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Bankruptcy Reorganization Jurisprudence: Matters of Belief, Faith, and Hope—Stepping into the Fourth Dimension

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ARTICLES

BANKRUPTCY REORGANIZATION JURISPRUDENCE: MATTERS OF BELIEF, FAITH, AND HOPE—STEPPING INTO THE FOURTH DIMENSION*

Linda J. Rusch**

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* The use of the phrase, fourth dimension, is based on Timothy P. Terrell, *Flatlaw: An Essay on the Dimensions of Legal Reasoning and the Development of Fundamental Normative Principles*, 72 CAL. L. REV. 288, 339-40 (1984) (arguing that there are four dimensions to legal reasoning: rules from cases, connections between rules, social policy, and faith based on beliefs and values).

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I. INTRODUCTION

Debate among bankruptcy scholars about the purpose of bankruptcy reorganization has been ongoing and strident.¹ The

1. John D. Ayer, *So Near To Cleveland, So Far From God: An Essay on the Ethnography of Bankruptcy*, 61 U. CIN. L. REV. 407 (1992) (detailing the debate among commentators); David A. Skeel, Jr., *Markets, Courts, and the Brave New World of Bankruptcy Theory*, 1993 WIS. L. REV. 465 (detailing the debate among commentators).

For criticisms of the existing bankruptcy scheme and responses to those criticisms, see Barry E. Alder, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311 (1993) [hereinafter Alder, *Financial and Political*] (proposing a chameleon equity structure and the elimination of the bankruptcy scheme); Barry E. Alder, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439 (1992) [hereinafter Alder, *Bankruptcy and Risk*] (arguing contractual risk allocations outside of bankruptcy are superior to risk allocation in bankruptcy); James W. Bowers, *The Fantastic Wisconsin Zero-Bureaucratic-Cost School of Bankruptcy Theory: A Comment*, 91 MICH. L. REV. 1773 (1993) [hereinafter Bowers, *Wisconsin*] (responding to Warren's and LoPucki's criticisms of the Bradley and Rosenzweig article); Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1050 (1992) (proposing the "extreme version of the [economic,] 'market-based' solution to corporate bankruptcy": the repeal of Chapter 11 of the Bankruptcy Code); Hon. Edith H. Jones, *Chapter 11: A Death Penalty for Debtor and Creditor Interests*, 77 CORNELL L. REV. 1088 (1992) (arguing Chapter 11 has failed to achieve its purposes); Donald R. Korobkin, *The Unwarranted Case Against Corporate Reorganization: A Reply to Bradley and Rosenzweig*, 78 IOWA L. REV. 669 (1993) (responding to Bradley and Rosenzweig article); Lynn M. LoPucki, *The Trouble with Chapter 11*, 1993 WIS. L. REV. 729 [hereinafter LoPucki, *Trouble*] (arguing Chapter 11 process takes too long to be successful in reorganizing companies); Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosenzweig*, 91 MICH. L. REV. 79 (1992) [hereinafter LoPucki, *Strange Visions*] (responding to Bradley and Rosenzweig article); Elizabeth Warren, "Why Have a Federal Bankruptcy System?", 77 CORNELL L. REV. 1093 (1992) [hereinafter Warren, *Why*] (arguing Chapter 11 is better than state law alternatives in spreading losses caused by financial distress); Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 YALE L.J. 437 (1992) [hereinafter Warren, *Untenable Case*] (responding to Bradley and Rosenzweig article).

For support of the creditors' bargain account and criticism of the non-economic account of bankruptcy, see Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 816 (1987) [hereinafter Baird, *Loss Distribution*] (arguing that the noneconomic, value-based account of bankruptcy law "rests on a number of fairly simple propositions . . . [which] sound innocuous enough, but none of [which] can withstand close scrutiny, and adher[ence] to [which] invites analysis that is unfocused and misguided"); Douglas G. Baird, *The Uneasy Case for Corporate Reorganization*, 15 J. LEGAL STUD. 127, 128 (1986) [hereinafter Baird, *Uneasy Case*] (arguing that "the law of corporate reorganizations is hard to justify under any set of facts and virtually impossible when the debtor is a publicly held corporation"); Thomas H. Jackson, *Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules*, 60 AM. BANKR. L.J. 399, 399-400 (1986) [hereinafter Jackson, *Of Liquidation*] (arguing that nonbankruptcy entitlement preservation should underlie bankruptcy policy, not "undefined consid-

commentators' viewpoints of the purpose of bankruptcy influence their approaches to resolution of particular substantive bankruptcy issues.² The differing perspectives of the purpose of bankruptcy re-

erations of equity or notions of balancing"); Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements and the Creditors' Bargain*, 91 YALE L.J. 857, 860 (1982) [hereinafter Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*] (arguing that non-bankruptcy entitlements should be recognized in bankruptcy using the "creditors' bargain" paradigm, which views the bankruptcy system as designed to "mirror the agreement one would expect the creditors to form among themselves were they able to negotiate . . . from an *ex ante* position"); Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155, 155-56 (1989) (arguing for the creditors' bargain conceptual paradigm which provides that prebankruptcy entitlements "should be impaired in bankruptcy only when necessary to maximize net asset distributions to the creditors as a group and never to accomplish purely distributional goals" justified on the basis of "equity, wealth redistribution, or appeals to communitarian values").

For criticisms of the creditors' bargain account of bankruptcy and support of the non-economic account, see Charles W. Adams, *An Economic Justification for Corporate Reorganizations*, 20 HOFSTRA L. REV. 117, 117 (1991) (criticizing the economic account/creditor's bargain paradigm for "not attach[ing] sufficient significance to the transaction costs involved in using the market to raise the capital necessary to reorganize a corporation's capital structure"); James W. Bowers, *Groping and Coping in the Shadow of Murphy's Law: Bankruptcy Theory and the Elementary Economics of Failure*, 88 MICH. L. REV. 2097 (1990) [hereinafter Bowers, *Groping and Coping*] (criticizing creditors' bargain approach as ignoring debtor behavior); James W. Bowers, *Whither What Hits the Fan?: Murphy's Law, Bankruptcy Theory, and the Elementary Economics of Loss Distribution*, 26 GA. L. REV. 27 (1991) [hereinafter Bowers, *Murphy's Law*] (criticizing both creditors' bargain and loss allocation theories); David G. Carlson, *Bankruptcy Theory and the Creditors' Bargain*, 61 U. CIN. L. REV. 453 (1992) [hereinafter Carlson, *Theory*] (evaluating and criticizing the creditors' bargain economic model); David G. Carlson, *Game Theory and Bankruptcy Reorganizations*, 9 BANKR. DEV. J. 219 (1992) [hereinafter Carlson, *Game Theory*] (criticism of Douglas Baird & Randal C. Picker, *A Simple Noncooperative Bargaining Model of Corporate Reorganizations*, 20 J. LEGAL STUD. 311 (1991)); Donald R. Korobkin, *Value and Rationality in Bankruptcy Decision Making*, 33 WM. & MARY L. REV. 333, 335 (1992) [hereinafter Korobkin, *Value and Rationality*] (criticizing the economic account as based on a "false foundation"—simple wealth maximization—and arguing for a "value-based account" that posits a bankruptcy law which exists to "create a context in which the economic and noneconomic values of all those affected by financial distress" is addressed); Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 720-21 (1991) [hereinafter Korobkin, *Rehabilitating Values*] (arguing that the purpose of bankruptcy law is to respond to "the many aspects of financial distress—moral, political, personal, social, and economic—and, in particular, to the grievances of those who are affected by financial distress" and describing the economic account of bankruptcy law as "impoverished"); Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 777, 813 (1987) [hereinafter Warren, *Bankruptcy Policy*] (arguing that the purpose of bankruptcy law encompasses many competing and conflicting values in determining how loss should be distributed and describing economic analyses as "giv[ing] quick answers, but only by sliding past the troublesome issues that pervade resolution of real problems").

2. See Baird, *Uneasy Case*, *supra* note 1, at 127-29 (starting from the assumption that the bankruptcy proceeding is best seen as the "creditors' bargain," and concluding that "the entire law of corporate reorganizations is hard to justify under any set of facts and virtually impossible when the debtor is a publicly held corporation" because debt holders and equity holders of a corporation would not agree to a reorganization before the fact if they had the opportunity to bargain for such a contingency); David G. Carlson, *Philosophy in Bank-*

organization are based upon divergent visions.³ Each commentator appears to have in mind a vision of what reorganization should accomplish and critiques current reorganization law for failing to fulfill that vision. Some scholars have argued that maximizing creditors' wealth should be the goal of bankruptcy law, and that current law is inefficient because it fails to achieve this end.⁴ Other scholars have argued that the goal of bankruptcy law is to respond to financial distress, and suggest that any new legislation should reflect the plurality of interests affected by that distress.⁵ Each writer then attempts to persuade the reader to adopt the writer's vision as the correct vision for bankruptcy reorganization.⁶

ruptcy, 85 MICH. L. REV. 1341, 1389 (1987) (reviewing THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* (1986), suggesting that bankruptcy law's purpose can only be discerned through "infinitely complex" jurisprudential explanations); Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 857-61 (starting from the assumption that the debtor discharge-centered view of bankruptcy is incorrect historically, finding that bankruptcy is an inherently collectivizing process that should be viewed as a creditors' bargain which is a "system designed to mirror the agreement . . . from an *ex ante* position"); Jackson & Scott, *supra* note 1, at 156-58 (starting from an assumption that an enhanced "creditors' bargain" paradigm should inform bankruptcy jurisprudence, and concluding that such a model best ensures that assets are deployed to all claimants, thus satisfying the authors' view of the central goal of bankruptcy law); Korobkin, *Rehabilitating Values*, *supra* note 1, at 762 (assuming that bankruptcy law is a response to "financial distress," a phrase that encompasses moral, political, personal, social, as well as economic, aspects of bankruptcy); Warren, *Bankruptcy Policy*, *supra* note 1, at 796-97. Warren also starts from a premise that

bankruptcy is a distributional process, the purpose of which can only be identified by "[inquiring] into many issues, including who may be hurt by a business failure, how they may be hurt, whether the hurt can be avoided, at what cost it can be avoided, who is helped by the business failure, whether aid to those helped offsets the injury to those hurt, who can effectively evaluate the risks of business failure, who may have contributed to the business failure, how they may have contributed, whether the contribution to failure serves other useful goals, who can best bear the costs of business failure, and who expected to bear the costs of business failure—just to name a few."

Warren, *Bankruptcy Policy*, *supra* note 1, at 796-97.

3. See *infra* part II.

4. See THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* (1986) [hereinafter JACKSON, *LOGIC AND LIMITS*]; Baird, *Uneasy Case*, *supra* note 1; Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97 (1984); Lucian A. Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775 (1988); Bradley & Rosenzweig, *supra* note 1; Jackson & Scott, *supra* note 1; Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527 (1983).

5. Korobkin, *Value and Rationality*, *supra* note 1; see also Carlson, *supra* note 2; Donald R. Korobkin, *Contractarianism and the Normative Foundations of Bankruptcy Law*, 71 TEX. L. REV. 541 (1993) [hereinafter Korobkin, *Contractarianism*]; Korobkin, *Rehabilitating Values*, *supra* note 1; Warren, *Bankruptcy Policy*, *supra* note 1.

