coexist comfortably with the general goals of the reorganization process or the general thrust of bankruptcy law." He

51. 3 NORTON BANKRUPTCY LAW AND PRACTICE § 60.05. *But see* Blair, *Classification of Unsecured Claims in Chapter 11 Reorganization,* 58 AM. BANKR. L.J. 197, 197, 226 (1984).

52. For the broad intellectual ramifications of "as if" propositions, see H. VAIHINGER, THE PHILOSOPHY OF 'AS IF': A SYSTEM OF THE THEORETICAL, PRACTICAL AND RELIGIOUS FICTIONS OF MANKIND (Ogden trans. 2d ed. 1935).

conceives it as special interest legislation in response to an ill-resolved timing and valuation problem, of the type so frequent in the administration of the Code.

The remaining contribution by Professor Carlson consists in an analysis of contractual debt and lien subordination. The author stresses the different nature of these two types of subordination agreements and identifies debt subordination as the contractual creation of a proprietary right of the promisee in the promissor's bankruptcy dividends, resulting in the usual good faith requirements imposed upon an anticipatory conveyor. Actually, the subordinated party also obtains dividend rights from the party receiving priority. The parties pool their rights to dividends, according first resort to the party having precedence and the balance to the subordinated party.

Although at first blush the topics treated by the contributors cover only the tip of the iceberg, the comprehensiveness and depth of their discussions sheds light on a myriad of perplexing aspects of the Code that are in need of exploration for a full-scale appraisal of the reforms of 1978.