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Fishing in Muddy Waters: Clarifying the Common Pool Analogy as Applied to the Standard for Commencement of a Bankruptcy Case

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INTRODUCTION

Economic models are like stick figures: stripped-down representations of real-life situations.[1] Like stick figures, models are judged by how successfully they replicate complex phenomena.[2] A stick person whose legs grow from its ears is not as accurate as one whose legs grow from a torso.[3] Similarly, an economic model that informs us that *2 + 2 = 7* should be reconsidered, for something surely is wrong, either with the assumptions made in formulating the model or in the application of the model to real world experiences.[4]

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1. *See* EDITH STOKEY & RICHARD ZECKHAUSER, A PRIMER FOR POLICY ANALYSIS 9 (1978) (describing common conception of models as "a more or less accurate physical representation or image of some real-life phenomenon").

2. *See* Allan Gibbard & Hal R. Varian, *Economic Models*, COLUM. J. PHIL. 664, 665 (1978) (indicating that underlying motive of economic modeling is desire to explain economic structures in societies). There exists a range of phenomena that the modeling process attempts to explain, resulting in a variety of models. *See id.* at 664-65 (describing different phenomena and their subsets). Not all models seek to replicate a phenomenon. Some, referred to as caricatures, instead seek to emphasize, and even distort, a particular aspect of reality in order to learn about the effects of the highlighted factor on the whole. *Id.* If Baird and Jackson intended for their creditors' bargain model to be a caricature, they have not made their intent known.

3. This is not to say that the drawing will not be aesthetically pleasing; many fine artists seek to distort rather than replicate reality. *See, e.g.*, HENRI MATISSE, BATHERS BY A RIVER (1916-1917), PABLO PICASSO, MAN SMOKING A PIPE (1911); MAN RAY, PORTRAIT OF ALFRED STIEGLITZ (1912-1913); NICOLAS DE STAËL, FIGURE BY THE SEA (1952). Nonetheless, a figure whose legs grow from its ears does not accurately replicate the human form.

4. There is nothing "wrong" in assuming that *2 = 3.5*, in which case "2" + "2" = *7* (unless "7" were assigned some other value). The problem in this instance arises in applying this model to the real world in which the rule is "*2 + 2 = 4*."

Thomas Jackson, alone[5] and in conjunction with Douglas Baird[6] or Robert Scott,[7] has developed a model for the evaluation of bankruptcy law that rests on basic principles of economic analysis. This contractarian model[8] is both positive and normative. Jackson and

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5. *See, e.g.*, THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 228-48 (1986) [hereinafter JACKSON, LOGIC AND LIMITS] (delineating comprehensive and coherent model that describes bankruptcy law in normative terms); Thomas H. Jackson, *Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules*, 60 AM. BANKR. L.J. 399, 401-04 (1986) [hereinafter Jackson, *Bankruptcy Policy and Nonbankruptcy Rules*] (outlining core goals of bankruptcy law and describing relationships therein); Thomas H. Jackson, *Translating Assets and Liabilities to the Bankruptcy Forum*, 14 J. LEGAL STUD. 73, 74-77 (1985) [hereinafter Jackson, *Translating Assets and Liabilities*] (describing role of bankruptcy proceedings in terms of normative theory); Thomas H. Jackson, *Avoiding Powers in Bankruptcy*, 36 STAN. L. REV. 725, 727-31 (1984) [hereinafter Jackson, *Avoiding Powers*] (creating framework for examining contours of "avoiding powers" in bankruptcy); Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 858-71 (1982) [hereinafter Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*] (developing normative theory against which bankruptcy rules can be examined).

6. *See, e.g.*, DOUGLAS G. BAIRD & THOMAS H. JACKSON, CASES, PROBLEMS AND MATERIALS ON BANKRUPTCY 20-30 (2d ed. 1990) [hereinafter BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS] (detailing history of bankruptcy law and concluding that it may be unwise to grant social rights in bankruptcy that do not exist outside it); Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganization and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 103-04 (1984) [hereinafter Baird & Jackson, *Adequate Protection*] (positing that bankruptcy law should be concerned only with interests of those who would have property rights in assets even in absence of bankruptcy law and suggesting that broader social goals should be left to other areas of law); *accord* Douglas G. Baird, *A World Without Bankruptcy*, 50 LAW & CONTEMP. PROBS. 173, 183-84 (1987) [hereinafter Baird, *World Without Bankruptcy*] (arguing that current inclusion of broad societal concerns in bankruptcy is inappropriate).

7. *See, e.g.*, Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155, 178 (1989) (creating expanded economic model based on creditors' bargain theory to evaluate bankruptcy law).

8. As an important corollary of the contractarian aspects of their creditors' bargain theory, Baird and Jackson contend that prebankruptcy entitlements should only be subject to limitation when essential to the maximization of asset distributions to creditors. *See* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 41-55 (arguing that mere use of collective proceeding does not justify granting creditors rights that do not exist outside bankruptcy, and also does not justify altering priority of claims from what would exist in absence of collective proceeding); JACKSON, LOGIC AND LIMITS, *supra* note 5, at 71-83 (stating that "[c]hanges in substantive rules unrelated to preserving assets for the collective good of the investor group, however, run counter to the goals of bankruptcy"); Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815, 823 (1987) [hereinafter Baird, *Loss Distribution*] ("The only point Jackson and I make is that priorities that exist under non-bankruptcy law should run parallel to priorities in bankruptcy. To the extent that these priorities generate bad distributional consequences, they should be changed in both settings."); *see also* Jackson & Scott, *supra* note 7, at 155-56 (discussing problems resulting from alterations in original bankruptcy entitlements law as basis for denying such changes because of distributional goals).

Because this Article focuses on the commencement of a bankruptcy case rather than on what occurs in a case once it has begun, the Article does not address Baird and Jackson's controversial corollary to their creditors' bargain model, with one exception. This debate, which is essentially centered over the propriety of an independent federal judgment about the substantive law that governs distributions to creditors once a bankruptcy petition has been filed, has been obscured by the jargon of law and economics analysis. Although couched in more modern terminology, the debate is very nearly the same as an earlier debate conducted over the last 100 years that focuses on whether Article III courts can or should create federal common law when exercising diversity jurisdiction. *Compare* Swift v. Tyson, 41 U.S. 1, 18-19 his colleagues first apply this model to claim that the collective remedy of bankruptcy[9] is efficient[10] in that it is the likely bargain that creditors would strike in advance, before a debtor's financial difficulties develop.[11] They also apply this positive vision of bankruptcy law to make normative conclusions about the wisdom of numerous

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(1842) (holding that federal courts, in exercising diversity jurisdiction, need not follow decisions of state whose law is being applied), *overruled by* Erie R.R. Co. v. Tompkins, 304 U.S. 64, 79 (1938) *with* Erie R.R. Co. v. Tompkins, 304 U.S. 64, 79-80 (1938) (overruling *Swift* and holding that state, not federal common law, applies in diversity actions). Indeed, Baird and Jackson rely on the Supreme Court's decision in Butner v. United States, 440 U.S. 48 (1979), for its conclusion that federal bankruptcy law "should not create rights," and should only "act to ensure that the rights that exist [under nonbankruptcy law] are vindicated to the extent possible." JACKSON, LOGIC AND LIMITS, *supra* note 5, at 21-22; *accord* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 50 (describing Supreme Court's observation in *Butner* that nonbankruptcy rights should be respected in bankruptcy unless some bankruptcy policy calls for different result as "the most crucial inquiry we face in interpreting the Bankruptcy Code"); Baird, *Loss Distribution*, *supra*, at 818 n.3 (citing *Butner* and stating that "departing from non-bankruptcy rules in bankruptcy introduces the problem of forum shopping"). Baird and Jackson conclude that, as noted in *Butner*, "if we do not respect nonbankruptcy rights in bankruptcy . . . we introduce a forum shopping problem." BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 50.

The analogy between the proper role of federal law in cases governed by diversity jurisdiction and those governed by bankruptcy jurisdiction is not a perfect one. In contrast to the serious questions involving Article III courts' authority to create a federal common law from diversity jurisdiction, the constitutional power to create a federal common law surrounding the debtor/creditor relationship is clearer. Moreover, Baird and Jackson question not only the propriety of a federal common law in the context of bankruptcy, but also challenge the propriety of any federalization of the substantive laws surrounding the definition of a debtor's estate and its distribution to creditors. *See id.* at 39-42 (arguing that nothing concerning availability of collective procedures to promote interests of creditors as group, such as federal bankruptcy laws, explains why single creditor unable to satisfy its claims outside bankruptcy should be able to look to fund to do so). These questions, however, are best left for another article.

9. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 7 (describing bankruptcy as "collective debt-collection device in which creditors' interests are evaluated in the aggregate in order to get most for creditors as group"); *see also infra* notes 42-45, 67-74 and accompanying text (detailing collective remedies such as assignment for benefit of creditors and equitable receivership as options available to creditors under state law).

10. Jackson never explicitly contends that creditors' *ex ante* agreement to create a bankruptcy system is an efficient result, but that claim generally follows from this sort of contractarian analysis. *See* David G. Carlson, *Philosophy in Bankruptcy*, 85 MICH. L. REV. 1341, 1343-44 (1987) (characterizing Jackson's model of bankruptcy as "pursuit of efficiency").

11. *See* Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 5, at 860 (attempting to develop normative theory of bankruptcy law based on view that ideally bankruptcy law should "mirror the agreement one would expect the creditors to form among themselves were they able to negotiate such an agreement from an *ex ante* position"). In referring to the bargain as an *ex ante* agreement, Jackson is describing the result that creditors and debtors would achieve in the absence of bankruptcy proceedings and in the presence of perfect information. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 15-19 (arguing that creditors would agree in advance to arrangement that would guarantee all of them some portion of debtor's assets, rather than receiving nothing under individualized remedies that apply in absence of collective proceeding); *see also* JOHN RAWLS, A THEORY OF JUSTICE 136, 152 (1971) (advancing theory that rational, self-interested people, when stripped of all knowledge about themselves and possessing only general knowledge about society, will reach more fair and just solutions to problems). The justification for presuming the existence of an *ex ante* agreement has been sharply criticized. *See* Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 823-25 (1985) (questioning creditor bargain theory assumptions of perfect information and knowledge); Ronald Dworkin, *Why Efficiency?*, 8 HOFSTRA L. REV. 563, 578-79

provisions of the Bankruptcy Code and related judicial doctrines.[12] This Article focuses on one such application of creditors' bargain theory—Jackson's contention that the standard for commencement of a bankruptcy case can be made more efficient by adoption of an insolvency test, in place of the current "inability to pay debts as they come due" standard.[13]

In developing this creditors' bargain model, Jackson and his co-

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(1980) (criticizing contractarian theory which relies on *ex ante* premises because it requires ad hoc attribution of historical qualities to persons asked to take losses so others might benefit).