6. For example, Thomas H. Jackson espouses the creditors' bargain model as best embodying the bankruptcy policy of maximizing the deployment of assets to all claimants and

Before one can imagine differing visions for bankruptcy, one must have in mind a concept of what bankruptcy means. Perhaps, at its most elementary level, bankruptcy is about readjusting the relationships between and among a debtor and its creditors.⁷ That readjustment has historically been accomplished in two different ways—liquidation and reorganization.⁸ In a liquidation, the debtor's assets are gathered and sold and the proceeds distributed to creditors.⁹ The emphasis in a reorganization is on a restructuring of the debts and assets so that the business can continue opera-

then analyzes certain bankruptcy rules and argues that they reflect a normative view that is consistent with the creditors' bargain model. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1; see also Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. CHI. L. REV. 738 (1988).

Some in the academic community doubt whether anyone listens to (i.e., reads) these normative debates. See Symposium, *The Critique of Normativity*, 139 U. PA. L. REV. 801 (1991); Edward L. Rubin, *What Does Prescriptive Legal Scholarship Say and Who is Listening to It: A Response to Professor Dan-Cohen*, 63 U. COLO. L. REV. 731 (1992). In bankruptcy, it appears that some courts are listening; see, e.g., *Rosner v. Worcester (In re Worcester)*, 811 F.2d 1224, 1228 (9th Cir. 1987); *In re Mother Hubbard, Inc.*, 152 B.R. 189, 196 n.14 (Bankr. W.D. Mich. 1993). In addition, as one author has noted, the public attention to bankruptcy and the notoriety of big bankruptcy cases may cause Congress to take another look at reorganization issues. Skeel, *supra* note 1, at 467-69, 521. Finally, the amount of time and resources spent on Chapter 11 is staggering. Gordon Bermant et al., *A Day in the Life: The Federal Judicial Center's 1988-1989 Bankruptcy Court Time Study*, 65 AM. BANKR. L.J. 491, 517 (1991); see Lynn M. LoPucki & William C. Whitford, *Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 176 (1990) [hereinafter LoPucki & Whitford, *Bargaining Over Equity's Share*] (finding that from a sample of eleven large, publicly held corporations, the time period from filing of the bankruptcy petition until confirmation of the plan of reorganization took from .9 to 4.3 years, with 2.53 being the average); LoPucki, *Trouble*, *supra* note 1, at 744 n.65 (in various cited studies, median time in reorganization for large publicly held companies ranged from 16.2 months to 32 months).

7. See generally Rhett Frimet, *The Birth of Bankruptcy in the United States*, 96 COM. L.J. 160, 160-61 (1991); Louis E. Levinthal, *The Early History of English Bankruptcy*, 67 U. PA. L. REV. 1, 14 (1919) [hereinafter Levinthal, *English Bankruptcy*]; Louis E. Levinthal, *The Early History of Bankruptcy Law*, 66 U. PA. L. REV. 223, 225 (1917-18) [hereinafter Levinthal, *Early History*]; Max Radin, *The Nature of Bankruptcy*, 89 U. PA. L. REV. 1, 3-4 (1940); Robert Weisberg, *Commercial Morality, the Merchant Character, and the History of the Voidable Preference*, 39 STAN. L. REV. 3, 5-39 (1986) (detailing the historical struggle between creditors and debtors as embodied in the bankruptcy laws).

8. For example, a reorganization generally has creditors voluntarily or forcibly agreeing to accept a fraction of their claims to be paid out over a period of time. Frimet, *supra* note 7, at 185 (describing United States Bankruptcy Act of 1874); Levinthal, *Early History*, *supra* note 7, at 243 (describing Italian compositions); James M. Olmstead, *Bankruptcy A Commercial Regulation*, 15 HARV. L. REV. 829, 839-40 (1902) (describing United States Bankruptcy Act of 1874); Radin, *supra* note 7, at 4 (describing bankruptcy composition); Charles J. Tabb, *The Historical Evolution of the Bankruptcy Discharge*, 65 AM. BANKR. L.J. 325, 360-62 (1991) (describing United States Bankruptcy Act of 1874).

9. See generally Frimet, *supra* note 7, at 163; Levinthal, *English Bankruptcy*, *supra* note 7, at 18-20; Tabb, *supra* note 8, at 329-33 (describing English bankruptcy law prior to 1705).

tions.¹⁰ The writers' visions differ significantly in evaluating when the debtor and creditor relationship can be adjusted and what adjustments to that relationship should be allowed.¹¹

Each writer's vision of the purpose of bankruptcy is based upon various premises. In comparing and contrasting those premises, it is clear that each writer is starting from a different set of values and beliefs and each writer travels the path to his or her conclusion using their individualized experiences to interpret and apply those values and beliefs.¹² Thus, no one should be surprised that each writer comes to different conclusions about the correct vision for the bankruptcy law. Although many have focused on the merits and demerits of each writer's conclusions,¹³ the debate at

10. Christopher W. Frost, *Running the Asylum: Governance Problems in Bankruptcy Reorganizations*, 34 ARIZ. L. REV. 89, 91-94 (1992); LoPucki & Whitford, *Bargaining Over Equity's Share*, *supra* note 6, at 127-28; Raymond T. Nimmer, *Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions*, 36 EMORY L.J. 1009, 1035-36 (1987); Roe, *supra* note 4, at 528.

The primary difference between a liquidation and a reorganization is what assets are used to satisfy the creditors' claims. In a liquidation, all current assets are converted into cash and distributed to creditors. In a reorganization, some existing assets may be converted to cash. The main focus, however, is the use of the potential income stream to pay the existing and future liabilities of the business. In a liquidation, that income stream is not available because all of the assets are sold and no income stream is generated. In both a liquidation and a reorganization, all debts will not be paid in full, that is, some liabilities are discharged without full payment. With respect to reorganizations, see 11 U.S.C. § 1141(d) (1988) (providing that confirmation of a Chapter 11 plan operates as a discharge). See also 5 COLLIER ON BANKRUPTCY § 1141.01[4][a] (Lawrence P. King ed., 15th ed. 1993); GEORGE M. TREIFESTER ET AL., FUNDAMENTALS OF BANKRUPTCY LAW, 436-37 (1988). With respect to liquidation, see 11 U.S.C. § 727 (1988) (providing that discharge relieves the debtor from all debts that arose before the date of the order for relief under Chapter 7). See also 4 COLLIER ON BANKRUPTCY, *supra*, at § 727.01[1]; Treister, *supra*, at 310-14. Recent studies have suggested that current bankruptcy practice in particular cases involves aspects of both liquidation and reorganization. Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597, 604-06 (1993) [hereinafter LoPucki & Whitford, *Patterns*].

11. Providing a legal mechanism for readjusting debtor and creditor relationships is only necessary in a credit based economy where the population tolerates some failure to repay debts. If credit did not exist or if the population mores required all debt to be repaid in full without exception, the legal system would not provide for any mechanism for debt discharge. Professor Shuchman states as a premise that differences may occur in the felt obligation to repay money. These differences are based on the different types of transactions that give rise to the debt. For example, the obligation to repay a loan from a friend may carry a different moral repayment imperative than the obligation to repay a debt owed to a large commercial financial institution. Professor Shuchman believes that current bankruptcy law ignores such psychological realities as immaterial. Philip Shuchman, *An Attempt at a "Philosophy of Bankruptcy,"* 21 UCLA L. REV. 403, 428-32 (1973).

12. See generally Thomas Morawetz, *Understanding Disagreement, the Root Issue of Jurisprudence: Applying Wittgenstein to Positivism, Critical Theory, and Judging*, 141 U. PA. L. REV. 371 (1992) (examining the nature of legal reasoning and the role justification strategies, individual beliefs, and personal histories have in reasoning).

13. See Baird, *Loss Distribution*, *supra* note 1, at 817 (criticizing a non-economic ac-

that level is doomed to go on endlessly.

This Article examines the two dominant bankruptcy reorganization theories: the creditors' bargain theory and the loss allocation theory. After briefly explaining the major premises of each theory, this Article attempts to peel away the layers of assumptions to expose the writers' underlying beliefs and values about the nature of a person, the nature of community, the optimal method of distributing resources, and the optimal allocation of decision making power.¹⁴ Although based upon divergent belief and value systems, the theorists attempt to support their respective theories and convince others of the deficiencies in the opposing theory using three primary methods of justification. These primary justification methods are the appeal to the historical, the appeal to the empirical, and the appeal to the normative. Those justification methods, however, do not convince the opposing theorists.¹⁵

The bankruptcy jurisprudential debate is a microcosm of a larger jurisprudential debate. This larger debate has taken place over many decades. At issue in this debate are the following questions: (i) is law a legitimate exercise of power; (ii) can we be certain that the law is enforcing the "right" normative values; (iii) are the legal decision makers following the law or are they injecting their own values and beliefs into their decisions; and (iv) is the law just. The bankruptcy jurisprudential debate is addressing the same issues, but merely using different nomenclature. Nothing about the bankruptcy debate itself suggests that the answers to these questions in bankruptcy are more easily found than the answers to these questions in the jurisprudential debate as a whole. Just as in the bankruptcy debate, debate about the four jurisprudential questions themselves involve matters of beliefs and values. Different jurisprudential schools hold different beliefs about the appropriate

count of bankruptcy policy as "deriv[ing] what bankruptcy law ought to be from what it is," and asserting that the non-economic account is inappropriate because "one cannot derive the normative from the positive"; Bowers, *Murphy's Law*, *supra* note 1, at 69-76 (criticizing those who assert that non-economic values might be served by bankruptcy policy that seeks to promote "talk that makes someone feel better" as therapy for financial distress, and that shortcomings ascribed to the economic account are actually shortcomings in the Bankruptcy Code); Korobkin, *Contractarianism*, *supra* note 5, at 542-44 (relaying Carlson's criticism of the economic account of bankruptcy policy as failing to recognize that bankruptcy law is the product of "social exigency, moral conflict, and political compromise," and for not taking into account these complex practical origins of bankruptcy law); Warren, *Bankruptcy Policy*, *supra* note 1, at 797-804 (criticizing the economic account of bankruptcy policy as being overly narrow and failing to take into account the distributional consequences of its premises).

14. See *infra* part II.

15. See *infra* part III.

answers to those four questions.¹⁶

No matter which way the question is asked, either from a bankruptcy perspective or from a jurisprudential perspective, if enough layers are peeled away, what is left at the core is a set of beliefs and values. These beliefs and values do not seem to be subject to the test of truth or falsity, but are really matters of individual faith and aspiration.¹⁷

This Article attempts to start a bankruptcy jurisprudential conversation with the admission that we do not know the truth, that we cannot discover the truth, and thus, in law, we cannot enact the truth. All that we have are unprovable beliefs, unsupported values, and an unshakable faith in what would make a "better" society. The debate about law and doctrines is really a debate about belief and value systems. Although this debate is often couched in elaborate constructs and premises, it is impossible to divorce the question of what the law should be from the writers' values and beliefs.

This Article concludes with an initial list of questions designed to identify beliefs and values that should be examined in the debate about what bankruptcy should be. Until we closely examine our beliefs and values about debtors, creditors, and the credit system, we cannot begin to resolve the debate about bankruptcy jurisprudence.

16. See *infra* part IV.

17. I use the terms "beliefs," "values," and "faith" to mean as follows: a belief is a reference to what a person thinks about a fact; a value is something that is thought to be a "good"; and faith is a trust that is based upon a hope that if the beliefs are true and the values are promoted, the world will be a better place.

