WHITE'S WHEEL

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INTRODUCTION

An old saying states that to some history is a ladder, to others a wheel. In his article for this symposium, *Death and Resurrection of Secured Credit*,[1] Professor James J. White[2] throws his lot in with the wheel crowd. Put another way, I think he perceives that the twenty-five years since the adoption of the 1978 Bankruptcy Code (the "Code") has been a cycle which started with debtors in the ascendancy, and initially having the upper hand, and has ended with secured creditors, if not in the ascendancy, at least level with where they used to be. In this short response, I want to examine the premises for his position, and to show what I believe to be some of the adverse consequences of its truth.

I. WHAT WHITE SAYS

White's thesis seems to be simple. The Code contained provisions and adopted procedures that to some presaged the death of secured credit. Since the 1978 adoption of the Code, however, secured credit has been resurrected through cleverness and market power.[3] Those who live by plying secured credit now use the bankruptcy system to their advantage, rather than the other way around.

Along the way to his conclusion, White makes lots of claims, some insightful,[4] others just designed to incite.[5] A deeper look at the article may prove these claims true, or it may prove them false. Let me sketch, however, why such a deeper look may be unnecessary or unwise.

II. IT'S BEEN DONE

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and I thank him for his patience. As Bob would insist I state, however, and as is true, any remaining errors in this article are mine alone.

[1] James J. White, *Death and Resurrection of Secured Credit*, 12 AM. BANKR. INST. L. REV. 139 (2004).

[2] I refer to Professor White in this article simply by his last name "White." By doing so, I intend no disrespect; I only wish to save ink.

[3] White, *supra* note 1, at 148.

> The thesis of this paper is that the predictions from the Code and the early interpretations of the Code have proved wrong. I believe that Chapter 11s of public companies now form a market that facilitates dealings among secured and unsecured creditors, debtors, employees and others. In that market, the secured creditor has achieved a power and status (as this is written in 2004) that at least equals his status prior to the Code and, perhaps, exceeds it.

Id.

[4] I think White's comments about the rise of securitization have the ring of truth to them.

[5] If White really thinks that the 60 or so members of the National Bankruptcy Conference were the "most influential" group of those involved in the "drafting and lobbying" process, *supra* note 1, at 140, and that "for some [of them] . . . reorganizations under the Code could not be too long or too complex," *id.*, then we really need to think about whether his empirical insights should be given any weight. By way of disclosure, I am a member of the National Bankruptcy Conference, and sit on its Executive Committee. I did not become a member, however, until 1999, and thus most of the activity White ascribes to the NBC predates my membership by a good while.

The first reaction to White's thesis is that it is old hat. It's been done. Moreover, it's been done better, and in more nuanced ways. White states that, in 1978, the ideas of the "right" and of law and economics scholars were a "pale and moderate version"[6] of their later selves, presumably to give the impression that had such ideas been made with force (and with political backing), the Code would have been much more friendly to secured creditors. But other scholars have looked at the political debates and compromises that lead up to the Code, and the results of the Code, in quite different ways.

A. Easterbrook's Is Corporate Bankruptcy Efficient?

Fourteen years ago, just eleven or so years into the twenty-five years we celebrate, Judge Frank Easterbrook published *Is Corporate Bankruptcy Efficient?*[7] In this short piece, Judge Easterbrook asked questions fundamental to White's investigations: if chapter 11 is so bad, why does it persist? Why don't we just have straight auctions of corporate debtors? Although not giving an answer (that not being the purpose of the article), Judge Easterbrook does suggest an intriguing answer: that corporate bankruptcy may be cheaper than auctions. As he states it:

> Bankruptcy is a backup. When auctions are superior, creditors will arrange for them in or out of bankruptcy; when they are more expensive, the legal system supplies the method of writing down investments . . . . When we see creditors resort to bankruptcy, they are telling us that the legal process is superior to market methods available to them.[8]