12. *See, e.g.*, Baird & Jackson, *Adequate Protection*, *supra* note 6, at 125-29 (examining Bankruptcy Code and decisions of bankruptcy courts in light of creditors' bargain theory); Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 5, at 871-78 (applying original creditors' bargain model to bankruptcy code); Jackson & Scott, *supra* note 7, at 178-202 (applying expanded model of creditors' bargain theory to analyze distributional effects of bankruptcy).

The debate as to whether federal bankruptcy law should create substantive advantages over its state law counterparts invites critical assessment of the rights and obligations of debtors and creditors under the Bankruptcy Code as compared to those under state law. A complete comparison of these rights and obligations exceeds the scope of this Article, but a few examples will provide a brief overview of the concerns involved in the debate. First, there is an issue as to whether the avoidance provisions of the Bankruptcy Code can be justified in the face of differing nonbankruptcy entitlements. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 68-88, 123-46 (arguing that federal bankruptcy should not change relative entitlements); *see also* Jackson, *Avoiding Powers*, *supra* note 5, at 750-79 (contending that federal bankruptcy should not allow creditor to improve its position over that held under state law). A second issue is whether creditors should receive priority distributions from a bankruptcy estate when a priority distribution would not follow under the state law regime. *See* Baird, *Loss Distribution*, *supra* note 8, at 824-28 (analyzing problems of forum shopping that arise when federal Bankruptcy Code grants benefits not available in state proceedings). *But see* Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 789-93 (1987) (arguing that state law mostly results in different, but not necessarily less fair, distribution of bankrupt's assets than federal law allows). Also, the question whether secured creditors should be compensated for the time value of the delay in the enforcement of their rights represents an additional topic of debate. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 183-90 (arguing that those who benefit from delay should pay costs of those who suffer); Baird, *Loss Distribution*, *supra* note 8, at 831-33 (arguing that bankruptcy must give secured creditors some rights outside of proceeding that mandate adjustments in division of assets to account for delays related to imposition of bankruptcy proceedings); Baird & Jackson, *Adequate Protection*, *supra* note 6, at 114-16 (discussing methods of incorporating time value of money into overall value of rights); *see also* United Sav. Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 372-73 (1988) (holding that undersecured creditors are not entitled to compensation for delays caused by automatic stay in foreclosure on collateral). *But see* Warren, *supra*, at 803 (arguing that allowing secured creditors interest on their claims is simply different decision on distribution of debtors' assets, because secured creditor receives money that, in absence of such rule, it would otherwise have to share with unsecured creditors). An additional issue arises with respect to whether debtors should be able to reject executory contracts and unexpired leases in bankruptcy when they would be unable to do so under state law. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 110-11 (arguing that collectivization principle of bankruptcy should not confer right on debtor to reject executory contract or unexpired lease if debtor could not do so outside bankruptcy).

13. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 200-08 (arguing that current "inability to pay debts as they become due" standard is insufficient and advocating replacement with general insolvency standard); *see also* 11 U.S.C. § 303(h)(1) (1988) (detailing current standard to be applied for commencement of involuntary bankruptcy case). This section states that "the Court shall order relief against the debtor in an involuntary case . . . only if (1) the debtor is generally *not paying such debtor's debts as such debts become due* unless such debts are the subject of a bona fide dispute . . . ." *Id.* (emphasis added).

authors first compare a debtor's balance-sheet insolvency[14] to a "common pool problem."[15] The premise of the "common pool problem" is that in the case of a jointly owned body of water filled with fish, the invisible hand of self-interest fails to maximize joint welfare.[16] If the pool is not owned by any one person, then diverse, self-interested individuals are free to fish in the pool without restraint.[17] Absent a constraining mechanism of some sort, individual anglers have no incentive to limit the size of their catch, thus leaving too few fish to reproduce and maintain the pool's population for future years.[18]

According to Jackson, a debtor's insolvency resembles a "common pool," with the assets of the insolvent debtor substituted for the fish and the debtor's creditors substituted for the self-interested fishermen.[19] Rather than catch the insolvent debtor's assets with a

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14. Throughout this Article, the term "insolvent" is used in the bankruptcy or balance-sheet sense of the word. *See infra* note 27 (further defining "insolvency" for purposes of Article). A debtor is balance-sheet insolvent when the sum of its assets are less valuable than the sum of its liabilities. *See, e.g.*, 11 U.S.C. § 101(32) (Supp. III 1991) (defining insolvent as "[a] financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation"); Bankruptcy Act of 1898, ch. 541, § 1(19), 30 Stat. 544, 544 (codified as amended at 11 U.S.C. § 1(19) (1976)) (repealed 1978) (defining "insolvency" as occurring when aggregate of individual's property, exclusive of any property that is conveyed or removed with intent to defraud creditors, is valued as insufficient to repay individual's debts); UNIF. FRAUDULENT CONVEYANCE ACT § 2(1), 7A U.L.A. 442 (1978) ("A person is insolvent when the present fair salable value of his [or her] assets is less than the amount that will be required to pay his [or her] probable liability on his [or her] existing debts as they become absolute and matured."); UNIF. FRAUDULENT TRANSFER ACT § 2(a), 7A U.L.A. 648 (1985) ("A debtor is insolvent if the sum of the debtor's debts is greater than all of the debtor's assets at a fair valuation."); *see also* JAMES A. MACLACHLAN, BANKRUPTCY § 15, at 12 (1956) (noting that debtor is generally considered insolvent when sum of property is insufficient to pay debts).

15. BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 39-43; JACKSON, LOGIC AND LIMITS, *supra* note 5, at 10-19.

16. *See* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 39 (explaining that in common pool, "self-interest would dictate that everyone catch fish without restraint, despite the interest of the group as a whole in preserving the resource for the future").

17. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 11-13. Jackson demonstrates that diverse ownership is a necessary assumption for the premise that the result reached by individual action is worse than a cooperative solution. *Id.* at 12-19. Jackson illustrates this principle by contrasting the incentive that a sole profit-maximizing owner of a pond has to limit fishing in a current year, thereby permitting an increase in the stock for fishing in subsequent years, with the owner's incentive to catch as many fish today as possible that exists when the pond is subject to depletion through others' unchecked use. *Id.* at 11-12.

18. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 12-13.

19. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 12-13. The analogy is not a perfect one. In some instances, creditors may be interested in maintaining a debtor as a customer rather than always "fishing the pond dry." *See infra* notes 181-87 and accompanying text (arguing that where debtor's assets are replenishable, creditors will make efforts to structure payment in accord with replenishment). The likening of a debtor's assets to a pool of fish does not consider the replenishable characteristics of fish as compared to a common pool of assets. Although common pool problems involve exhaustible resources, the circumstances under which these problems arise will differ depending on whether the exhaustible resources are replenishable or not. *See* Alan E. Friedman, *The Economics of the Common Pool: Property Rights in Exhaustible Resources*, 18 UCLA L. REV. 855, 856 n.8 (1971) (describing two distinct types of exhaustible resources that may generate common pool problems: replenishable and

rod and reel, creditors will take the assets through individual collection remedies of attachment, garnishment, execution, and levy.[20] When Jackson and his colleagues posit that a debtor's insolvency presents a common pool problem, they are referring to the fact that the self-interested actions of individual creditors may run counter to the interest of the creditors as a group.[21] With this observation they

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nonreplenishable resources); *see also infra* notes 173-78 and accompanying text (discussing role of replenishable resources in common pool analysis).

A particular resource is termed replenishable if "nature will appreciably augment it before the end of the time period within which use of that stock is presently contemplated." *Friedman*, *supra*, at 856 n.8. Simply stated, if nature continues to produce the resource in question as it is being depleted, the resource is replenishable. In theory one might think a resource's replenishable qualities would prevent it from being exhausted, but as Friedman explains, even replenishable resources will be exhausted if the rate of exhaustion exceeds the rate of replenishment. *Id.* Friedman illustrates this last point with a reference to animal species. *Id.* Because animals reproduce, they can be said to be a replenishable resource. If, however, an animal species is killed at a rate that far exceeds its rate of reproduction, the species will become extinct. *Id.* At some point the last members of the species will be killed before having an opportunity to reproduce, and the replenishable resource will thus be exhausted. *Id.*

20. *See infra* notes 50-60 and accompanying text (describing operation of individual remedies available to creditors under state law); *see also* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 39-43 (using common pool analysis to describe advantages of collective proceeding in bankruptcy over individual collection remedies); JACKSON, LOGIC AND LIMITS, *supra* note 5, at 13 (comparing common pool problem of fish to bankruptcy where creditors pursue self-interest, potentially prejudicing other creditors' interests).

21. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 10 (arguing that "[t]he basic problem that bankruptcy law is designed to handle . . . is that the system of individual creditor remedies may be bad for the creditors as a group"). Jackson defines a common pool problem as resting on three essential premises, as follows. "One, that the participants are unable (for one reason or another) to get together and make a collective decision. Two, that the participants are selfish (or cold and calculating) and not altruistic. Three, that the result reached by individual action is worse than a cooperative solution." *Id.* at 10 n.9; *see also infra* notes 140-57 and accompanying text (delineating circumstances that create common pool problem).

Baird and Jackson identify these same three premises as underlying game theory's "prisoner's dilemma model," which may also be applied to evaluate bankruptcy law. *See* Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 5, at 862 ("The central feature of a prisoners' dilemma is rational individual behavior that, in the absence of cooperation with other individuals, leads to a sub-optimal decision when viewed collectively."); *see also* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 39 (explaining that creditors' pursuit of their interests, seemingly rational behavior to each individually at that time, will damage creditors' ability to collect debts in bankruptcy absent group cooperation); *see also infra* note 142 and accompanying text (detailing similarities between common pool problem and prisoners' dilemma theory).

