THE IMPLICIT "GOOD FAITH" REQUIREMENT IN CHAPTER 11 LIQUIDATIONS: A RULE IN SEARCH OF A RATIONALE?

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It is the dog, you know, that wags the tail—not the tail that wags the dog[1]

The United States Court of Appeals for the Third Circuit recently dismissed a liquidating chapter 11 case for "cause" under 11 U.S.C. § 1112(b) although the failed company was demonstrably in economic distress, "losing a lot of money" and "experiencing a dramatic downward spiral." The court's rationale? Where the solvent entity was not in "financial distress," in traditional rehabilitative terms, it did not establish that the petition was filed in good faith.[2]

"Good faith." The word means different things to different people.[3] Although courts have frequently expressed frustration with the vague and amorphous nature of the words,[4] the concept is firmly rooted in commercial law.[5] Indeed, the recurring theme of good faith has appeared with regularity throughout the history of U.S. bankruptcy statutes. The good faith requirement has historically appeared either as (i) a condition to the debtor's right to file and maintain proceedings aimed at

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[1] Letter from Charles Dogson to Marion Richards, (Feb. 8, 1886), *in* 2 THE LETTERS OF LEWIS CARROLL 620 (Morton Cohen ed., Oxford Univ. Press 1979).

[2] NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (*In re* Integrated Telecom Express, Inc.), 384 F.3d 108, 122 (3d Cir. 2004) (holding that chapter 11 petition was not filed in good faith and should have been dismissed although the debtor "was losing a lot of money," "was experiencing a dramatic downward spiral" and, as a result, had gone "out of business" where this distress otherwise "had no relation to any debt owned by Integrated."). The authors represented the Official Committee of Equity Security Holders in the case.

[3] BLACK'S LAW DICTIONARY 713 (8th ed. 2004) ("A state of mind consisting in (1) honesty in belief or purpose, (2) faithfulness to one's duty or obligation, (3) observance of reasonable commercial standards of fair dealing in a given trade or business, or (4) absence of intent to defraud or to seek unconscionable advantage."); *cf.* U.C.C. § 2-103 (2005) (defining good faith of merchant objectively as "honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade.").

[4] *See, e.g.*, *In re* Victory Constr. Co., 42 B.R. 145, 149 (Bankr. C.D. Cal. 1984) (stating "good faith" is meaningless, "merely a pejorative phrase, functioning at such a high level of abstraction that one can scarcely discern what might be underneath it.").

[5] *See, e.g.*, UCC § 1-203 ("Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement."); *see also* Wood v. Lucy, Lady Duff-Gordon, 222 N.Y. 88 (1917) (referring to the implied contractual covenant of good faith in terms of "instinct with an obligation.").

rehabilitation or reorganization; or (ii) a standard for the confirmation of debtor rehabilitation or reorganization proceedings.[6]

Today, however, a requirement that a chapter 11 petition be filed in good faith appears nowhere in chapter 11 of the Bankruptcy Code.[7] Rather, today's Bankruptcy Code requires only that a chapter 11 plan be "proposed in good faith" to be confirmed.[8] Any express requirement that a chapter 11 plan be filed in good faith was expressly deleted by Congress in 1978 when former chapters X and XI of the Bankruptcy Act were consolidated under the current chapter 11. The deletion appears to have been made in the recognition that the Bankruptcy Act's good faith filing requirement, which demanded that there be some realistic chance of a successful reorganization, was starkly inapposite to liquidating plans, which were otherwise enabled under chapter 11 of the Bankruptcy Code.[9]

Any requirement of good faith as a condition to the corporate debtor's right to file and maintain a liquidation proceeding is limited, at best. The good faith filing requirement has historically been required by statute only in cases of reorganization or rehabilitation—not in a case of the debtor's liquidation.[10] Although courts regularly read in good faith as "an implicit prerequisite to the filing or continuation of a proceeding" for reorganization or rehabilitation of a corporate debtor,[11] courts have approached dismissal of a liquidating debtor's case on the basis of the debtor's lack of good faith with much more restraint. Indeed, Collier concludes in the analogous chapter 7 setting that "the power to dismiss a chapter 7 case for lack of good faith, if it exists at all, is extremely limited."[12]

Courts assessing a debtor's good faith under a liquidating chapter 11 case, therefore, should be cognizant of the historical precedents as well as policy reasons behind the restraint traditionally shown by courts in their application of the good faith filing requirement under chapter 7 of the Bankruptcy Code. As explained below, the common law good faith filing requirement for a filing of a petition, traditionally utilized to patrol the equitable boundaries of the jurisdiction of the

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[6] *See In re* Victory Constr. Co., Inc., 9 B.R. 549 (Bankr. C.D. Cal. 1981) (reviewing good faith filing requirements under sections 12, 74, 75, 77, and 77B of the Bankruptcy Act of 1898, chapters IX, X, XI, XII, and XIII of the Bankruptcy Act, and discussing requirements under chapters 11 and 13 of the Bankruptcy Code), *vacated as moot*, 37 B.R. 222 (B.A.P. 9th Cir. 1984).

[7] References herein to the "Bankruptcy Code" are to Title 11 United States Code.

[8] For example, good faith *vel non* is absent from the non-exclusive list of factors supporting dismissal "for cause" of corporate chapter 7 filings. *See* 11 U.S.C. § 707(a) (2006). Similarly, chapter 11 contains a non-exclusive list of factors for which the case may be dismissed "for cause," and the lack of good faith is not one of the enumerated factors. *See id.* § 1112(b). Good faith is, however, an express requirement for a chapter 11 plan to be confirmed. *See id.* § 1129(a)(3).

[9] *See infra* notes 64–65 and accompanying text.

[10] *See In re Victory Constr.*, 9 B.R. at 558 ("[T]hose who invoke the reorganization or rehabilitation provisions of the bankruptcy law must do so in a manner consistent with the aims and objectives of bankruptcy philosophy and policy—must, in short, do so in 'good faith.'") (emphasis added).

[11] *Id.*

[12] 6 COLLIER ON BANKRUPTCY ¶ 707.03[c][2] (Alan N. Resnick & Harry J. Sommer eds., 15th ed. rev. 2004).

bankruptcy courts over a reorganizing debtor, has less force and a more limited role when it is applied to a liquidating debtor.

It is doubtful that Congress intended for the rubric of good faith to be wrested into a tool to deny open access to the Bankruptcy Code to distressed debtors needing to liquidate. Rather, good faith should be very narrowly construed when applied to the debtor who surrenders his assets into the control of the court for equitable distribution among parties in interest, irrespective of whether the liquidation takes place under the structure of a chapter 7 liquidation or a chapter 11 liquidating plan.

The judicially-implied good faith standard for the filing and maintenance of a case under the Bankruptcy Code must recognize the equitable distinctions between a liquidation and reorganization. Absent proper recognition of this dichotomy in its application, the doctrine of good faith can become the legal equivalent of "the tail that wags the dog."

I. GOOD FAITH IN CHAPTER 7 LIQUIDATIONS

Good faith is an extremely limited construct under chapter 7. It is generally deemed inappropriate and inequitable to limit a debtor's access to the voluntary liquidation provisions of the Bankruptcy Code. A principal goal of the Bankruptcy Code is to provide "open access" to the bankruptcy process for distressed debtors,[13] with access to bankruptcy relief which is as "open" as "access to the credit economy."[14] Congress intended that "there should be no legal barrier to voluntary petitions."[15]

Therefore, absent a finding of egregious misconduct and/or fraud, corporate liquidations under chapter 7 generally have not been subject to dismissal for cause on grounds of bad faith. Good faith *vel non* is absent from the enumerated non-exclusive grounds for dismissal of a corporate chapter 7 case.[16] Courts have otherwise been loath to read in more than a very narrow construction of good faith as cause for dismissal of a chapter 7 petition.[17] Although the amendments to the Bankruptcy Code under the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005[18] ("BAPCPA") provide for dismissal of an individual debtor's chapter 7 case if the debts are "primarily consumer debts" where the court finds that the

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[13] *See* REPORT OF THE COMMISSION OF THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 93-137, pt. I, at 75, 75–79 (1973) (describing open access to bankruptcy process as principal internal goal); *see also* H.R. REP. NO. 93-137, at 75 (1977) (discussing generally external and internal goals of bankruptcy process).

[14] H.R. REP. NO. 93-137, at 75 (1977) ("Access to collective relief should be . . . open except for safeguards against fraudulent use.").

[15] *Id.* (emphasis added).

[16] *See* 11 U.S.C. § 707(a) (2006) (listing non-exclusive list of reasons for dismissal).

[17] *See* 6 COLLIER ON BANKRUPTCY ¶ 707.03[2] (discussing lack of good faith requirement in chapter 7 and reluctance of federal circuit courts to make generalized bad faith inquiries).