In reviewing the efficacy of the Code, Judge Easterbrook took a tact different than that of White. His view was that if creditors (and presumably this would include secured creditors) wanted a different system, they would lobby for and receive it. That such a result is not the world as we know it is likely due to the fact that creditors are not (and were not) as dissatisfied as White would make them out. In Judge Easterbrook's words, "the Bankruptcy Code of 1978 is largely what creditors wished it to be."[9]

B. Carruthers and Halliday's Rescuing Business

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[6] *Id.*
[7] 27 J. FIN. ECON. 411 (1990).
[8] *Id.* at 416–17.
[9] *Id.* at 413. Judge Easterbrook also posited another proposition at odds with White's comments. As he put it: "Consider another possibility: the absence of auctions in bankruptcy may be attributable not to any comparative advantage of the legal process but to the infrequent bankruptcy of public corporations." *Id.* at 417. Given that the annual number of public companies filing chapter 11 has never exceeded 500, there may be some truth to this proposition.

One can find yet another take on secured creditors and the drafting of the Code in *Rescuing Business: The Making of Corporate Bankruptcy Law in England and the United States*.[10] In this book, sociologists Bruce Carruthers and Terence Halliday took an extensive look at the corporate bankruptcy law reform process in both England and the United States. In their chapter devoted to the role of secured creditors and the drafting of the Code, they state: "The secured creditors came to the meta-bargaining table at its inception. Their wide-ranging interests wove integrally into a process which the co-operation was encouraged and their potential for veto effectively acknowledged."[11]

Carruthers and Halliday describe the strong influence and calculated efforts of banks and other secured creditors in shaping the Code. Granted, secured creditors lost some absolute power through the Code, but in Carruthers and Halliday's view, "[b]ankers realized the high stakes of trading their strong security for greater procedural efficiency and flexibility."[12] Contrary to White's characterization of secured creditors as unaware or toothless bystanders, Carruthers and Halliday show that secured creditors were thus knowingly participating in the Code's reforms. It may be, as Carruthers and Halliday state, that the secured creditors "may have not comprehended in 1978 the full scope of their concessions,"[13] but dumbly participating is not the same thing as negligent indifference.

III. EVEN IF IT'S BEEN DONE, WHITE'S THESIS HAS MAJOR FLAWS

Even if one grants White's premise that the cause of the 1978 "death" of secured creditor was inchoate ideas and flaccid representation, his examples of inroads on the power of the secured creditor, and his argument of their resurrection, fail to persuade.

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[10] BRUCE CARRUTHERS & TERENCE HALLIDAY, RESCUING BUSINESS: THE MAKING OF CORPORATE BANKRUPTCY LAW IN ENGLAND AND THE UNITED STATES (Clarendon Press, 1998).

[11] *Id.* at 192–93.

[12] *Id.* at 193.

[13] *Id.*

A. Secured Creditors Weren't Toothless Babies in 1978

If secured credit really died in 1978, one has to ask the question of how secured creditors let it happen. White paints a picture of an industry taken unawares by the changes, or which foolishly declined to listen to warnings of various Cassandras as to the changes that were coming.

This explanation just doesn't wash. As Carruthers and Halliday point out, secured creditors were ever-present during the Code's drafting, and indeed had a long-term strategy in mind during their negotiations.[14] Examples such as the addition of section 1111(b) after the *Pine Gate* decision,[15] the intense fight over how to handle cash collateral and the ubiquitous presence of industry representatives at every major hearing belie White's basic assumptions.

Again, making a bad deal (as characterized by Carruthers and Halliday) is quite different than failing to even show up to the negotiations. If secured credit died in 1978, it did so as part of a studied, albeit flawed, plan by secured creditors.

But of course secured credit did not die. It was never even admitted to the hospital. Lenders continued to lend, and no one has yet showed that the Code alone caused their profits to disappear, or even lessen. White does point out, however, that securitization, debtor-in-possession financing and other practices have indicated a shift away from traditional secured lending, and into practices that attempt to distance themselves from bankruptcy. Perhaps this is not a resurrection but a rebirth, but the question remains, is the Code an unwitting sponsor to these changes?