Although the analogy of the relationship between a balance-sheet insolvent debtor and its creditors to the problem created by a common pool does not demand the conclusion that creditors would reach an *ex ante* agreement to institute the collective remedy of bankruptcy, Jackson contends that creditors would agree in advance to create a system of collective remedies that "runs parallel with a system of individual debt collection rules and is available to supplant them when and if needed . . . ." JACKSON, LOGIC AND LIMITS, *supra* note 5, at 13. Jackson argues this point for two reasons. First, Jackson contends that creditors would agree to collective remedies because they are risk averse and collective action reduces risk. *Id.* at 15. As an illustration of this principle, Jackson offers the following example of a debtor with two creditors who are asked to "agree in advance to a system that, in the event of Debtor's insolvency, guaranteed them $12,500, in lieu of a system that gave them a 50 percent chance of $25,000—payment in full—and a 50 percent chance of nothing . . . ." *Id.* Jackson concludes that risk averse creditors would prefer the assurance of $12,500 over a 50/50 chance of payment in full. *Id.* Second, Jackson argues that creditors would reach this *ex ante* agreement make a powerful case for the need for a collective bankruptcy remedy of some form, although their analysis is deficient on the details. No one has seriously suggested that the Bankruptcy Code[22] be repealed in its entirety though,[23] and as a result the conclusion that a

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because the size of the common pool, in this case the debtor's assets, will be greater in a collective forum than in a series of individual collection actions, either because enforcement of collective remedies saves administrative expenses or preserves a business debtor's going concern value. *Id.* at 16.

Although it is questionable whether creditors necessarily would enter into the *ex ante* agreement that Jackson posits, a criticism of this aspect of the creditors' bargain model exceeds the scope of this Article. *See* Carlson, *supra* note 10, at 1342-55 (arguing that if contractarian philosophers such as Jackson were to attribute real histories to people in their hypothetical bargains, they would be less likely to reach suggested bargains). Rather, this Article focuses on whether and under what circumstances a debtor's financial difficulties would pose a common pool problem to its creditors, and disagrees with Jackson's identification of balance-sheet insolvency as that set of circumstances.

22. 11 U.S.C. §§ 101-1330 (1988 & Supp. III 1991). The current Bankruptcy Code substantially derives from the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2683 (codified as amended at 11 U.S.C. §§ 101-1330 (1988 & Supp. III 1991)). The Bankruptcy Reform Act was subsequently amended, most notably in 1984 and 1986, and is commonly referred to as the "Code" or the "Bankruptcy Code." This Article adopts these references.

23. *But see* Baird, *World Without Bankruptcy*, *supra* note 6, at 174 (imagining "world without bankruptcy" in attempt to identify what bankruptcy law adds or should add to creditors' remedies, although ultimately concluding that need exists for some form of federal bankruptcy law). James Bowers has argued in several articles, replete with tongue-in-cheek references to Murphy's Law and "Far Side" cartoons about vultures, that nonbankruptcy law is as efficient as bankruptcy law (although, based on Murphy's Law, neither even approaches perfection). James W. Bowers, *Groping and Coping in the Shadow of Murphy's Law: Bankruptcy Theory and the Elementary Economics of Failure*, 88 MICH. L. REV. 2097, 2099-2100 (1990) [hereinafter Bowers, *Bankruptcy Theory*]; James W. Bowers, *Whither What Hits the Fan? Murphy's Law, Bankruptcy Theory, and the Elementary Economics of Loss Distribution*, 26 GA. L. REV. 27, 29 (1991) [hereinafter Bowers, *Loss Distribution*]. In a similar vein, Ronald Picker criticizes the literature that defends bankruptcy as resolving a common pool problem among creditors and argues, by means of game theory, that the problem could be better resolved through the use of security interests. Ronald C. Picker, *Security Interests, Misbehavior, and Common Pools*, 59 U. CHI. L. REV. 645, 645-49 (1992). Picker does not explicitly call for the repeal of the Bankruptcy Code, but he does imply that the Code is irrelevant in light of Article 9 of the Uniform Commercial Code (U.C.C.) *Id.* at 649. *Contra infra* notes 246-91 and accompanying text (rebutting Picker's contention that security interests are capable of resolving common pool problem presented by creditors' collection efforts).

Recently, a number of scholars, led by Baird and Jackson, have questioned the need for chapter 11 of the Bankruptcy Code. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 218-24 (examining justifications for chapter 11 bankruptcy and arguing that chapter 11's elimination is desirable because remedy fails to provide claimants with procedures that result in fair distributions of assets); Douglas G. Baird, *The Uneasy Case for Corporate Reorganization*, 15 J. LEGAL STUD. 127, 128 (1986) [hereinafter Baird, *Uneasy Case*] (noting that it is very rare for value of company in financial trouble to be greater when company is reorganized than when company is liquidated piece by piece). *But see* Jackson & Scott, *supra* note 7, at 190-99 (retreating from position supporting abolition of chapter 11 by arguing that theory of risk sharing explains need for reorganization provisions). Others have followed Baird and Jackson in contending that bankruptcy theory insufficiently supports the need for reorganization. *See, e.g.*, Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439, 441 (1992) (examining risk sharing theory of bankruptcy critically and concluding that theory does not justify corporate bankruptcy reorganization); Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1049-50 (1992) (contending on empirical grounds that no need exists for chapter 11 of Bankruptcy Code).

need exists for the collective remedy of bankruptcy is hardly controversial.

More importantly, Jackson uses the creditors' bargain model to support a normative conclusion about the initiation of bankruptcy cases.[24] He proposes the rebuttable presumption[25] that an involuntary bankruptcy petition be granted whenever "there are multiple creditors and a reasonable prospect of insolvency."[26] Jackson argues that the dominant standard for involuntary relief, the debtor's general inability to pay debts as they come due standard,[27] is insufficient to ensure that bankruptcy proceedings are conducted in all

24. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 193-209 (using creditors' bargain model to raise questions regarding appropriateness of current standards for commencement of bankruptcy cases, and arguing for adoption of insolvency standard for both voluntary and involuntary petitions; also discussing without resolution wisdom of bounty to provide creditors and shareholders incentives to commence proceedings before debtors become entirely unable to carry their loan burdens). The only application of the creditors' bargain model to determine the proper standard of commencement for bankruptcy is found in Jackson's book, *The Logic and Limits of Bankruptcy Law*. *Id.* Thus, although Baird and Scott have joined Jackson in works that embrace the common pool metaphor, they have not joined Jackson in his argument that an insolvency standard for commencement of bankruptcy cases should be adopted. In fact, Baird supports a standard that would leave the decision regarding when to bring a voluntary case to the discretion of the debtor. Douglas G. Baird, *The Initiation Problem in Bankruptcy*, 11 INT'L REV. OF LAW & ECON. 223, 225-27 (1991) [hereinafter Baird, *Initiation Problem*].

25. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 200. Jackson would rebut the presumption of the availability of bankruptcy relief when a petitioner's motives are strategic and not in good faith—namely, when a petition is filed solely to secure some benefit of federal bankruptcy law that is not available under state law. *Id.* at 191-97; *cf. infra* notes 381-83 and accompanying text (noting that Jackson's willingness to penalize petitioners under these circumstances based on their motives is inconsistent with his premise that debtors and creditors act purely out of their own self-interest).

26. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 200. Jackson never explains the significance of the presence of multiple creditors in terms of his "creditors' bargain" model, but presumably it relates to the assumption of diverse ownership or use of the common pool. *See infra* notes 141-57 and accompanying text (discussing competing claims of creditors over common pool of debtor's available assets); *cf. infra* note 98 and accompanying text (pointing out that most courts have agreed with proposition that there is no need for collective relief if debtor has only one creditor).

27. 11 U.S.C. § 303(h)(1) (1988). The Bankruptcy Code's use of equitable insolvency is to be contrasted with bankruptcy, or balance-sheet, insolvency. The term "equitable insolvency" refers to an entity that is unable, or has failed, to pay debts as they become due, that is, an entity in general default. BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 105. Bankruptcy insolvency, on the other hand, refers to an entity whose assets, when fairly valued, are insufficient to pay all outstanding debts. *Id.* Theoretically, one could be insolvent in bankruptcy but not in equity because of long-term debt that has not yet come due. *Id.* Similarly, there are situations in which the debtor is unable to meet payments as they become due, despite the fact that the value of the debtor's assets exceeds its liabilities. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 198.

Jackson's view that a debtor's equitable insolvency or general default serves as a good indication of its balance-sheet insolvency is not new. *See* Israel Treiman, *Acts of Bankruptcy: A Medieval Concept in Modern Bankruptcy Law*, 52 HARV. L. REV. 189, 211-15 (1938) (discussing merits of equitable insolvency as indication of insolvency).

Because it is confusing to use the term "insolvent" to refer both to balance-sheet or bankruptcy insolvency and to equitable insolvency, the term "insolvent" is used in this Article to refer only to balance-sheet insolvency, with reference to a debtor that is "insolvent in the equitable sense" as a debtor in general default.

qualifying cases.[28] Specifically, Jackson criticizes the current standard as insufficient because it does not permit the commencement of an involuntary bankruptcy case against a balance-sheet insolvent debtor that is able to meet debts as they come due.[29] To a reader unfamiliar with the historical development of the involuntary bankruptcy commencement standard, Jackson's proposed insolvency standard may appear to be an uncontroversial extension of the common pool analogy. A brief review of this history, however, indicates that Jackson's proposal should be viewed with a great deal of skepticism, because Congress abolished a similar standard in 1978 largely to remove the requirement that creditors prove a debtor's balance-sheet insolvency.[30] Jackson offers little justification for his proposed return to an insolvency standard other than through his analogy of a balance-sheet insolvent debtor to a common pool of fish.

In other contexts, commentators have criticized both the conclusions and methodology of the creditors' bargain model, arguing that as a law and economics-based theory, the model provides a skewed perspective from which to analyze bankruptcy law.[31] Similarly, com-

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28. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 200 ("The test in section 303(b)(1) of showing that the debtor is 'generally not paying debts as they come due' is, as a matter of theory, insufficient by itself.").

29. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 200.

30. *Compare* Bankruptcy Act of 1898, ch. 541, § 3a-b 30 Stat. 544, 546-47 (codified as amended at 11 U.S.C. § 21(a)-(b) (1976)) (repealed 1978) (permitting commencement of involuntary bankruptcy case upon showing of act of bankruptcy) *with* 11 U.S.C. § 303(h)(1) (1988) (permitting commencement of involuntary bankruptcy case upon showing of debtor's failure to pay debts as they come due). For a discussion of the merits of various bankruptcy standards, see REPORT OF THE COMMISSION OF THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. Doc. No. 137, 93d Cong., 1st Sess., pt. I, at 14-15 (1973) [hereinafter REPORT ON BANKRUPTCY LAWS] (arguing that "failure to pay" standard provides more effective relief for creditors); Susan Block-Lieb, *Why So Few Creditors File Involuntary Petitions and Why the Number Is Not Too Small*, 57 BROOKLYN L. REV. 803, 803 (1991) (attributing adoption of "failure to pay" standard as due to Congress' understanding that it would be easier standard for creditors to prove).

31. *See, e.g.*, Bowers, *Bankruptcy Theory*, *supra* note 23, at 2105-07 (using "parable of the vultures" analogy to demonstrate that bargaining among creditors advocated in creditors' bargain model is not profitable for those creditors); David G. Carlson, *Bankruptcy Theory and the Creditors' Bargain*, 61 U. CINN. L. REV. 453 [hereinafter Carlson, *Creditors' Bargain*] (noting that creditors' bargain model has been criticized because of its focus on wealth maximization as overriding goal); Countryman, *supra* note 11, at 823-25, 827 (attacking creditors' bargain model for its assumptions of perfect information and its reliance on concept of "fully informed greed"); Donald R. Korobkin, *Value and Rationality in Bankruptcy Decisionmaking*, 33 WM. & MARY L. REV. 333, 335 (1992) [hereinafter Korobkin, *Bankruptcy Decisionmaking*] (outlining foundation of creditors' bargain model that focuses largely on maximizing economic returns, and offering several alternative approaches to bankruptcy that are premised on broader social values than simply wealth enhancement); Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 737 (1991) [hereinafter Korobkin, *Jurisprudence of Bankruptcy*] (criticizing Jackson's economic model for its failure to explain complex dimensions of bankruptcy law); Warren, *supra* note 12, at 789-93 (criticizing creditors' bargain theory as only representing different distributional choice). James Bowers also criticizes the economic analysis of Baird and Jackson's model by arguing that their common pool analogy is inapt because it fails to account for the actions of debtors and secured creditors. Bowers,

mentators argue that in particular instances the value judgments inherent in an economic analysis of the law have led to misplaced policy decisions.[32] This Article does not join these commentators in criticizing Jackson's basic methodology, however. Rather, it accepts the usefulness of building a model that questions the result that would follow if perfectly informed, risk-neutral actors, who face no strategic or practical impediments to bargaining, are assumed to behave only in their own self-interest.

Constructing a simplified version of some complex reality is not the end of the model-building process, however. The modeler should also step back from her handiwork and determine whether the model indeed resembles and thus explains the real world. In considering this resemblance, the modeler should question both the results reached by means of the model and the model's underlying premises. Very often, economic models simplify reality by assuming a perfect market in which there exist no externalities or transaction costs. In determining how well the model reflects the real world, this second step in model building may require a relaxation of these simplifying assumptions.

This Article takes that second step by asking whether the insolvent debtor actually presents a common pool problem to its creditors—are the legs growing out of the stick person's ears or its torso? It accepts the basic contours of Jackson's model, which theorizes that the creditors of a financially distressed debtor may face a com-

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Bankruptcy Theory, *supra* note 23, at 2103-13. He contends that under nonbankruptcy law, debtors are likely to be efficient distributors of their own assets, and that bankruptcy law may be unnecessary to achieve an efficient result. *Id.*

In his most recent collaboration with Professor Scott, Jackson has slightly tempered his assertion that bankruptcy law should never seek to accomplish distributional goals. *See* Jackson & Scott, *supra* note 7, at 157-58 (expanding framework of creditors' bargain model to argue that distributional effects premised on anticipation of uncontrollable business failures would be explicitly included in *ex ante* bargain unless cost of implementation did not outweigh benefits of enhancing creditors' wealth). Commentators have criticized Jackson's risk-sharing theory of bankruptcy law as insufficient to justify the need for a separate body of bankruptcy law. *See* Carlson, *Creditors' Bargain*, *supra* (arguing that risks that cannot be mitigated through human precaution can be allocated through contracts).

32. *See, e.g.*, Lynn A. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 180 (1990) (criticizing creditors' bargain model's assumptions that absolute priority rule will be strictly enforced in bankruptcy proceedings); David G. Carlson, *Postpetition Interest Under the Bankruptcy Code*, 43 U. MIAMI L. REV. 577, 624-31 (1989) [hereinafter Carlson, *Postpetition Interest*] (arguing that Baird and Jackson's creditors' bargain model fails to offer efficient results); Raymond J. Nimmer, *Negotiated Bankruptcy Reorganization Plans: Absolute Priority and New Value Contributions*, 36 EMORY L.J. 1009, 1014 n.5 (1987) (arguing that proper issue in bankruptcy law is extent to which federal policy should alter state outcomes and not whether state law should have any role); Jay L. Westbrook, *A Functional Analysis of Executory Contracts*, 74 MINN. L. REV. 227, 251 n.114, 337 (1989) (criticizing Jackson for preoccupation with notion that bankruptcy should not change state law results because such preoccupation obfuscates executory contract analysis).

mon pool problem when seeking to collect their delinquent debts. It instead critiques Jackson's conclusion that insolvency should be the sole standard governing the commencement of bankruptcy cases and his contention that the common pool analogy justifies this conclusion.

Thus, rather than attacking the methodology of law and economics or of modeling in general, this Article takes issue with Jackson's application of the creditors' bargain model to the question of the proper standard for bringing a bankruptcy case. Part I surveys debtor/creditor law by first describing procedures through which a debtor might cooperatively repay delinquent obligations to individual groups of creditors. It then discusses various coercive collection remedies,[33] including involuntary bankruptcy, as ways in which an individual creditor or group of creditors might force a debtor to make payment. Next, Part I contrasts the current standard for commencement of an involuntary case with the standard's predecessor under the Bankruptcy Act of 1898.[34] Part I concludes by contrasting the nearly unfettered ability of a debtor to voluntarily commence a bankruptcy case under the current Bankruptcy Code with the eligibility requirements under the former Act.

Part II of this Article explains in detail the circumstances under which a common pool problem will exist.[35] It defines a common pool problem as negative production or consumption externalities caused when use of exhaustible resources cannot be resolved

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33. Commentators have not consistently defined the term "coercive" remedies. *Compare* Robert E. Scott, *Rethinking the Regulation of Coercive Creditor Remedies,* 89 COLUM. L. REV. 730, 730 n.2 (1989) (defining "coercive collection" and "coercive creditor remedies" as "only those self-enforcing remedies that are, at least to some extent, prior to and independent of the alternative process of postjudgment execution") *with* William C. Whitford, *A Critique of the Consumer Credit Collection System,* 1979 WIS. L. REV. 1047, 1048 n.3 (defining "coercive execution" as "legally valid transfers of value to the creditor that occur without the debtor's consent"). Throughout this Article, the term "coercive collection remedies" is used in accordance with Whitford's definition. Whitford provides a useful illustration of his definition:

> [W]hen the sheriff seizes the debtor's property pursuant to a writ of execution, when the debtor's employer pays a portion of wages owed the debtor to the creditor pursuant to a writ of garnishment, or when the creditor under a security interest forcibly but legally repossesses property of the debtor by self help these creditors have exercised a coercive collection remedy.

Whitford, *supra,* at 1048 n.3.

34. Bankruptcy Act of 1898, ch. 541, 30 Stat. 544 (codified as amended at 11 U.S.C. §§ 1-1255 (1976)), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2682 (codified at 11 U.S.C. §§ 101-1330 (1988 & Supp. III 1991)). In contrast to the common reference to the Bankruptcy Reform Act of 1978 as the "Code" or the "Bankruptcy Code," *see supra* note 22, practitioners, courts, and commentators commonly refer to the Bankruptcy Act of 1898, including its numerous amendments, as the "Act," the "Bankruptcy Act," or the "former Act." This Article follows this common usage.

35. *See infra* notes 141-57 and accompanying text (articulating definition of common pool problem and Jackson and Baird's metaphor to explain concept and its effect).

through the definition of property rights,[36] and argues that Jackson's view of the circumstances under which the creditors of a financially troubled debtor face a common pool problem is too narrow for several reasons. First, Jackson does not distinguish between the potential for a common pool problem and the problem itself. In addition, Jackson too narrowly defines the exhaustible resources against which creditors can proceed. An insolvent debtor's assets are easily described as exhaustible resources, but, to a debtor whose earnings accrue more slowly than its obligations on claims, its earnings too are a scarce resource. Moreover, Jackson too narrowly describes the ways in which collection efforts by one creditor affect those efforts of the debtor's other creditors. He considers only the pure consumption externality that occurs when multiple actors seek to consume exhaustible resources. Part II defines the concepts of rate and product consumption externalities and applies these concepts to various types of debtors, noting that the timing of a rate consumption externality depends on the replenishable nature of a debtor's assets and that the existence of a product consumption externality depends on the interrelationship of a debtor's assets to its earning capacity. Moreover, Part II notes that creditors face options in determining how best to collect delinquent claims. Some methods are more effective than others, and under certain circumstances pursuit of a less effective remedy can cause externalities. Finally, Jackson does not explore the possibility that a common pool problem may be resolved through the definition of property rights. Part II concludes that it is possible to avoid the common pool problem that creditors of a financially troubled debtor may face by the creation of a voluntary security interest.

