

BANKRUPTCY PHOBIA

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I. INTRODUCTION

My title might seem to herald an extended discussion about the reluctance of Americans who are deeply in debt to file for bankruptcy. The question of whether the stigma of bankruptcy curbs the number of bankruptcy filings has indeed been the subject of a long, hotly contested debate. On the one hand, interviews with debtors suggest that most file for bankruptcy only reluctantly and as a last resort.¹ A surprising number of Americans believe that the 2005 amendments to the bankruptcy laws abolished bankruptcy, and thus that they could not file for bankruptcy even if they wanted to.² On the other hand, enormous numbers of Americans have made use of bankruptcy, both in the past generation and in the past year. After averaging over 1,000,000 a year starting in the mid-1990s, bankruptcy filings dropped precipitously after the 2005 amendments, to 618,000 in 2006.³ But they have been climbing ever since, to 851,000 in 2007, and back to over 1,000,000 once again last year.⁴

I do think there are links between the stigma debate and the bankruptcy phobia I have in mind. As with stigma, perceptions of bankruptcy and their effect on the use or avoidance of bankruptcy will figure prominently in the discussion that follows. But the focus of this Essay will be a little different. Rather than asking whether ordinary Americans have an aversion to filing for bankruptcy, the discussion that follows will consider the puzzling—and, I will argue, costly—aversion of *regulators and lawmakers* to bankruptcy: the bankruptcy phobia as it played out in Washington and as regulators descended on troubled investment banks in New York and struggling automakers in Detroit.

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1. See, e.g., TERESA A. SULLIVAN ET AL., *THE FRAGILE MIDDLE CLASS: AMERICANS IN DEBT* 32–33 (2000) (surveying debtors and finding nearly fifty who reported that bankruptcy filing was last resort only after alternatives failed).

2. See Cathy Moran, *Bankruptcy Survives*, On the Bankruptcy Soapbox, <http://www.moranlaw.net/blog/bankruptcy-survives> (last visited Nov. 7, 2009) (noting that "some large portion of the public" thinks that bankruptcy relief is no longer available). See *infra* notes 47–50 and accompanying text for a discussion of the 2005 amendments to the bankruptcy laws.

3. Am. Bankr. Inst., *Annual Business and Non-business Filings by Year (1980–2008)*, <http://www.abiworld.org/AM/AMTemplate.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=56822> (last visited Nov. 7, 2009).

4. The exact numbers are 617,660 in 2006, 850,912 in 2007, and 1,117,771 in 2008. *Id.* Bankruptcy filings exceeded 1,000,000 for the first time in 1996, continued climbing, and then leveled off at roughly 1,500,000 a year before the 2005 amendments. *Id.*

As the recent economic crisis has unfolded, bankruptcy has offered possible solutions at several key junctures. The first of these solutions was geared toward homeowners who faced the loss of their homes in the months—now several years—since the start of the subprime crisis.⁵ As several million consumers have defaulted or faced default on their mortgages over the last year or so, lawmakers have debated a reform that would allow homeowners to restructure their mortgages in bankruptcy. Under current law, a bankruptcy debtor cannot reduce the principal balance of a mortgage on her primary residence.⁶ If she owes \$1000 on her mortgage, for instance, but the value of the house has dropped to \$700, she must pay the full \$1000 in order to keep her house. First offered in similar versions by Senator Durbin and Representative Conyers, and variously referred to as “cramdown,” “stripdown,” or “mortgage modification,” the proposed reform would allow the homeowner to restructure the mortgage, reducing it to \$700, thus giving it the same treatment as most other assets in bankruptcy.⁷ At least in theory, this might both help many homeowners keep their homes and contribute to price discovery in the real estate markets.⁸ While lawmakers and the Obama administration have adopted a variety of other proposals that are designed to help homeowners, Congress has repeatedly stymied the mortgage modification solution.⁹

On the corporate side, Chapter 11 was an obvious alternative when large nonbank financial institutions like Bear Stearns and AIG stumbled in 2008, and with General Motors and Chrysler as well. But regulators consistently shied away from bankruptcy. The first exception, Lehman Brothers, was an anomaly. By bailing out Bear Stearns in

5. The subprime crisis does not have an agreed-upon starting date, but one candidate is the failure of two Bear Stearns hedge funds in the summer of 2007. *See, e.g.*, David A. Skeel, Jr., *Governance in the Ruins*, 122 HARV. L. REV. 696, 734 (2008) (book review) (suggesting that failure of two hedge funds will be identified as beginning of recent subprime crisis).

6. 11 U.S.C. § 1322(b)(2) currently precludes debtors who propose a payment plan under Chapter 13 from altering the terms of a mortgage on their principal residence. 11 U.S.C. § 1322(b)(2) (2006).

7. *See* Helping Families Save Their Homes in Bankruptcy Act of 2009, H.R. 200, 111th Cong. (2009) (delineating bill sponsored by Representative Conyers that Congress is currently considering); Press Release, Sen. Dick Durbin, Durbin Introduces Bill to Stem Record Foreclosures (Jan. 6, 2009), <http://durbin.senate.gov/showRelease.cfm?releaseId=306368> (providing brief overview of Durbin’s efforts).

8. By “price discovery,” I mean determination of the value of mortgaged properties and of the complex financial instruments based upon them. Many commentators believe that uncertainty about the value of mortgage-backed securities was one of the major contributing factors in the credit crunch. *See, e.g.*, Michael Steinberg, *Mortgage “Cram Downs” Quickest Route to CDO, MBS Price Discovery*, SEEKING ALPHA, Feb. 1, 2009, <http://seekingalpha.com/article/117805-mortgage-cram-downs-quickest-route-to-cdo-mbs-price-discovery> (emphasizing need for price discovery in order to unplug movement of toxic assets).

9. The Bush and Obama administration mortgage relief efforts as of March 2009 are summarized in CONG. OVERSIGHT PANEL, 111TH CONG., FORECLOSURE CRISIS: WORKING TOWARD A SOLUTION 30–37 (2009), available at <http://cop.senate.gov/documents/cop-030609-report.pdf>. The early results of the programs were disappointing. *See* Ruth Simon, *Mortgage Servicers Are Under Pressure to Modify More Loans*, WALL ST. J., July 29, 2009, at A6 (stating that administration officials are “[f]rustrated with the slow progress”). As of this writing, more loans are being modified, but the efficacy of the modifications is still in doubt. *See, e.g.*, CONG. OVERSIGHT PANEL, 111TH CONG., OCTOBER OVERSIGHT REPORT: AN ASSESSMENT OF FORECLOSURE MITIGATION EFFORTS AFTER SIX MONTHS 3-5 (2009), available at <http://cop.senate.gov/documents/cop-100909-report.pdf> (discussing Panel’s concerns with current modification programs and offering suggestions for improvement).