In the bankruptcy debate, the facts could be historical facts or empirical facts. What makes the statement a belief instead of a statement that could be true or false is the inability to have proven the fact to be true or false. Beliefs that are not based upon objectively provable facts cannot be proven true or false. See Jeremy Waldron, *On the Objectivity of Morals: Thought on Gilbert's "Democratic Individuality"*, 80 CAL. L. REV. 1361, 1398-1403 (1992). For example, the statement "I believe that God exists" cannot be attacked as factually false or supported as factually true. That I believe in the existence of God is true in the sense that I really believe it. But the fact that God exists cannot currently, nor perhaps ever, be proven true to the satisfaction of someone who believes that God does not exist. The fact in the belief statement, "God exists," will be true to me and false to the atheist. Neither of us will be successful in persuading the other of the truth or falsity of that "fact." The "facts" inherent in the beliefs of the writers in the bankruptcy debate are just like the "God exists" fact in the example above. Neither side is persuaded of the falsity of their own "facts" nor the truth of the opposing side's "facts."

In the bankruptcy debate, something is a value if it is thought to be a desirable outcome or activity. Each set of theorists has a set of values regarding what would be a good outcome or activity that should be promoted. See *infra* part II.

II. TWO COMPETING PARADIGMS OF BANKRUPTCY REORGANIZATION

During the last ten years, two primary theories of bankruptcy reorganization have emerged—the creditors' bargain theory and the loss allocation theory.¹⁸ The creditors' bargain theory is based upon an economic principle maximizing the collective wealth of creditors. The loss allocation theory is based upon distributing losses among the affected parties. Each theory is built upon different beliefs and values regarding the nature of people, the nature of community, the optimal method of distributing resources, and the optimal allocation of decision making power. The reasoning of each theory and the theorists' apparent¹⁹ underlying beliefs and values will be explained below.

A. Creditors' Bargain

The creditors' bargain theory of bankruptcy reorganization is derived from the law and economics school of thought.²⁰ This theory has as its starting assumption that a business has at least two different values, a liquidation value and a going concern value.²¹

18. Lawrence Ponoroff & F. Stephen Knippenburg, *The Implied Good Faith Filing Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 NW. U. L. REV. 919, 948 (1991); Linda J. Rusch, *The New Value Exception to the Absolute Priority Rule in Chapter 11 Reorganizations: What Should the Rule Be?*, 19 PEPP. L. REV. 1311, 1322 (1992).

19. In most instances, I am inferring what the beliefs and values appear to be based upon the justifications and reasoning the theorist uses to explain the theory. The theorists rarely admit that their own values and beliefs are an inextricable part of the respective theories.

20. The economic approach to law posits a world in which resources are limited in relation to human wants. This approach assumes that humans are rational maximizers of their self-interest and that, as such, they will respond to incentives by making choices which will increase their satisfaction. Thus, human behavior can be altered by changing surroundings in such a manner that a modification of behavior would increase satisfaction. From this proposition, the economic approach to law derives three fundamental concepts. First, there is an inverse relation between price charged and quantity demanded. Second, the cost of doing an activity is measured by the value resources would command at their next best use—the foregone opportunity. Third, resources tend to gravitate toward their highest valued use if exchange is permitted. When resources are being used where their value is greatest, they are described as being deployed in an efficient manner. See RICHARD A. POSNER, *ECONOMIC ANALYSIS OF THE LAW* § 1.1, at 3-10 (3d ed. 1986).

For an explanation and illustration of the application of the creditors' bargain, see JACKSON, *LOGIC AND LIMITS*, *supra* note 4; Thomas H. Jackson, *Translating Assets and Liabilities to the Bankruptcy Forum*, 14 J. LEGAL STUD. 73 (1985); Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725 (1984); Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1; Jackson & Scott, *supra* note 1.

21. Jackson & Scott, *supra* note 1, at 158-60; Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 864-65. Some debate exists regarding methods and times at which the value of property should be determined. See, e.g., David G. Carlson, *Secured Creditors and the Eely Character of Bankruptcy Valuations*, 41 AM. U. L. REV. 63 (1991) [hereinafter Carlson, *Eely Character*]; David G. Carlson, *Undersecured Claims Under*

The liquidation value is based upon the sale of the business' assets on a piecemeal basis.²² The going concern value reflects the worth of the operating business, typically using a capitalized earnings estimate.²³ If the going concern value is greater than the liquidation value, the greater value should be preserved for the creditors.²⁴

When confronted with a financially distressed business, individual creditors, acting on their own behalf, have an incentive to pursue their state collection remedies to procure as big a part of the debtor's value as possible.²⁵ Collection remedies in most states are designed for liquidation, that is, seizing and selling assets.²⁶ If a creditor is afraid that the debtor will not have enough value to pay that creditor's claim, the creditor has an incentive to use procedures designed to liquidate assets to collect its debt.²⁷ Once some of the debtor's business assets are seized, several consequences fol-

Bankruptcy Code Sections 506(a) and 1111(b): Second Looks at Judicial Valuations of Collateral, 6 BANKR. DEV. J. 253 (1989); Patrick Fitzgerald, Comments, *Bankruptcy Code Section 506(a) and Undersecured Creditors: What Date for Valuation?*, 34 UCLA L. REV. 1953 (1987); James F. Queenan, Jr., *Standards for Valuation of Security Interest in Chapter 11*, 92 COM. L.J. 18 (1987); Kaaran E. Thomas, *Valuation of Assets in Bankruptcy Proceedings: Emerging Issues*, 51 MONT. L. REV. 126 (1990). See generally 1 JAMES C. BONBRIGHT, *THE VALUATION OF PROPERTY* 3-39 (1937) (reprinted 1965) (discussing various valuation methods). This debate leads to uncertainty in the values that can properly be assigned to the liquidation value and going concern value of a business for purposes of the application of the creditors' bargain paradigm.

22. 1 BONBRIGHT, *supra* note 21, at 44-46; 2 JAMES C. BONBRIGHT, *THE VALUATION OF PROPERTY* 759-68 (1937) (reprinted 1965); see also Carlson, *Eely Character*, *supra* note 21, at 75.

23. The basic principle of capitalized earnings valuations is that the value of an enterprise is dependent entirely on that enterprise's prospective earnings. Such an enterprise valuation is designed to reflect the acquisition value to those persons who are in a position to exploit the business for their own profit. Under this method, present value is calculated by applying a multiple to the enterprise's projected profit. See 1 BONBRIGHT, *supra* note 21, at 233-38; see also Queenan, *supra* note 21, at 38-43 (explaining capitalization multiples and their application). Scholars who advocate for the creditors' bargain theory identify capitalized earnings valuations as a basis for measuring the present value of going concerns. See Baird, *Uneasy Case*, *supra* note 1, at 136-38.

24. Whether the going concern value is generally greater than the liquidation value of enterprises is a matter of some dispute. See Baird & Jackson, *supra* note 6, at 747. See generally Baird, *Uneasy Case*, *supra* note 1, at 133-34, 136-38; Bradley & Rosenzweig, *supra* note 1, at 1046-47 (if any going concern value exists, it is not given to the creditors); Roe, *supra* note 4, at 534-58.

25. See Alder, *Bankruptcy and Risk*, *supra* note 1, at 444-45; LoPucki & Whitford, *Bargaining Over Equity's Share*, *supra* note 6, at 127.

26. See, e.g., MINN. STAT. §§ 550.01-42 (1992); IOWA CODE ANN. §§ 626.1-108 (West 1950); CONN. GEN. STAT. §§ 52-350a to -400e (1993); FLA. STAT. ANN. §§ 56.011-29 (West 1993). See generally Stefan A. Riesenfeld, *Enforcement of Money Judgments in Early American History*, 71 MICH. L. REV. 691 (1973) (describing historical basis for state collection remedies).

27. Alder, *Bankruptcy and Risk*, *supra* note 1, at 444-45; Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 860-65.

low. Other creditors start to get nervous that the debtor will be unable to pay debts owed to them and move to collect their debts using state liquidation type remedies.²⁸ The more assets the debtor loses in this liquidation process, the less likely the debtor can keep operating the business.²⁹ Thus, this state law liquidation process will prevent a debtor from operating the business to generate the greater going concern value.³⁰

To have any hope of preserving the greater going concern value, all of the creditors would have to agree that no one should try to liquidate the debtor's assets to pay their respective claims.³¹ The difficulty with getting all the creditors to make this agreement is the cost of bargaining, or in economic terms, high transaction costs.³² On their own, without some process for doing so, the creditors will not be able to agree to act in concert to preserve the debtor's greater going concern value because high transaction costs are a barrier to that agreement.³³ Bankruptcy reorganization provides the process that stays creditors' individualized efforts to liquidate the debtor and provides the opportunity to generate the greater going concern value.³⁴ The tradeoff for staying the creditor's ability to liquidate the debtor's assets immediately is twofold: the greater going concern value is distributed to the creditors and the creditors are entitled to control how that greater going concern value is generated.³⁵

Based upon the above rationale, reorganization is "justified" as a method for preserving the debtor's greater going concern value if several conditions are met. First, the debtor must have a going concern value that is greater than the liquidation value. Second,

28. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 862 (discussing the incentives for a creditors' race and the associated strategic costs).

29. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 862 (noting that a creditors' race to use individualistic remedies is likely to lead to a premature termination of the debtor's business).

30. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 862; *see* Bowers, *Groping and Coping*, *supra* note 1, at 2105-06 (describing the process as a creditors' feeding frenzy).

31. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 863-64.

32. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 865. *But see* Adams, *supra* note 1 (arguing that none of the proposed economic alternatives to bankruptcy show that the costs of buying and selling businesses outside of bankruptcy are less than the costs inside bankruptcy).

33. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 864-65.

34. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 864, 866-67.

35. *See, e.g.*, JACKSON, LOGIC AND LIMITS, *supra* note 4, at 10-19, 209-29; Baird, *Uneasy Case*, *supra* note 1, at 138-45; Jackson, *Of Liquidation*, *supra* note 1, at 404-11; Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 868-72; Jackson & Scott, *supra* note 1, at 158-62.

the creditors must receive that greater going concern value. Third, the creditors must be the recognized beneficiaries of the process and in control of the process.³⁶

Based upon that brief explanation of the creditors' bargain theory, one can identify several beliefs and values. The first belief is that the greater going concern value in fact exists. If the greater value does not exist, then the justification for reorganization instead of liquidation of the business fails.³⁷

The second belief is that people, primarily creditors, make rational decisions. One of the most basic premises of capitalistic economic models is that people make decisions using a cost-benefit analysis.³⁸ In the creditors' bargain theory, the creditor is presumed to desire to engage in a pecuniary cost-benefit analysis regarding collection of its debt from the debtor. The creditor is rational if the creditor tries to maximize its own pecuniary wealth. If the benefits of collection are higher than the costs of collection, the creditor will rationally try to collect the debt.³⁹

Coupled with this belief in creditor rationality is the value that maximizing the creditors' collective pecuniary wealth is a good

36. Based on these conditions, the creditors' bargain theorists attack the current reorganization scheme as unworkable and a candidate for repeal or significant change. The major criticisms of the current reorganization scheme are:

- (i) the going concern value is illusory, *see supra* note 24;
- (ii) the going concern value, if existing, is siphoned off by other non-creditor entities, such as management, lawyers, and other professionals during the course of the reorganization, *see Baird, Uneasy Case, supra* note 1, at 135; *Bradley & Rosenzweig, supra* note 1, at 1047;
- (iii) the going concern value is distributed to claimants junior to the senior creditors, *Bradley & Rosenzweig, supra* note 1, at 1052-53; *but see* Edward I. Altman, *Evaluating the Chapter 11 Bankruptcy Reorganization Process*, 1993 COLUM. BUS. L. REV. 1 (critiquing *Bradley and Rosenzweig's* empirical analysis); and
- (iv) current bankruptcy law leaves too much control in the hands of management to take unwise risks with the assets or to use the threat of bankruptcy to gain leverage against the creditors and the stockholders, *Bradley and Rosenzweig, supra* note 1, at 1047; *Baird, Uneasy Case, supra* note 1, at 131-32.