Part III expands on the economic analysis developed in Part II as applied to the question regarding the proper standard for commencement of a bankruptcy case. The circumstances under which creditors of a financially troubled debtor face a common pool problem suggest that both the present standard for commencement of an involuntary case and Jackson's proposed refinements of the standard are insufficient. Moreover, the resolution of a common pool problem was not Congress' exclusive policy goal in enacting the Bankruptcy Code. Part III considers the standard for involuntarily thrusting a debtor into bankruptcy in light of these alternative policy goals. It also considers whether debtors should be required to prove their insolvency or general default as a precondition to obtaining voluntary bankruptcy relief. After comparing and contrast-

36. *See infra* notes 141-306 and accompanying text.

ing Congress' purposes in permitting creditors to file involuntary petitions with Congress' goal of permitting debtors to voluntarily commence bankruptcy cases, this Part concludes that the standards for the two types of petitions should not be equated.

I. CREDITORS' OPTIONS UNDER STATE AND FEDERAL LAW FOR DEBT REPAYMENT

Creditors extend credit primarily on the expectation that they will be paid out of a debtor's earnings.[37] Earnings include the debtor's salary, wages, or commissions if the debtor is an individual,[38] or the debtor's revenue if it is a partnership, corporation, or other business entity.[39] An individual debtor may quit or lose his job, however, able to find employment only at a lesser rate; a business debtor may become less profitable or close its doors. In either event, not all of the debtor's creditors can be paid out of the debtor's earnings.

A. *Overview of Collection Remedies*

Creditors face two basic choices in deciding which remedies to pursue. First, a creditor must decide whether to adopt a cooperative or adversarial stance toward a debtor. The creditor may seek the debtor's cooperation in scheduling repayment of the debt, or the creditor may coerce repayment from the debtor through a variety of remedies. In the second choice, the creditor must decide whether to proceed alone or collectively with all or some of the debtor's other creditors. A creditor's remedial choices will differ depending on whether it is unsecured or secured.[40]

1. *Cooperative repayment*

Many debtors that find themselves in financial difficulties want

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37. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 8 ("Whatever the reasons for lending and whatever its form, the terms on which consensual credit is extended depend to a substantial extent on the likelihood of voluntary repayment and on the means for coercing repayment.").

38. The Bankruptcy Code does not explicitly define an individual as a natural person, but courts have generally adopted this interpretation based on usage of the term in the Code. *See* Toibb v. Radloff, 111 S. Ct. 2197, 2199 (1991) (noting that "person," as used in Code, includes individuals (natural persons) and holding that individuals not engaged in business may qualify as debtors under Code). This Article uses the term "individual" in this sense.

39. The Code does not define the term "business debtor," but the term is used in this Article to refer to a debtor engaged in business. Most often a business debtor will be a corporation, partnership, or other business association, but an individual debtor might also engage in business as a sole proprietor. Business debtors are additionally contrasted with consumer debtors. *See infra* note 178 (defining consumer debtor).

40. *See generally* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 15-17 (describing special rights of secured creditors to pursue property that is usually exempt and to take possession of property without consent of owner or sanction of court).

only to repay their creditors as best they can and then move on with their affairs. These cooperative debtors can repay delinquent debts one at a time, or as a group.[41]

a. Individual cooperative repayment

The debtor may cooperate with an individual unsecured creditor and either pay or settle the past-due claim.[42] A secured creditor also may find that the debtor is cooperative in turning over collateral for repossession and resale.

b. Collective cooperative repayment

An insolvent debtor may instead cooperate with its creditors as a group, ensuring that creditors not paid in full are at least paid an equitable portion of the debtor's liquidated assets. Under state law, debtors may accomplish this either through "workout" agreements or by assigning their assets to assignees for the benefit of creditors.[43] A workout agreement is simply a contract between a delinquent debtor and two or more of its creditors by which the parties agree to either the payment of a reduced amount of the debtor's outstanding indebtedness or an extension of the due date for repayment of the outstanding indebtedness, or to a combination of a reduction and an extension.[44] And while no single definition of a voluntary assignment for the benefit of creditors exists, the phrase generally refers to a voluntary transfer to an assignee by a debtor of some or all of its assets to be subsequently applied to the debtor's outstanding debts.[45]

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41. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 9 (describing voluntary options of debtor that include simply paying off creditor or creditors to terminate debt).

42. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 9 (noting voluntary option of paying creditors before bankruptcy proceedings commence). Depending on the timing of the voluntary payment by the debtor and on the debtor's financial picture at the time the transfer is made, a voluntary payment may amount to an avoidable preference. *See* 11 U.S.C. § 547(b) (1988) (defining preference as transfer of property of debtor made to or for benefit of creditor, within 90 days or 1 year before filing of bankruptcy petition, on account of antecedent debt, while debtor is insolvent, and enabling transferee to receive more than it would have received if transfer had not occurred and transferee had participated in hypothetical chapter 7 liquidation case); *see also* LYNN M. LOPUCKI, STRATEGIES FOR CREDITORS IN BANKRUPTCY PROCEEDINGS § 2.4 (2d ed. 1991) (citing examples to illustrate contrary goals of preference law and lawyers' objectives in prebankruptcy period).

43. LAWRENCE F. KING & MICHAEL L. COOK, CREDITORS, DEBTORS, AND BANKRUPTCY 375-76 (2d ed. 1989).

44. BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 1283-84; KING & COOK, *supra* note 43, at 575-76. The contract doctrine of consideration requires that a workout agreement involve at least two of the debtor's creditors, so that one creditor's promise to forbear is exchanged for another creditor's promise to do the same. BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 1283; KING & COOK, *supra* note 43, at 577.

45. ALEXANDER M. BURRILL, A TREATISE ON THE LAW AND PRACTICE OF VOLUNTARY ASSIGNMENTS FOR THE BENEFIT OF CREDITORS 4 (5th ed. 1887). These assignments "are usually

Under federal law, debtors can "cooperate" in repaying their creditors simply by filing a voluntary bankruptcy petition.[46] The current Bankruptcy Code does not require that debtors show insolvency or any other level of financial hardship as a precondition to the filing of a voluntary petition.[47] All that a debtor must allege in its voluntary bankruptcy petition is that it is a "person"[48] eligible for relief under title 11 of the United States Code.[49]

2. *Coercive collection*

Of course, the debtor may not be so agreeable. If the debtor is uncooperative, unsecured and secured creditors can coerce repayment of the debtor's obligations by forcing a sale of the debtor's property. Creditors can also forcibly collect outstanding claims through either individual or collective collection remedies.

a. *Individual coercive collection*

For unsecured creditors, individual collection remedies are governed by state law through actions of attachment, garnishment, execution, or levy.[50] Under each of these individual remedies, general creditors are precluded from forcing a sale of a debtor's property

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resorted to by debtors who find themselves unable to pay their creditors in full, or the embarrassed state of whose affairs has compelled them to discontinue the transaction of business." *Id.*

Both statutes and common law govern an assignment for the benefit of creditors. *See, e.g.*, ARK. CODE ANN. §§ 16-117-401 to -407 (Michie 1987) (establishing guidelines for those making assignment for benefit of creditors); GA. CODE ANN. §§ 18-2-41 to -59 (1989) (detailing procedures and rules governing assignment for benefit of creditors); *see also* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 1289-1301 (noting that trust, not contract, law generally governs common-law assignments for benefit of creditors); STEFAN A. RIESENFELD, REMEDIES AND DEBTORS' PROTECTION 430-41 (4th ed. 1987) (describing state common and statutory law as historically and currently applied to assignment for benefit of creditors).

46. *See* 11 U.S.C. § 301 (1988) (providing that voluntary bankruptcy case is commenced by filing of petition by eligible debtor).

47. *See id.* § 109 (delineating categories of individuals and businesses that qualify as debtors but omitting mandatory financial criteria for such classifications).

48. 11 U.S.C. § 101(41) (Supp. III 1991); 11 U.S.C. § 109 (1988); *see also* Toibb v. Ratner, 111 S. Ct. 2197, 2199 (1991) (ascribing literal meaning to Code's definition of "person" in deciding that individual with no business is "person" eligible for chapter 11 relief).

49. 11 U.S.C. § 109 (1988). The Code excludes such "persons" as railroads, banks, and insurance companies from the definition of "debtor" for purposes of chapter 11 bankruptcy. *Id.* § 109(d).

50. *See* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 4-10 (detailing prejudgment and postjudgment remedies available to creditors under state law). An attachment refers to the creditor's ability to seize a specific piece of property as early as the filing of a complaint, which can in turn be used to satisfy judgment once entered. *Id.* at 6. Execution and levy refers to a postjudgment remedy to enforce a judgment against property of the debtor that is in the debtor's possession. *Id.* at 8-9. Garnishment, which can be either a prejudgment or postjudgment remedy, refers to attachment or execution of property of the debtor in the possession of a third party, most notably a debtor's wages or other forms of personal income. *Id.* at 6-7.

until they obtain a judgment against the debtor and follow complicated procedures for enforcing their right to payment.[51] Unsecured creditors that successfully sue a defaulting debtor generally obtain an automatic judgment lien against the debtor's nonexempt real property,[52] but this lien is not self-executing.[53] To enforce a judgment lien against real property, judgment creditors ordinarily must take other judicially supervised steps, usually involving mortgage foreclosure[54] or execution and levy.[55] To enforce a judgment against a debtor's personal property, judgment creditors generally must take additional steps.[56] In order to obtain a lien against the debtor's personal property, the judgment creditor generally must seek a writ of execution.[57] As in the case of judgment liens, these

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51. BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 4-10. In limited circumstances, general creditors may be entitled to attach the debtor's property before judgment. *See, e.g.*, N.J. STAT. ANN. § 2A:26-2(a)-(e) (West 1987) (detailing circumstances in which prejudgment attachment is proper); N.Y. CIV. PRAC. L. & R. 6001, 6201 (McKinney 1978) (establishing general provisional remedies and prejudgment attachment in particular); WIS. STAT. ANN. §§ 811.01-.03 (West 1989) (granting creditor right to attach property of debtor). A prejudgment attachment lien merely provides general creditors with an inchoate lien that is unenforceable until after judgment. *See, e.g.*, N.Y. CIV. PRAC. L. & R. 6222, 6224 (McKinney 1978) (delineating grounds for discharge or annulment of attachment and including cases in which judgment has been fully satisfied as providing one such ground); R.I. GEN. LAWS § 9-25-23 (1989) (mandating final judgment prior to proper attachment of debtor's property); *see also* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 6-7 (noting that prejudgment lien does not give creditor title to property because creditor might not win suit and because even if creditor prevails, creditor must take additional steps to obtain writ of execution before ownership of property passes to creditor).