B. Secured Creditors Do Not Have a Monopoly on Cleverness

White states that "[s]ecured creditors have achieved this resurrection by clever use of the provisions of the Code and, more importantly, by using their economic power to get agreements from debtors and debtors in possession that mitigate the sting of injurious provisions of the Code."[16] Initially, as indicated above, secured creditors were part of the creation of any "injurious provisions." But when they realized the error of their ways, did their cleverness really aid them in reviving a supposedly moribund industry?

I think not. Cleverness has little to do with the rise of secured credit and secured credit substitutes. Rather, it is the most modern version of the age-old adage that if it is in A and B's interest to collude and disfavor C, they will do so. White describes a world in which debtors and secured creditors have teamed up to ensure secured creditors do well, and in which they use willing courts to assist

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[14] *Id.* at 166–93.

[15] *See* Tampa Bay Assocs. v. DRW Worthington, LTD. (*In re* Tampa Bay Assocs.), 864 F.2d 47, 49–50 (5th Cir. 1989) (noting Congress enacted section 1111(b) to address *Pine Gate* decision and "to preserve the undersecured non-recourse creditor's benefit of the bargain, while preserving the debtor's ability to retain encumbered property essential to its reorganization plan").

[16] White, *supra* note 1, at 148.

them; he could have just as easily been describing reorganization practice over 100 years earlier. *Northern Pacific Railway Co. v. Boyd*[17] was all about such collusion, and all about stopping the parties from using the courts to carry out such schemes.

Further, if any parties have shown cleverness in reorganization, it is debtors. Of course, history shows that debtors were always at the vanguard of schemes to avoid paying their debts.[18] But creative uses of bankruptcy and fraudulent transfer evidenced by the leveraged buy-out era of the 1980s into the early 1990s, the use of bankruptcy to address mass tort issues that legislators ignored, and the general use of preemptive bankruptcy as evidenced in Texaco, indicate that the debtor side of the ledge was far more active.

White is probably closer to the mark when he points to the possession by secured creditors of sufficient market power to extract favorable agreements from debtors. But to borrow a phrase that White himself has used in another, albeit different context, the consent in such deals is like the consent of someone who is autistic.[19] Moreover, the structure of such deals often overlooks the fact that they impose significant, and difficult to quantify, externalities on non-parties such as other creditors. The traditional reaction to the use of such excess power was not, I would assert, to validate; rather, the general response is to regulate it to reduce the adverse externalities or pass their cost on to the parties themselves.[20]

C. The Enthusiastic Export of American Reorganization Law

Separate from questioning some of the factual assertions White makes, it ought to be said that additional doubts about his thesis can be found outside of the United States. For whatever reason, the world is experiencing an interest in fostering a "rescue culture," that is, one in which businesses can be saved instead of shuttered.[21] The bankruptcy laws of Japan and other countries have or are being changed to limit the unfettered power of secured creditors, usually with the

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[17] 228 U.S. 482 (1913).

[18] In *The Clouds*, by Aristophones, dated to 423 B.C., Strepsiades tells Socrates of a plan to avoid paying interest: he will hire a witch to take the moon from the sky, since in Ancient Greece interest was payable each new moon, and if the moon couldn't rise, then presumably interest wouldn't be payable. See also CHARLES ROSS, ELIZABETHAN LITERATURE AND THE LAW OF FRAUDULENT CONVEYANCE: SIDNEY, SPENSER AND SHAKESPEARE (2003), positing fraudulent transfers by debtors were so common in Elizabethan times; references to them can be found in many works of the day.

[19] James J. White, *Autistic Contracts*, 45 WAYNE L. REV. 1693 (2000) ("Parties to modern form contracts sometimes interact with one another in the same way a parent of an autistic child interacts with that child.").