early 2008, the government had strongly signaled its intent to rescue large, troubled financial institutions. Against this backdrop, the decision by then Treasury Secretary Henry Paulson and others to withhold financing from Lehman took Lehman, its buyer, and the markets by surprise.¹⁰ Similarly, the Treasury put the car companies in bankruptcy only after they received roughly \$13.4 billion in bailout money and other options had proven fruitless.¹¹ “[A] GM or Chrysler bankruptcy ‘would be the start of a cascade of failures,’” a typical article concluded during the months when the car companies refused to even consider the possibility of a bankruptcy filing.¹²

Bankruptcy has been resisted for often inconsistent reasons. The principal opponents of the mortgage modification proposal are conservatives, who decry it as an unconscionable interference with markets and the sanctity of contract. “We look at this bill as a bailout. But worse than that, it is interfering with contracts,” a spokesman for the Bush administration stated when the mortgage modification proposal was announced.¹³ Critics of using bankruptcy to resolve the financial distress of nonbank financial institutions and the carmakers, on the other hand, often have included liberals who complain that bankruptcy means leaving *too* much to the markets, and that it is a dangerously market-oriented response.¹⁴

This shared aversion to bankruptcy, which seems to pervade all sides of the political spectrum, is the bankruptcy phobia that I would like to explore in this Essay. I will begin by speculating in more detail about the reasons for resisting bankruptcy-based solutions. Although this initial analysis will be descriptive, my own view that the aversion to bankruptcy was quite costly, and that it steered regulators and lawmakers away from promising responses to the economic crisis, will seep through. The second and third parts of the Essay will then put the recent crisis in historical perspective. While the absence of bankruptcy solutions and new bankruptcy reforms at the outset of the crisis was puzzling, the historical analysis suggests that it is consistent with the pattern of previous crises. Using the late nineteenth century and the Great Depression as my principal examples, I will argue that significant bankruptcy reform, in striking contrast to major corporate reform, has often come well after a financial crisis was underway, and that the proliferation of dramatically different proposed bankruptcy and nonbankruptcy solutions that we see today is also consistent with historical patterns. I will conclude by speculating about some of the implications for bankruptcy reform.

10. This argument is made in detail in Kenneth Ayotte & David A. Skeel, Jr., *Bankruptcy or Bailouts?*, 35 J. CORP. L. (forthcoming 2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1362639.

11. See, e.g., Chris Isidore, *Bush Announces Auto Rescue*, CNNMONEY.COM, Dec. 19, 2008, http://money.cnn.com/2008/12/19/news/companies/auto_crisis/index.htm (outlining details and purpose of auto rescue plan).

12. Michael McKee, *GM, Chrysler Failure Would Push Economy into Abyss*, BLOOMBERG.COM, Dec. 15, 2008, <http://www.bloomberg.com/apps/news?pid=20601087&sid=aW2D17IBa2Kk&refer=home> (quoting Dennis Virag, president of Automotive Consulting Group in Ann Arbor, Michigan).

13. David Cho & Lyndsey Layton, *Housing Woes Put Bush, Hill at Odds: White House Opposes Use of Tax Dollars*, WASH. POST, Feb. 27, 2008, at A1 (internal quotation marks omitted).

14. See generally Paul Krugman, Op-Ed., *The B Word*, N.Y. TIMES, Mar. 17, 2008, at A19 (defending Bear Stearns bailout, despite Bear’s unsavory reputation, as necessary to prevent potentially catastrophic market effects). The Obama administration’s proposed resolution authority for systemically important institutions is based on a similar distrust of bankruptcy. See *infra* notes 92–96 and accompanying text for a discussion of the administration’s reform plan.

Although the government's use of bankruptcy for Chrysler and GM could mitigate the bankruptcy phobia, its circumvention of ordinary bankruptcy processes makes this unlikely. The prospects for legislative reform—particularly the undoing of several costly 2005 changes—are more promising.

II. WHY THE AVERSION TO BANKRUPTCY?

Start with the question that lies at the heart of this Essay: why were regulators and lawmakers so reluctant to use bankruptcy during the current crisis? One can point to at least four contributing factors.

First, we cannot rule out the possibility—call it the public-spirited explanation—that bankruptcy is flawed or simply a bad idea as a response to the mortgage crisis, or for resolving financial institutions' distress. This first explanation is sufficiently plausible that we will want to consider it in some detail. Critics of the mortgage modification proposal argue that the proposal would exacerbate the credit crunch. In response to the reduction in homeowners' payment obligations, the reasoning goes, and the prospect that future mortgages could also be modified in bankruptcy, lenders would tighten their already tight lending standards. Would-be home buyers would face higher interest rates or would simply be denied access to credit. The cost of mortgage modification would be "borne by aspiring future homeowners," according to one commentator, and "[t]he ripple effects could further roil America's consumer credit markets."¹⁵ Given the large number of homeowners whose mortgages are under water, critics also speculate that the bankruptcy system would be overwhelmed by a flood of new bankruptcy filings if Congress enacted the proposal.¹⁶

Proponents of mortgage modification responded to the concerns about deleterious effects on access to credit by limiting the scope of the proposal.¹⁷ The revised proposal would apply only to existing mortgages and would require homeowners to negotiate for a voluntary restructuring before using bankruptcy to modify a mortgage.¹⁸ The proposal would help write off the current crisis, but the rules would then revert to normal, with mortgages once again being treated as sacrosanct in bankruptcy. Although this adjustment assuaged a few critics, most predicted dire consequences even under

15. Todd J. Zywicki, *Don't Let Judges Tear Up Mortgage Contracts*, WALL ST. J., Feb. 13, 2009, at A13.

16. See, e.g., Alan Schwartz, Op-Ed., *Don't Let Judges Fix Loans*, N.Y. TIMES, Feb. 27, 2009, at A27 (detailing problems that could arise in bankruptcy courts if Congress passed mortgage modification proposal); Zywicki, *supra* note 15 (predicting likely increase in bankruptcy filings as result of mortgage modification proposal).

17. See, e.g., *U.S. Senate Rejects Mortgage Modification in Chapter 13 Cases*, AM. BANKR. INST. J., June 2009, at 10, 10 [hereinafter *U.S. Senate Rejects*] (excerpting statements of Senators Durbin and Kyl, including Durbin's emphasis that modification, while broad enough to help debtors, also contains limitations that protect mortgage servicers).