52. *See, e.g.*, N.J. STAT. ANN. § 2A:26-11 (West 1989) (stating that "[t]he judgment in the action shall be a lien on defendants' real estate"). The entry of a judgment results in the automatic attachment of a judgment lien against the debtor's real property in all jurisdictions except Kentucky, Massachusetts, Michigan, New Hampshire, and Rhode Island. BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 8; RIESENFELD, *supra* note 45, at 89-90. In Alabama, Georgia, and Mississippi, entry of a judgment may result not only in an automatic lien against the debtor's real property, but also in a lien against certain of the debtor's personal property. RIESENFELD, *supra* note 45, at 150 nn.44-45.

53. BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 8.

54. *See* RIESENFELD, *supra* note 45, at 97 (stating that creditors may only enforce judgment liens through mortgage foreclosure procedures in several jurisdictions).

55. *See, e.g.*, N.J. STAT. ANN. §§ 2A:17 to :60 (West 1989) (requiring "leave of court" to levy and subsequently sell "rights and credits" of debtor); N.Y. CIV. PRAC. L. & R. 5230 (McKinney 1990) (establishing procedural guidelines for executions by specifying that debtor's property may be levied upon and sold); R.I. GEN. LAW § 9-25-23 (1989) (requiring final judgment to attach debtor's property for subsequent execution and levy); *see also* RIESENFELD, *supra* note 45, at 97 (noting that some jurisdictions only allow levy and sale under writ of execution to enforce judgment liens while other jurisdictions allow execution and foreclosure as alternative remedies).

56. *See* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 9 (explaining different procedures required to seize various types of real property, and noting that generally transitory nature of chattels requires sheriff to take possession or otherwise deprive debtor of use of property).

57. *See, e.g.*, N.J. STAT. ANN. §§ 2A:17 to :60 (West 1989) (declaring that writ to bind property or goods of person is not binding until delivered by appropriate officer); N.Y. CIV. PRAC. L. & R. 5230 (McKinney 1990) (establishing requirements for writ of execution); R.I. GEN. LAWS § 9-25-23 (1989) (requiring writ of execution for attachment); *see also* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 9 (explaining that in most states

execution liens are not self-executing.[58] In most jurisdictions, execution liens are only enforceable by a sheriff or other official who levies against the debtor's property and sells it,[59] paying the creditor out of the proceeds of the sale.[60] And when general creditors instead seek to enforce a judgment against a debtor's personal property that is in the possession of another, they must resort to a writ of garnishment rather than a writ of execution.[61] These individual col-

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judgment itself does not create lien against debtor's personal property, but that issuance or service of writ of execution may).

58. ELIZABETH WARREN & JAY L. WESTBROOK, THE LAW OF DEBTORS & CREDITORS 36 (1986).

59. *See, e.g.*, CAL. CIV. PROC. CODE §§ 699.510-.548 (West 1990 & Supp. 1992) (setting forth writ of execution and notice of levy procedures, specifically focusing on issuance of writ and information that must be contained therein, as well as on proper time to levy upon any property named in writ and necessary notice for individuals involved in levying process); FLA. STAT. ANN. §§ 56.21-.25 (West 1990 & Supp. 1991) (detailing phases of execution sale including mandating notice that must take place over one-month period; precise hours and day of week of sale; location of sale either to take place on courthouse steps or where property was taken into possession; and execution and delivery of bill of sale); N.J. STAT. ANN. §§ 2A:26-15, :17-45, :17-60 (West 1989) (explaining execution sale, special order, and leave of court); N.Y. CIV. PRAC. L. & R. 5230, 5232, 5233 (McKinney 1990 & Supp. 1992) (highlighting execution procedure and levy and sale of debtor's personal property); *see also* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 10 (advocating stringent regulation of creditor-induced property sales as necessary to protect debtor and junior creditors); WARREN & WESTBROOK, *supra* note 58, at 36-37 (noting that creditor remains unsecured general creditor until "execution" process begins and outlining procedures for collection or "levying" process, beginning with court-ordered writ and leading to sheriff's seizure of any personal property and posting of notice of seizure on any real property).

60. *See, e.g.*, CAL. CIV. PROC. CODE §§ 701.810-.830 (West 1990) (providing order for distribution of proceeds from sale or collection of debtor's assets, giving highest priority to creditors with preferred labor claims; which include unsecured claims for wages, salaries, or commissions and for contributions to employee benefit plans; specifying 30-day time limit to pay out proceeds; and granting levying officer option of depositing proceeds that might be subject to conflicting claims with court before distribution); FLA. STAT. ANN. § 56.27 (West 1990) (requiring that all money collected under writ of execution be paid to party favored in outcome of execution cause of action); N.J. STAT. ANN. § 2A:17-1 (West 1989 & Supp. 1992) (outlining law enforcement officer's duty to collect debt and other sums of money from debtor); N.Y. CIV. PRAC. L. & R. 5234(a) (McKinney 1990 & Supp. 1992) (sanctioning distribution of proceeds to creditor from sale of debtor's personal property).

61. *See, e.g.*, FLA. STAT. ANN. §§ 77-77.28 (West 1991) (explaining details of garnishment); N.J. STAT. ANN. § 2A:17-63 (West 1989) (noting authority of court to order payment of debt by garnishment); WIS. STAT. ANN. § 812.02 (West 1989 & Supp. 1991) (delineating circumstances under which garnishment may and may not take place); *see also* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 9 (differentiating between writs of execution and garnishment as related to liens on personal property); JACKSON, LOGIC AND LIMITS, *supra* note 5, at 9 (explaining that writs of execution usually revolve around seizure of tangible real and personal property, whereas writs of garnishment involve seizure of intangible property); RIESENFELD, *supra* note 45, at 217-33, 242, 243 (providing case examples of scope and effect of garnishment proceedings and interrelationship between garnishment and trustee process). *But see, e.g.*, CAL. CIV. PROC. CODE §§ 700.030-.050 (West 1990) (allowing execution and levy to be wielded by creditors against both property in possession or control of debtor and property in possession or control of third persons or bailees); CONN. GEN. STAT. ANN. § 52-361 (West 1991) (providing for wage execution cause of action); N.Y. CIV. PRAC. L. & R. 5231 (McKinney 1990) (creating income execution remedy for creditors). The most common forms of garnishment are brought against a debtor's receivables, business or otherwise. Even debtors that are not in business have receivables. For example, a debtor's deposits and other bank accounts represent obligations owed to the debtor by banks to which the debtor has lent

lection remedies are referred to as "grab laws," because unsecured creditors pursue them on a piecemeal basis, independent of one another. Pursuit of various state law remedies such as execution, attachment, garnishment, levy, and the like may involve a "race to the courthouse" by a debtor's creditors, with the creditors who win the race entitled to "grab" the debtor's assets away from the debtor's slower creditors.[62]

Secured creditors need not jump through so many hoops in collecting a delinquent claim. If a creditor's security interest in a debtor's collateralized property has been properly created and perfected under state law,[63] the creditor can proceed to repossess the collateral, thereby enforcing the claim without the aid of any court or officer of the court.[64] Once the collateral is repossessed, the secured creditor is authorized to sell it[65] in a commercially reasonable fashion[66] and apply the proceeds of the sale to the overdue debt.[67]

b. Collective coercive collection

Grab laws are not the only type of coercive collection remedy available under state law. Most states also provide creditors with a collective means for the repayment of loan obligations. State collec-

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funds merely by setting up accounts. Similarly, the debtor's rights to be paid regular wages, salaries, or commissions also constitute obligations owed to the debtor by his or her employers.

62. *See* MACLACHLAN, *supra* note 14, § 5, at 3 (examining various types of local "grab laws" and distinguishing them from standard bankruptcy remedies); *see also* Jackson, *Translating Assets and Liabilities*, *supra* note 5, at 74 (discussing problematic nature of grab laws that arise because most debtors owe more than one creditor).

63. In all 50 states, Article 9 of the U.C.C. governs the creation, perfection, and priority of most voluntary security interests in personal property. *See* U.C.C. § 9-102 (1981) (clarifying scope of personal property definition); *cf.* U.C.C. § 9-104 (1985) (listing transactions to which Article 9 does not apply). Other state laws govern many involuntary security interests in personal property, commonly referred to as statutory or mechanics' liens. *See, e.g.*, ARIZ. REV. STAT. ANN. § 33-981 (1990 & Supp. 1991) (providing for imposition of lien for labor in construction, alteration, or repair of buildings or other structures); MASS. GEN. LAWS ANN. ch. 254, § 1 (West 1988) (granting liens to employees or trustees for personal labor performed on buildings or structures). Finally, state mortgage laws govern the creation, perfection, and priority of voluntary liens against real property. *Cf.* Stellwagen v. Clum, 245 U.S. 605, 613 (1918) (explaining that where state laws and laws of Congress with respect to liens against property conflict, state laws will be suspended to extent of actual conflict as provided by Federal Bankruptcy Act).

64. *See* U.C.C. § 9-503 (1981) (granting secured party right to proceed without judicial intervention as long as done peacefully).

65. *See id.* § 9-504 (allowing secured party to sell, lease, or otherwise dispose of repossessed collateral); *see also id.* § 9-505 (illustrating ways in which secured creditor may not be required to sell collateral that is repossessed and indicating that if proper procedures are followed, secured creditor may instead elect to retain collateral in satisfaction of debt).

66. *See id.* § 9-504 (outlining elements of commercially reasonable sale).

67. *See id.* § 9-504(1) (permitting application of proceeds of sale to reasonable expenses, attorneys fees, and satisfaction of indebtedness by holders of both security interests and subordinate security interests).

tive remedies include an assignment for the benefit of creditors[68] or equitable receivership.[69] In most states, the collective remedy of assignment for the benefit of creditors is not a coercive remedy, however, because it cannot be commenced involuntarily against a debtor.[70]

In addition, federal law provides creditors with a collective[71] means for compelling repayment: involuntary bankruptcy.[72] The

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68. *See supra* note 45 and accompanying text (discussing state law basis and elements of assignment for benefit of creditors).