[20] Something that section 506(c) of the Code might be used to address. *See* 11 U.S.C. § 506(c) (2002).

[21] *See, e.g.*, Philip Smart & Charles D. Booth, *Corporate Rescue: Hong Kong Development*, 10 AM. BANKR. INST. L. REV. 41 (2002); Richard F. Broude, Judith K. Fitzgerald, Peter Kelly, Bernard Piot, Heinz Vallender, Louis Bernard Buchman, Hans-Gerd H. Jauch, Francis Sowman & John White, *Panel Discussion: The Judge's Role in Insolvency Proceedings: The View from the Bench; The View from the Bar*, 10 AM. BANKR. INST. L. REV. 511 (2002); Barry L. Zaretsky, *Symposium: Bankruptcy in the Global Village*, 23 BROOK. J. INT'L L. 1 (1997).

extension of some form of automatic stay.[22] Even in England, legislation was recently passed which adopts a surcharge on secured creditors to pay unsecured creditors.[23] While it may be that such changes are temporary, or simply an example of delayed adoption of American customs, it remains the fact that the world is not finding that secured creditor cleverness or market power should expand unchecked.

IV. IMPLICATIONS OF WHITE'S WARPED VIEW

My basic problem with White's view is that it is essentially anti-progressive, and its inevitability component tends to improperly absolve proponents of extreme views from the consequences of their actions. In White's view, interest groups such as secured creditors get their way if they are strong enough, and all others ought to recognize that fact and jump on the appropriate bandwagon.

A. Partisanship, Not Ideas

Of course, if White is right, partisanship has triumphed over ideas. This concept, I believe, has several adverse consequences, some of which have already taken root in current practice. I note just two.

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[22] *See, e.g.*, Shinichiro Abe, *Recent Developments of Insolvency Laws & Cross-Border Practices in the United States and Japan*, 10 AM. BANKR. INST. L. REV. 47, 53 (2002) (discussing comprehensive injunction under Japanese law); Guillermo A. Moglia Claps & Julian B. McDonnell, *Secured Credit & Insolvency Law in Argentina & the U.S.: Gaining Insight From a Comparative Perspective*, 30 GA. J. INT'L & COMP. L. 393 (2002); Ulrich Drobnig, *Secured Credit in Int'l Insolvency Proceedings*, 33 TEX. INT'L L.J. 53 (1998). Although the recent revisions to German insolvency laws did not radically impact secured creditors, some restrictions were imposed. Klaus Kamlah, *The New German Insolvency Act: Insolvenzordnung*, 70 AM. BANKR. L.J. 417, 428–29 (1996) (describing modest restrictions on secured creditors).

The current draft of UNCITRAL's Secured Transactions legislative guide mentions and suggests the imposition of the stay in reorganization proceedings, and for a limited time in liquidation proceedings. UNITED NATIONS COMM'N ON INT'L TRADE LAW, WORKING GROUP VI (SECURITY INTERESTS), DRAFT LEGISLATIVE GUIDE ON SECURED TRANSACTIONS, REP. OF THE SECRETARY-GENERAL, at 5–7, U.N. Doc. A/CN.9/WG.VI/WP.9/Add.6, U.N. Sales No. E/V.03.85476 (prov. ed. 2003).

[23] Enterprise Act, 2002, c. 40, § 252 (Eng.) (amending Insolvency Act of 1986 to add section 176A thereto). New section 176A takes a specified percentage of the net property of companies in administration, and transfers that property to unsecured creditors for payment of their claims. The effect of this provision is to carve out a percentage of the debtor's property subject to a secured creditor's floating charge, and give it to unsecured creditors. The amount carved out is 50% of the first £10,000, and 20% of all remaining assets. The total amount that can be paid to unsecured creditors pursuant to this carve out, however, is capped at £600,000. Insolvency Act 1986 (Prescribed Part), (2003) SI 2003/97.