37. In fact, as noted previously, according to creditors' bargain theorists, the failure of the current reorganization scheme to identify or preserve the greater going concern value to the exclusive benefit of senior creditors is a primary defect of the current reorganization scheme. *See supra* note 36.

38. POSNER, *supra* note 20, § 1.1 at 3-4. For an interesting criticism of this belief, see Mark Cooney, *Why is Economic Analysis So Appealing to Law Professors?*, 45 STAN. L. REV. 2211, 2230 (1993) (book review) ("It is striking that empirical scholars, particularly those whose work brings them into close and sustained contact with their subjects . . . do not adopt a rational actor-model of human behavior.").

39. Some have questioned whether this belief about presumed creditor behavior is in fact true as a matter of observable human behavior. *See, e.g.,* Carlson, *Theory, supra* note 1, at 463; Korobkin, *Rehabilitating Values, supra* note 1, at 737-38 nn. 91-94; Rusch, *supra* note 18, at 1327-28.

that should be promoted.⁴⁰ Each creditor is *presumed* to not object to a procedure that will allow other creditors to collect their debts as long as its own debt also is collected. Thus if the law fosters creditors' collective wealth maximization, the creditors are presumed not to object. This combination of a belief about creditor rationality and a value of collective creditor wealth maximization paints a creditor as existing for one purpose—maximizing creditor collective pecuniary wealth.⁴¹

In spite of the above described belief and value, which seem to depend upon a type of cooperative human behavior, the creditors' bargain theory has an underlying belief that people will not cooperate without coercion of some sort. This belief about community behavior is reflected in the idea that creditors must be stayed by law from pursuing their own individual attempts to collect debts.⁴² Without the benefit of the law forcing creditors to stop collection efforts, each creditor would be unwilling to put aside its own interests for the interests of the community. This belief presents the community as a group of people forced to work together based upon an external determination of the common good defined above—creditor collective wealth maximization.

A value promoted in the creditors' bargain theory is that the contractual bargaining model embodied in state law debtor and creditor relations is the optimal way to distribute resources in the market. This value is reflected in the creditors' bargain theory by the idea that distributions of property and money in bankruptcy should be based upon state law created property and contract rights.⁴³ Without this underlying value, the creditors would have no greater right to the going concern value than would the equity owners.⁴⁴ As in many economic models, contracts and bargaining in the market is held to be the ideal resource distribution system.⁴⁵

An additional value promoted in the creditors' bargain theory

40. See, e.g., Jackson & Scott, *supra* note 1, at 160.

41. Reducing all considerations to one value is attractive in the sense that it appears to make solutions to problems easier. Such reductionism, however, does not really make the choices easier; it merely masks the relevant considerations. See Steven D. Smith, *Reductionism in Legal Thought*, 91 COLUM. L. REV. 68, 77-84 (1991).

42. Jackson, *Of Liquidation*, *supra* note 1, at 402-03.

43. Jackson & Scott, *supra* note 1, at 160.

44. For criticism of the creditors' bargain reliance on state law rights, see Carlson, *Theory*, *supra* note 1, at 460-62; Rusch, *supra* note 18, at 1331 n.82.

45. In the creditors' bargain view, only those with contractual rights are considered part of the creditors' bargain. Baird & Jackson, *Corporate Reorganizations*, *supra* note 4, at 103-05. See generally Posner, *supra* note 20, § 1.2 at 14 (efficiency tested by what would happen in a hypothetical market). For criticism of the exclusion of non-creditors and the debtor from the bargaining, see Carlson, *Theory*, *supra* note 1, at 471-78.

is that the creditors should have the power to control the debtors' future.⁴⁶ This value of creditor control is based on three things: the belief that creditors are rational, the value of creditor collective wealth maximization, and the value of contractual bargaining. Because contracts based upon bargaining should be respected, the creditors and the debtor through their pre-bankruptcy contracts have decided how to divide the debtor's assets. The creditors will rationally decide how to put the assets to the best use to maximize collective creditor recovery. The creditors are viewed as the owners of the debtor's assets when the debtor fails to pay and the creditors should control how those assets are used. This leads to the conclusion that the creditors should have the power to decide if and how to create any going concern value.

The beliefs and values that support the creditors' bargain theory paint a picture of a person as an individual whose only concern is maximizing individual pecuniary wealth. This person does not willingly agree to be a part of a community but must be coerced to subordinate individual immediate gratification for a longer term community interest. The community is not held together by a common bond of well being but rather by the dictates of an external force, i.e. law. The optimal way to distribute resources in the community is bargaining in the market between members of the community. Parties will bargain based upon the principle of maximizing their individual pecuniary wealth. This bargaining process within a debtor's bankruptcy case is presumed to enhance collective wealth. Other considerations in the redistribution of resources should be ignored. Finally, the persons in charge of making decisions regarding communal rules and resources are those with the recognized contractual claims to the assets. Those persons who have no recognized contractual claims to the assets should have no input into community decisions regarding those assets.

B. Loss Allocation

The commentators who favor a loss allocation perspective⁴⁷ of bankruptcy naturally draw a different portrait of the nature of a

46. See Baird & Jackson, *supra* note 6.

47. Several authors write from this perspective, although not necessarily in concert with each other. See Ayer, *supra* note 1, at 435-43. The main proponents of this perspective are Donald R. Korobkin, Elizabeth Warren, Raymond T. Nimmer, and David Gray Carlson. See, e.g., Korobkin, *Contractarianism*, *supra* note 5; Warren, *Bankruptcy Policy*, *supra* note 1; Nimmer, *supra* note 10, at 1013-34; Carlson, *supra* note 2. Professor Korobkin has proposed an alternative to the economic model to justify bankruptcy law. Korobkin, *Contractarianism*, *supra* note 5; Korobkin, *Rehabilitating Values*, *supra* note 1; Korobkin, *Value and Rationality*, *supra* note 1. Part II.B of this Article is based on Korobkin's work.

person, the nature of the community, the optimal resource distribution method, and the proper allocation of decision making power. Given the different beliefs and values that underlie the loss allocation perspective, it is no surprise that this theory looks different from the creditors' bargain theory.

The loss allocation theorists describe bankruptcy as a process used to allocate resources among all parties affected by a debtor's financial distress.⁴⁸ Bankruptcy is designed to respond to the problem of financial distress, not the problem of creditor collection.⁴⁹ Bankruptcy reorganization provides a process for the parties to engage in discussion about what the future of the debtor will be, i.e. how the debtor's future value will be generated and divided among the affected parties.⁵⁰ The circumstance of financial distress provides the catalyst for a reexamination of the debtor's future.⁵¹

The bankruptcy process is designed to respond in a flexible manner to the crisis of financial distress and to competing concerns and values of the affected parties.⁵² These concerns and values cannot be compared on some absolute hierarchical scale that will lead to a decision about a dominant value.⁵³ Through coordination of behavior, bankruptcy should attempt to accommodate as many of these concerns and values as possible.⁵⁴ In deciding how to accommodate as many of the competing interests as possible, once the limits of coordination are reached, some consideration should be given to those parties who occupy the most vulnerable position, that is, those parties with the most to lose if their values are frustrated.⁵⁵

In the loss allocation school, the focus of bankruptcy is on the "fairness" of the process, not the ultimate distributional result achieved. The bankruptcy process is a justified response to financial distress if it is inclusive of all affected parties, is flexible, seeks to achieve as many divergent aims as possible, and gives consideration to the parties in the most vulnerable position.⁵⁶ The bank-

48. Korobkin, *Rehabilitating Values*, *supra* note 1, at 762; Warren, *Bankruptcy Policy*, *supra* note 1, at 781, 783-84.

49. Korobkin, *Rehabilitating Values*, *supra* note 1, at 766-68.

50. Korobkin, *Rehabilitating Values*, *supra* note 1, at 768-87.

51. Korobkin, *Rehabilitating Values*, *supra* note 1, at 763-66.

52. See Korobkin, *Value and Rationality*, *supra* note 1, at 351-65.

53. Korobkin, *Rehabilitating Values*, *supra* note 1, at 765 & n.222; Korobkin, *Value and Rationality*, *supra* note 1, at 341-42. See generally Richard H. Pildes, *Conceptions of Value in Legal Thought*, 90 MICH. L. REV. 1520 (1992) (reviewing MARTHA C. NUSSBAUM, *LOVE'S KNOWLEDGE* (1990)) (discussing incommensurable values).

54. Korobkin, *Contractarianism*, *supra* note 5, at 581-84.

55. Korobkin, *Contractarianism*, *supra* note 5, at 584-89.

56. Korobkin, *Contractarianism*, *supra* note 5, at 572-89.

ruptcy judges who adjudicate the disputes of the parties guide this process in particular cases using these principles within the framework of the applicable legislation.⁵⁷ In making those decisions, the judges should not be controlled by an end result rule, but by the rationality of the process of decision making along the guidelines outlined above within the statutory framework.⁵⁸

The loss allocation theorists base this process orientated school on beliefs and values both similar and different from the creditors' bargain beliefs and values. The first belief is the same as the creditors' bargain belief that a greater going concern value exists and can be preserved if the business is reorganized rather than liquidated. This greater going concern value consists of more than the capitalized earnings and the balance sheet of the business.⁵⁹ In the loss allocation theory, this belief provides the basis for the ongoing discussion concerning the future of the business.

The second belief is that individuals make rational decisions using a type of cost-benefit analysis but also take into account many values and aims other than individual wealth maximization.⁶⁰ Because an individual will not know all the costs or benefits of a particular course of action, a cost-benefit analysis which affords certainty to the decisionmaker cannot take place. In addition, an individual will often have to make choices between incommensurable aims.⁶¹ Both the belief that individuals consider more than monetary wealth and the belief that cost-benefit analysis is uncertain are necessary to the loss allocation theory, as these beliefs create the common ground necessary to have productive discussions about the debtor's future. If solely pecuniary interest controlled an individual's decision making, outcomes were certain, or values commensurable, common ground for discussion about the debtor's future would not exist.

The loss allocation theorists' belief about the nature of the community is also different from the creditors' bargain theorists' belief. In the loss allocation theory, the belief is that the community affected by the debtor's financial distress will recognize that everyone is in the process together. The community, once it recog-

57. See Korobkin, *Value and Rationality*, *supra* note 1, at 351-65; Korobkin, *Contractarianism*, *supra* note 5, at 595-627.

58. See Korobkin, *Value and Rationality*, *supra* note 1, at 351-65.

59. See Korobkin, *Rehabilitating Values*, *supra* note 1, at 768-72 (proposing that the enterprise's value consists of more than its balance sheet).

60. Korobkin, *Rehabilitating Values*, *supra* note 1, at 772-74; see Korobkin, *Contractarianism*, *supra* note 5, at 579-89; Korobkin, *Value and Rationality*, *supra* note 1, at 342-43.