[18] Pub. L. No. 109-8, 119 Stat. 23 (2005).

granting of relief would be "an abuse of the provisions" of chapter 7, Congress eschewed imposing a similar express good faith filing requirement on corporate debtors filing a chapter 7 petition.[19]

The policy behind this construction of the doctrine of good faith under chapter 7 is fundamental and recognizes that liquidation amounts to the complete divestment of the debtor's property. When a debtor liquidates, thereby giving up his property into the control of the court for purposes of its distribution to parties in interest, "the law takes [the debtor] at his word, and makes effectual provision . . . to effectuate his alleged intent of giving up all his property."[20]

As such, recognizing that liquidation is a choice borne of desperation, courts have traditionally refused to withhold the inherent right of a debtor to liquidate, regardless of the debtor's subjective intent or animating motive:

> [The bankrupt] had the undoubted right under the Bankruptcy law to file its petition in bankruptcy and to be adjudged a bankrupt, whether solvent or insolvent . . . . [I]f the bankrupt, however solvent, or however impure its motive may have been, or whatever may have been the actuating purpose, saw fit to surrender its assets into the custody and jurisdiction of the court for the benefit of its creditors, the creditors as a matter of law have no cause for complaint.[21]

Furthermore, recent decisions have construed the policies and purposes underlying chapter 7 of the Bankruptcy Code and continue to hold that the good faith inquiry is very limited where a debtor liquidates. First, courts have reasoned that the debtor's good faith is irrelevant in a case where the liquidated debtor ceases its corporate existence. In such case, the debtor surrenders its assets for distribution to parties in interest, unlike the reorganized debtor, who reaps the future economic benefits of a restructured continuing relationship with its creditors. Because a liquidation "requires no ongoing relationship between the debtor and its creditors [it] should be available to any debtor willing to surrender all of its nonexempt

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[19] Section 707(b) provides that the court may—on its own motion, or on a motion by the United States Trustee, but not at the request or suggestion of any party in interest—dismiss an individual debtor's chapter 7 case after notice and a hearing if the debts are "primarily consumer debts" and the court finds that the granting of relief would be "an abuse of the provisions" of chapter 7. *See* 11 U.S.C. § 707(b). The fact that Congress did not impose this same good faith standard on a corporate debtor is telling. Under the *inclusio unius est exclusio alterius* doctrine, when a law expressly describes a particular situation in which something should apply, an inference must be drawn that what is not included by specific reference was intended to be omitted or excluded. *See, e.g.*, United States v. Ram Kumar Singh, 291 F.3d 756, 762 (11th Cir. 2002) (applying the maxim in construing parallel, but dissimilar, provisions of a statute).

[20] Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 191 (1902) (quoting *In re* Fowler, 9 F. Cas. 614 (D. Mass. 1867) (No. 4,998)).

[21] Alabama v. Montevallo Mining Co. (*In re* Montevallo Mining Co.), 278 F. 989, 990 (M.D. Ala. 1922) (reviewing "straight" liquidation proceeding under the Bankruptcy Act) (emphasis added).

assets."[22] Second, courts have reasoned that the good faith inquiry is only relevant in a case where the debtor has "bargained" for a discharge: "[A]ccuracy, honesty, and full disclosure are . . . inherent in the bargain for the discharge."[23] Section 707 of the Bankruptcy Code implicitly recognizes this distinction and provides that dismissal for "abuse" of the Bankruptcy Code is only applicable to a case filed by an individual debtor, who receives a discharge under chapter 7.[24] No such dismissal for abuse is applicable to a corporate debtor, who accordingly does not receive a discharge under chapter 7.[25] Although the recent amendments to the Bankruptcy Code under BAPCPA made substantial changes to the Code, the provisions concerning conversion or dismissal of a case involving a corporate debtor were left virtually unchanged.[26]

Rare cases have found bad faith in a chapter 7 liquidation. These cases, however, all involved extreme circumstances, such as the debtor's fraud, hiding of assets, or patent dishonesty toward a legal tribunal.[27] Courts have explicitly refused to consider under the rubric of "bad faith" such factors such as the debtor's solvency, ability to pay its debts,[28] or the fact that the debtor files the chapter 7 petition to take strategic advantage of legal rights available under the Bankruptcy Code.[29]

Dismissal of a corporate debtor's chapter 7 petition for cause thus appears to largely track the standard for dismissal of a civil action for cause under Rule 11 of the Federal Rules of Civil Procedure and is an extraordinary remedy, reserved for rare and extreme cases.[30] Oddly, however, a corporate debtor choosing to accomplish substantially the same liquidation under the efficiencies of a chapter 11

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[22] Neary v. Padilla (*In re* Padilla), 222 F.3d 1184, 1193 (9th Cir. 2000) (quoting Katie Thein Kimlinger & William P. Wassweiler, *The Good Faith Fable of 11 U.S.C. § 707(a): How Bankruptcy Courts Have Invented a Good Faith Filing Requirement for Chapter 7 Debtors*, 13 BANKR. DEV. J. 61, 65 (1996)) (emphasis added).

[23] *See, e.g.*, Kestell v. Kestell (*In re* Kestell), 99 F.3d 146, 149 (4th Cir. 1996) (quoting *In re* Mascolo, 505 F.2d 274, 278 (1st Cir. 1974)).

[24] *See* 11 U.S.C. §§ 707(b), 727(a) (2006) (promulgating conditions under which court may dismiss or convert an individual debtor's chapter 7 case, or discharge an individual's debt).

[25] *See id.* §§ 707(a), 727(a)(1).

[26] Compare 11 U.S.C. § 707(a) (2006) with 11 U.S.C. § 707(a) (2000).

[27] *See, e.g.*, Tamecki v. Frank (*In re* Tamecki), 229 F.3d 205, 207 (3d Cir. 2000) (quoting Indus. Ins. Serv., Inc. v. Zick (*In re* Zick), 931 F.2d 1124, 1129 (6th Cir. 1991)) (stating dismissal for lack of good faith should be confined to cases involving egregious misuses and abuses).

[28] "In passing on a motion for dismissal under § 707(a), then, the Bankruptcy Court should exclude any consideration that goes to the debtor's financial means. It cannot make judgmental pronouncements that the debtor really should be paying his or her debts rather than seeking refuge in bankruptcy liquidation." *In re* Khan, 172 B.R. 613, 624 (Bankr. D. Minn. 1994) (citing *In re* Goulding, 79 B.R. 874, 876 (Bankr. W.D. Miss. 1987)).

[29] *See, e.g.*, *In re* Motaharina, 215 B.R. 63, 69 (Bankr. C.D. Cal. 1997) (finding debtor's motivations for filing consistent with underlying policies of bankruptcy system).

[30] "The remedy [of dismissal] is pungent, rarely used, and conclusive. A district judge should employ it only when he is sure of the impotence of lesser sanctions." Chira v. Lockheed Aircraft Corp., 634 F.2d 664, 665 (2d Cir. 1980) (footnote omitted).

liquidating plan will encounter a much different, less restrictive judicial standard for dismissal.

II. THE STRANGE CAREER OF THE GOOD FAITH FILING REQUIREMENT IN CORPORATE RE-ORGANIZATIONS

A. The History of the Good Faith Filing Requirement in Corporate Reorganizations under Chapter 11

Chapter 11 of the Bankruptcy Code contains no express requirement of good faith for the filing or maintenance of a chapter 11 petition. Although the requirement that a plan be confirmed in good faith has been a constant under reorganization statutes, the good faith filing requirement had a more limited appearance in prior reorganization statutes. The requirement that a petition be filed in good faith first appeared in 1934 under section 77B,[31] was excluded from chapter XI and cabined to apply only to classic reorganizations under chapter X of the 1938 Act,[32] and was eliminated entirely upon the enactment of the Bankruptcy Code in 1978.[33] A summary of the applicable statutes is as follows:

Statute	Description	Good Faith Filing Requirement	Good Faith Confirmation Requirement
Section 12 (1898)[34]	Composition with creditors, revesting the bankrupt with all his property, free of the claims of creditors		X
Section 74 (1933)[35]	Composition or extension with creditors	X	X
Section 75 (1933)[36]	Permitted a farmer to effect a composition or extension of time to pay accumulated debts		X
Section 77 (1933)[37]	Railroad reorganizations	X	X

[31] *See* Bankruptcy Act of 1898, 55 Cong. Ch. 541, 30 Stat. 544, amended by Act of June 7, 1934, Pub. L. No. 73-296, 48 Stat. 911, 912–25 (creating section 77B) (repealed 1978).

[32] Act of Aug. 16, 1937, Pub. L. No. 75-302, 50 Stat. 653 (creating chapter X of 1898 Act), amended by Chandler Act, Pub. L. No. 75-696, 52 Stat. 840, 883–905 (1938).

[33] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (repealing Bankruptcy Act of 1898 and enacting the Bankruptcy Code).

[34] Bankruptcy Act of 1898, 55 Cong. Ch. 541, § 12, 30 Stat. 544, 549 (repealed 1978).

[35] Act of Mar. 3, 1933, Pub. L. No. 72-420, 47 Stat. 1467, 1467–70 (creating section 74 of Bankruptcy Act of 1898).

[36] *Id.*, 47 Stat. at 1470–74 (creating section 75 of Bankruptcy Act of 1898).

[37] *Id.*, 47 Stat. at 1474–82 (creating section 77 of Bankruptcy Act of 1898).

Statute	Description	Good Faith Filing Requirement	Good Faith Confirmation Requirement
Section 77B (1934)[38]	Corporate reorganization	X	X
Chapter IX (1934)[39]	Authorized a municipality and certain other political subdivisions to file a petition to effect readjustment of debts.	X	
Chapter X (1938)[40]	Corporate reorganization	X	X
Chapter XI (1938)[41]	Arrangement with creditors		X
Chapter XII (1938)[42]	Arrangement with creditors		X
Chapter XIII (1938)[43]	Composition or extension, or both, with creditors		X
Chapter 11 (1978)[44]	Provided for reorganization as well as liquidating plans		X

The Bankruptcy Code therefore, does not impose an express good faith filing requirement on a corporate debtor. Furthermore, Congress eschewed any addition of such a requirement when it very significantly amended the Code under BAPCPA.

Notwithstanding Congress's deliberate elimination in 1978 of an express good faith requirement for the filing of a chapter 11 petition, courts have otherwise independently implied good faith as an essential precondition.[45] Indeed, most of the

[38] Act of June 7, 1934, Pub. L. No. 73-296, 48 Stat. 911, 912–25 (creating section 77B of 1898 Act).

[39] Act of May 24, 1934, Pub. L. No. 73-251, 48 Stat. 798 (creating chapter IX of 1898 Act).

[40] Act of Aug. 16, 1937, Pub. L. No. 75-302, 50 Stat. 653 (creating chapter X of 1898 Act), amended by Chandler Act, Pub. L. No. 75-696, 52 Stat. 840, 883–905 (1938).