18. See, e.g., *id.* (emphasizing plan for amendment to assist troubled homeowners whose last resort is bankruptcy); Robert M. Zinman & Novica Petrovski, *The Home Mortgage and Chapter 13: An Essay on Unintended Consequences*, 17 AM. BANKR. INST. L. REV. 133, 142–43 (2009) (noting that House bill introduced by Congressman Conyers includes each of these restrictions); John Conyers Jr., *Loan Modification Can Stop the Foreclosure Crisis*, WALL ST. J., Jan. 30, 2009, at A11 (explaining narrow application of proposal only to existing mortgages).

the revised proposal.¹⁹

As to financial institutions and auto companies—the objects of corporate bankruptcy phobia—critics have argued that a bankruptcy filing would have catastrophic spillover effects. Regulators justified each of the major financial institution bailouts at the time, as did commentators after the fact, as necessary to prevent a market meltdown. If Bear Stearns had not been bailed out, the reasoning went, repo lending—a major form of very short-term lending for investment banks—or the credit default swap market might have been paralyzed.²⁰ Because AIG had sold large amounts of credit protection, its failure would have crippled the market for credit default swaps, and its inability to make good on its contractual promises would have precipitated a wave of bankruptcies among its counterparties—that is, the institutions with which AIG entered into derivatives contracts.²¹ The one exception to the string of financial institution bailouts was Lehman, whose bankruptcy sent shock waves through the commercial paper market and caused a money market fund to “break the buck” for the first time ever.²² Lehman’s bankruptcy is regularly—and in my view mistakenly—described as having triggered the worst effects of the recent crisis.²³

Far more than financial institutions, troubled car companies would seem to be ideal candidates for Chapter 11. Like the nineteenth-century railroads whose turmoil was the crucible in which American reorganization was created, car companies have large amounts of fixed assets and complicated capital structures.²⁴ Yet here too, regulators and commentators treated bankruptcy as radioactive while GM’s and Chrysler’s troubles mounted. Critics worried that no one would buy a company’s cars if it filed for bankruptcy, in part due to a fear that the company would disappear and fail to honor its warranty obligations. They also predicted that a bankruptcy filing could have devastating spillover effects, prompting bankruptcies of the company’s major suppliers. Former GM CEO Rick Wagoner pointed to each of these concerns, especially the claim that the “stigma” of bankruptcy would discourage customers from buying GM cars, as reasons for refusing to consider bankruptcy as an option.²⁵

The objections to bankruptcy for GM and Chrysler were never plausible. The track record of other industries, from the railroads of the nineteenth century to the airlines more recently, suggests that customers will not abandon a viable business

19. See, e.g., *U.S. Senate Rejects*, *supra* note 17, at 69 (presenting Senator Kyl’s statement that cramdown will prolong malaise of housing market by increasing interest rates).

20. See Gretchen Morgenson, *Fair Game: A Window in a Smoky Market*, N.Y. TIMES, July 6, 2008, at BU1 (suggesting that concerns about credit default swaps were key factor in bailout).

21. See William K. Sjostrom, Jr., *The AIG Bailout*, 66 WASH. & LEE L. REV. 943, 977–83 (2009).

22. A mutual fund “breaks the buck” when a customer who withdraws her money will receive less than a dollar for each dollar she invested. See, e.g., Ayotte & Skeel, *supra* note 10 (manuscript at 24–25) (detailing Lehman bankruptcy and subsequent effects).

23. See *id.* (manuscript at 21–25) (arguing that information that major bank was tottering, not bankruptcy filing, best explains market reaction).

24. The complex capital structures of the nineteenth-century railroads, and their role in the advent of corporate reorganization, are discussed in DAVID A. SKEEL, JR., *DEBT’S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 60–63 (2001).

25. See Justin Fox, *Don’t Call It Bankruptcy*, TIME, Dec. 1, 2008, at 32, 32 (describing Wagoner’s objections to bankruptcy).

simply because Chapter 11 is attached to its name.²⁶ But the public-spirited critique of bankruptcy responses to the mortgage crisis and the distress of nonbank financial institutions were more realistic. For instance, a group of coauthors from Columbia's law and business schools proposed an interesting alternative to the mortgage modification proposal, which would remove the impediments to restructuring mortgages that have been securitized and would give servicers a financial incentive to restructure mortgages where this would enable homeowners to continue making payments.²⁷ While the existing empirical evidence is mixed, it does not rule out the possibility that mortgage modification would make mortgages more costly.²⁸ The concerns about the effect of allowing a large financial institution to file for bankruptcy also are plausible; it is at least possible that a bankruptcy filing by a large financial institution would unleash systemic risk, with destructive market-wide consequences, as regulators feared when they intervened to rescue Bear Stearns and AIG.²⁹

But each of these public-spirited arguments also is subject to significant question. Even if mortgage modification did increase the cost of mortgages, the cost might well be small and worth bearing.³⁰ Mortgage modification could help establish credible values for the mortgages—and more importantly, for the mortgage-related financial assets associated with them—thus addressing the valuation uncertainty that has significantly complicated efforts to move beyond the credit crisis.³¹ Although the reform would spur a surge of new bankruptcy filings, there is little reason to believe that this would overwhelm the bankruptcy courts. Bankruptcy judges have stepped up to handle surges of new cases in the past—most recently, when a wave of debtors filed for bankruptcy before the most recent bankruptcy amendments went into effect in October 2005—and it seems likely they would do so again.³² While it is difficult to

26. See, e.g., Michael E. Levine, *Why Bankruptcy Is the Best Option for GM*, WALL ST. J., Nov. 17, 2008, at A19 (noting that “consumers buy tickets from bankrupt airlines” and rejecting argument that carmakers are different in this regard).

27. See Christopher Mayer, Edward Morrison & Tomasz Piskorski, *A New Proposal for Loan Modifications*, 26 YALE J. ON REG. 417, 419–20 (2009) (proposing three-part plan of servicer incentives, second-lien lender incentives, and litigation protection). The Obama administration adopted somewhat analogous strategies in the Homeowner Affordability and Stability Plan. Announced on February 18, 2009, the plan provides financial incentives for mortgage servicers to modify troubled mortgages. CONG. OVERSIGHT PANEL, *supra* note 9, at 3–4 (providing overview of plan).

28. Compare Adam J. Levitin & Joshua Goodman, *The Effect of Bankruptcy Strip-Down on Mortgage Markets* 41 (Geo. L. & Econ. Research Paper No. 1087816, 2008), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1087816 (concluding that mortgage modification would have only modest effects on lending), and Adam J. Levitin, *Resolving the Foreclosure Crisis: Modification of Mortgages in Bankruptcy*, 2009 WIS. L. REV. 565, 647 (same), with Mayer et al., *supra* note 27, at 427 (surveying existing studies, including study by Levitin and Goodman, and concluding that effect is substantial).

29. See *supra* notes 20–21 and accompanying text for a discussion of the fears that prompted the Bear Stearns and AIG bailouts.

30. See, e.g., Levitin & Goodman, *supra* note 28, at 41 (concluding that markets are generally indifferent to mortgage modification risk).