61. See Korobkin, *Value and Rationality*, *supra* note 1, at 344-51.

nizes that common interest, will work to come to an agreed result regarding the debtor's future. The primary role of the automatic stay is not to force the community to forgo its individual interests; rather, the automatic stay provides the space necessary to allow the community to recognize its shared stake in the debtor and engage in a dialectic process regarding the debtor's future.⁶²

Both the loss allocation and creditors' bargain theorists value the contractual bargaining model as a method of resource distribution. In the loss allocation theory, however, each party's claim to the assets is not determined solely by contractual entitlements, but also by legislative and judicial distributional judgments⁶³ designed to protect traditionally disenfranchised parties⁶⁴ or to prefer certain types of claimants based upon non-bankruptcy reasons.⁶⁵ Although the loss allocation theorists also support bargaining as a way to distribute resources outside of the bankruptcy process, the loss allocation theorists broaden the distribution of leverage necessary to the bankruptcy bargaining process to both contractual and non-contractual claimants.⁶⁶ This focus on inclusiveness of all claimants is necessary to make the process of distributing losses among all affected parties work.

Finally, the loss allocation theorists value the impartiality and wisdom of the bankruptcy judge as the proper repository of power to decide an issue in the event the parties do not agree and Congress has not given a clear answer.⁶⁷ Given that the focus of the loss allocation school is on the process of decision making rather than on the final result, the judges decide the particular issues before them based upon the fairness of the process in light of legislative judgments in the statute.⁶⁸ While some consideration is given to the ideal of deciding like cases alike, in the throes of financial distress, like cases are unlikely. Thus, the benchmark for a just decision in a particular case is to come to the fairest result possible at this time in this case consistent with the legislative rules using the concepts of inclusiveness, flexibility, achieving as

62. Korobkin, *Rehabilitating Values*, *supra* note 1, at 777-80; Korobkin, *Contractarianism*, *supra* note 5, at 598-601. *But see* Bowers, *Murphy's Law*, *supra* note 1, at 72-76 (criticizing Korobkin's account as "talk therapy" for debtors); Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 *Tex. L. Rev.* 51, 90-92 (1992) (criticizing Korobkin's account as unrealistic).

63. *See* Korobkin, *Contractarianism*, *supra* note 5, at 581-89, 607-08.

64. *See, e.g.*, 11 U.S.C. § 507(a)(3) (1988) (priority distributions for wage claimants).

65. *See, e.g.*, 11 U.S.C. § 507(a)(7) (1988) (priority distribution for unsecured tax claims).

66. Korobkin, *Contractarianism*, *supra* note 5, at 572-75.

67. *See* Korobkin, *Value and Rationality*, *supra* note 1, at 351-65.

68. *See* Korobkin, *Value and Rationality*, *supra* note 1, at 351-65.

many aims as possible, and protecting the most vulnerable.⁶⁹ This allocation of judicial power is necessary because otherwise the process of allocation of losses would stagnate indefinitely if recalcitrant parties who refused to cooperate could stymie the process.

Just as in the creditors' bargain theory, the values and beliefs inherent in the loss allocation theory outlined above reflect a set of values and beliefs about the nature of a person, the nature of the community, the optimal method for distributing resources, and the optimal allocation of decision making power. In the loss allocation world, an individual is a person who makes decisions using a type of cost-benefit analysis laced with value choices and uncertain outcomes. That individual recognizes that he or she is part of a community of persons affected by another's financial distress and that all members of the community will bear some loss because of that distress. The community is governed both by legislative judgments and by bargaining in deciding how the losses should be allocated among the parties. Legislative distributional judgments are guided by the ideas of protection of disenfranchised parties or other non-bankruptcy considerations. Given the possibility of widely divergent opinions regarding optimal resource distribution when the statute does not provide a clear answer, the decision making power regarding such distribution in a particular case should reside in the bankruptcy judge. The judge should attempt to come to the fairest result possible in a particular case, seeking to achieve as many of the divergent aims as possible.

C. Conclusion

In comparing the beliefs of the creditors' bargain theorists with the beliefs and values of the loss allocation theorists, one can see both similarities and differences in those beliefs and values regarding the nature of a person and the optimal method of resource distribution. Both sets of theorists believe in the rationality of the individual in making decisions. However, the beliefs diverge in defining rationality. The creditors' bargain theorists define rationality by one value only, pecuniary wealth maximization. In contrast, the loss allocation theorists define rationality as allowing the individual to consider other values in addition to pecuniary interests. Both sets of theorists believe in bargaining as the optimal method of resource distribution. The creditors' bargain theorists advocate for a "pure" market unfettered by legislative distributional judgments. The loss allocation theorists recognize the legitimacy of

69. See Korobkin, *Contractarianism*, *supra* note 5, at 572-89.

such legislative judgments to protect some types of claimants from the full force of the debtor's losses.

Very little common ground in beliefs can be found regarding the nature of the community and the optimal allocation of decision making power. The creditors' bargain theorists portray the community as a group that must be forced against its will to participate in the debtor's rehabilitation. The loss allocation theorists paint the community as a group that relies on the prospect of cooperative behavior to rehabilitate the debtor, once the members of that community consider a perspective other than their own. The creditors' bargain theorists almost deify the creditors in their wisdom to make "correct" decisions about the debtor's future. The loss allocation theorists do the same to the bankruptcy judge, trusting that entity with the decision making power when the statute does not provide a clear answer.

III. ATTEMPTED JUSTIFICATIONS FOR THE THEORISTS' BELIEFS AND VALUES

Each proponent of the various theories attempts to justify his or her own beliefs and values regarding the "proper" bankruptcy paradigm using three primary methods: (1) an appeal to a historical foundation, (2) an appeal to empirical proof, and (3) an appeal to the normative aspirations for society. This process of justification is generally done on two parallel tracks: first, that these bases support the proposed theory; and, second, that these bases demonstrate the absurdity of the other theory. None of the three justification methods, however, convince the opposing theorist that his or her own beliefs are false or that his or her own values are unworthy. Repeatedly reiterating these justification methods does not go very far towards justifying either side's beliefs and values.

A. *Appeal to the Historical Foundation*

Both the creditors' bargain theorists and the loss allocation theorists appeal to the history of debtor-creditor legislation as support for the values and beliefs embodied in those theories.⁷⁰ The laws governing debtor-creditor relationships have embodied various concepts over time. In the history of bankruptcy and debtor-creditor relations, the law has reflected the concepts of punishing

70. See Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 860 & n.18; JACKSON, *LOGIC AND LIMITS*, *supra* note 4, at 7-11; Korobkin, *Rehabilitating Values*, *supra* note 1, at 744-55.

the debtor for not paying,⁷¹ coercing the debtor to pay,⁷² and forgiving the debtor for not paying.⁷³ These laws have been in response to economic cycles⁷⁴ and reflect perceptions of various beliefs and values, such as the desirability of credit and the merchant class,⁷⁵ the relative fault of the debtor for being unable to pay,⁷⁶ the creditor's right to be paid,⁷⁷ and the morality of not paying all of one's just debts.⁷⁸

The creditors' bargain theorists seem to rely on the historically based values of the immorality of not paying one's just debts and the creditors' right to be paid. These historically based values directly support the creditors' bargain theorists' values of holding state sanctioned contract and property rights as sacrosanct⁷⁹ and of placing the decision making power in the hands of the "true" owners of the insolvent debtor, i.e. the creditors.⁸⁰ The creditors' bargain theorists advocate that state law that created the reciprocal duty to pay and the right to be paid should be respected and enforced in bankruptcy because one should pay one's debts and creditors have a right to be paid.

The loss allocation theorists seem to rely on the historically based values and beliefs that debtors are not necessarily immoral if unable to pay all of their debts, the debtor is not always at fault for its inability to pay debts, and the creditor is not always entitled to be paid. These historically based values and beliefs are some-

71. Frimet, *supra* note 7, at 161-63; Levinthal, *Early History*, *supra* note 7, at 228-31; PETER J. COLEMAN, DEBTORS AND CREDITORS IN AMERICA 12 & n.3 (1974); CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY 5 (1935); EDWARD T. BALDWIN, A CONCISE TREATISE UPON THE LAW OF BANKRUPTCY 1-2 (3d ed. 1883).

72. COLEMAN, *supra* note 71, at 3-5 (stating debtor's prison was a coercive tool to attempt to force debtors to pay their creditors); Jay Cohen, *The History of Imprisonment and Its Relation to the Development of Discharge in Bankruptcy*, 3 J. LEGAL HIST. 153, 155 (1982) (discussing debtor's prison as a coercive tool).

73. See Tabb, *supra* note 8; WARREN, *supra* note 71, at 49-92 (describing the historical period of 1827-61 where agitation for debtor relief occurred); Richard E. Flint, *Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor*, 48 WASH. & LEE L. REV. 515, 527-31, 543-54 (1991).

74. See WARREN, *supra* note 71, at 9; Frimet, *supra* note 7. For a good description of the economic cycles in United States history, see PAUL STUDENSKI & HERMAN E. KROSS, FINANCIAL HISTORY OF THE UNITED STATES 83-86, 108-09, 124, 127, 181-82, 218-21, 252-53, 330, 334-36 (2d ed. 1963).

75. See Tabb, *supra* note 8, at 335-36; Weisberg, *supra* note 7, at 22-34.

76. See COLEMAN, *supra* note 71, at 16-30. See generally Weisberg, *supra* note 7, at 34-39; Tabb, *supra* note 8, at 338.

77. Weisberg, *supra* note 7, at 40-43; Radin, *supra* note 7, at 3 (bankruptcy is a creditors' remedy); Levinthal, *Early History*, *supra* note 7, at 225 (bankruptcy seeks primarily to protect creditors).

78. Shuchman, *supra* note 11, at 428-39; Frimet, *supra* note 7, at 165.

79. See *supra* notes 43-45 and accompanying text.

80. See *supra* note 46 and accompanying text.

times summed up in the phrase "a fresh start for the 'honest but unfortunate debtor'."⁸¹ The loss allocation theorists use these values and beliefs to support their ideas that contractual entitlements based upon the duty to pay and right to be paid are not the only determinates of how to distribute resources in a bankruptcy.⁸² Both the community of persons affected by the debtor's financial distress and the bankruptcy judge are involved in deciding when it is "just" for the debtor not to pay its contractual and non-contractual obligations,⁸³ that is, is this that honest but unfortunate debtor who deserves a fresh start?

Both the creditors' bargain and the loss allocation theories have support in the history of debtor and creditor relationships. While history may give context to the development of both sets of values and beliefs, it is difficult to see how either theory can be wholeheartedly accepted or rejected based solely on history. Historically held values and beliefs are evidence that people at one time perceived a particular result or activity as a good thing or thought that a particular fact was true. Merely because those values and beliefs did exist does not mean that the values are in fact desirable or that the beliefs are in fact true. Precisely because the historical values and beliefs can be easily discounted as presently not desirable or untrue, each set of theorists can easily discount the opposing theorists' reliance on history as justification for their respective theories.

B. Appeal to Empirical Proof

Both theories have a set of beliefs about the "true" nature of a person and the "true" nature of a community.⁸⁴ Each belief appears to be the type of fact that could be tested empirically. Writers in each camp seem to draw on personal experience and instinct to support their view of the empirical truth of these beliefs. Unfortunately, very little scientifically based empirical work is done in the area of how debtors and creditors interact and make decisions in the context of a debtor's financial distress.⁸⁵

The empirical work that has been done points to a state of

81. See Weisberg, *supra* note 7, at 7-10; Tabb, *supra* note 8, at 338, 370. This phrase "honest but unfortunate debtor" is derived from *Local Loan Co. v. Hunt*, 292 U.S. 234, 244 (1934).