69. *See* WILLIAM A. ALDERSON, A PRACTICAL TREATISE ON THE LAW OF RECEIVERS § 2, at 2 (1905). Alderson defined equitable receivership as follows:

> A receiver, generally speaking, is one to whom anything is delivered by another . . . [or, more specifically, is] a ministerial officer of a court of chancery, appointed as an impartial and indifferent person between the parties to a suit to take possession of and preserve, *pendente lite*, and for the benefit of the party ultimately entitled to it, the fund or property in litigation, when it does not seem equitable to the court that either party should have possession or control of it.

Id.; *accord* CHARLES F. BEACH, COMMENTARIES OF THE LAW OF RECEIVERS § 1, at 1 (1888) (defining receiver as ministerial officer of court whose powers are limited to those prescribed by court and who may be viewed as indifferent or impartial to interests of parties in suit). As in the case of assignments for the benefit of creditors, the provisional remedy of receivership is both a creature of common law and of statute. *See generally* KING & COOK, *supra* note 43, at 599-604 (indicating that receiver may be appointed in mortgage foreclosure proceedings to represent judgment lien creditors or to administer all assets of financially distressed debtor); RIESENFELD, *supra* note 45, at 443-54 (detailing demise of federal general receivership and identifying basic tenets of general receivership under state law); Robert A. Greenfield, *Alternatives to Bankruptcy for the Business Debtor*, 51 L.A. BAR J. 135, 136-38 (1975) (describing benefits and advantages of using assignments in liquidating bankruptcy proceedings). For a general discussion of the common law of receivership, see ALDERSON, *supra*, §§ 12-18, at 16-20 (tracing history of appointment of receivers from Court of Chancery to U.S. courts as well as statutory history of power to appoint receivers); BEACH, *supra*, §§ 1-7, at 1-9 (providing brief introduction on law of receivers and concept of receivership in general). For examples of state statutes permitting the appointment of a receiver, see, e.g., GA. CODE ANN. § 9-8-3 (1989) (allowing appointment of receiver without prior notice to trustee in extraordinary circumstances); IOWA CODE ANN. § 626.33 (West 1989) (authorizing court to appoint receivers when it deems such appointment necessary and proper); MASS. GEN. LAWS ANN. ch. 155, § 52 (West 1992) (providing powers for receiver in event of termination or corporate dissolution); MO. ANN. STAT. § 351.490 (Vernon 1988) (granting court power to appoint one or more receivers to aid corporation in liquidation proceedings; allowing either individual or domestic or foreign corporation to be named as receiver and describing corresponding powers); S.D. CODIFIED LAWS ANN. § 21-21-5 (1989) (noting appointment of receivers by judge or court when bankruptcy action is pending); TEX. BUS. CORP. ACT ANN. art. 7.06 (West 1980) (allowing district courts to appoint receivers and in turn order liquidation of assets and businesses).

70. *See* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 1289 (noting that assignment for benefit of creditors generally takes place pursuant to agreement by which debtor voluntarily conveys property to third party who then executes agreement's terms).

71. Neither the Bankruptcy Code nor any other federal law provides general creditors with an individual collection remedy. The Internal Revenue Code provides the Internal Revenue Service with collection remedies that are applicable only to the Service. *See* 26 U.S.C. §§ 6321-6323, 6325 (1988) (establishing lien process for collection of overdue taxes).

72. *See* 11 U.S.C. § 303(a)-(k) (1988) (outlining procedures for commencement of involuntary bankruptcy cases, describing types of debtors involuntary cases can be brought against, and explaining notice and hearing procedures as well as actions that can be taken in event of dismissal of creditor's petition for involuntary bankruptcy). The earliest bankruptcy laws only provided a means for commencing an involuntary case and, thus, were exclusively collection remedies. *See* MACLACHLAN, *supra* note 14, §§ 26-27, at 20-21 (noting that early English and

federal Bankruptcy Code permits creditors to initiate either a chapter 7 liquidation or a chapter 11 reorganization case against the will of a debtor,[73] but the Code does not permit creditors to file an involuntary chapter 12 or 13 petition.[74]

American bankruptcy laws were creditor remedies, initiated only at request of creditors). *See generally* CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY 3-45 (1972) (describing bankruptcy legislation from 1789-1827 as "The Period of the Creditor"); Baird, *World Without Bankruptcy*, *supra* note 6, at 174 (hypothesizing world where bankruptcy is nonexistent in order to determine precise role bankruptcy law should play in legal realm); Louis E. Levinthal, *Early History of Bankruptcy Laws*, 66 U. PA. L. REV. 223, 224 (1918) (criticizing scant development of historical background of English and American bankruptcy law); Treiman, *supra* note 27, at 191-92 (tracing historical notion of "act" of bankruptcy and reconciling it with objectives of modern law).

73. 11 U.S.C. § 303(a) (1988); *see* DANIEL R. COWANS, BANKRUPTCY LAW AND PRACTICE § 3.4, at 134 (1986) (defining chapter 7 as "liquidation bankruptcy" in which debtor surrenders all nonexempt assets to creditors while trustee collects remaining assets and sells them, distributing proceeds pro rata to creditors; defining chapter 11 as "reorganizational bankruptcy" because debtor need not surrender assets, but rather may enter into workout arrangements with creditors while remaining in business).

74. Chapter 12 involves the debt adjustment of a family farmer. 11 U.S.C. § 109(f) (1988); *see id.* § 101(19) (Supp. III 1992) (explaining regular annual income requirement necessary to qualify as "family farmer"). Chapter 13 involves the debt adjustment of an individual with a regular income. *See id.* § 109(e) (1988) (limiting debtor eligibility under chapter 13 to those debtors having noncontingent, liquidated, unsecured debts of less than $100,000 and noncontingent, liquidated, secured debts of less than $350,000); *see also id.* § 101(30) (Supp. III 1991) (defining individual with regular income sufficiently stable to make debt payments under chapter 13). Involuntary chapter 12 and 13 cases are not permitted under the Code. *See, e.g.*, Foster v. Heitkamp (*In re* Foster), 670 F.2d 478, 492-93 (5th Cir. 1982) (stating in dicta that involuntary chapter 13 case is not permissible); *see also* 2 WILLIAM M. COLLIER, COLLIER ON BANKRUPTCY § 303.03, at 303-10 (Lawrence P. King et al. eds., 15th ed. 1992) (discussing inapplicability of involuntary bankruptcy proceedings under chapters 12 and 13).

B. Involuntary Bankruptcy

As the law currently exists,[75] three or more creditors[76] holding claims[77] that are neither contingent[78] nor the subject of a bona fide

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75. *See* Bankruptcy Amendments and Federal Judgeships Act of 1984 (BAFJA), Pub. L. No. 98-353, § 303, 98 Stat. 333, 352 (codified as amended at 11 U.S.C. § 303 (1988)) (amending sections 303(b) and (h) of Code as part of omnibus substantive and jurisdictional amendments to bankruptcy provisions). Section 303(b) currently provides that an involuntary bankruptcy case may be commenced via the filing of a petition:

> (1) by three or more entities, each of which is either a holder of a claim against such person that is not contingent as to liability or the subject of a bona fide dispute, or an indenture trustee representing such a holder, if such claims aggregate at least $5,000 more than the value of any lien on property of the debtor securing such claims held by the holders of such claims;
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> (2) if there are fewer than 12 such holders, excluding any employee or insider of such person and any transferee of a transfer that is voidable under section 544, 545, 547, 548, 549, or 724(a) of this title, by one or more of such holders that hold in the aggregate at least $5,000 of such claims;
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> (3) if such person is a partnership—
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> (A) by fewer than all of the general partners in such partnerships; or
>
> (B) if relief has been ordered under this title with respect to all of the general partners in such partnership, by a general partner in such partnership, the trustee of such a general partner, or a holder of a claim against such partnership; or
>
> (4) by a foreign representative of the estate in a foreign proceeding concerning such person.

11 U.S.C. § 303(b)(1)-(4) (1988).

76. 11 U.S.C. § 303(b)(1) (1988). *But see id.* § 303(b)(2) (permitting single creditor to file involuntary petition when debtor has fewer than 12 creditors; in counting debtor's creditors for this purpose, employees, insiders, and creditors whose claims are voidable are excluded). For a general discussion of the intricacies of counting a debtor's creditors for purposes of § 303(b) of the Bankruptcy Code, see 2 COLLIER, *supra* note 74, §§ 303.07[1][b], 303.08[12], at 303-19 to -21, 303-41 to -45.

77. *See* 11 U.S.C. § 101(5) (Supp. III 1991) (defining claim as right to payment or right to equitable remedy giving rise to payment, regardless of whether fixed or liquidated in nature). Although there exists no explicit requirement that a petitioning creditor exhaust its state collection remedies as a prerequisite to commencement of an involuntary bankruptcy case, courts are divided on this issue. *Compare, e.g., In re* Win-Sum Sports, Inc., 14 B.R. 389, 392-93 (Bankr. D. Conn. 1981) (holding that exhaustion of state remedies is not required) *with, e.g., In re* F.R.P. Indus., Inc., 73 B.R. 309, 313 (Bankr. N.D. Fla. 1987) (discussing petition as having been filed in bad faith where debtor appeared solvent, petitioning creditors did not first pursue state collection remedies, and creditor's true motive in filing was to effectuate takeover of debtor); *In re* Dwoskin, 24 B.R. 41, 42 (Bankr. S.D. Fla. 1982) (acknowledging that cases involving sole creditor's involuntary petition will be dismissed when creditor will not be prejudiced by pursuit of state collection remedies); *In re* R.V. Seating, Inc., 8 B.R. 663, 665 (Bankr. S.D. Fla. 1981) (considering "economy of bankruptcy administration" when determining if creditors' or debtors' interests are better served by dismissal).