31. See *supra* note 8 and accompanying text for a discussion of the uncertainty surrounding price discovery.

32. Bankruptcy filings exceeded two million in 2005, due to debtors' rush to file before the 2005 changes went into effect. In 2006, the first full year under the amendments, there were only 617,660

prove or disprove the systemic risk concerns that are used to justify the preference for bailouts rather than bankruptcies with financial institutions, these concerns seem overstated. Even in the case of AIG, which had a huge, imbalanced derivatives portfolio, counterparties may well have been able to adjust if the insurance conglomerate had filed for bankruptcy.³³ Moreover, if regulators are convinced that default could have dangerous ripple effects in the market, nothing prevents them from stepping in and providing financing or guarantees for a company that has filed for bankruptcy. Regulators can make loans to a debtor in bankruptcy, or promise to backstop counterparties that could be hobbled by the debtor's default. This, of course, is precisely what the Obama administration did when Chrysler and GM finally filed for bankruptcy.³⁴

The public-spirited explanations are thus credible but quite debatable. They do not fully explain the aversion to bankruptcy as the crisis developed. Several other factors also seem to have played a role.

Shifting from platonic to more political realms, the most obvious impediment to bankruptcy-based solutions was lobbying by banks and other financial institutions. Given that banks had become dependent on government handouts for survival, one would expect their political influence to have been at low ebb. In some respects it was. The government successfully pressured Bank of America to follow through on its acquisition of Merrill Lynch even after major losses at Merrill gave Bank of America second thoughts about the transaction.³⁵ Bank lenders that had received federal bailout money quickly succumbed to administration pressure prior to the Chrysler bankruptcy, for instance, and agreed to accept significant losses, even though the banks' priority status seemed to entitle them to a greater recovery.³⁶

But lenders clearly remained a potent lobbying force. Until Citigroup broke ranks in the wake of a promise of additional bailout money from the government, the banking industry had presented a united front opposing the mortgage modification reform.³⁷

bankruptcy filings. See Am. Bankr. Inst., *supra* note 3 (compiling data for annual business and non-business bankruptcy filings by year from 1980 to 2008).

33. See, e.g., Peter J. Wallison, On Regulating and Resolving Institutions Considered "Too Big to Fail," Testimony Before the Senate Banking Committee (May 6, 2009) (transcript), available at <http://www.aei.org/speech/100044> (criticizing claim that AIG bankruptcy would have crippled derivatives markets).

34. See Jeff Plungis, *Chrysler Bankruptcy Won't Interrupt Warranties, Treasury Says*, BLOOMBERG.COM, May 2, 2009, <http://www.bloomberg.com/apps/news?pid=20601103&sid=ai1YZ10u7BcE> (explaining application of government warranty program to GM and Chrysler).

35. See Liz Rappaport, *Lewis Testifies U.S. Urged Silence on Deal: Bank of America Chief Says Bernanke, Paulson Barred Disclosure of Merrill Woes Because of Fears for Financial System*, WALL ST. J., Apr. 23, 2009, at A1 (describing pressure to complete deal because "otherwise it would 'impose a big risk to the financial system'").

36. See Neil King Jr. & Jeffrey McCracken, *Chrysler Pushed Into Fiat's Arms*, WALL ST. J., May 1, 2009, at A1 ("The most compliant of Chrysler's big creditors . . . have received hundreds of billions of dollars in TARP aid.").

37. See Theo Francis, *Does Citigroup Stand Alone? Industry Balks at Bankruptcy Bill*, BUSINESSWEEK.COM, Jan. 8, 2009, http://www.businessweek.com/election/2008/blog/archives/2009/01/does_citigroup.html?chan=top+news_top+news+index+-+temp_news+%2B+analysis (detailing industry's opposition to mortgage modification legislation).

Arguing that the reform would cripple future lending, financial institutions persuaded Congress to dilute the proposal and played a central role in defeating even the more limited proposal.³⁸

To resolve their own financial distress, banks and nonbank financial institutions pushed for bailouts, the principal alternative to resolving their failures in Chapter 11. AIG's principal accomplishment as it neared collapse in the fall of 2008, for instance, was producing a memo documenting for regulators the chaos that allegedly would ensue if the government allowed AIG to file for bankruptcy.³⁹ When the government proposed to give banking regulators the authority to take control of systemically important bank financial institutions—a reform that would essentially expand the government's bailout policy—financial institutions signaled their approval.⁴⁰

Intertwined with the political influence of financial institutions as institutions is a third factor: their executives and the executives of other companies affected by the economic crisis. One would expect executives to have had less clout than anyone during the economic crisis. They, after all, are widely viewed as the chief villains in the crisis, a status cemented by a bonus scandal at AIG.⁴¹ While their influence in the halls of Congress seems to have waned temporarily, the executives of each of the faltering firms were able to persuade regulators and the public that bankruptcy should not be taken seriously as a response to financial distress. Former General Motors CEO Rick Wagoner repeatedly insisted that bankruptcy was unthinkable—it would be “a highly risky and highly costly process,” he claimed—as the company burned through \$2 billion in cash per month in the final quarter of 2008, and lost \$20 billion for the year.⁴² As already noted, AIG's executives produced a worst-case-scenario memo that struck a responsive chord with regulators.⁴³

Executives' influence in these cases was essentially negative, but it nevertheless shaped the regulatory response. By refusing to take any steps to prepare for a bankruptcy, the managers of Bear Stearns, Lehman, AIG, and General Motors maximized the disruption that would occur if bankruptcy became necessary and used this as leverage in their negotiations for a bailout.⁴⁴

38. See *U.S. Senate Rejects*, *supra* note 17, at 10 (“The mortgage industry has twice succeeded in helping to kill the bankruptcy proposal . . .”).

39. See Andrew Ross Sorkin, *The Case for Saving A.I.G.*, by *A.I.G.*, N.Y. TIMES, Mar. 3, 2009, at B1 (outlining confidential memo's concern that failure of AIG could spur catastrophic failure of insurance industry).

40. See, e.g., Wallison, *supra* note 33 (noting this support and expressing surprise that smaller institutions did not initially oppose proposed legislation, which would likely benefit the largest institutions by identifying them as too big to fail).

41. See, e.g., Andrew Clark, *Congress Grills Geithner and Bernanke over AIG Bonus Scandal*, GUARDIAN.CO.UK, Mar. 24, 2009, <http://www.guardian.co.uk/business/2009/mar/24/bernanke-geithner-aig-bonuses-testimony> (discussing backlash resulting from distribution of bonuses).

42. Philip Nussel, *Wagoner's Words Underscore Industry Crisis*, AUTOMOTIVE NEWS, Mar. 30, 2009 (internal quotation marks omitted), <http://www.autonews.com/article/20090330/ANA02/903299981/1178/ANA03>.

43. See *supra* note 39 and accompanying text for additional information on the AIG executives' memo.

44. Lehman, of course, did not succeed, and the government ultimately steered the carmakers into bankruptcy as well. Cf. Jeffrey McCracken, *Lehman's Chaotic Bankruptcy Filing Destroyed Billions in Value*, WALL ST. J., Dec. 29, 2008, at A10 (discussing some costs of Lehman's failure to plan for possible bankruptcy).