82. See *supra* notes 63-66 and accompanying text.

83. See *supra* notes 62, 67-69 and accompanying text.

84. See *supra* notes 38-39, 42, 60-62 and accompanying text.

85. Ayer, *supra* note 1, at 443-47; Teresa A. Sullivan et al., *The Use of Empirical Data in Formulating Bankruptcy Policy*, 50 LAW & CONTEMP. PROBS. 195, 198-209 (Spring 1987).

affairs unlike either theorists' set of beliefs about the nature of a person and the nature of the community. For example, Professors LoPucki and Whitford have presented some evidence that persons affected by a debtor's financial distress do not look to notions of the collective good of the enterprise nor to their own individual pecuniary interest in deciding how the assets of the debtor are distributed or the reorganization of the debtor is achieved.⁸⁶ Professors Sullivan, Warren, and Westbrook paint a picture of consumer debtor behavior based upon the debtor's individual moral convictions, and the local legal culture in deciding whether to file a Chapter 7 or a Chapter 13 petition,⁸⁷ not on whether the debtor is advocating its own pecuniary or other interests. Professor Shuchman's work supports the idea of the unfortunate but deserving consumer debtors who need relief from their debts.⁸⁸

The empirical research that has been done to date has not extensively analyzed the affected parties' motivations or decision making process in the context of the debtor's financial distress. Professors LoPucki and Whitford have studied extensively a group of large publicly held companies,⁸⁹ but that research might be very difficult to use to draw generalizations to the behavior of other types of debtors and creditors.⁹⁰ Given the lack of empirical research on the motivations of both debtors and creditors in all types of bankruptcy cases, both sides of the bankruptcy debate are unjustified in relying on empirical data to support their respective

86. See LoPucki & Whitford, *Bargaining Over Equity's Share*, *supra* note 6, at 154-58 (noting study of 43 large publicly held companies on the issue of distribution to "underwater" equity holder concludes that ability to get distribution depends upon equity's bargaining leverage and the negotiating skill of the persons representing equity); Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669, 673 (1993) [hereinafter LoPucki & Whitford, *Corporate Governance*] (stating management incentives in reorganization are not consistently for the benefit of any one of the three major groups: management, creditors, or shareholders).

87. TERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS 243-44, 246-52, 337 (1989).

88. Philip Shuchman, *New Jersey Debtors 1982-83: An Empirical Study*, 15 SETON HALL L. REV. 541 (1985) (examining income/assets/liabilities of individual debtors, concluding that majority were just barely above poverty level); Philip Shuchman, *The Average Bankrupt: A Description and Analysis of 753 Personal Bankruptcy Filings in Nine States*, 88 COM. L.J. 288 (1983) (examining income/assets/liabilities of individual debtors, concluding that majority were just barely above poverty level); see also Jagdeep S. Bhandari & Lawrence A. Weiss, *The Increasing Bankruptcy Filing Rate: An Historical Analysis*, 67 AM. BANKR. L.J. 1 (1993) (increase in filings after adoption of 1978 Code more likely caused by the decreasing ability of society as a whole to pay debts than to change in the law).

89. See LoPucki & Whitford, *Bargaining over Equity's Share*, *supra* note 6; LoPucki & Whitford, *Corporate Governance*, *supra* note 86; LoPucki & Whitford, *Patterns*, *supra* note 10.

90. See LoPucki, *Trouble*, *supra* note 1, at 756-59.

belief systems about the "true" nature of a person or community.

C. *Appeal to Normative Aspirations for Society*

Given the inability of either set of theorists to support convincingly their theories with historical or empirical evidence, the theorists engage in a battle over the correct normative paradigm for debtor and creditor relationships in the context of the debtor's financial distress. The creditors' bargain theorists argue against the current bankruptcy scheme as violating their normative paradigm.⁹¹ The loss allocation theorists support the current bankruptcy scheme as following their normative paradigm.⁹² Both in the courts and in Congress, the battle between the underlying values and beliefs of the two schools is captured in the inquiry, "what are the purposes of bankruptcy?"⁹³ The creditors' bargain theorists want that answer to be enhanced collective creditor recovery. The loss allocation theorists want that answer to be a fair process of loss allocation among all affected parties.⁹⁴

This debate over the "correct" normative paradigm is the debate over how society should deal with financial distress in a credit based economy⁹⁵ and cannot be divorced from value judgments regarding the obligation to pay debts.⁹⁶ Although the creditors' bargain theorists do not admit that their theory requires any value choices, the theory nevertheless demands that a value choice be made that relief from debt obligations should exist only on terms acceptable to the debtor's creditors. The loss allocation theorists attempt to soften the essential value choice about the scope of the appropriate debtor relief by diffusing the decision making authority among the affected parties, the courts, and Congress. Even though both theories attempt to sidestep the value choice, both are in fact making different value choices regarding the debtor's obligation to pay debts. Each set of theorists think that the value choices they propose are the desirable choices for society and lobby the legal community to accept their divergent views of the correct aspirational normative paradigm.

At this normative paradigm level, the value choices are very

91. See *supra* note 1.

92. See *supra* note 1.

93. See Ponoroff & Knippenberg, *supra* note 18, at 695.

94. See *supra* notes 20-69 and accompanying text. One can see in these divergent answers the dichotomy between rules and standards that Duncan Kennedy drew almost 20 years ago. Duncan Kennedy, *Form and Substance in Private Law Adjudication*, 89 HARV. L. REV. 1685 (1976).

95. See Weisberg, *supra* note 7, at 5.

96. Shuchman, *supra* note 11, at 414-18; see Smith, *supra* note 41, at 73-75.

stark. Both sides clearly cherish different things as important and desirable. The debate rages on. The creditors' bargain theorists do not convince the loss allocation theorists. The loss allocation theorists do not convince the creditors' bargain theorists. In the absence of convincing justification for either theory as the "correct" aspirational normative paradigm, the debate at this level cannot be resolved.

IV. BANKRUPTCY JURISPRUDENCE AS PART OF THE OVERALL JURISPRUDENTIAL PICTURE

The bankruptcy jurisprudence debate is just one segment of a larger jurisprudential debate regarding law that has taken place over the centuries in the writings of various jurisprudential writers. In reviewing the historical jurisprudential debate, the same questions seem to be addressed repeatedly: (1) is law a legitimate exercise of power; (2) is the law enforcing the "correct" normative values; (3) are the legal decision makers following the law or are they making decisions using their own values and beliefs; and (4) is the law just? The theorists in the bankruptcy area are addressing those same questions using the language of debtor and creditor relations rather than the language of philosophy. The values and beliefs of the writer influence the resolution of these jurisprudential questions. Even though an understanding of the jurisprudential thinking can expand an understanding of the bankruptcy debate, jurisprudential thinking will not help the bankruptcy debaters escape from the necessary confrontation of their respective beliefs and values.

A. *Legitimacy of Law*

To legitimize law as authority that should be respected, the jurisprudential writing addresses whether law is different than the naked assertion of power by those who are in power in a particular society.⁹⁷ Thus, the jurisprudential writings on this issue ask the question, "what is law," or "what counts as law?" In attempting to answer those questions and, thus, legitimize law as a source of authority in a society, legal philosophers have espoused several different approaches.

97. See C. MURPHY, JR., *MODERN LEGAL PHILOSOPHY* 41-42, 48-61 (1978); Steve J. Burton, *Law as Practical Reason*, 62 S. CAL. L. REV. 747, 758-76 (1989). See generally Francis J. Mootz III, *Is the Rule of Law Possible in a Postmodern World?*, 68 WASH. L. REV. 249 (1993) (discussing the concept of the rule of law which posits that those in power follow the law rather than make the law).

One approach to that issue is natural law theory. The essence of natural law theory is that law is grounded in morality.⁹⁸ Morality is, in turn, grounded upon the needs and nature of human beings,⁹⁹ where a prime motivating need of humans is the need for social cooperation.¹⁰⁰ If the law can be traced to the need for human social cooperation or to other moral norms based upon the nature of the human being, then the law is legitimate and not a naked assertion of power.¹⁰¹ Conversely, those laws that contravene those moral norms are not legitimate laws and should not be "counted" as law.¹⁰²

The positivist approach to this issue originally was that law is the legitimate command of the state.¹⁰³ Legal positivists attempted to divorce law from moral norms.¹⁰⁴ Law was law even though not necessarily based upon any moral principles.¹⁰⁵ Law was not a mere naked assertion of power if law was enacted and enforced according to a fair process.¹⁰⁶

In reaction to the natural law and positivist approaches,¹⁰⁷ the

98. HADLEY ARKES, *FIRST THINGS: AN INQUIRY INTO THE FIRST PRINCIPLES OF MORAL AND JUSTICE* 8 (1986); JAMES E. HERGET, *AMERICAN JURISPRUDENCE, 1870-1970: A HISTORY* 8 (1990); Daniel C.K. Chow, *A Pragmatic Model of Law*, 67 WASH. L. REV. 755, 761-62 (1992); John Finnis, *Natural Law and Legal Reasoning*, 38 CLEV. ST. L. REV. 1, 3-4 (1990); Steven R. Salbu, *Law and Conformity, Ethics and Conflict: The Trouble with Law-Based Conceptions of Ethics*, 68 IND. L.J. 101, 108 (1992).

For an interesting perspective on the historical relationship between concepts of morality and law and the role of religious beliefs, see HAROLD J. BERMAN, *LAW AND REVOLUTION: THE FORMATION OF THE WESTERN LEGAL TRADITION* 165-98, 292-94, 520-38 (1983). See also Suzanne L. Stone, *In Pursuit of the Counter-Text: The Turn to the Jewish Legal Model in Contemporary American Legal Theory*, 106 HARV. L. REV. 813, 871 (1993) (discussing the differences between Jewish law, where the coercion of the law is justified by faith or belief in God, and contemporary legal theory, which has no ultimate coercive belief system).

99. HERGET, *supra* note 98, at 9-10; Robert P. George, *Recent Criticisms of Natural Law Theory*, 55 U. CHI. L. REV. 1371, 1373-75 (1988).

100. HERGET, *supra* note 98, at 9-10.

101. ARKES, *supra* note 98, at 27; HERGET, *supra* note 98, at 10-11.

102. ARKES, *supra* note 98, at 169-172; Harold J. Berman, *Toward an Integrative Jurisprudence: Politics, Morality, History*, 76 CAL. L. REV. 779, 780 (1988).

103. Berman, *supra* note 102, at 780; Daniel C.K. Chow, *Trashing Nihilism*, 65 TUL. L. REV. 221, 231-32 (1990) [hereinafter Chow, *Trashing*]; Chow, *supra* note 98, at 762-63; Herbert Hovenkamp, *Positivism in Law & Economics*, 78 CAL. L. REV. 815, 818 (1990); Salbu, *supra* note 98, at 126; see Hergert, *supra* note 98, at 12-21. Professor Hovenkamp briefly sketches the expansion of the positivist's approach to consider as law more than duly enacted or court stated rules. Hovenkamp, *supra*, at 819.

104. Berman, *supra* note 102, at 780; Hovenkamp, *supra* note 103, at 818; Steven R. Salbu, *Differentiated Perspectives on Insider Trading: The Effect of Paradigm Selection on Policy*, 66 ST. JOHN'S L. REV. 373, 376-77 (1992).