[41] Chandler Act, Pub. L. No. 75-696, 52 Stat. 840, 905–16 (1938) (creating chapter XI of 1898 Act).

[42] *Id.*, 52 Stat. at 916–30 (creating chapter XII of 1898 Act).

[43] *Id.*, 52 Stat. at 930–38 (creating chapter XIII of 1898 Act)

[44] Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (replacing the 1898 Act with the Bankruptcy Code), amended by the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, Pub. L. No. 109-8, 119 Stat. 23.

[45] *See, e.g.*, *In re* Victory Constr. Co., 42 B.R. 145, 146 (Bankr. C.D. Cal. 1984) (describing earlier Victory case as having "entered the folklore on the doctrine of 'good faith' in bankruptcy law" (citing *In re* Victory Constr. Co., 9 B.R. 549 (Bankr. C.D. Cal. 1981))).

Judge Ordin's opinion in *In re Victory Construction Co.*, 9 B.R. 549, has been cited 146 times to date as authority for an implied good faith filing requirement. Ironically, the case itself languished in chapter 11 for years, and the opinion was vacated as moot by the 9th Circuit B.A.P., which found that Judge Ordin had

federal circuit courts of appeal have now adopted some form of the doctrine of good faith *vel non* as a standard for dismissal into chapter 11 jurisprudence.[46]

The standard for determining what constitutes a lack of good faith (*i.e.*, bad faith) is, however, far from uniform, perhaps stemming from the fact that its animating source is unclear. Although the better view is that the doctrine of good faith is a separate requirement of bankruptcy law generally, many courts have embraced it as another example of "cause" for dismissal under 11 U.S.C. § 1112(b)(1).[47] For example, courts construing dismissal for bad faith *in pari materia* with dismissal for cause under section 1112(b)(1) generally require a showing that the debtor has no feasible hope of rehabilitation.[48] Courts construing the good faith requirement in this manner have generally coupled the standard to the rehabilitative goals of chapter 11, holding that it is necessary that the debtor show that its filing presupposes a "valid reorganizational purpose,"[49] thereby requiring that there be some showing of the need for rehabilitation, in order to justify the discharge that is granted to the reorganized debtor.[50] Courts generally look to factors such as whether there is a business to save, jobs to preserve, and whether there is truly any chance of emerging from the reorganization process to continue as a viable business. Thus,

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reversed his own prior order. On subsequent review, another court lamented the confusion and "uncertainty" wrought by the introduction of the good faith filing concept. *See In re Victory Constr.*, 42 B.R. at 149.

[46] *See* Janet A. Flaccus, *Have Eight Circuits Shorted? Good Faith and Chapter 11 Bankruptcy Petitions*, 67 AM. BANKR. L.J. 401 (1993) ("Hundreds of courts and eight circuit courts of appeal have ruled that an implied good faith requirement limits access to chapter 11.").

[47] *See* 7 COLLIER ON BANKRUPTCY ¶ 1112.07 (Alan N. Resnick & Harry J. Sommer eds., 15th ed. rev. 2005) (criticizing this form of analysis but suggesting that there is "little harm in embracing it as an example of cause, provided that the distinct dimensions of the doctrine are recognized and maintained").

[48] *See* C-TC 9th Ave. P'ship v. Norton Co. (*In re* C-TC 9th Ave. P'ship), 113 F.3d 1304, 1310–11 (2d Cir. 1997) (finding filing of bankruptcy may be frivolous when debtor has no reasonable probability of emerging from bankruptcy and no realistic chance of reorganization); Little Creek Dev. Co. v. Commonwealth Mtg. Corp. (*In re* Little Creek Dev. Co.), 779 F.2d 1068, 1073 (5th Cir. 1986) (holding filing is in bad faith where there is no hope of rehabilitation). Compare the express good faith requirement for plan confirmation, under which a plan of reorganization must be "proposed in good faith and not by any means forbidden by law." 11 U.S.C. § 1129(a)(3) (2006). Courts construe good faith in terms of the objective futility of the plan, and "will not consider the motive of the debtor or its partners in filing their chapter 11 petition in determining whether or not its Plan fulfills the good faith requirement for confirmation." Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship, 195 B.R. 692, 702 (Bankr. N.D. Ill. 1996), *aff'd* 126 F.3d 955 (7th Cir. 1997), rev'd on other grounds, 526 U.S. 434 (1999).

[49] *See, e.g.*, *In re* SGL Carbon Corp., 200 F.3d 154, 164 (3d Cir. 1999) (finding compelling evidence for lack of valid reorganizational purpose where debtor was "financially healthy" and where its "normal business operations" would continue regardless of its bankruptcy).

[50] *See In re* SB Props., Inc., 185 B.R. 198, 205 (Bankr. E.D. Pa. 1995) ("If there is not a potentially viable business in place worthy of protection and rehabilitation, the Chapter 11 effort has lost its raison d'etre." (quoting *In re* Little Creek Dev. Co., 779 F.2d 1068, 1073 (5th Cir. 1986))); *see also In re* 68 W. 127 St., LLC, 285 B.R. 838, 846 (Bankr. S.D.N.Y. 2002) ("The critical test of a debtor's bad faith remains whether on the filing date there was no reasonable likelihood that the debtor intended to reorganize and whether there is no reasonable possibility that the debtor will emerge from bankruptcy."). Note that a discharge is not granted to a corporate debtor undergoing a true liquidation and cessation of business operations under chapter 11. 11 U.S.C. § 1141(d)(3) (2006) (denying discharge where debtor "does not engage in business after consummation of the plan").

for example, companies having ceased all operations are generally inappropriate candidates for a plan of reorganization and thus would be a candidate for dismissal.[51]

Other courts require findings of both objective futility as well as a showing of the debtor's subjective bad faith.[52] Others take a more gestalt approach, determining the debtor's bad faith under the "totality of facts and circumstances."[53] The courts adopting the totality of the circumstances test have otherwise attempted to remedy the inherent vagueness of the implied good faith standard by defining the test in objective terms vis-à-vis the underlying purposes of the Bankruptcy Code. Thus, where the debtor's petition is found to have a valid bankruptcy purpose, *i.e.*, where it is consistent with the rehabilitative objectives of the Bankruptcy Code, these courts find that good faith is established.[54] In general, the majority view is that the test of good faith must be tethered to the underlying purposes of chapter 11.[55]

The Supreme Court has observed that chapter 11 reorganizations embrace the "two recognized policies . . . of preserving going concerns and maximizing property available" to satisfy parties in interest.[56] Similarly, the House Report states:

> The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business's finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders. The premise of a business reorganization is that assets are used for production in the industry

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[51] *See, e.g., In re SB Props.*, 185 B.R. at 205 (describing shell corporation created for purpose of filing bankruptcy petition).

[52] *See In re* Carolin, 886 F.2d 693, 694 (4th Cir. 1989) (determining whether bankruptcy court may dismiss voluntary chapter 11 bankruptcy petition at very outset because it was not filed "in good faith.").

[53] *See In re* SGL Carbon Corp., 200 F.3d 154, 162, 165 (3d Cir. 1999); Solow v. PPI Enters. (U.S.), Inc. (*In re* PPI Enters. (U.S.), Inc.), 324 F.3d 197, 211 (3d Cir. 2003); *see also* Laguna Assocs. L.P. v. Aetna Cas. & Sur. Co. (*In re* Laguna Assocs. L.P.), 30 F.3d 734, 738 (6th Cir. 1994) ("Whether debtor filed for relief in good faith is discretionary determination that turns on bankruptcy court's evaluation of multitude of factors."); *but cf. In re* Winshall Settlor's Trust, 758 F.2d 1136, 1137 (6th Cir. 1985) (stating factors only in terms of objective futility of reorganizational effort).

[54] *See In re PPI Enters.*, 324 F.3d at 212 (analyzing purpose of statute and totality of circumstances to find PPIE's bankruptcy filing did not contravene good faith requirement); Stonington Partners, Inc. v. Official Comm. of Unsecured Creditors (*In re* Lernout & Hauspie Speech Prods. N.V.), 308 B.R. 672, n.1, 675 (Bankr. D. Del. 2004) (citing Platinum Capital, Inc. v. Sylmar Plaza, L.P. (*In re* Sylmar Plaza, L.P.), 314 F.3d 1070, 1074 (9th Cir. 2002)).

[55] This is analogous to the principle of good faith in contract law, which is generally agreed to be objectively determined, with respect to the reasonable commercial expectations of the parties. *See* OLIVER WENDELL HOLMES, THE COMMON LAW 242 (Transaction Publishers 2005) (1881) ("The law has nothing to do with the actual state of the parties' minds. In contract, as elsewhere, it must go by externals, and judge parties by their conduct.").

[56] *See* Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. La Salle St. P'ship, 526 U.S. 434, 453 (1999) (using less absolute statutory prohibition to interpret "on account of" language in section 1129(b)(2)(B) in order to reconcile these goals); *see also* Toibb v. Radloff, 501 U.S. 157, 163–64 (1991) (discussing congressional purposes of chapter 11 in terms of the dual goals of maximizing value and preserving going concerns).

> for which they are designed are more valuable than those same assets sold for scrap.[57]

As such, a debtor who can prove a valid reorganizational purpose, *i.e.*, generally any debtor for whom reorganization is necessary and feasible, will be found to have filed its chapter 11 petition in good faith. The test makes perfect sense when applied to a classic rehabilitative reorganization scenario. The test, however, loses much of its underlying rationale when applied to a debtor filing a chapter 11 for non-rehabilitative liquidation purposes.[58]

B. Good Faith Under a Chapter 11 Liquidating Plan

Although courts have historically had some difficulty with the idea of whether liquidations may be effectuated in the context of reorganization proceedings, since approximately 1944 there has been general judicial recognition of liquidating reorganizations.[59] This judicial movement under the Bankruptcy Act was codified in 1978 under section 1123 of the Bankruptcy Code, which contains enabling sections expressly allowing liquidations as part of chapter 11 proceedings.[60]

In fact, the use of chapter 11 often is a liquidation device much like chapter 7:

> With the large and apparently increasing number of liquidating plans in chapter 11, it may now be rare for a business of any size to liquidate in chapter 7. . . . There are two corporate chapters: chapter 7 for liquidating small businesses no one wants to fool with any more, and chapter 11 for all the rest.[61]

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[57] H. REP. NO. 95-595, at 220 (1977). Section 77B of the Act of 1898 was premised on the same dual purposes. *See* Case v. L.A. Lumber Prods. Co., Ltd., 308 U.S. 106, 124 (1939) (describing function of 77B).

