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Book Review: Debt's Dominion: A History of Bankruptcy Law in America, by David A. Skeel Jr.

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Book Review

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DEBT'S DOMINION, A HISTORY OF BANKRUPTCY LAW IN AMERICA BY DAVID A. SKEEL JR. (PRINCETON: PRINCETON UNIVERSITY PRESS, 2001) 281 pages.[1]

BY JANIS SARRA[2]

Debt's Dominion is a mix of political intrigue and historical drama in the evolution of U.S. bankruptcy law. The number of bankruptcies has skyrocketed in the United States, with more than one million individuals filing for bankruptcy annually. The U.S. bankruptcy regime, like those of most developed market economies, provides corporations with a liquidation option and a reorganization option. Similarly, personal bankruptcy offers two avenues of discharge: straight liquidation, in which the individual debtor relinquishes all assets except specified exemptions; and a rehabilitation option, where the debtor retains all assets and a portion of income is directed towards partial repayment of the debt over a defined period. Skeel provides a well-researched and comprehensive description of the historical development of the U.S. system.

Skeel attempts a "fully theorized explanation" of the current bankruptcy regime.[3] He grounds his account in public choice theory, and the political and institutional devices used by special interest groups to advance and protect their normative vision of bankruptcy law. At the heart of his account is the public choice notion that concentrated interest groups frequently benefit at the expense of widely scattered groups, even if the

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1 [*Debt's Dominion*].

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3 *Debt's Dominion, supra* note 1 at 1-19.

latter have more at stake with legislative change. In the United States, organized interest groups—such as boards of trade, chambers of commerce, the National Association of Credit "Men," and the post-war consumer credit industry—were better organized and served as an important source of political funding for early reform efforts.[4] As a result, these groups were influential in creating the framework of national bankruptcy law that continues today. For many years, there were no countervailing pro-debtor organizations. Debtors faced collective action problems because they did not know they were future bankrupts and those debtors already bankrupt did not have the information, energy, or resources to lobby for protection of their interests. Public choice theory suggests that the well-funded and well-organized lobbying efforts of creditor organizations would benefit the most from reforms to bankruptcy legislation, with the resultant system being creditor-oriented. Hence the reader is left slightly puzzled as to how the United States evolved as one of the most pro-debtor regimes in the world. Skeel attributes this evolution to political balancing that occurred between the powerful credit lobby and the countervailing influence of widespread populism and other pro-debtor movements. He also paints a remarkable picture of more than a century of influence by bankruptcy judges and lawyers, who were key driving forces in developing bankruptcy law—not only in the courts but also in the political and legislative process.

The genesis of the current U.S. bankruptcy regime was the common law tool of judicial equity receiverships, developed as a means of dealing with insolvent railways. Financing of railway companies in the nineteenth century included equity stock and capital raised primarily through railway bonds secured by discrete sections of track. If a railway company failed, the security on one section of track was essentially worthless. Any potential value was in the railway's continued operation, and thus, there was a convergence of interest among creditors and equity owners to find a going concern solution. Although railways were privately held, they were considered a public good because the economy depended on an effective national transportation industry. Thus public interest was deeply implicated in railway equity receivership as an effective reorganization mechanism that set the stage for consideration of a more formal bankruptcy law.

Skeel describes three distinct eras of U.S. bankruptcy law. The first era began with the Federalists (later Republicans), who believed that bankruptcy was essential to protect non-fraudulent debtors and to encourage the speculative extension of credit that fuelled commercial growth. In contrast, the Jeffersonian Republicans (later the Democratic

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[4] *Ibid.* at 46, 80.

Party) opposed federal bankruptcy legislation as a collection device that would displace farmers from their homesteads and inappropriately shift power away from the southern agrarian states. Thus the early era was divided on both political and geographic lines, and bankruptcy debates overlapped with regionalized states' rights movements. However, by the late nineteenth century the United States was shifting its economic base from one that was primarily agrarian to one based on trade, and pressure grew to have a bankruptcy regime that fostered credit, trade, and economic growth.

Skeel suggests that the instability in bankruptcy law at the turn of the century was the result of legislators' inconsistent perspectives on the necessity of a federal bankruptcy law. He attributes the end of uncertainty to the rise of organized creditor groups that created a demand and organized lobby for bankruptcy legislation. However, populists, and others with a pro-debtor ideology, resisted a federal bankruptcy regime and, ultimately, concessions were made to these interests as a means of securing federal legislation. The result was the enactment of the 1898 *Bankruptcy Act*[5] and codification of the equity receivership. The legislation had a minimalist administrative structure that Skeel observes shaped bankruptcy's apparatus as adversarial and judicial in nature, as opposed to an administrative process such as that in the United Kingdom. In turn, this judicially driven system created enormous demand for lawyers, and thus an active federal bankruptcy bar developed. The influence of this bar, and in particular, the Wall Street bankruptcy elite, continued during the decade of Republican control following the legislation, thus consolidating and entrenching the 1898 framework.