105. Morawetz, *supra* note 12, at 412-14.

106. Salbu, *supra* note 104, at 377-78; see Chow, *supra* note 98, at 763.

107. Martin P. Golding, *Jurisprudence and Legal Philosophy in Twentieth-Century America—Major Themes and Developments*, 36 J. LEGAL EDUC. 441, 452-53, (1986) (discussing realism as a reaction against positivist approach); Gary Minda, *The Jurisprudential*

legal realists started with the premise that language, the primary vehicle for law, is indeterminate.¹⁰⁸ Therefore, the interpretation of the law necessarily depends upon the values and perspective of the interpreter.¹⁰⁹ The enactment and enforcement of law is influenced by the political and cultural milieu of both the enactor and enforcer.¹¹⁰ Legal realists thus started toward the view of law as the assertion of power by those who happened to be in power or positions of authority.¹¹¹

As can be seen from the above summary, jurisprudential writing has gone from one side of the spectrum to the other on whether law is more than the naked assertion of power by those who happen to be in power. Theorists continue to debate this issue today.¹¹²

One can see the same debate regarding the legitimacy of law in the bankruptcy area. The creditors' bargain theorists challenged the academic world to "justify" bankruptcy reorganization.¹¹³ Such justification is needed only if one takes a non-positivist approach and looks beyond constitutionally prescribed authority to legitimize the law.¹¹⁴ In the creditors' bargain view, the mere enactment of positive law according to the constitutional parameters was in-

Movements of the 1980s, 50 OHIO ST. L.J. 599, 633-34 (1989) (discussing realism as a reaction against formalism). See generally HERGET, *supra* note 98, at 147-70; Robert S. Summers, *Pragmatic Instrumentalism in Twentieth Century American Legal Thought—A Synthesis and Critique of Our Dominant General Theory About Law and its Use*, 66 CORNELL L. REV. 861, 868-69 (1981).

108. Minda, *supra* note 107, at 634 & n.195; Salbu, *supra* note 104, at 379; Joseph W. Singer, *Legal Realism Now*, 76 CAL. L. REV. 465, 468-69 (1988) (book review).

109. Salbu, *supra* note 104, at 379-80; Singer, *supra* note 108, at 470-71.

110. Chow, *Trashing*, *supra* note 103, at 250-57; Singer, *supra* note 108, at 474-75; see Golding, *supra* note 107, at 448-63.

111. As has been noted by others, the critical legal studies movement can claim legal realism as its not too distant ancestor. Minda, *supra* note 107, at 636-37. Critical legal scholars take legal realism to another level of skepticism about law. Critical legal scholars have advanced the position that law is only politics and power. ANDREW ALTMAN, *CRITICAL LEGAL STUDIES* 14-15 (1990); Chow, *Trashing*, *supra* note 103, at 233-34; Mark Tushnet, *Critical Legal Studies: A Political History*, 100 YALE L.J. 1515, 1524-26 (1991).

112. See Mootz, *supra* note 97 (critiquing the Enlightenment version of the rule of law and offering a post-Enlightenment interpretation of the same); Minda, *supra* note 107 (describing philosophical debate about the legitimacy of law and new critiques of law such as law and economics, critical legal studies and feminist jurisprudence); Morawetz, *supra* note 12 (describing and analyzing debate between foundationalists and anti-foundationalists in judicial decision making); Chow, *supra* note 98 (describing a method of thinking about law that is neither foundationalist nor anti-foundationalist but charts a "middle course" based on the principle of coherence). *But see* Joseph Raz, *The Relevance of Coherence*, 72 B.U. L. REV. 273 (1992) (coherence with existing beliefs does not justify beliefs; law coherent with those beliefs is also not justified because of the coherence).

113. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 858-59, 907.

114. See U.S. CONST. art. I, § 8, cl. 4.

sufficient to support bankruptcy as a legitimate law. Although not advocating disobedience to the enacted bankruptcy law, the creditors' bargain theorists looked for guiding principles outside the bankruptcy legislation to legitimize the positive law. In contrast, the loss allocation theorists take a more positivist approach and support the duly enacted law that is enforced according to a fair process and implements the norms the state has accepted.¹¹⁵ The fairness of the process justifies the law.¹¹⁶ The loss allocation theorists also acknowledge the role of political compromise in the enactment of the positive law.¹¹⁷ This debate about justifying bankruptcy law is the same as the debate about justifying law in general.

How one addresses this question of law's legitimacy is influenced by one's beliefs about the nature of a person and by one's values regarding optimal power allocations. For example, given that the creditors' bargain theorists believe that creditors are rational wealth maximizers who should hold the decision making power about the debtor's future, it makes sense that the creditors' bargain theorists think current bankruptcy law is not a legitimate exercise of congressional power. Current bankruptcy law gives enormous power to the debtor to decide its future.¹¹⁸ Conversely, the loss allocation theorists are more willing to accept the duly enacted positive law because that law accords with (i) the belief that individuals make decisions by choosing among incommensurable aims with uncertain outcomes and (ii) the allocation of decision making power when parties disagree to an impartial third party, the bankruptcy judge.¹¹⁹ One's perspective of the legitimacy of a particular law is apparently influenced by whether that law accords with one's beliefs and values.

B. Law and the "Correct" Normative Paradigm

Jurisprudential thinkers have struggled with whether we can be certain that the law is enforcing the "right" normative goals. In this search for the correct normative paradigm, three dominant approaches have emerged; natural law, cultural relativism, and criti-

115. See *supra* notes 56-62 and accompanying text.

116. See *supra* notes 56-58 and accompanying text; Korobkin, *Contractarianism*, *supra* note 5, at 572-89 (summarizing the bankruptcy choice model based on JOHN RAWLS, *A THEORY OF JUSTICE* (1971) as an inclusive process model).

117. Korobkin, *Contractarianism*, *supra* note 5, at 543; see Warren, *Bankruptcy Policy*, *supra* note 1, at 785-93.

118. LoPucki, *Trouble*, *supra* note 1, at 732-39.

119. See Korobkin, *Contractarianism*, *supra* note 5, at 595-98.

cal legal studies.

The natural law theorists have advanced two normative bases: (1) the normative goal of social cooperation to promote the common good,¹²⁰ and (2) the ability to derive moral truths about individual rights from the ideas that humans are rational beings and the concept of morals itself.¹²¹ If the law can be traced to these identified normative bases through logical reasoning, then we can be certain that we have the "right" normative answer.¹²² In addition, most natural law theorists have advanced the idea that these normative bases are the "right" answer for all people, in all times, and in all cultures.¹²³ These normative goals are the desirable normative goals regardless of the desires of the community itself.¹²⁴

In direct contrast to the natural law concept of normative bases, the relativists respond with the idea that the people of the particular community decide what normative goals should be advanced through law.¹²⁵ The relativists depend upon the idea of community consensus to determine whether the law advances the "right" normative goal.¹²⁶ If the community has a consensus that the norm advanced in the law is "right," then we can be more certain that the norm is a valid "right" answer.

Unlike either of the two approaches above, the critical legal scholars advance the skeptics' argument that the search for certainty of normative principles is itself an illusion. They argue that we can never have any certainty that the normative goal advanced is the "right" answer.¹²⁷ The uncertainty is created by the indeter-

120. HERGET, *supra* note 98, at 9-10; Kent Greenawalt, *The Natural Duty to Obey the Law*, 84 MICH. L. REV. 1, 8-9 (1985).

121. ARKES, *supra* note 98, at 72-92, 159-74; Finnis, *supra* note 98, at 11 (moral absolutes exist).

122. ARKES, *supra* note 98, at 168-69; Berman, *supra* note 102, at 780; George, *supra* note 99, at 1387-89. *But see* Finnis, *supra* note 98, at 4-7 (reasoning from the "good" premises to the right answer in a particular case is not easy or clear).

123. ARKES, *supra* note 98, at 92, 162; Salbu, *supra* note 98, at 107-08.

124. Chow, *supra* note 98, at 761-62; Salbu, *supra* note 98, at 108 & n.27.

125. R. George Wright, *The Consequences of Contemporary Legal Relativism*, 22 U. TOL. L. REV. 73, 75-77 & n.6 (1990); *see* GRANT GILMORE, *THE AGES OF AMERICAN LAW* 109 (1977); Berman, *supra* note 102, at 795-97 (historical perspective needed on development of community values); Frederic R. Kellogg, *Legal Scholarship in the Temple of Doom: Pragmatism's Response to Critical Legal Studies*, 65 TUL. L. REV. 15, 52-53 (1990) (law is derived from individual moral and political beliefs of a society).

126. *See* Stephen A. Gardbaum, *Law, Politics, and the Claims of Community*, 90 MICH. L. REV. 685, 694 (1992); Dennis M. Patterson, *Law's Pragmatism: Law as Practice & Narrative*, 76 VA. L. REV. 937, 987-94 (1990) (law itself is a dialogue of competing visions for society); Salbu, *supra* note 98, at 109-10; *see also* LAWRENCE M. FRIEDMAN, *THE REPUBLIC OF CHOICE: LAW, AUTHORITY AND CULTURE* 197 (1990); MURPHY, *supra* note 97, at 131-34.

127. ALTMAN, *supra* note 111, at 13-15; Salbu, *supra* note 104, at 381; Salbu, *supra* note 98, at 124; Tushnet, *supra* note 111, at 1524-26.

minacy of language and the inability to demonstrate the clear choice for one normative goal over another.¹²⁸ Thus, the certainty that both the natural law theorists and the relativists have searched for regarding the correct normative principles is unattainable.

The parallel to the bankruptcy debate is striking. As stated previously, when the historical and empirical justification methods fail to convince the opposing theorist of the validity of the proposed beliefs and values, the only justification method left is the appeal to the normative aspirations for society.¹²⁹ The creditors' bargain theorists advance the correct normative paradigm as enhanced collective creditor pecuniary wealth maximization.¹³⁰ This relevance on a set normative principle using an economic model of human behavior is reminiscent of natural law reasoning. The loss allocation theorists, on the other hand, advance as the correct normative paradigm the distribution of losses among affected parties, as decided by Congress and reflective of some sense of community consensus.¹³¹ The reliance on a more free-flowing balancing of interests is reflective of a relativist approach to normative principles.

These differences in normative paradigms can be traced directly to the divergent values regarding distribution of resources. The creditors' bargain theorists support the normative goal of enhanced collective creditor recovery in part upon the notion of contractual entitlements.¹³² The loss allocation theorists support the

128. ALTMAN, *supra* note 111, at 14-15. Critical legal scholars look at power as an important part of how law defines norms. ALTMAN, *supra* note 111, at 14-15; see Stephen J. Schnably, *Property and Pragmatism: A Critique of Radin's Theory of Property and Personhood*, 45 STAN. L. REV. 347, 361 (1993). In the extreme version of skepticism, one confronts the epistemological dilemma of proving how one acquires "knowledge" of anything. One version of this issue is how do we know that we really exist. See Chow, *Trashing*, *supra* note 103, at 261-62 & n.182. See generally 3 & 4 ENCYCLOPEDIA OF PHILOSOPHY 8-38 (reprinted 1972) (historical account of various epistemological schools of thought).

In partial response to an extreme version of skepticism, some writers are looking at law as a pragmatic means to identified ends. This view of law does not seek to identify moral norms and then enforce those norms. Rather, this view of law asks what do we want the law to address and suggests that the law should then be structured to achieve those ends. See R.A. POSNER, *THE PROBLEMS OF JURISPRUDENCE* 465 (1990); Singer, *supra* note 108, at 501-03; Summers, *supra* note 107, at 882-89. See generally Steven D. Smith, *The Pursuit of Pragmatism*, 100 YALE L.J. 409 (1990); *Symposium on the Renaissance of Pragmatism in American Legal Thought*, 63 S. CAL. L. REV. 1569 (1990).

Professor Chow advances a slightly more elaborate version of pragmatism drawing into the ends-means analysis the need for coherence with existing beliefs and traditions. Chow, *supra* note 98, at 810-14. *But see* Raz, *supra* note 112.