[58] Similar concern over the misapplication of reorganization purposes to chapter 11 liquidating plans have been expressed concerning the rule in *United States v. Energy Resources*, 495 U.S. 545 (1990). The circuits are split on the issue. *See, e.g.*, Tal Marnin, *Trust Fund Taxes in Chapter 11 Liquidations: A Challenge to Energy Resources*, 3 AM. BANKR. INST. L. REV. 231, 238 (1995) (analyzing split in courts as to whether the rule in Energy Resources that bankruptcy court could direct the IRS to allocate payments in the manner requested by a corporate taxpayer where that designation is "necessary to a successful reorganization plan" applies to chapter 11 liquidation cases).

[59] *See generally* William L. Cary, *Liquidation of Corporations in Bankruptcy Reorganization*, 60 HARV. L. REV. 173, 174 (1946) (outlining history of section 77B).

[60] *See* 11 U.S.C. § 1123(a)(5)(B), (D), (b)(4) (2006) (providing for sale of all or substantially all of property of estate and distribution of proceeds of such sale among holders of claims or interests). Chapter X of the Bankruptcy Act previously allowed for the sale of assets of the debtor in a reorganization. RICHARD N. BROUDE, REORGANIZATIONS UNDER CHAPTER 11 OF THE BANKRUPTCY CODE § 9.13[2] (1995) (citing the Bankruptcy Act § 216(10)). Chapter XI, however, did not originally contemplate the liquidation of a debtor. *Id.* (citing *In re* Pure Penn Petroleum Co., 188 F.2d 851 (2d Cir. 1951)). In consolidating the reorganization chapters, it was decided that a liquidation could be the result of a chapter 11 plan. *Id.*

[61] Elizabeth Warren, *Remembering Chapter 7*, AM. BANKR. INST. J., May 2004, at 22 (discussing when business should be liquidated in chapter 7 and chapter 11).

Under the *Lionel* exception,[62] section 363 sales of the entire business have become quite common under chapter 11. Empirical research also indicates that many of the firms that conduct section 363 sales "nevertheless file and confirm plans of reorganization, instead of converting the cases to chapter 7 and liquidating under that chapter."[63] Indeed, there are many advantages of a chapter 11 liquidation over a chapter 7 liquidation. First, chapter 11 provides additional flexibility, with less rigid procedures than those found in chapter 7. Second, in a chapter 11 liquidation, preexisting management may remain in place to conduct the liquidation, which helps to maximize value by virtue of management's historical knowledge of the business and familiarity with the assets. Additionally, chapter 11 has distinct advantages in those cases where third-party interests must be protected. Chapter 11 provides both for the appointment of a creditors' committee and occasionally will also provide for the appointment of an equity committee to represent the interests of equity security holders. These facilitators for collective action are absent both from chapter 7 and state dissolution procedures.

Although the liquidating plan of reorganization is firmly rooted in the Bankruptcy Code, any requirement that such a petition must adhere to reorganizational purposes or be dismissed is not. Essential to Congress's express recognition of liquidating plans of reorganization under the Bankruptcy Code was the elimination of the statutory "good faith filing requirement," which had previously existed under the Bankruptcy Act restricting the use of liquidating plans under chapter X.[64] Significantly, the deletion of the good faith filing requirement was specifically geared toward permitting the use of the liquidating plan under chapter 11: "[T]he deletion of the 'good faith' standard as a prerequisite to the initial filing of reorganization proceedings under the new Code eliminates the thres[ ]hold problems and disputes over whether the proceeding will be one of reorganization or liquidation."[65] This modification of the Bankruptcy Code thus demonstrates Congress's express desire that one of the legitimate purposes to be served by a chapter 11 reorganization is an orderly liquidation and distribution of assets.

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[62] Comm. of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063, 1670 (2d Cir. 1983) (holding such sales appropriate if "articulated business justification" is apparent).

[63] Ronald J. Mann, *An Empirical Investigation of Liquidation Choices of Failed High Tech Firms*, 82 WASH. U. L.Q. 1375, 1415 & n.121 (2004). In fact, some commentators argue that "traditional reorganizations have largely disappeared," and chapter 11 is most often, if not always, utilized to sell the assets of the business. *See* Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 673–74 (2003) (suggesting conditions of traditional corporate reorganizations are "rarely found in a financially distressed business today.").

[64] The "good faith" standard was contained in section 146 of the Bankruptcy Act, which provided that a petition under chapter X was not filed in good faith where there was no prospect that the debtor could be reorganized, i.e., where a liquidation was known to the be inevitable result. *See, e.g.*, Fidelity Assurance Ass'n v. Sims, 318 U.S. 608, 615 (1943) (stating test for determining good faith filing included determination of whether reorganization could be achieved).

[65] John C. Anderson & Peter G. Wright, *Liquidating Plans of Reorganization*, 56 AM. BANKR. L.J. 29, 30 (1982) (discussing need to eliminate good faith standard in order to permit liquidating plans).

It is therefore axiomatic that the good faith inquiry under a chapter 11 plan of liquidation should be analytically distinct from the good faith inquiry under a chapter 11 reorganization. A filing under the Bankruptcy Code for corporate liquidation does not implicate the rehabilitative purposes underlying the Bankruptcy Code because there is to be no "rehabilitation." Rather, the inquiry in a chapter 11 plan of liquidation should more properly focus on the liquidation purpose of the filing and thus be subject to the same standard of review as is applicable in a chapter 7 liquidation. First, as discussed above, with the exception of the efficiencies that can be gained through the chapter 11 process, there is no meaningful distinction between a corporate chapter 11 liquidating plan and a chapter 7 liquidation, whether viewed in terms of the treatment of creditors or the priority scheme for distribution of assets.[66] Second, the "fresh start" purpose of the Bankruptcy Code, so essential to evaluation of the reorganizing debtor, is inapposite as applied to the liquidating corporate debtor winding down its operations, who has long abandoned the idea of a fresh start.[67]

Third, the higher standard for good faith that is tied to the rehabilitative purposes of the Bankruptcy Code is inappropriately applied to a liquidating debtor under chapter 11, who does not obtain many of the privileges granted to the reorganized debtor. For example, the Bankruptcy Code withholds the discharge from the liquidating corporate debtor.[68] As noted above, under a plan of reorganization, it can at times produce an inequitable result—*i.e.*, where the debtor truly has no need to "reorganize"—for the debtor to obtain a discharge and then, relieved of its debts, remain in business and continue to provide value to stakeholders.[69] When a debtor reorganizes, it is allowed to retain its assets and reorder its contractual obligations to its creditors. In return for these benefits and the accordant discharge of debt, Congress requires the debtor to approach its new

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[66] To evaluate whether liquidation in chapter 11 appropriately serves the purposes of maximizing value under chapter 11, "the court should compare the costs and benefits of liquidation in chapter 7 versus chapter 11." 7 COLLIER ON BANKRUPTCY ¶ 1112.04[5][b] (Alan N. Resnick & Harry J. Sommer eds., 15th ed. rev. 2004) (summarizing process of determining efficacy of reorganization liquidations).

[67] City of New York v. Quanta Res. Corp., 739 F.2d 912, 915 n.7 (3d Cir. 1984) (interpreting liquidation provisions of Bankruptcy Act, stating "[w]hile it has been held that the old bankruptcy law advanced a second purpose, to provide a fresh start for the debtor, that purpose can no longer be said to be advanced in present liquidation law, with respect to nonindividuals (*i.e.*, corporations and partnerships), since the 1978 Act eliminated the provision for discharge of debts of nonindividuals." (citations omitted)).

[68] *See* 11 U.S.C. § 1141(d)(3) (2006) (referring to chapter 11 liquidation); accord 11 U.S.C. § 727(a) (referring to chapter 7 liquidation).

[69] *See, e.g.*, Marsch v. Marsch, 36 F.3d 825, 827 (9th Cir. 1994) (finding bad faith where ex-wife filed chapter 11 petition in reorganization in order to avoid a restitution judgment by ex-husband); *In re* SB Properties, Inc., 185 B.R. 198, 205 (Bankr. E.D. Pa. 1995) (finding bad faith under section 1112(b) where individual debtor created shell corporation for purpose of filing plan of reorganization, stating "The record here shows no viable business entity" in need of protection and rehabilitation.); Furness v. Lilienfield, 35 B.R. 1006, 1011–12 (Bankr. D. Md. 1983) (stating good faith inquiry insures a company cannot "avoid or postpone a judicial determination of liability, or lack thereof, by a chapter 11 [reorganization] filing which allows the company to continue to operate and to make a healthy profit.").

relationship with the creditors in good faith, for the mutually beneficial purpose of reorganization.