Floating charges are used primarily for inventory lending. Prior to the change, the Crown Preference came ahead of payment of such floating charges. Section 251 of the Enterprise Act abolished the Crown Preference; that is, it eliminated the priority given to debts owed to the government which, prior to the amendment, had been senior to floating charges. Enterprise Act, 2002, c. 40, § 251 (Eng.).

1. The Position of the Solicitor General – Representing the Interests of All People or Representing Creditor Interests?

The Solicitor General represents the interest of the United States before the Supreme Court. One would hope that such representation would include the effort and the desire to suggest readings of federal statutes in ways that are consistent with their legislative aims. With respect to bankruptcy statutes in the past, this hope has been realized when the Solicitor General has advised the Court on how bankruptcy law should be interpreted without necessarily referring to the public fisc.[24]

Such past practices, however, are not in vogue currently. If one looks at the amicus briefs filed by the Solicitor General in several recent bankruptcy cases in which the United States or governmental agency was not a party, you will find no mention of the aim or goal of bankruptcy, or any arguments for interpretations that achieve such aims. Rather, you will see a depressingly similar reference to the fact that the United States is often a creditor, or even a secured creditor, followed by arguments in favor of an interpretation that favors creditors.[25] As a consequence, the

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[24] An example is the Solicitor General's brief in *Case v. Los Angeles Lumber Prods. Co.*, from which Justice Douglas took *Case's* formulation of new value principles. Brief for the United States as Amicus Curiae at 40–41, Case v. Los Angeles Lumber Prods. Co., 308 U.S. 106 (1939) (Nos. 39-23 & 39-24). *See* Bruce A. Markell, *Owners, Auctions, & Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69, 91 n.143 (1991).

[25] *See, e.g.*, Brief for the United States as Amicus Curiae at 1–2, Till v. SCS Credit Corp., No. 02-1016 (7th Cir. Aug. 28, 2003):

> This case concerns whether, when a bankruptcy plan schedules payments to a secured creditor and those payments must be discounted to present value under 11 U.S.C. [section] 1325(a)(5)(B)(ii), the discount rate should be presumptively equal to the debtor's pre-bankruptcy contract rate. That issue is of substantial importance to the United States because it potentially affects the treatment of all secured creditors under Chapters 11, 12, and 13 of the Bankruptcy Code. The United States appears in thousands of bankruptcy proceedings each year, and a number of federal agencies--including the Department of Housing and Urban Development, the Commerce Department's Economic Development Administration, the Small Business Administration, the Internal Revenue Service, and the Federal Deposit Insurance Corporation – appear as creditors in proceedings analogous to the case at hand. Because a bankruptcy estate's assets are typically scarce, the United States' rights are often affected by demands from secured creditors for payment based on inordinately high pre-bankruptcy contract rates.

Id. (citation omitted); Brief for the United States as Amicus Curiae Supporting Petitioners at 1–2, Archer v. Warner, 123 S.Ct. 1462 (2003) (No. 01-1418):

> Section 523(a)(2)(A) of the Bankruptcy Code, 11 U.S.C. [section] 523(a)(2)(A), excepts from discharge in bankruptcy all debts arising from the debtor's fraud. The question presented in this case is whether a settlement agreement precludes a creditor from proving that the debtor's obligations under the settlement agreement arise from the debtor's fraud and are, therefore, non-dischargeable under Section 523(a)(2)(A). The United States has an interest in preventing the discharge in bankruptcy of debts stemming from settlement agreements that resolve claims for fraud in connection with government programs under the False Claims Act, 31 U.S.C. [section] 3729-3733, or under the common law. Thus, the United States, as a party, has urged courts to adopt the rule that a settlement agreement does not bar a creditor in bankruptcy proceedings from proving fraud as the source of the settlement debt.

United States winds up arguing for secured creditors. Perhaps this capturing of the Solicitor General accounts for some of the resurrection White spots; if so, I think it is a depressing observation.