129. See *supra* notes 91-96 and accompanying text.

130. See *supra* notes 40-41 and accompanying text.

131. See *supra* notes 48-58 and accompanying text.

132. See *supra* notes 40-45 and accompanying text.

normative goal of loss distribution in part upon the recognition of contractual and non-contractual claims to the debtor's assets.¹³³ The values that lie beneath the surface of the theories influence the writers' perspective on whether the law is advancing the "correct" normative paradigm.

C. Constraining the Decision Maker's Discretion

Many jurisprudential writers address whether the decision maker's discretion in applying the law in particular cases can be constrained. The primary concern is whether there is a method of law that can constrain the discretion of the decision maker in adjudicating disputes so that the adjudicator's own values and beliefs will not intrude into the application of the law.¹³⁴ The basic dichotomy of philosophy is between the realists and the formalists.

The formalistic style of legal reasoning was based upon the idea that the application of the legal rule to the facts at hand depended solely on reasoning using deductive logic.¹³⁵ Essential to a formalistic type of reasoning is a beginning taxonomy of propositions or classification of concepts.¹³⁶ Some scholars such as Oliver Wendell Holmes and John H. Wigmore attempted to develop such classifications.¹³⁷ This school of thought was heavily influenced by the idea that law could be a science, with set principles and logical reasoning from those principles to conclusions in particular cases.¹³⁸

The legal realists attacked this methodology by demonstrating the indeterminacy of language and the multiplicity of facts that went into defining the legal rule or the choosing of the particular legal rule to apply to the facts at hand.¹³⁹ This attack focused on the idea that the judge's own values and beliefs must influence the

133. See *supra* notes 63-66 and accompanying text.

134. See Morawetz, *supra* note 12, at 389-96; Golding, *supra* note 107, at 461; Salbu, *supra* note 104, at 379-82; Summers, *supra* note 107, at 909-10. See generally Paul Gewirtz, *Remedies and Resistance*, 92 YALE L.J. 585, 607-08 (1983); P. John Kozyris, *In the Cauldron of Jurisprudence: The View From Within The Stew*, 41 J. LEGAL EDUC. 421, 427 (1991); Steven D. Smith, *Why Should Courts Obey The Law?*, 77 GEO. L.J. 113, 115-17 (1988).

135. Mark R. Brown & Andrew C. Greenberg, *On Formally Undecidable Propositions of Law: Legal Indeterminacy and the Implications of Metamathematics*, 43 HASTINGS L.J. 1439, 1445 (1992).

136. *Id.*

137. HERGET, *supra* note 98, at 31-116.

138. HERGET, *supra* note 98, at 12-22; see also BERMAN, *supra* note 98, at 151-64 (explaining law as deductive legal science); Singer, *supra* note 108, at 496-99.

139. See, e.g., Golding, *supra* note 107, at 459-60; Steven J. Burton, *Reaffirming Legal Reasoning: The Challenge From the Left*, 36 J. LEGAL EDUC. 358, 359-63 (1986); Chow, *supra* note 98, at 782; Minda, *supra* note 107, at 633-38; Singer, *supra* note 108, at 470-71.

judge's interpretation and application of the law.¹⁴⁰ Thus, the ability to constrain the judge's discretion through legal doctrine and methodology is unattainable.¹⁴¹

The creditors' bargain theorists and loss allocation theorists also debate if and how the decision maker's discretion should be constrained. The creditors' bargain theorists attempt to constrain bankruptcy judges' decision making and application of the law by criticizing decisions that veer from the creditors' bargain norms and that do not analyze the bankruptcy issue at hand using the economic methodology of finding the least costly or creditor wealth maximizing option.¹⁴² The creditors' bargain theorists' style of reasoning thus is a formalistic type of reasoning. The loss allocation theorists, in contrast, do not advocate the use of set normative principles, other than those embodied in the statute, and deductive logic from those non-statutory principles to constrain the judges' decision making. The ability of the judge to use discretion is vital to the loss allocation belief in the need for a flexible decision maker doing the best that can be done at the time in this one case.¹⁴³ The loss allocation theorists' style of reasoning is formalistic when discussing statutory analysis and non-formalistic when the statute does not provide a clear answer.

The debate about the appropriate range of discretion for the decision maker is influenced by the beliefs and values of the theorists. The creditors' bargain theorists' beliefs and values outlined earlier¹⁴⁴ lead to a desire to constrain significantly the bankruptcy judge's discretion in making decisions in particular cases. The bankruptcy judge's use of power to contradict the will of the credi-

140. ALTMAN, *supra* note 111, at 14-15; Chow, *supra* note 98, at 782-83; Salbu, *supra* note 104, at 379-80.

141. ALTMAN, *supra* note 111, at 14-18; Chow, *supra* note 98, at 782-83. *But see* Summers, *supra* note 107, at 908-16.

142. *See supra* note 1. In recent times, off-the-shelf formal methods of reasoning from other disciplines have been applied in legal reasoning as an attempt to provide a yardstick for acceptable legal reasoning. Perhaps one of the most pervasive uses of a non-legal discipline is the growth of the field called law and economics. Gary Lawson, *Efficiency and Individualism*, 42 DUKE L.J. 53, 53-54 (1992). Economics provides a formalistic style of reasoning that is viewed as more certain, less open ended and thus a better constraint on judicial decision making.

For a summary of main tenets of law and economics, see POSNER, *supra* note 20, at §§ 1.1-1.3, at 3-17; Thomas S. Ulen, *The Lessons of Law and Economics*, J. LEGAL ECON., Dec. 1992, at 103. For some of the typical criticisms of the principles of law and economics, see Hovenkamp, *supra* note 103; Kozyris, *supra* note 134, at 435-38; Gary Lawson, *Efficiency and Individualism*, 42 DUKE L.J. 53 (1992).

143. *See supra* notes 67-69 and accompanying text.

144. *See supra* notes 37-46 and accompanying text.

tors is criticized.¹⁴⁵ In contrast, the loss allocation theorists' beliefs and values¹⁴⁶ lead to a view of the bankruptcy judge's discretion as not only necessary but very desirable.

D. Justice and the Law

Perhaps the most difficult debate in jurisprudence is the question of justice. This debate involves the writers' visions of what constitutes a just society. The law itself is held up to the ideal that it should be an instrument of justice. The law should lead to just results in particular cases and is deemed a failure or inadequate when justice does not prevail.

The debate about what is justice, what is a just society, and whether the law is just, pervades both jurisprudential and philosophical debate. For example, the natural law theorists argue from their normative principles that societies and laws that compare favorably to those principles are just, whereas those societies and laws that do not compare favorably are unjust.¹⁴⁷ The relativists have a more difficult time of determining whether a society or law is just because of the inability to identify a workable criterion of justice beyond the consensus of the society itself.¹⁴⁸

In many ways, ideas about what is a just law are bound up with the ideas of law's legitimacy, normative paradigm, and methodology. If a law is legitimate, enforcing the correct norms and appropriately constraining the decision maker's discretion, the law is perceived as just. Just as those jurisprudential questions involve beliefs and values, ideas of justice involve questions of beliefs and values about morality and society. These beliefs are about many things, such as how society should be structured, how individuals should relate to the community, and how individuals should relate to other individuals.¹⁴⁹ The debate about justice depends upon the debaters starting with sets of beliefs and values. The natural law theorists start with the belief that people are rational beings who act with free will and ability to make choices to be "moral" or not.¹⁵⁰ The cultural relativists start with the belief that there is no

145. See Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 1, at 877.

146. See *supra* notes 47-68 and accompanying text.

147. See *supra* notes 98-102 and accompanying text.

148. See *supra* notes 125-26 and accompanying text.

149. See MARION SMILEY, *MORAL RESPONSIBILITY AND THE BOUNDARIES OF COMMUNITY* 255-72 (1992); Paul G. Haskell, *Teaching Moral Analysis in Law School*, 66 NOTRE DAME L. REV. 1025, 1029 (1991); Kennedy, *supra* note 94, at 1766-78; Michael S. Moore, *Moral Reality Revisited*, 90 MICH. L. REV. 2424, 2533 (1992); Pildes, *supra* note 53, at 1530-45; Stone, *supra* note 98, at 865-70.

150. See *supra* notes 120-21 and accompanying text.

set of ultimate beliefs against which to judge another society.¹⁵¹

The debate between the creditors' bargain theorists and the loss allocation theorists about whether the bankruptcy law is just is driven by the fundamental differences in the belief and value systems of the participants in the debate. As described earlier, those belief systems diverge in four main areas: (i) the nature of a person, (ii) the nature of the community, (iii) the optimal method of resource distribution, and (iv) the optimal allocation of decision-making power. Because the belief and value systems are so divergent, the writers' visions of what is a just bankruptcy law also diverge. That should be no surprise.

E. Conclusion

The debate in bankruptcy is a microcosm of the ongoing and unresolved debate in jurisprudence. Whether the debate uses jurisprudential terms or bankruptcy terms, the theorists' positions depend upon their respective values and beliefs. Nothing that any theorist has stated leads to a hope that the debate will be resolved in bankruptcy, any more than the debate will be resolved in jurisprudential thinking as a whole without confronting the underlying beliefs and values.

V. VALUES AND BELIEFS IN DEBTOR AND CREDITOR RELATIONSHIPS

To even begin to address the question of the purpose of bankruptcy law, scholars need to begin a forthright debate about the beliefs and values that lie beneath the words. Instead of debating doctrinal analysis and normative goals, we should be acknowledging and confronting the beliefs and values that influence that debate. In bankruptcy theory, the beliefs that seem to be the most basic are those beliefs and values that Professor Shuchman identified almost 20 years ago.¹⁵² Those beliefs and values revolve around the deceptively simple question, when is someone obligated to pay or excused from paying a debt.

That question encompasses a whole host of other questions. Is incurring debt a good or a bad thing? How much debt should be tolerated? What do we believe about those people who are unable to pay all of their debts? Should all debts be paid? What do we believe about those people who want the debts owed to them repaid? Do we value risk taking? When is risk taking to be discouraged? Do we value personal responsibility? When are we willing to

151. See *supra* notes 125-26 and accompanying text.

152. Shuchman, *supra* note 11.

relieve someone from that responsibility? Who do we believe is that "honest, but unfortunate" debtor?

Do the answers to those questions vary on a case-by-case basis? For example, perhaps a business run by a sole proprietor where the cause of financial distress is an unforeseeable medical catastrophe should be treated differently than a multimillion dollar company where the cause of financial distress is an overleveraged buyout by a group of insiders. Should society treat those two scenarios of financial distress with a law based on a one-size-fits-all mentality or should society treat those scenarios with a law tailored to the individual circumstances?¹⁵³ Can society financially afford a balkanized debtor-creditor law which conceivably might allow such individualized treatment?

This list of initial questions is intended to start a conversation about the beliefs and values in the area of debtor and creditor relations. Once we acknowledge that the debate about bankruptcy jurisprudence is really about our beliefs and values and how those beliefs and values both converge and diverge, perhaps we can see the common ground for building a bankruptcy system that will cohere with those beliefs and values to a great enough degree that we can say that the law is truly just.

153. See LoPucki, *Trouble*, *supra* note 1, at 756-59. In many ways, current practice could be moving toward individualized chapters that address different types of debtors; see also 11 U.S.C. §§ 1201-31 (1988) (farm debtor reorganization); S. 540, 103d Cong., 1st Sess. § 201 (1993) (proposing Chapter 10 reorganization for small businesses).