The final factor is widespread misconceptions about bankruptcy. Many people still seem to think that bankruptcy means corporate death—the inevitable end of an enterprise—as it does in much of the world. Even I had to chuckle when I realized that a bankruptcy conference I attended during the height of the crisis was being held at the same time, and in the same hotel, as the national undertakers' convention. But the reality is that for well over a century, bankruptcy has meant a fresh start for individual debtors, and corporate reorganization has often meant a second chance for large companies.⁴⁵ According to a recent study, more than seventy percent of the companies that enter bankruptcy with a plausible prospect of reorganizing do in fact successfully restructure.⁴⁶ Even when companies are sold rather than reorganized, bankruptcy is a very effective mechanism for dealing with their financial distress.

The misconceptions about bankruptcy may have been magnified by the major amendments to the bankruptcy laws that Congress passed in 2005.⁴⁷ The debate over the amendments and the amendments themselves cast bankruptcy—especially consumer bankruptcy—in a bad light. Proponents of the changes argued that bankruptcy filings impose a cost amounting to \$400 for each American.⁴⁸ As enacted, the reforms imposed substantial new obligations on bankruptcy lawyers and curbed the discretion of bankruptcy judges, each of which suggested that something was amok with the bankruptcy system.⁴⁹ As noted earlier, many Americans thought that the changes tolled the death knell for bankruptcy.⁵⁰

Ordinary Americans are not the only ones who seem to have had a limited or even mistaken understanding of bankruptcy. As the financial crisis unfolded, the principal decision makers were regulators whose experience was far removed from bankruptcy. The decisions to bail out Bear Stearns and AIG were made by then Treasury Secretary Hank Paulson, then New York Federal Reserve Bank President Timothy Geithner, and Federal Reserve Chairman Ben Bernanke. None of the three has any evident bankruptcy expertise.⁵¹ Similarly, the Federal Reserve banks, which produced much of the research that informed regulators' decision making, had numerous economists with a sophisticated understanding of the banking system but few with any familiarity with

filing).

45. See, e.g., SKEEL, *supra* note 24, at 1–2 (emphasizing uniqueness of American bankruptcy law).

46. Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 618 (2009).

47. Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23 (codified as amended in scattered sections of 11 U.S.C.).

48. E.g., SKEEL, *supra* note 24, at 203.

49. See, e.g., Jean Braucher, *The Challenge to the Bench and Bar Presented by the 2005 Bankruptcy Act: Resistance Need Not Be Futile*, 2007 U. ILL. L. REV. 93, 94 (describing hostility to bankruptcy lawyers and judges reflected in 2005 reforms).

50. See Moran, *supra* note 2 (discussing public fears after 2005 amendments).

51. Paulson came from Goldman Sachs, where he had risen to the chairmanship from Goldman's investment banking group; Geithner cut his teeth in the international affairs division of the Treasury during the Clinton administration; and Bernanke, a scholar with expertise in monetary policy, was best known for studies concluding that monetary policy exacerbated the Great Depression. See, e.g., DAVID WESSEL, IN FED WE TRUST: BEN BERNANKE'S WAR ON THE GREAT PANIC 10–12, 40–41, 73–75, 111–13 (2009) (detailing backgrounds of leaders confronting crisis).

bankruptcy.⁵² This gap in expertise seems to have reinforced the inclination to dismiss bankruptcy as unthinkable.⁵³

The importance of this last factor should not be understated. If lawmakers and regulators had been more familiar and more comfortable with bankruptcy, the interest group obstacles might well have been overcome. Although financial institutions wield enormous clout, lawmakers could have coupled the billions of dollars of bailout money with an insistence that banks accept the mortgage modification proposal as part of a package deal. If Bear Stearns and AIG had been allowed to file for bankruptcy, perhaps with some government support for their trades, the crisis might have unfolded differently—and been dealt with more effectively.⁵⁴ If regulators had prodded Chrysler and General Motors toward bankruptcy earlier, these carmakers might have saved billions of dollars and been in much better shape when they began their restructuring.

III. HISTORY LESSON #1: REFORM OFTEN COMES LATE

As frustrating as the absence of bankruptcy-related reforms has been for advocates of bankruptcy-based solutions, it is not surprising from a historical perspective. Although economic crises have often prompted bankruptcy reforms in the past century, major legislative change often seems to come well after the onset of the crisis. To see this, it is useful to contrast bankruptcy reform with its near cousin, corporate and financial regulation.

In the wake of major corporate or financial crises—particularly those that involve corporate scandals, as most do—Congress often springs into action immediately.⁵⁵ The most familiar example is the Great Depression. By the time Franklin Roosevelt took office, the Depression had fully taken hold, and the election campaign itself had been punctuated by spectacular collapses such as the failure of Samuel Insull's utilities empire.⁵⁶ The Roosevelt administration responded immediately, passing major banking reforms and the first of two securities laws in its first hundred days.⁵⁷ More recently, Congress's response to the Enron and WorldCom scandals followed a similar pattern. Within weeks of the revelation that WorldCom had committed a multibillion-dollar fraud, Congress enacted the Sarbanes-Oxley Act reforms.⁵⁸

Unlike new corporate or financial regulation, the most important bankruptcy

52. This comment is based on conversations with current and former Federal Reserve economists.

53. The carmaker bankruptcies were a notable exception to this pattern. The auto task force made extensive use of top bankruptcy professionals. See Emily Chasan, *U.S. Autos Task Force Hires Bankruptcy Lawyer*, REUTERS, Mar. 13, 2009, <http://www.reuters.com/article/newsOne/idUSTRE52C5V520090314> (discussing U.S. government's consultation with bankruptcy lawyers at several large law firms in conjunction with GM and Chrysler restructuring).

54. See David Skeel, *Give Bankruptcy a Chance*, WKLY. STANDARD, June 29, 2009, at 25–27 (discussing these points in greater detail).

55. The relationship between corporate scandals and regulatory reform is a major theme of DAVID SKEEL, *ICARUS IN THE BOARDROOM: THE FUNDAMENTAL FLAWS IN CORPORATE AMERICA AND WHERE THEY CAME FROM* (2005), and David A. Skeel, Jr., *Icarus and American Corporate Regulation*, 61 BUS. LAW. 155 (2005).

56. See, e.g., SKEEL, *supra* note 55, at 80–89 (analyzing Insull failure).

57. See *id.* at 94–103 (detailing government's regulatory response).

58. *Id.* at 175–77.

reforms seem to come well after the onset of a crisis. Lawmakers have often responded with immediate, temporary fixes, which are then followed by more thoroughgoing reforms later in the cycle. Two historical examples will illustrate the pattern.