2. Trivializing Organizations That Represent Balance

Another disturbing development has been the compromise of organizations that seek to find balance in lawmaking. White mentions the National Bankruptcy Conference as being instrumental in the reforms that lead to the death of secured credit in 1978, but the influence of that organization clearly has been on the wane; without dollars to back its recommendation, it seems that few are interested in what it has to say.[26] On the state law side, no one who has watched the Article 2B/UCITA debacle, or the fight over Article 2, can fail to notice that various industries have tried to co-opt the process, lobbying the members of the National Conference of Commissioners on Uniform State Laws and the American Law Institute while simultaneously threatening that such organizations' statutory work—one of their primary reason for being—will arrive stillborn unless concessions to industry, and away from balance, are made. Again, when partisanship counts more than the commonweal, the hunt for the highest average good mutates into a struggle for the extremism of one side or the other to prevail.

B. Abandonment of the Goal of Balance: Or, the Fool and the Ratchet

These views lead the self-interested to abandon balance as a goal. Indeed, only a fool or a hopeless (or hapless) altruist would make concessions in a game in which no one has the incentive or desire to reciprocate. This ratcheting leads, I think, to a warped view of advocacy; if professors have to be extreme to make a

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Id.; United States v. Spicer, 57 F.3d 1152 (D.C. Cir. 1995), *cert. denied*, 516 U.S. 1043 (1996); United States v. Turner, 179 B.R. 273 (Bankr. D. Colo. 1995); *see also* Brief for the United States as Amicus Curiae Supporting Petitioner at 1, Bank of America Nat'l Trust & Sav. Ass'n v. 203 North LaSalle St. P'ship, 526 U.S. 434 (1999) (No. 97-1418):

> The United States appears as a creditor in approximately 12,000 to 15,000 bankruptcy reorganization proceedings a year. A number of federal agencies – including the Department of Housing and Urban Development, the Rural Utility Service, the Maritime Administration, and the Commerce Department's Economic Development Administration – frequently appear as the major creditor in single-asset bankruptcy reorganizations analogous to the case at hand. The Internal Revenue Service appears in approximately 10,000 Chapter 11 cases annually, enforcing governmental claims averaging $1.75 billion in aggregated value. Other federal agencies, such as the Small Business Administration, the Department of Agriculture's Farm Service Agency and Rural Housing Service, and the Federal Deposit Insurance Corporation, also often participate as creditors in bankruptcy proceedings.

Id. (citation omitted).

[26] The Conference's recent study on the Code, NATIONAL BANKRUPTCY CONFERENCE, REFORMING THE BANKRUPTCY CODE: THE NATIONAL BANKRUPTCY CONFERENCE'S CODE REVIEW PROJECT: FINAL REPORT (May 1, 1994), is an impressive piece of work, but went exactly nowhere in Congress.

point (or to achieve tenure), then their students will find it all the easier to be extreme for their clients, and so on. In that way lies madness.

The philosophy of the wheel only fuels such madness. If what goes around inevitably comes around, then extremism is not inherently evil; it is just a temporary phase. Put another way, viewing bankruptcy policy as just a meaningless mediator in the timeless struggle between those who have and those who have-not deprives bankruptcy policy of any permanence, and absolves proponents of extreme views from considering future effects.

V. BACK WHERE WE STARTED, WITH SISYPHUS AS OUR GUIDE

White's paper is in one respect maddening; in other respects banal. It is maddening for the reasons put forward above, and also for the indifference with which it proceeds. Its banality stems from more or less the same source. While one could quibble with the various factual statements made, why bother? If you can't keep secured credit down, why try?

I have categorized White's philosophy as that of the wheel; that interests once compromised will find ways to claw back, only to be compromised again. Sisyphus would have no trouble recognizing the fate of these interests. I have said little about the competing metaphor of history as a ladder; that is, that there is or can be a direction to what we do. Most often, the metaphor of the ladder assumes a rise upward, an improvement for all over time. If White is correct that power and cleverness can undo the Code, we then have a reminder that movement on a ladder is not always up.