To the contrary, a filing for purposes of liquidating in chapter 11 does not present the same opportunities for subversion of the bankruptcy purpose as does a reorganization because, under a plan of liquidation, the corporate debtor ceasing its operations is not discharged and must marshal all assets for equitable distribution among the stakeholders.[70] A plan of liquidation, unlike a corporate reorganization, requires the death of the business entity. Similar to a chapter 7 liquidation, the bankruptcy purpose supporting a chapter 11 liquidating plan is to achieve a swift and equitable distribution of assets under the priority scheme put in place by Congress:

> The objectives of federal bankruptcy law can be broadly stated: to provide for an equitable settling of creditors' accounts by usurping from the debtor his power to control the distribution of his assets. The purpose of a liquidation proceeding . . . is to provide a fair distribution of the debtor's assets among the creditors.[71]

Accordingly, this distributive purpose for a chapter 11 plan of liquidation also reflects on the analysis of value maximization. The overriding bankruptcy goal of value maximization is achieved in a chapter 11 liquidation (as it is in chapter 7) "by requiring an organized liquidation, monitored by all the creditors and supervised by the bankruptcy court, . . . produc[ing] greater value than the chaotic mix in self-help repossession and judicial execution available at state law."[72] Put simply, the "greater value" to be derived from a chapter 11 liquidation is achieved—not necessarily by capturing the going-concern value of a going business—but also by leveraging the Bankruptcy Code's efficiencies and collective action processes, on disposition unrelated to any going concern. Indeed, the Third Circuit Court of Appeals recognized as much in *In re PPI Enterprises (U.S.)*, when it found that a proper purpose for a chapter 11 liquidating plan was to enable the debtor "to divide its assets during the dissolution of its parent company."[73] Most importantly, in a liquidation the impact on value maximization from both sides of the balance sheet must be considered. That is, value maximization stems from not only the maximization of assets through efficient sale or other disposition, but also from the

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[70] This should be distinguished from a debtor who otherwise holds out the possibility that it will operate post-confirmation in order to take advantage of the discharge. *Cf. In re* Liberate Technologies, 314 B.R. 206, 215 (Bankr. N.D. Cal. 2004).

[71] *Quanta Res. Corp.*, 739 F.2d at 915 (citations omitted).

[72] Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 350 (1993).

[73] Solow v. PPI Enters. (U.S.), Inc. (*In re* PPI Enters. (U.S.), Inc.), 324 F.3d 197, 211 (3d Cir. 2003).

minimization of liabilities through efficient liquidation of claims—the essential numerator and denominator of the value equation, so to speak.[74]

As such, some "valid reorganizational purpose" cannot be a meaningful paradigm for good faith in the chapter 11 liquidation. A "valid liquidation purpose," *i.e.*, efficient and equitable distribution of the debtor's assets in accordance with the mandates of the Bankruptcy Code, should be the alternative paradigm for good faith in a liquidating chapter 11.

III. GOOD FAITH AS A CONSTITUTIONAL DELIMITER: GOOD FAITH AS A BACKDOOR INSOLVENCY REQUIREMENT

It has been suggested that the implicit good faith filing requirement is utilized by courts to enforce the overriding jurisdictional limitations of the Bankruptcy Clause of the United States Constitution.[75] Indeed, one commentator goes so far as to suggest that the doctrine of good faith "demonstrates that only solvent debtors may properly take advantage of bankruptcy relief."[76] G. Eric Brunstad argues that "[s]imply stated, the Bankruptcy Power cannot extend to a solvent debtor because a solvent debtor [is] in no sense 'bankrupt' within the meaning of the constitutional requirement.[77] Mr. Brunstad primarily cites an equity receivership case, *First National Bank of Cincinnati v. Flershem*,[78] as authority for this proposition. In *Flershem*, the Court denied relief to a solvent debtor attempting to use an equity receivership to restructure its capitalization.[79]

An analysis of the constitutional boundaries of the Bankruptcy Clause, however, cannot end with a discussion of cases involving corporate restructuring and reorganizations. Rather, a complete analysis must incorporate the numerous

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[74] Value may be maximized by virtue of efficient liquidation of either the asset side of the equation or the liabilities. For example, assets valued at $100 less liabilities of $50 will net $50. On the other hand, equivalently valued assets of $100 less liabilities more efficiently liquidated to $10 will net $90. *See* Opening Brief of Appellee Official Committee of Equity Security Holders at 6, 11 n.4, NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (*In re* Integrated Telecom Express, Inc.), 389 F.3d 423 (3d Cir. 2004) (No. 04-2411); *see also* Robert J. Keach, *Solvent Debtors and Myths of Good Faith and Fiduciary Duty*, AM. BANKR. INST. J., Dec. 2004-Jan. 2005, at 74 (commenting *Integrated* court incorrectly focused "entirely on the asset side of the bankruptcy balance sheet . . . .").

[75] U.S. CONST. art. I, § 8.

[76] G. Eric Brunstad, Jr., *Good Faith, Solvent Debtors, and the Subject of Bankruptcies*, *in* 79TH ANNUAL MEETING OF THE NATIONAL CONFERENCE OF BANKRUPTCY JUDGES (2005) 4–5.

[77] *Id.*

[78] 290 U.S. 504, 517 (1934) (reversing lower court's approval of a suit for the appointment of a receiver for purposes of a reorganization of the corporation through a judicial sale of its property to accomplish a revision of its capital structure because company had defaulted on its creditors while both solvent and liquid). Mr. Brunstad also cites other similar cases involving corporate reorganizations where the debtor was solvent and continued in control of his property such as *In re Francfair, Inc.*, 13 F. Supp. 513 (Bankr. S.D.N.Y. 1935), *Caruso v. U.S.A. Motel Corp. (In re U.S.A. Motel Corp.)*, 450 F.2d 499 (9th Cir. 1971), and *S.E.C. v. U.S. Realty & Improvement Co.*, 310 U.S. 434 (1940) as support for this proposition. Brunstad's article does not discuss cases involving liquidations.

[79] 290 U.S. at 517.

precedents dealing with the case of a debtor voluntarily surrendering his assets into the power of the federal bankruptcy court for equitable distribution to parties in interest. In cases of voluntary liquidation, the law has long been settled: a showing of insolvency is not, and never has been, a constitutional requirement for a voluntary liquidation.[80]

From the beginning, the bankruptcy laws served the overriding purpose of providing an exclusive federal forum in which to best "secure a prompt and effectual administration and settlement of the estate of all bankrupts within a limited period."[81] As such, under the bankruptcy statutes, specified "acts of bankruptcy" required no showing of insolvency, and otherwise received no scrutiny by the courts into the debtor's motives.

For example, section 3a of the Bankruptcy Act of 1898 defined the following as acts of bankruptcy: (1) fraudulent conveyances or concealments of property, (2) transfers while insolvent, (3) permitting, while insolvent, a creditor's lien to attach to property through legal proceedings, (4) assignments for the benefit of creditors, (5) permitting or procuring, while insolvent in either the bankruptcy or equity sense, a receiver to be appointed to take charge of the bankrupt's property, (6) admissions in writing of inability to pay debts and of willingness to be adjudged a bankrupt.[82] Relying on the precedents under the English bankruptcy laws, the Supreme Court construed section 3a to hold that with respect to the acts of bankruptcy enumerated as 1, 4, and 6, "there is no express requirement that the acts should have been committed while insolvent."[83]

Furthermore, there was no implicit good faith requirement placed upon such a voluntary bankrupt.[84] As stated in *Hanover National Bank v. Moyses*,[85] the debtor's good faith *vel non* was deemed immaterial in a case of a voluntary bankrupt surrendering all his property over to the authority of the court. Instead, the law "takes him at his word and makes effectual provision, not only by civil but even by

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[80] *See, e.g.*, *In re* Marshall, 41 Bankr. Ct. Dec. 221 (Bankr. C.D. Ca. 2003) (rejecting argument insolvency is requirement for debtor to voluntarily invoke Bankruptcy Clause).

[81] *Ex parte* City Bank of New Orleans, 44 U.S. 292, 312 (1845).

[82] *See* National Bankruptcy Act of 1898, § 3 (a) (1898), amended by Pub. L. No. 69-301, 44 Stat. 662, 663 (1926) (adding subsection six to section 3 (a) of National Bankruptcy Act of 1898).

[83] West v. Lea, 174 U.S. 590, 594 (1899).

[84] In fact, such a challenge could not even be brought by a creditor because upon the adjudication in bankruptcy of a voluntary bankrupt, a creditor generally had no standing to contest the petition. *See* Royal Indemnity Co. v. Am. Bond & Mortgage Co., 289 U.S. 165, 171 (1933) (explaining creditors had no standing to attack voluntary bankruptcy adjudication even if action of directors created act of bankruptcy under section 21 of Bankruptcy Act).

[85] 186 U.S. 181, 190–91 (1902) (discussing implications of fraudulent debtor who files voluntary proceeding and is able but unwilling to pay his debts); *See, e.g.*, Tally v. Fox Film Corp. (*In re* Fox West Coast Theatres), 88 F.2d 212, 224–26 (9th Cir. 1937) ("[A] creditor ordinarily has no right to attack an adjudication of bankruptcy made in a voluntary proceeding . . . . [T]he bankruptcy follows as a matter of course upon the voluntary act of the alleged bankrupt.").

criminal process to effectuate his alleged intent of giving up all his property."[86] Perhaps this is because the Court also held "a general divestment of property [to be the] equivalent to insolvency in its technical sense."[87]

Following the Court's lead in *Hanover National Bank*, courts uniformly rejected arguments suggesting that the Bankruptcy Clause limited the application of the bankruptcy laws to insolvent debtors, holding that the federal bankruptcy regime sheltered solvent debtors who otherwise met one or more of the requirements of section 3a.[88] Furthermore, courts construing the enumerated provisions 2 and 3 of section 3a of the 1898 Act, which did require a specific finding of insolvency, did not adhere to a strict definition of that term, and instead required only that the filing had some "relation to insolvency."[89]

Later, courts extended this same logic to section 74 of the Bankruptcy Act, enacted in 1933. For example, in *Collins v. Welsh*, the Ninth Circuit followed other circuits in holding that a "liberal construction of the Constitution with reference to the power of Congress to legislate upon the subject of bankruptcy . . . definitely established the proposition that a bankruptcy law enacted for the relief of debtors was within the purview of the Constitution . . . [and] that the debtor need not be insolvent."[90]

As such, neither a finding of insolvency nor a finding of good faith has historically been required with respect to a voluntary filing by a liquidating debtor. Instead, the principle of good faith "undoubtedly was an outgrowth of the equity receivership background of Section 77B," under which the idea that "reorganization cases should be founded on good faith" came to fruition.[91] Although courts had traditionally not questioned the motives of a solvent debtor surrendering his assets, with the genesis of the reorganization statutes, courts generally found it inappropriate for a debtor to be "solvent and continuing in control of [his] property."[92] As such, the good faith filing standard came to be embraced by the courts.