The first is the federal bankruptcy laws of the nineteenth century. When an economic crisis—or “panic,” as they were called—hit, state lawmakers quickly passed stay laws that prevented or delayed efforts of creditors to foreclose on the property of farmers and small businessmen. As Charles Warren pointed out in his 1935 history of bankruptcy:

While these [stay] laws were in most instances held invalid by the State Courts (and eventually by the United States Supreme Court), they largely achieved their purpose of giving temporary protection to the debtor and conservation of his property from forced sales, during the interval between enactment of the law and its invalidation by the Court.⁵⁹

Thus, the first move during a crisis was usually to pass laws that provided for temporary relief. Later in the crisis, sometimes much later, Congress would finally pass bankruptcy legislation that effectively wrote off the effects of the crisis. This was the case with the short-lived bankruptcy laws passed in 1800, 1841, and 1867, and with the permanent federal legislation finally passed in 1898.⁶⁰

The second illustration is once again the New Deal. Both Congress and the states passed legislation designed to facilitate restructuring early in the New Deal, but the early legislation was much more like the nineteenth-century stay laws than true bankruptcy reform. As they had in the nineteenth century, the states responded to the crisis by enacting stay laws, which the Supreme Court initially struck down but subsequently upheld.⁶¹ The federal response had three components. First, Congress enacted several measures that were designed to address farm mortgage distress.⁶² These measures, which were largely ineffectual, amounted to federal stay laws.⁶³ Second, in 1933 and 1934 Congress codified corporate reorganization for the first time.⁶⁴ The main purpose of the legislation was to make corporate reorganization—or equity receivership, as it was called then—a little less costly by establishing voting rules that would enable a majority of bondholders or other creditors to bind the class as a whole, thus removing the holdup power dissenters enjoyed in the absence of a binding vote.⁶⁵ In most other respects, the legislation simply put a congressional seal of

59. CHARLES WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* 150 (1935).

60. See SKEEL, *supra* note 24, at 24–28 (discussing pattern of enactment and prompt repeal of various pieces of legislation).

61. The Supreme Court struck down the stay laws in 1933 and then finally upheld them a year later. (The Supreme Court voted against them before it voted for them, one might say). See *Home Bldg. & Loan Ass'n v. Blaisdell*, 290 U.S. 398, 447–48 (1934) (upholding Minnesota stay law that extended temporary relief to homeowners in certain mortgage foreclosures).

62. See, e.g., Anna Gelpern & Adam J. Levitin, *Rewriting Frankenstein Contracts: Workout Prohibitions in Residential Mortgage-Backed Securities*, 82 S. CAL. L. REV. 1075, 1141–48 (2009) (describing Frazier-Lemke Act and the enactment of Section 75 of the Bankruptcy Act).

63. *Id.*

64. See SKEEL, *supra* note 24, at 101–09 (discussing these reforms, which added section 77 to Bankruptcy Act for railroad reorganization in 1933 and section 77B for other corporations the following year).

65. *Id.* at 106–07.

approval on the procedures that the parties had been using for decades.⁶⁶

A third stopgap measure implemented by Congress was 1933 legislation abrogating the so-called “gold clause” in corporate bonds. This clause gave bondholders the right to be paid in gold, or to a higher payout in dollars if the price of gold rose.⁶⁷ By abrogating the clause the Roosevelt administration made it much easier for corporate debtors to repay their bond debt, effectively reducing the repayment obligation by a whopping sixty-nine percent.⁶⁸ Each of these measures was important, but they were tourniquets—immediate measures to stop the bleeding rather than substantial and permanent reforms. The major reforms did not come until 1938, when Congress completely overhauled the bankruptcy laws under the Chandler Act, which we will consider in the next section.⁶⁹

Why do we often see such a significant time lag between the onset of a financial crisis and the enactment of bankruptcy reform? One reason for the difference may be that, while corporate and financial crises are usually evidence of a breakdown of the existing corporate regulation, they do not necessarily reflect problems with the bankruptcy laws.⁷⁰ It is important not to overstate this point. As we have seen, lawmakers do often respond to a crisis with insolvency-related legislation. But the more lasting reforms seem to come later in the cycle of crisis and recovery.

IV. HISTORY LESSON #2: THE NATURE OF REFORM IS NOT PREORDAINED

If one lesson from history is that lasting bankruptcy reform often lags the crisis that spawned it, the second is that the direction of reform is not preordained.⁷¹ Looking back at the response to a crisis with the benefit of twenty-twenty hindsight, we sometimes assume that whatever regulatory response eventuates was inevitable. But this, of course, is not the case at all. There often are a variety of possible responses, ranging from doing nothing at all to completely transforming American bankruptcy law. Which option is selected depends on numerous factors, not least of which are the strategic decisions and political savvy of the particular men and women who are promoting them. The two illustrations we considered earlier—the nineteenth-century bankruptcy laws and the enactment of the Chandler Act in 1938—are once again instructive.

The legislation that became the Bankruptcy Act of 1898 was hardly the only option on the table at the end of the nineteenth century. The debates that finally led to

66. *Id.*

67. The gold clause is described in Randall S. Kroszner, *Is It Better to Forgive than to Receive? Repudiation of the Gold Indexation Clause in Long-Term Debt During the Great Depression* 4 (Oct. 1998) (unpublished manuscript), available at <http://faculty.chicagobooth.edu/finance/papers/repudiation11.pdf>.

68. This is because the value of gold climbed from \$20.47 at the time of the abrogation during Roosevelt's first one hundred days to \$35 the following year. *Id.* at 1.

69. See *infra* notes 88–90 and accompanying text for a discussion of the passage of the Chandler Act.

70. Cf. David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 917–18 (2003) (noting absence of pressure for bankruptcy reform after Enron and WorldCom scandals of early 2000s).

71. In this second respect, bankruptcy reform is much more similar to corporate reform.

the 1898 Act began in 1881 and lasted almost twenty years.⁷² In the 1880s, there was significant support for a so-called Equity Bill, which was really a glorified stay law.⁷³ Under the Equity Bill, existing state laws that provided for the marshalling of a debtor's assets on behalf of its creditors would be implemented in federal court.⁷⁴ During this same period, creditors rallied around the Lowell Bill, which Massachusetts District Court Judge John Lowell had drafted at the instigation of chambers of commerce and other creditors' groups.⁷⁵ The Lowell Bill, which provided for both voluntary and involuntary bankruptcy and for the avoidance of preferential prebankruptcy transfers, was subsequently replaced by the Torrey Bill, which would serve as the template for the law that was finally enacted in 1898.⁷⁶

The Torrey Bill might never have prevailed had it not been for Jay Torrey himself. Torrey—a colorful figure whose resume included participation in the Rough Riders campaign in Cuba—was a passionate lobbyist for the bill,⁷⁷ but he also was willing to compromise. Even William Jennings Bryan, who thought federal bankruptcy legislation a terrible idea, commented at one point, “I have never known of any person interested in the passage of a bill through this House who seems to be so fair in the presentation of a case.”⁷⁸ The compromises Torrey and his allies made were responsible both for the success of his bill and for what I think of as the genius of the 1898 Act.⁷⁹