The second era included the Great Depression and the reawakening of populism and pro-debtor sentiment, resulting in the New Deal, which entrenched and expanded the debtor-friendly aspects of the bankruptcy regime. The prestigious National Bankruptcy Conference was also established and was highly influential in advancing bankruptcy reform, developing case law before the courts, and offering expertise in congressional and senate hearings. However, Skeel also documents the inconsistencies in quality and professionalism of the bar during this era. In the early years of the Depression, two governmental investigations exposed corruption, serious abuses, and conspiracy to control bankruptcy administration, resulting in numerous indictments of attorneys. These revelations led to populist hostility towards Wall Street lenders and their agents and pressure for increased government intervention into the

[5] *Bankruptcy Act of 1898*, c. 541, 30 Stat. 544 (repealed 1978).

bankruptcy process. Amendments in the 1930s included provisions for individual and farmer rehabilitation and the first codification of large-scale corporate reorganizations. Thus, the second era resulted in a huge shift from debt collection towards rehabilitation. The rehabilitation option under bankruptcy legislation was part of the New Deal era development of social safety nets. Skeel notes that the well-organized bar had extraordinary influence, utilizing "public interest" arguments to ensure that the system remained largely court driven, thus protecting their own stake. In this respect, bankruptcy law differed from many other New Deal initiatives that were administratively grounded, such as welfare reform and social security. However, the Securities and Exchange Commission (SEC) was formed during this period, and part of its legislative mandate was to intervene, scrutinize, and report on all large reorganizations in the public's interest.

The third era appears more consistent with public choice theory. It includes the 1978 *Bankruptcy Code*,[6] enacted in part to address the huge increase in personal bankruptcies. Consumer debt in the United States had risen to $569 billion by 1974. Skeel suggests that bankruptcy professionals played a leading role in "stymieing administrative change and promoting the expansion of bankruptcy."[7] The resultant *Code* reflected the continuing political bargain between creditor and pro-debtor interests. Skeel suggests that previous partisan divisions were not reflected in this legislation. Rather, there was an increase in interest group activism that significantly influenced the political process. He concludes that the 1978 *Code* was a repudiation of the New Deal vision of bankruptcy law. Skeel suggests that this legislation also marked the demise of the SEC's role in monitoring on behalf of the public: a demise that was entirely political because the SEC failed to garner political support from the bankruptcy bar and because the legislative process shifted to the Judiciary Committee that was less sympathetic to the SEC.

What is fascinating for the reader outside of the United States is the extraordinary political activism of the judges. This lack of separation between the judicial and legislative arms of government is almost unheard of in Canada. For example, a proposal being considered in the 1970s to establish a central bankruptcy agency would have meant elimination of more than one third of existing bankruptcy judges. These judges actively lobbied politicians to prevent this change, forming alliances with the consumer credit industry. Skeel recounts the extraordinary tale of then sitting Supreme Court Chief Justice Warren Burger and his direct lobbying

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[6] *Bankruptcy Code*, 11 U.S.C. (amended 1978) [*Code*].

[7] *Debt's Dominion*, *supra* note 1 at 19.

efforts in 1978 of Republican senators and of President Carter not to enact parts of the *Code* that would give bankruptcy judges status similar to that of Article III judges. Similarly, Skeel points out that much of the political debate on specific issues was driven by bankruptcy judges and lawyers. He gives cogent examples of this, such as the history of exempted assets for consumer bankruptcy, and Chapter 11 of the *Code* as the mechanism of choice by corporate debtors with its temporary retention of control by managers and relaxing of the Absolute Priority Rule.

In Canada, while there has been growing activism by bankruptcy professionals in the past two decades, the history of insolvency and bankruptcy law has largely been one that is creditor driven, resulting in a very creditor-oriented regime. Unlike Canada, where there has been powerful influence by creditor groups on both major parties in power at different times, in the United States, organized creditors primarily influence the Republican Party. Skeel's public choice narrative about concentrated interest groups benefiting at the expense of less organized groups who may have proportionately more at stake is an important lesson for Canadian legislators. As Canada conducts its 2003 parliamentary review of the *Bankruptcy and Insolvency Act*,[8] it is evident that powerful well-organized creditor groups and their agents are lobbying for their normative vision of bankruptcy law. Clearly their views must be considered. However, it is equally important to take account of others who will be affected by bankruptcy as much or more than these groups, but who do not have the information or resources to present an alternative vision.