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[86] Hanover Nat'l Bank, 186 U.S. at 191 (quoting *In re* Fowler, 9 F. Cas. 614, 614 (D. Mass. 1867) (No. 4,998)) (finding the law will take the word of the bankruptcy debtor's unwillingness to pay even if he is actually able to pay).

[87] United States v. Hooe, 7 U.S. 73, 91 (1805) (indicating true fraud only exists if purpose is to evade "the intention of the act.").

[88] *See, e.g.*, Germania Nat. Bank of Milwaukee v. Lachenmaier, 203 F. 32 (7th Cir. 1913); Martin v. Freeman (*In re* Southern Arizona Smelting Co.), 231 F. 87 (9th Cir. 1916); *In re* Dressler Producing Corp., 262 F. 257 (2d Cir. 1919) ("A solvent corporation . . . may have its property distributed among its creditors in the manner provided by the Bankruptcy Act."); *In re* Mohawk Weaving Mills, Inc. 275 F. 589 (N.D.N.Y. 1921); United States v. Middle States Oil Corp., 18 F.2d 231 (8th Cir. 1927) (stating "[t]he debtor may be ever so solvent . . . still it is technically an act of bankruptcy.").

[89] *See* , *e.g.*, Exploration Mercantile Co. v. Pacific Hardware & Steel Co., 177 F. 825 (9th Cir. 1910); *In re* Maplecroft Mills, 218 F. 659 (W.D.S.C. 1914).

[90] Collins v. Welsh, 75 F.2d 894, 897 (9th Cir. 1935).

[91] 6 COLLIER ON BANKRUPTCY ¶ 6.07 at 1042 (15th ed. 1988).

[92] *In re* Francfair, Inc., 13 F. Supp. 513, 514 (Bankr. S.D.N.Y. 1935).

IV. THE JUDICIAL RESPONSE

Most of the courts that have construed the implied good faith requirement under a liquidating chapter 11 have unfortunately failed to adequately elucidate the essential analytical (and historical) distinction between the proper bankruptcy purposes for a reorganizing plan and that of a liquidating plan. Courts, however, generally have appeared to have weighed the facts and circumstances, being cognizant of the underlying distinction and concomitant equitable considerations.[93]

A. The Import of the Landlord Cap Under Section 502(b)(6)

Cases involving the application of section 502(b)(6) (commonly referred to as the "landlord cap") have proved fertile territory for the subject of good faith in liquidating chapter 11 plans.[94] There is good reason. Disputes over the landlord cap arise most frequently in cases of severe market shifts (*i.e.*, economic downturns resulting in oversupply in the rental market), resulting in companies in economic distress burdened by future rent obligations in long term, above market leases. At the same time, the lessor otherwise retains all the risks and benefits as to the underlying value of the real estate, may refuse to accept surrender of the property, or may receive a windfall by virtue of a judgment on the future contingent lease damages claim, where the property is otherwise relet at prevailing market rates.

Section 502(b)(6) was enacted, *inter alia*, to solve this problem, essentially by imposing statutory liquidated damages on lease rejection damages under the Bankruptcy Code, pursuant to its policy judgment that, although the landlord's

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[93] *Compare In re* SGL Carbon Corp., 200 F.3d 154, 166 (3d Cir. 1999) (finding lack of good faith where debtor filed plan of reorganization for sole purpose of avoiding possibility of significant antitrust judgment) *and In re* HBA East, Inc., 87 B.R. 248, 262 (Bankr. E.D.N.Y. 1988) (finding because there was "no realistic probability of a successful reorganization," it was bad faith to file solely to obtain benefit of automatic stay) *with* Solow v. PPI Enters. (U.S.), Inc. (*In re* PPI Enters. (U.S.), Inc.), 324 F.3d 197, 211–12 (3d. Cir. 2003) (finding good faith where company entered liquidation for sole purpose of capping landlord's claim) *and In re* Chameleon Sys., Inc., 306 B.R. 666, 672 (Bankr. N.D. Cal. 2004) (commenting "[t]here is no reason Chameleon should remain in operation for the sole purpose of servicing this lease") *and In re* Federated Dept. Stores, Inc., 131 B.R. 808, 813 (Bankr. S.D. Ohio 1991) ("[A] debtor's duty to unsecured creditors who happen to be lessors does not include the performance of an otherwise useless act for the sole purpose of helping the lessor to avoid the statutory cap of § 502(b)(6).").

[94] *See* NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (*In re* Integrated Telecom Express, Inc.), 389 F.3d 423, 423–24 (3d Cir. 2004) (holding equity holders of debtor may not file chapter 11 bankruptcy petition "to reap [for themselves] a substantial gain through bankruptcy . . . at the expense of the [landlord creditor]."); *In re PPI Enters*., 324 F.3d at 207 (discussing legislative history reflecting Congress' intent to limit lease termination claims to prevent landlords from receiving a windfall over other creditors); *In re* Liberate Technologies, 314 B.R. 206, 215 (Bankr. N.D. Cal. 2004) (stating purpose of statute was to protect creditors where landlords' claims for future rent would reduce payment to other unsecured creditors); *In re Chameleon*, 306 B.R. at 672 (holding corporate debtor should not remain in operation for sole purpose of servicing lease); *In re Federated Dept. Stores*, 131 B.R. at 813 (rejecting the suggestion that the court should engage in a solvency analysis each time the debtor in possession wants to reject a lease).

claim for future rent would be provable, it was equitable to limit such claims for future rent:

> Historically, the limitation on allowable claims of lessors of real property was based on two considerations. First, the amount of the lessor's damages on breach of a real estate lease was considered contingent and difficult to prove. Partly for this reason, claims of a lessor of real estate were not provable prior to the 1934 amendments to the Bankruptcy Act. Second, in a true lease of real property, the lessor retains all risks and benefits as to the value of the real estate at the termination of the lease. Historically, it was, therefore, considered equitable to limit the claims of a real estate lessor.[95]

The market has adapted to this statutory efficiency, as the section 502(b)(6) cap is a backdrop to lease negotiations, and commercial leases appear to fully incorporate this risk into the lease price terms.[96] It should come as no surprise, therefore, that the operation of section 502(b)(6) is routinely upheld by courts in a liquidating case, regardless of the debtor's solvency. The operation of the cap not only enables an efficient liquidation of the lease obligation absent expensive and time consuming litigation, but also encourages the landlord to immediately relet the property at efficient market rates, and facilitates a quick and more economical wind down of the debtor's estate.[97]

The analysis is the same in a chapter 11 liquidation. Indeed, the operation and impact on the creditor of section 502(b)(6) is identical under both chapters. First, the operation of section 502(b)(6) does not result in any impairment of that creditor's claim under the debtor's plan.[98] Rather, under section 502(b)(6), Congress has mandated by statute that the liquidated damages amount allowed for a landlord's claim under the Bankruptcy Code be in accordance with a predetermined formula.[99]

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[95] 124 CONG. REC. H11, 094 (daily ed. Sept. 28, 1978) (comments of Mr. Edwards). In recognition of the underlying policy of placing an absolute limit on speculative damages that would erode the debtor's limited pool of assets, courts have applied the cap where debtor is a third party guarantor as well. *See, e.g.*, *In re* Farley, Inc., 146 B.R. 739, 745 (Bankr. N.D. Ill. 1992).

[96] Marcus Cole, *Limiting Liability Through Bankruptcy*, 70 U. CIN. L. REV. 1245, 1289 (2002) ("Commercial landlords have become so familiar with the risk that it shapes the terms of their leases.").

[97] *See, e.g., In re Chameleon*, 306 B.R. at 666.

[98] *See In re PPI Enters.*, 324 F.3d at 204 (" [A] creditor's claim outside of bankruptcy is not the relevant barometer for impairment; we must examine whether the plan itself is a source of limitation on a creditor's legal, equitable, or contractual rights.")

[99] 11 U.S.C. § 502(b)(6) (2006). Under the Bankruptcy Code, the claim of a landlord for damages resulting from the termination of a lease of real property is allowed,

except to the extent that:

> the rent reserved by such lease, without acceleration, for the greater of one year, or 15 percent, not to exceed three years, of the remaining term of such lease, following the

The section 502(b)(6) cap should therefore logically operate to limit a landlord's claim regardless of whether a corporate debtor files under chapter 7 or confirms a liquidating plan under chapter 11.[100]

Second, the ultimate recourse is the same under either chapter. The section 502(b)(6) cap applies regardless of whether a distribution devolves to equity rather than to or for the benefit of creditors.[101] Regardless of the fact that in chapter 7 under section 726(a), the remaining property of the estate is to be distributed "to the debtor," a landlord would not remain free to purse its state law claim against the assets in the hands of the debtor after the conclusion of the bankruptcy. Because this claim liquidation mechanism is mandated by Congress as a matter of fairness under the Bankruptcy Code, it is absolute and not otherwise altered by state law.[102] Furthermore, final judgments of a federal bankruptcy court are accorded full faith and credit in subsequent state court proceedings. As such, the section 502(b)(6) cap, once applied to a landlord's claim under the Bankruptcy Code, bars any subsequent state action on the part of the landlord to recover the proceeds. As was noted by the Honorable Peter J. Walsh of the United States Bankruptcy Court for the District of Delaware:

> Since section 502(g) requires that a landlord's rejection (breach) damage claim be "determined" in the chapter case pursuant to section 502(b), if the landlord in a subsequent action in a nonbankruptcy court seeks recover over and above the section 502(b) determined amount, it would be asking the subsequent court to ignore the bankruptcy court judgment on the issue. To grant the

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> earlier of (i) the date of the filing of the petition; and (ii) the date on which such lessor repossessed, or the lessee surrendered, the leased property; plus . . . any unpaid rent due under such lease, without acceleration, on the earlier of such dates . . . .