Although the formula for success was somewhat different in the 1930s,⁸⁰ the overall pattern was quite similar. The key figure in the 1930s was William O. Douglas. Douglas was a law professor at Columbia and then Yale; later, chair of the Securities and Exchange Commission; and then a Supreme Court Justice for over thirty years.⁸¹

Douglas was extremely hostile to Wall Street investment banks and lawyers— as personified by the Cravath law firm and leading banks J.P. Morgan and Kuhn, Loeb— and he wanted to radically reform large scale corporate reorganization to reduce their role.⁸² As the chief reporter for a major corporate reorganization study authorized by

72. See, e.g., SKEEL, *supra* note 24, at 33.

73. For a brief description, see WARREN, *supra* note 59, at 128.

74. *Id.*

75. See, e.g., SKEEL, *supra* note 24, at 36–37.

76. For a discussion of the Lowell and Torrey Bills, see, for example, SKEEL, *supra* note 24, at 40–43, and Charles Jordan Tabb, *A Century of Regress or Progress? A Political History of Bankruptcy Legislation in 1898 and 1998*, 15 BANKR. DEV. J. 343, 354–61 (1999).

77. SKEEL, *supra* note 24, at 37.

78. 25 CONG. REC. 2815 (1894) (statement of William Jennings Bryan).

79. See generally David A. Skeel, Jr., *The Genius of the 1898 Bankruptcy Act*, 15 BANKR. DEV. J. 321 (1999) (describing compromises such as incorporation of state exemption laws, minimal administrative structure, and limits on creditors' ability to file involuntary petitions).

80. Compromise across party lines was much less essential in the late 1930s because the Democrats had a huge numerical majority. In 1938, they held seventy-six Senate seats, as opposed to sixteen Republicans (as well as one Progressive, two Farmer-Labor, and one Independent). U.S. Senate, Party Division in the Senate, 1789–Present, http://www.senate.gov/pagelayout/history/one_item_and_teasers/partydiv.htm (last visited Nov. 7, 2009).

81. See SKEEL, *supra* note 24, at 101–04, 109–27 (discussing Douglas's background and his role in New Deal bankruptcy reforms).

82. *Id.* at 110–13.

the Securities and Exchange Act of 1934,⁸³ and then as SEC chair and a regular participant in Franklin Roosevelt's weekly poker games, Douglas was in a great position to effectuate his vision.⁸⁴ But success was hardly guaranteed. There was substantial resistance to Douglas's vision—which called for managers to be kicked out when a large corporation filed for bankruptcy and would disqualify the debtor's prebankruptcy bankers and lawyers (read: J.P. Morgan and the Cravath firm) from participating in the reorganization.⁸⁵ Congressman Adolph Sabath had proposed an alternative bill that would provide for conservatorships of large insolvent corporations, and there were at least two other bills as well.⁸⁶ Douglas's correspondence with Abe Fortas—his protégé and also an eventual Supreme Court Justice—shows just how worried they were about being preempted by the Sabath Bill. "I believe the situation is so serious," Fortas wrote to Douglas, "that these contingencies [the possibility that the Sabath committee proposal would preempt Douglas's proposal] are actually and extremely possible."⁸⁷

Despite his ties to the administration and overwhelming Democratic control in the late 1930s, Douglas's legislative track record was mixed. His efforts to promote a federal incorporation statute ran into a solid wall of bipartisan resistance.⁸⁸ But Douglas and his allies cleverly, and in the end successfully, navigated the bankruptcy debates. In addition to stymieing the Sabath Bill internally, Douglas had his large-scale reorganization reforms attached as a separate chapter to a more technical bill that had been proposed by Congressman Chandler and which focused mostly on small-business bankruptcy.⁸⁹ With the support of much of the bankruptcy bar, and with a Democratic Congress happy to curtail Wall Street influence, the proposed legislation sailed through in 1938.⁹⁰ Just as Douglas intended, the Chandler Act radically altered large-scale corporate reorganization, removing Wall Street from a practice it had dominated for decades.⁹¹

83. The report was published in multiple volumes as SEC. & EXCH. COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES (1937–1940).

84. Douglas recounted his relationship with Roosevelt in his autobiography. *See generally* WILLIAM O. DOUGLAS, GO EAST, YOUNG MAN *passim* (1st ed. 1974); *cf.* Jeffrey Rosen, *The Justice Who Came to Dinner*, N.Y. TIMES, Feb. 1, 2004, § 4, at 1, 3 (describing social relationship between Douglas and Roosevelt).

85. *See* SKEEL, *supra* note 24, at 118 (describing resistance and Douglas's refusal to soften mandatory trustee provision).

86. In addition to the Chandler Bill, the principal proposals were the Sabath Bill and the Lea Bill. *See, e.g.*, John Gerdes, *Section 77B, The Chandler Bill and Other Proposed Revisions*, 35 MICH. L. REV. 361, 368–409 (1937) (describing Sabath and Chandler Bills, and noting that other bills were expected); Cloyd Laporte, Note, *Changes in Corporate Reorganization Procedure Proposed by the Chandler and Lea Bills*, 51 HARV. L. REV. 672, 673–89 (1938) (describing proposals of Chandler and Lea Bills).

87. Memorandum from Abe Fortas to William O. Douglas 3 (Oct. 7, 1935) (from William O. Douglas Papers, Library of Congress, copy on file with author).

88. The story is recounted in JOEL SELIGMAN, THE TRANSFORMATION OF WALL STREET: A HISTORY OF THE SECURITIES AND EXCHANGE COMMISSION AND MODERN CORPORATE FINANCE 205–11 (rev. ed. 1995).

89. *Cf.* Benjamin Wham, *Chapter X of the Chandler Act: A Study in Reconciliation of Conflicting Views*, 25 VA. L. REV. 389, 392 (1939) (recognizing SEC's ability to persuade Drafting Committee of National Bankruptcy Conference to add certain SEC recommendations to Chandler Bill).

90. *See* SKEEL, *supra* note 24, at 119 (describing enactment of Chandler Act).

91. *Id.* at 125–27.

V. IMPLICATIONS

Each of the history lessons of the two previous parts has been very much in evidence in the recent crisis. The first two years of the credit crisis brought a variety of efforts to minimize foreclosures, ranging from a quite successful foreclosure relief plan here in Philadelphia to the much larger efforts of the Bush and Obama administrations.⁹² But Congress did not enact any significant bankruptcy reforms. Moreover, the first legislative proposal that did have bankruptcy implications was part of a package of proposed corporate and financial reforms.⁹³ Its principal effect on bankruptcy was to take regulatory authority over large, systemic financial institutions away from the bankruptcy courts, and give it to banking regulators.⁹⁴

One could argue that the recent credit crisis was simply the final stage of a longer crisis that began with the Enron and WorldCom scandals or even the bursting of the dotcom bubble at the beginning of the decade. If we take this longer perspective, the story is essentially the same. Unlike with corporate reform, which came immediately, there were no bankruptcy changes until 2005, and the vast majority of the changes in 2005 had nothing to do with the economic crisis.⁹⁵ They were a project the credit card companies had already been working on for a decade, and which was designed to force more consumer debtors to enter into three- to five-year repayment plans, rather than receiving an immediate discharge.⁹⁶

As of this writing, the verdict is still out on potential bankruptcy reforms, with a variety of proposals swirling around. As already noted, the administration has proposed that bank regulators be given the authority to take over systemically important investment banks and hedge funds, and that the resolution of their financial distress be taken away from the bankruptcy courts.⁹⁷ Other proposals would add a special set of new provisions for large nonbank financial institutions to the bankruptcy laws, or

92. See, e.g., Alan J. Heavens, *What a Relief for 1,400 Phila. Foreclosures*, PHILA. INQUIRER, July 1, 2009, at C1 (describing success of Philadelphia plan).