Unlike the Canadian insolvency regime, the U.S. Chapter 11 reorganization mechanism is available to both solvent and insolvent corporations. Thus, it has become the tool of choice for reorganizations. *Code* amendments in 1978 expanded the definition of claim, paving the way for Chapter 11 reorganizations to be used as the vehicle to resolve mass tort actions such as Johns Manville (asbestos harms) and A.H. Robbins (adverse health effects of the Dalkon contraceptive shield). The device used is a trust, from which claimants receive a proportional share of the asset value based on specified criteria, such as harm or exposure. This device avoids the cost and delay of class actions outside of bankruptcy. However, the trust fund can also have negative consequences for tort claimants because sufficient funds may not be set aside for satisfaction of future claims. While a representative is appointed to protect the interests of future tort claimants in the proceedings, it is not clear that this is adequate

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[8] Standing Senate Committee on Banking, Trade and Commerce, *Debtors and Creditors Sharing the Burden: A Review of the Bankruptcy and Insolvency Act and the Companies' Creditors Arrangement Act* (Ottawa: Standing Senate Committee on Banking Trade and Commerce, 2003).

representation of tort claimants who do not yet know they exist. Yet the debtor exits Chapter 11 free from both current and future tort liabilities.

Debt's Dominion also makes some interesting observations in respect of the academic scholarship from the late 1970s to present day. The rise of law and economics scholars, arguing that the goal of bankruptcy law is an effective debt-collection mechanism to resolve collective action problems among creditors and to prevent forum shopping, was an important development in the scholarship on the theoretical underpinnings of bankruptcy law. The views of law and economics scholars were in sharp contrast to the progressive scholars, who Skeel suggests are the traditionalists in U.S. bankruptcy law. Each has defended his or her normative vision of bankruptcy law, advocating objectives of efficient allocation of resources and fairness and equity respectively.

Skeel also examines the recent struggle in the consumer bankruptcy regime, and concludes that there is moral incoherence in the current framework for the debtors' choice between liquidation and rehabilitation. He tracks the development of political lobbying by the credit card industry, now the largest holders of outstanding debt in the United States with more than $1.7 trillion in outstanding consumer credit.[9] Skeel describes in detail how particular amendments, such as the "substantial abuse" provisions in Chapter 7 of the *Code*, have given rise to uneven judicial decision-making resulting from the influence of local legal culture in discharge cases. Similarly, on the corporate bankruptcy side, Skeel makes important observations about the link between the leveraged buyout era of corporate takeover and Chapter 11 of the *Code.* Managers acquired firms by over-leveraging and managers of target firms took on excessive debt as a defence mechanism, both actors confident that a miscalculation of risk would be cushioned by the availability of Chapter 11 remedies. It might have been helpful to have extended this analysis of the link between the market for corporate control and bankruptcy protection to examining how costs were then externalized in this process, particularly, the huge losses to small equity investors and unsecured creditors.

Debt's Dominion includes observations about the most recent National Bankruptcy Review Commission and its failure to garner congressional support for its recommendations.[10] Skeel concludes that this failure resulted from the highly partisan approach of the Commission and the shift in political power to the right between the time it was appointed and the time that it reported in 1997. As a result, the Commission's

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[9] *Debt's Dominion, supra* note 1 at 190.

[10] *Ibid.* at 188-90.

recommendations, many of which were pro-debtor, were largely ignored by the Republican administration. Congress was more responsive to the well-funded and aggressive lobbying of the consumer credit industry, which Skeel describes as taking pre-emptive action to ensure that the recommendations of the Commission were discounted even before they were made public. However, at this point in the book, Skeel appears to depart from a dispassionate assessment of bankruptcy developments. While he acknowledges that these debates reflected a larger ideological struggle of the 1990s, Skeel attributes to some scholars and advocates a "high degree of disingenuousness"[11] and he engages in what appear to be quite personal attacks on particular individuals that attempted to raise issues of gender bias and imbalance in power.[12] This part of the book is a departure from the role of giving a theorized account of bankruptcy history. To scholars observing from outside the United States, it is evident that there are clear normative and ideological divisions within the U.S. bankruptcy scholarship, and that these are frequently transferred to the political and legislative process. However, rather than observing this division and analyzing its theoretical underpinnings, Skeel's discussion of this period leaves the reader wondering whether the author believes himself "wronged" by these individuals. While not enough to detract from the overall value of the book, this analysis is certainly curious.

Skeel concludes with a discussion on globalization; however, it is too brief and appears more as an afterthought. He concludes that U.S. bankruptcy law is retaining its features and that globalization is pressuring other nations to adopt more of a U.S. approach. This is a very thin analysis of current international developments and is a somewhat disappointing conclusion.

On the whole, *Debt's Dominion* is a compelling and comprehensive analysis of the history of U.S. bankruptcy law, particularly in the century ending in the early 1990s. The book suffers somewhat from repetitiveness. However, that should not detract from the book's considerable merits and its valuable contribution to a more fulsome understanding of the underpinnings of U.S. bankruptcy law.

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[11] *Ibid.* at 188-89, 206-07.

[12] *Ibid.*