Id.

[100] 11 U.S.C. § 502(f)(1) ("[A] claim arising from the rejection, under section 365 of this title or under a plan under chapter 9, 11, 12, or 13 of this title, of an executory contract or unexpired lease of the debtor that has not been assumed shall be determined . . . .") (emphasis added).

[101] *See* Kuehner v. Irving Trust Co., 299 U.S. 445, 451 (1937) (permitting a landlord creditor's claim to be capped under predecessor to section 502(b)(6) where the benefit would run to equity shareholders); *see also In re* Farley, Inc., 146 B.R. 739, 748 (Bankr. N.D. Ill. 1992) ("It is irrelevant to analysis under § 502(b)(6) whether Farley is solvent or insolvent, or whether other creditors will receive a windfall at [landlord's] expense."); *In re* Federated Dep't Stores, Inc. 131 B.R. 808, 816 (Bankr. S.D. Ohio 1991).

[102] *See In re PPI Enters.*, 324 F.3d at 204 ("[U]nlike some other Code sections, the limitation on damages under § 502(b)(6) is 'absolute' and 'is a limit based on fairness rather than a rule of convenience.'" (quoting 4 COLLIER ON BANKRUPTCY ¶ 502.03, at 7a (Alan N. Resnick & Harry J. Sommer eds., 15th ed. rev. 2003))). Although post-petition interest limited by section 502(b)(2) has been held to be recoverable under state law, this is due to the fact that it is simply a rule of administrative convenience, which is abrogated outside of bankruptcy. *Id.*

> relief would be a clear violation of the full faith and credit clause of the Constitution and the doctrine of res judicata.[103]

It therefore makes no practical difference whether the debtor liquidates under chapter 7 or under chapter 11.

Conceptually, the application of the cap on the landlord's claim is no different than other Bankruptcy Code provisions that implement Congress' distribution priority scheme. For example, under section 510(b), the claim for damages by purchasers of securities are subordinated to that of general unsecured creditors.[104] Section 510(b) applies equally in a chapter 7 and chapter 11 case. Furthermore, like the cap under section 502(b)(6), the operation of section 510(b) creates no impairment of the creditor's claim. Although section 510(b) modifies state law rights, this modification, similar to the cap on the landlord's claim, is pursuant to the Bankruptcy Code—not pursuant to a plan and thus does not legally impair the creditor within the meaning of the Bankruptcy Code.[105]

An unimpaired unsecured creditor therefore has no reason to complain of the debtor's choice of chapter 11 over chapter 7. As such neither should such a creditor under such circumstances have cause to object to the debtor's chapter 11 filing on the basis that the filing was not in good faith.

B. In re *Integrated Telecom Express,* In re *Liberate Technologies, and* In re *Chameleon Systems, Inc*.

Two recent cases out of the United States Bankruptcy Court for the Northern District of California involving solvent debtors vis-à-vis the application of section 502(b)(6) clearly demonstrate the dichotomy between reorganization and liquidation: (i) *In re Liberate Technologies*[106] and (ii) *In re Chameleon Systems*, Inc.[107] Although both cases seemingly involved similar facts,[108] the cases are distinguishable in several important respects.

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[103] Order Regarding Ruling and Court's Memorandum at 5, NMSBPCSLDHB L.P. v. Integrated Telecom Express, Inc. (*In re* Integrated Telecom Express), No. 02-12945 (Bankr. D. Del. Apr. 7, 2003), *aff'd*, 2004 WL 1136547 (D. Del. May 19, 2004), *rev'd*, 384 F.3d 108 (3d. Cir. 2004) (on file with authors); *see also* Supplemental Memorandum, Integrated Telecom (No. 02-12945) (on file with authors) (stating final judgments of federal bankruptcy court are accorded full faith and credit in subsequent court proceedings).

[104] "For the purpose of distribution under this title, a claim arising from the rescission of a purchase or sale of a security of the debtor . . . for damages arising from the purchase or sale of such a security . . . shall be subordinated to all claims or interests that are senior to or equal the claim or interest represented by such security . . . ." 11 U.S.C. § 510(b) (2006).

[105] *Cf. In re PPI Enters.*, 324 F.3d at 205 (holding once debtor filed for chapter 11 protection, landlord was only entitled to his existing "legal, equitable, and contractual rights," and such limitation was due to Bankruptcy Code, not plan).

[106] 314 B.R. 206, 215 (Bankr. N.D. Cal. 2004) (reorganization case involving debtor's attempted application of section 502(b)(6) of the Bankruptcy Code).

[107] 306 B.R. 666, 671 (Bankr. N.D. Cal. 2004) (stating that Chameleon, while the business was solvent "chose to file Chapter 11, reject the lease and cap [landlord's] claim under § 502(b)(6).").

1. *In re* Liberate Technologies

In re Liberate Technologies involved a solvent debtor seeking to reorganize under chapter 11. Liberate Technologies developed and marketed software for video-on-demand services and high-definition television. In 2004, due primarily to market competition, the company earned $9 million, but expected to incur annual losses of approximately $32 million. The company was also faced with a significant patent infringement lawsuit as well as lawsuits for securities violations and was under investigation by the SEC. Liberate had also entered into a long term lease, with an obligation for future rent amounting to approximately $45 million. The landlord refused to accept Liberate's surrender of the premises. Liberate filed a chapter 11 petition, with the somewhat ill defined goal of confirming a plan of reorganization.[109]

At the time of its petition in April 2004, the debtor had $212 million in cash and total liabilities between $59 million and $167 million, having settled or otherwise substantially resolved all but the landlord's claim and the infringement action. Furthermore, the company held an open offer from the patent litigant to purchase the assets of the company outside of bankruptcy, which would have allowed it to stop its operating losses, sell its business as a going concern and, after paying all its liabilities, have at least $130 million cash and contributed stock to distribute to shareholders.[110]

The court therefore focused on whether the debtor's petition had a proper rehabilitative purpose and found it to be deficient. Notably, the debtor in *Liberate* did not articulate any unequivocal intent to surrender its assets for distribution to parties in interest. Indeed, the debtor did not express a liquidation purpose for its filing: "The effect of Debtor's plan is to obtain a discharge by holding out the possibility that Debtor will operate post-confirmation, but without offering any scenario for a genuine rehabilitation of the business."[111] The court focused on the propriety of reorganization and found that the debtor did not need the bankruptcy filing to conduct the sale of its business as a going concern. Liberate had no cognizable reorganizational or liquidation purpose. As such, the court's dismissal of the petition as a bad faith filing was proper.

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[108] The debtor in *In re Liberate Technologies, Inc.* was, of course, more strikingly solvent than the debtor in *In re Chameleon Systems, Inc.* However, that is arguably legally irrelevant where the principle remains that Chameleon had full reserves to cover its full liability under the lease and all other known and unknown liabilities. *See id.* at 669 ("Chameleon admits it has reserves for its full liability under the Nortech lease and all other known and outstanding liabilities, as well as a reserve for unknown liabilities and for legal expenses.").

[109] *In re Liberate*, 314 B.R. at 208–09

[110] *Id.* at 212.

[111] *Id.* at 217–18.

2. *In re* Chameleon Systems, Inc.

In *In re Chameleon Systems, Inc.*, the debtor was in the telecom business and, like many others in this industry, found itself in financial straits in 2002. In February 2003 it had decided to liquidate the company under California law, necessitating only the sale of its intellectual property, close-out of its 401(k) plan, and negotiation of a settlement with its landlord. By May 2003, Chameleon had sold the intellectual property and resolved any issues with the 401(k) plan. Its only remaining impediment to winding down operations was an obdurate landlord who refused to accept surrender of the premises and otherwise failed to respond to settlement offers towards terminating the lease. As such, in July, 2003, Chameleon filed a chapter 11 petition "for the purpose of rejecting the lease with its landlord . . . and then capping [the landlord's] damage claim pursuant to section 502(b)(6) of the Bankruptcy Code."[112] As of the petition date, Chameleon had "reserves for its full liability under the . . . lease and all other known and outstanding liabilities, as well as a reserve for unknown liabilities and for legal expenses."[113] In a word, Chameleon was solvent.

The *Chameleon* court properly focused on the liquidation purpose of the debtor.[114] The court recognized that the debtor's use of section 502(b)(6) to close out the lease obligation was economically efficient as well as equitable, providing a mechanism for the debtor to liquidate the claim of the landlord so as to quickly wind down its operations and to accomplish an efficient dissolution of the corporation:

> [T]he court's focus is . . . whether the use of Chapter 11 in these circumstances represents a legitimate use of the Bankruptcy Code. After considering all the evidence and argument, the court's answer to the question is yes. If this case had been filed under Chapter 7 we would not be having this discussion. Failed businesses regularly file for Chapter 7 turning the wind-down over to a trustee. The owners provide the pertinent information to the trustee and "go home." The fact that the business is solvent does not change that right. The fact that this petition was filed under Chapter 11, and not Chapter 7, similarly does not change the right to terminate operations completely and "go home."[115]

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[112] *In re Chameleon*, 306 B.R. at 668 (emphasis added).
[113] *Id.* at 669.
[114] *Id.* at 670–71 (acknowledging that debtor Chameleon was only trying to complete its "liquidation, wind up its affairs, and dissolve").
[115] *Id.* at 671 (emphasis added) (citations omitted).