93. The original proposal is summarized in Davis Polk & Wardwell Client Memo, Treasury's Proposed Resolution Authority for Systemically Significant Financial Companies (Mar. 30, 2009), available at <http://www.davispolk.com/1485409/clientmemos/2009/03.30.09.resolution.authority.pdf>. The administration subsequently introduced a revised and expanded set of reforms in June 2009. The subsequent proposals are described in DEP'T OF THE TREASURY, FINANCIAL REGULATORY REFORM: A NEW FOUNDATION (2009), available at http://www.financialstability.gov/docs/regs/FinalReport_web.pdf.

94. See DEP'T OF THE TREASURY, *supra* note 93, at 76–77 (proposing new resolution authority). *But see* Ayotte & Skeel, *supra* note 10 (manuscript at 27–29) (critiquing proposals that would shift significant regulatory authority from bankruptcy courts to bankruptcy regulators).

95. Two exceptions are a provision that requires the U.S. trustee to request the appointment of a trustee if there are reasonable grounds for believing the debtor's management has committed fraud, 11 U.S.C. § 1104(e) (2006), and a provision that attempts to limit "pay to stay" bonuses for executives, *id.* § 503(c). These provisions are discussed in David A. Skeel, Jr., *Déjà Vu All Over Again in Corporate Bankruptcy* (2005) (unpublished manuscript, on file with author).

96. Cf. Henry J. Sommer, *Trying to Make Sense Out of Nonsense: Representing Consumers Under the "Bankruptcy Abuse Prevention and Consumer Protection Act of 2005,"* 79 AM. BANKR. L.J. 191, 221 (2005) (asserting that "[t]he real goal of the creditor lobby was to make bankruptcy of all types more difficult for debtors who need it").

97. See *supra* notes 93–94 and accompanying text for a description of the legislative proposal to shift regulatory authority from bankruptcy courts to bankruptcy regulators.

provide for an interim period during which a large nonbank's obligations would remain while it sought to raise cash or arrange a sale.⁹⁸

On the consumer side, the mortgage writedown proposal has been hotly debated in Washington and seemed on the verge of passing in March 2009, and then again in late April 2009.⁹⁹ This approach is competing with alternative approaches, including Ed Morrison and two Columbia colleagues' proposal to pass legislation facilitating the restructuring outside of bankruptcy of securitized mortgages, and a foreclosure relief package that the Obama administration put in place in February.¹⁰⁰

The obvious implications of the recent tumult are that bankruptcy reform may still be forthcoming, and that the direction of reform is not yet clear. As already suggested, my own wish list would include the mortgage writedown provision and a commitment to using bankruptcy as the location of choice for resolving the financial distress of investment banks and hedge funds.¹⁰¹ This also would be a good time to commission a careful study of the role—particularly from a disclosure perspective—of hedge funds and equity funds in bankruptcy, much as Congress commissioned the vast study overseen by William O. Douglas in the 1930s.¹⁰² Such a study would fit naturally into recent debates about hedge fund regulation and oversight of the derivatives markets.

Perhaps the biggest wildcard for the perception of bankruptcy is the Chapter 11 filings by Chrysler and General Motors.¹⁰³ Chapter 11's role in restructuring the carmakers could help dispel the myth that bankruptcy is the end of the road for a troubled corporation. On the other hand, the administration's commandeering of the bankruptcy process in these cases, and the efforts it took to circumvent the ordinary Chapter 11 process,¹⁰⁴ could reinforce the suspicion that bankruptcy means liquidation absent an extraordinary intervention. Overall, the administration's response is unlikely to significantly alter most Americans' impression of bankruptcy. Moreover, if other firms replicate the government's strategy in future cases, concerns about manipulation in bankruptcy could increase.¹⁰⁵

This is a terrible time for millions of Americans. But history suggests that it is also a time of great opportunity to make a difference, hopefully for the better, for those

98. I have developed and promoted these bankruptcy-oriented proposals elsewhere. David A. Skeel, Jr., *Bankruptcy Boundary Games*, 4 BROOK. J. CORP. FIN. & COM. L. (forthcoming 2010) (manuscript at 22–26, on file with author) (advocating special provisions, including stay on derivatives, for large nonbank financial institutions); Lee C. Buchheit & David A. Skeel, Jr., Op-Ed., *Some Bankruptcies Are Worth It*, N.Y. TIMES, May 19, 2009, at A25 (proposing interim period for financial institutions in distress).

99. See, e.g., *U.S. Senate Rejects*, *supra* note 17, at 10 (noting, after April 30, 2009 vote, that “mortgage industry has twice succeeded in helping to kill the bankruptcy proposal”).

100. See *supra* notes 9, 27 and accompanying text for a discussion of the Columbia and Obama mortgage modification proposals.

101. The latter argument is developed in detail in Ayotte & Skeel, *supra* note 10.

102. See Jonathan C. Lipson, *The Shadow Bankruptcy System*, 89 B.U. L. REV. 1609, 1632–38 (2009) (suggesting that Douglas's study provides template for how to approach study of shadow bankruptcy system).

103. The carmaker bankruptcies are described in detail in Mark J. Roe & David A. Skeel, Jr., *Assessing the Chrysler Bankruptcy* 5–8 (Univ. of Pa. Law Sch., Pub. Law Research Paper No. 09-17; Univ. of Pa., Inst. for Law & Econ. Research Paper No. 09-22; Harvard Law & Econ. Discussion Paper No. 645; Harvard Pub. Law Working Paper No. 09-42, 2009), available at <http://www.ssrn.com/abstract=1426530>.

104. See *id.* at 12–20 (critiquing terms of Chrysler transaction).

105. *Id.* at 27–29.

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of us who are involved in the bankruptcy system—whether it be as scholars, as lawmakers, as judges, or as lawyers. Perhaps one of us will even prove to be a Jay Torrey or a William O. Douglas. We cannot be certain that history will conclude that we have contributed to recovery, either in individual lives or in the economy more generally. But from a historical perspective, I believe that the American bankruptcy laws, more than the insolvency laws of any other country, have made it possible to do just that.