The court recognized that, just as in a chapter 7 liquidation, the debtor liquidating under chapter 11 can never have it "both ways."[116] The liquidating debtor foregoes a discharge and surrenders all of its assets for final distribution in accordance with Congress's mandate as an integral part of the debtor's ultimate corporate death.[117] As such, the court correctly found that the debtor's petition was filed in good faith.

3. *In re* Integrated Telecom Express

A third case out of the Third Circuit Court of Appeals, *In re Integrated Telecom Express*,[118] failed to recognize the reorganization/liquidation dichotomy. *In re Integrated Telecom Express*, like *In re Chameleon Systems*, involved a chapter 11 liquidation.

Like Chameleon Systems, Integrated Telecom Express, a supplier to the broadband access communications equipment industry, found itself in dire financial straits as a result of the bursting of the "technology bubble." In early 2001 the market for telecom equipment deteriorated rapidly, and Integrated incurred a net loss for 2001 of $36.2 million. Shortly thereafter, a class action lawsuit was filed against Integrated, its officers and directors, and certain underwriters, in which the claimants asserted damages in the amount of $93 million. In April 2002, the board of directors approved a Plan of Complete Liquidation and Dissolution under Delaware law and attempted to enter into a settlement with the landlord for disposition of a ten year lease. Settlement discussions proved unfruitful. After considering a number of factors, including the potential impact on the landlord's claim and Integrated's potential liability exposure arising from the $93 million securities class action claim, Integrated's board caused the debtor to commence a liquidation under the protection of chapter 11 of the Bankruptcy Code. At the time of its petition, Integrated was potentially solvent in the balance sheet sense, with approximately $107 million in assets and $5 million in liquidated debts. However, Integrated also faced approximately $114 million in contingent, unliquidated claims, including the shareholder class action lawsuit claiming damages of $93 million.[119]

The landlord brought a motion to dismiss the case for "cause" under section 1112(b), on the ground that the petition was filed in bad faith. The bankruptcy court denied the landlord's motion to dismiss. In analyzing the good faith issue, the bankruptcy court found the Debtor's solvency to be irrelevant. Focusing on the debtor's dramatic downward spiral and severe economic distress, the court focused

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[116] *Id.* (determining simply because debtor filed under chapter 11 does not change right to terminate completely, rather than continue business).

[117] *Id.* at 670 (noting Bankruptcy Code provides for liquidating plan providing for sale of all or substantially all of property of estate).

[118] NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (*In re* Integrated Telecom Express, Inc.), 384 F.3d 108 (3d Cir. 2004).

[119] *Id.* at 112–13.

on the debtor's liquidation purpose and the appropriateness of the board having exercised "its fiduciary responsibility in pursuing a liquidation course of action" in order to fulfill its "obligation [] to give the investors their money back."[120]

The bankruptcy court focused on the extraordinary difficulty of accomplishing Integrated's liquidation under state law with a $93 million securities class action lawsuit pending, stating "I am puzzled to understand how that claim could be resolved in a non-bankruptcy law liquidation context absent a final resolution of that claim."[121] Within a bankruptcy proceeding, this claim was subordinated under section 510(b) of the Bankruptcy Code to be *in pari passu* with equity, thereby enabling a settlement. Absent this subordination and classified as general unsecured creditors, the securities class action claimants would have been unlikely to reach such a settlement. The district court affirmed, reviewing the bankruptcy court's fact-intensive inquiry and finding that the bankruptcy court had "exercised sound discretion."[122]

The Third Circuit reversed, dismissing the case under 11 U.S.C. § 1112(b) for "cause," finding that the petition had not been filed in good faith. Minimizing the impact of the securities class action lawsuit, and ignoring the fact that the operation of section 502(b)(6) would be the same regardless of whether the debtor had filed a chapter 7 or a chapter 11 petition, the Third Circuit essentially threw the baby out with the bathwater, framing the debate in terms of strictly reorganizational objectives, *i.e.*, whether the filing "preserve[d] some going concern value. . . ."[123] The court commented without analysis in a footnote that it rejected the argument that:

> [T]he good faith inquiry applies with less force to liquidation plans because, since ownership is not allowed to retain an interest in the reorganized entity, the potential for bad faith is reduced. The good faith requirement is necessitated as much by the hardship of Chapter 11 to certain interests as it is by the benefit to others.[124]

The court declined to explain why the identical treatment of the landlord creditor (which was mandated by Congress) would be permissible under a chapter 7

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[120] *In re* Integrated Telecom Express, Inc., No. 02-12945, (Bankr. D. Del. Jan. 30, 2003) (order denying landlord's motion to dismiss).

[121] *In re Integrated Telecom*, 384 F.3d at 117 (quoting bankruptcy court's order)

[122] NMSBPCSLDHB, L.P. v. Integrated Telecom Express, Inc. (*In re* Integrated Telecom Express, Inc.), No. 03-236-KAJ, 2004 U.S. Dist. LEXIS 9109, at *25 (D. Del. May 24, 2004).

[123] *In re Integrated Telecom*, 384 F.3d at 129. Downplaying the importance of the securities class action claim and the importance of section 510(b) to the disposition of that claim, the Third Circuit never answered the sage and judicious query of Judge Walsh as to how that claim could practically be resolved in a non-bankruptcy law liquidation context, absent final disposition of the securities litigation. Ironically, although the Third Circuit complained that the bankruptcy court had failed to specify which of the debtor's other circumstances justified the petition, the Third Circuit simply reversed and did not otherwise remand for further factual findings. *Id.*

[124] *Id.* at 120 n.4.

liquidation, but was impermissible under a chapter 11 liquidating plan. The answer to that question is perhaps left for adjudication in a future case.[125]

The *In re Integrated Telecom Express* decision reflects a construction of good faith under a chapter 11 liquidating plan that is devoid of its original rationale to monitor the rehabilitation process of a reorganizing debtor.[126] The decision therefore carries the judicially-created doctrine of good faith into the impermissible territory of judicial activism:

> [The congressional jurisdiction over the subject of bankruptcies] extends to all cases where the law causes to be distributed, the property of the debtor among his creditors: this is its least limit. Its greatest, is a discharge of the debtor from his contracts. And all intermediate legislation, affecting substance and form, but tending to further the great end of the subject—distribution and discharge—are in the competency and discretion of Congress. With the policy of a law . . . permitting the bankrupt to come in voluntarily, and be discharged without the consent of his creditors, the courts have no concern; it belongs to the lawmakers.[127]

Congress has affirmatively deleted any bar to a liquidating plan of reorganization on the basis of "good faith." Any further limitation on the right of a debtor to liquidate and surrender its assets to the control of the court for equitable distribution to parties in interest must come from Congress, not the courts.

The Third Circuit's ruling in *In re Integrated Telecom Express* is a radical departure from historical precedent, in that it denies the liquidating corporate debtor the previously unquestioned right (absent fraud or other similar misconduct) to surrender its assets into the control of the federal bankruptcy courts for equitable distribution of the property to parties in interest under the federal priority scheme. Holding that "[t]o be filed in good faith, a petition must . . . seek to create or preserve some value that would otherwise be lost . . . outside of bankruptcy,"[128] the

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[125] The debtor and Official Committee's joint petition to the United States Supreme Court for a writ of certiorari was denied. *See In re* Integrated Telecom Express, 125 S.Ct. 2542, 2542 (2005).

[126] *In re Integrated Telecom*, 384 F.3d at 119–20 (describing the permissible use of chapter 11 solely in terms of "rehabilitative purpose[s]").

[127] Nelson v. Carland, 42 U.S. 265, 281 (1843) (emphasis added).

[128] *In re Integrated Telecom*, 384 F. 3d at 129. This aspect of the court's rule of decision creates uncertainty and jeopardizes chapter 11 filings unnecessarily, having incorporated the school of thought that under the modern corporate economy, little or no value is ever preserved in bankruptcy that cannot otherwise be dealt with by contract outside of bankruptcy. *See generally* Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 696 (2003) (noting parties can use creativity in designing contracts to their liking); Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 781–82 (2002) (explaining how control rights and most important corporate decisions are made outside of bankruptcy). Mr. Rasmussen was an author of an amicus brief filed on behalf of the landlord creditor in *In re Integrated Telecom Express*.

court discounted the maximization of value that is achieved by an efficient liquidation held within the confines of an exclusive federal forum and in accordance with the federal priority scheme. Refusing to allow the defunct entity to be "interred in a federal cemetery, to wit, bankruptcy, and to have its assets liquidated in that jurisdiction,"[129] the court instead dismissed the petition and abandoned the parties to their various remedies in state court.

Under *In re Integrated Telecom Express*, the solvent liquidating debtor in severe economic distress is denied access to the efficient liquidating regime of bankruptcy absent a finding of "financial distress" in the classical restructuring/reorganization sense.[130] The decision in Integrated fails to recognize the dichotomy between liquidation and reorganization vis-à-vis the good faith inquiry. The decision also fails to appreciate the duality of chapter 11, which is not limited solely to restructuring or reorganization in either its scope or its purposes. Absent proper recognition of this dichotomy, the doctrine of good faith as applied to the liquidating chapter 11 is a rule without a rationale.

[129] McClung v. Hill, 96 F.2d 236, 236 (5th Cir. 1938).

[130] The term "economic distress" describes an entity with operating revenues less than its operating costs that is not viable and should be liquidated. "Financial distress" has never applied to liquidating cases but is a term describing an entity that cannot pay its bills but that is otherwise is viable and should be reorganized. *See* Robert K. Rasmussen & David A. Skeel, Jr., *The Economic Analysis of Corporate Bankruptcy Law*, 3 AM. BANKR. INST. L. REV. 85, 87 (1995). Under the framework of Messrs. Rasmussen and Skeel, the Bankruptcy Code should therefore provide refuge to the economically distressed debtor as well as the debtor in financial distress.