78. 11 U.S.C. § 303(b)(1) (1988). Although the Code does not explicitly define the term "contingent," courts have generally agreed on its meaning. *See, e.g., In re* Causcus Distribs., Inc., 83 B.R. 921, 928 (Bankr. E.D. Va. 1988) (defining contingent claim as "one which is dependent on some future event for liability to attach"); *see also* 2 COLLIER, *supra* note 74, § 303.08[11][a], at 303-32 to -33 (expanding definition of contingent claim to require dependence on occurrence of future event and not merely on actions of debtor to dispute claim and enter counterclaim).

dispute[79] and that total more than $5000 of the value of any lien[80] against the debtor's encumbered property can file either an involuntary petition for a chapter 7 liquidation[81] or a chapter 11 reorganization[82] against an eligible debtor.[83] The debtor is entitled to contest an involuntary petition within twenty days of the filing.[84] If the petition is timely controverted, the court must determine whether to enter an order for relief, which serves to commence the case, or to sustain the debtor's objections to the petition.[85] A debtor may object to the petition on a number of grounds,[86] including (1) that an insufficient number of creditors joined in the petition;[87] (2) that one or more of the petitioning creditors did not have standing to file;[88]

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79. 11 U.S.C. § 303(b)(1) (1988); *see also* 2 COLLIER, *supra* note 74, § 303.08[11][b], at 305-35 (noting that only since 1984 have petitioning creditors been required by statute to show that their claims were not subject of "bona fide dispute"). The Code does not define the term "bona fide dispute." For a discussion of the various definitional uses of the term, see *infra* notes 99-102 and accompanying text (outlining several circuit court applications of term "bona fide dispute").

80. 11 U.S.C. § 303(b)(1) (1988). Nothing in § 303 precludes a fully secured creditor from joining in an involuntary petition. *See* Paradise Hotel Corp. v. Bank of Nova Scotia, 842 F.2d 47, 49 (3d Cir. 1988) (holding that fully secured creditor is entitled to join in involuntary bankruptcy petition with two creditors whose unsecured claims exceed $5000); *In re* Crabtree, 32 B.R. 837, 839 (Bankr. E.D. Tenn. 1983) (allowing secured creditor to act as petitioning creditor if aggregate of other petitioning creditors' claims is at minimum $5000 above value of any lien). *But see* Pleas Doyle & Assocs. v. James Plaza Joint Venture (*In re* James Plaza Joint Venture), 67 B.R. 445, 448 (Bankr. S.D. Tex. 1986) (determining that fully secured creditors are not entitled to commence involuntary bankruptcy case where no proof as to number of creditors exists).

81. 11 U.S.C. §§ 701-766 (1988 & Supp. III 1991).

82. *Id.* §§ 1101-1174. Involuntary chapter 12 and 13 cases are not permitted under the Code. *See supra* note 74 and accompanying text (stating that Code's limitations on criteria that satisfy chapters 12 and 13 standards have been interpreted to not permit involuntary bankruptcy under these chapters).

83. *See* 11 U.S.C. § 109(b)-(f) (1988) (articulating qualifications for debtors under chapters 7 and 11 of Bankruptcy Code). With narrow exceptions, § 303(a) of the Code permits the filing of an involuntary petition against any debtor eligible for voluntary relief; involuntary petitions may not be filed against commercial farmers, family farmers, or corporations that do not qualify as moneyed, business, or commercial corporations. *Id.* § 303(a); *see also id.* § 303(k) (outlining requirements for commencing involuntary case against foreign bank).

84. *Id.* § 303(h) (setting forth 20-day contest period and mandating in addition that court issue order of relief against debtor if petition is not timely filed); *see* FED. R. BANKR. P. 1011(b) (alloting 20 days after service of summons for debtor to present defenses and objections to involuntary bankruptcy petitions, except where party is not within state, in which case court will prescribe appropriate extended time limit); FED. R. BANKR. P. 1013(b) (granting court power to enter order for relief if no defenses or pleadings have been filed within time limits). *But see* Wynn v. Erikson, 889 F.2d 644, 646 (8th Cir. 1989) (holding that delay between filing and granting of relief did not violate bankruptcy procedures requiring timely orders).

85. 11 U.S.C. § 303(h) (1988).

86. *See* 2 COLLIER, *supra* note 74, § 303.23, at 303-100 to -104 (providing complete list of defenses against involuntary petition, including lack of jurisdiction, improper venue, and debtor's denial that standard for commencement is satisfied).

87. 11 U.S.C. § 303(b) (1988) (establishing requisite number of petitioning creditors needed for commencement of involuntary case).

88. 11 U.S.C. § 303(b)(1) (1988) (indicating that creditors may be barred from joining in petition if claim is contingent or subject to bona fide dispute).

or (3) that the standard for commencement of an involuntary case had not been satisfied.[89]

There are two statutory standards for commencement of an involuntary bankruptcy case. The first is a "general failure to pay" debts as they become due standard.[90] The second focuses on whether a custodian has been appointed to oversee and take possession of the debtor's assets.[91]

The "general failure to pay" standard requires an allegation that the debtor is generally not paying debts as they come due, with an exception for certain disputed obligations.[92] Legislative history indicates that Congress intended to give courts considerable discretion in determining a debtor's "general failure to pay,"[93] and courts have applied a flexible standard that considers the totality of the circumstances.[94] Consistent with the analysis prescribed in the legislative history,[95] courts generally consider both the number and

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89. *See id.* § 303(h) (establishing standards for commencement of involuntary case); *see also infra* notes 90-108 (delineating current statutory standards for commencement of bankruptcy case).

90. *Id.* § 303(h)(1). This provision states:

> (h) If the petition is not timely controverted, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed. Otherwise, after trial, the court shall order relief against the debtor in an involuntary case under the chapter under which the petition was filed, only if—
>
> (1) the debtor is *generally not paying such debtor's debts as such debts become due* unless such debts are the subject of a bona fide dispute . . . .

Id. (emphasis added). Congress amended this provision in 1984, removing debts that are subject to bona fide dispute from the determination of whether the debtor meets this standard. *See infra* notes 99-102 (discussing types of controversies that constitute "bona fide" dispute).

91. 11 U.S.C. § 303(h)(2) (1988). This provision allows for relief under the involuntary bankruptcy petition in situations in which:

> (2) within 120 days before the date of the filing of the petition, a custodian, other than a trustee, receiver, or agent appointed or authorized to take charge of less than substantially all of the property of the debtor for the purpose of enforcing a lien against such property, was appointed or took possession.

Id.

92. *See id.* § 303(h)(1) (excepting certain bona fide disputed debts from standard of "general failure to pay").

93. *See* REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. II, at 75 ("The scope and meaning of 'generally unable' and 'generally failed' are left to the courts; it is not possible to lay down guidelines that will fit all cases."); *see also In re* B.D. Int'l Discount Corp., 701 F.2d 1071, 1075-76 (2d Cir.) (noting historic fluctuation in Congress over specific requirements of "general failure to pay" standard), *cert. denied*, 464 U.S. 830 (1983).

94. *See* Bartmann v. Maverick Tube Corp., 853 F.2d 1540, 1546 (10th Cir. 1988) (confirming that bankruptcy court determination of whether creditors have met their burden should examine all circumstances in balancing interests of creditors and debtors); *In re* Bishop, Baldwin, Rewald, Dillingham & Wong, Inc., 779 F.2d 471, 475 (9th Cir. 1985) (noting that standard of "generally not paying" was adopted to allow for greater flexibility in initiating involuntary cases by encouraging courts to consider totality of circumstances that existed at time petition filed); *see also* 2 COLLIER, *supra* note 74, § 303.12[4], at 303-61 (describing "generally not paying standard" as one that balances interests of debtor and creditor).

95. *See* REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. II, at 75 (indicating congressional intent for courts to consider more than alleged debtor's inability to pay some portion of

amount of unpaid claims,[96] as well as other factors such as the manner in which the debtor has conducted its financial affairs.[97] Absent special circumstances, however, the majority of courts will not find that a debtor's failure to pay a single debt constitutes a "general" failure to pay debts as they come due.[98]

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debts, and including other factors, such as number and amount of debts, in determination of whether debtor is "generally unable to pay").

96. *See, e.g.*, *In re* Bishop, Baldwin, Rewald, Dillingham & Wong, Inc., 779 F.2d at 475 (holding that debtor's failure to pay 26 creditors constituted failure to generally pay debt despite debtor's consistency in making small monthly payments); *In re* B.D. Int'l Discount Corp., 701 F.2d at 1076 (emphasizing congressional intent to have courts examine totality of circumstances in considering debtor's ability to pay, but noting that standard's application has not made courts' determination quick or easy); *In re* J.B. Lovell Corp., 80 B.R. 254, 255 (Bankr. N.D. Ga. 1987) (emphasizing nonpayment of few large debts as sufficient to meet "generally not paying" standard even if debtor is paying most creditors); *In re* B.D. Int'l Discount Corp., 15 B.R. 755, 763 (Bankr. S.D.N.Y. 1981) (stipulating that nonpayment of single claim can constitute general nonpayment), *aff'd*, 24 B.R. 876 (Bankr. S.D.N.Y. 1982), *aff'd on other grounds*, 701 F.2d 1071 (2d Cir.), *cert. denied*, 464 U.S. 830 (1983); *In re* All Media Properties, Inc., 5 B.R. 126, 142 (Bankr. S.D. Tex. 1980) (holding that determination of reasons why alleged debtor is not paying debts is not relevant to examination of totality of circumstances), *aff'd*, 646 F.2d 193 (5th Cir. 1981); *In re* Hill, 5 B.R. 79, 83 (Bankr. D. Minn. 1980) (stating that "generally not paying" standard should consider percentage of debt being paid to accommodate individuals who may inadvertently overlook minor claims); *In re* Kreidler Import Corp., 4 B.R. 256, 260 (Bankr. D. Md. 1980) (holding that when amount of debt not being paid constitutes significant portion of debtor's total liability, it is reasonable to find that debtor has failed to meet "generally paying its debt" standard).

97. *See, e.g.*, *In re* Bishop, Baldwin, Rewald, Dillingham & Wong, Inc., 779 F.2d at 475 (factoring debtor's involuntary closure of business into consideration of "generally not paying" standard); *In re* Covey, 650 F.2d 877, 884 (7th Cir. 1981) (weighing voluntary closure of car dealership into balancing test of creditors' and debtor's interests); Boston Beverage Corp. v. Turner, 81 B.R. at 747 (allowing evidence of involuntary debtor's inability to pay consumer debt to be examined in determination of whether individual was generally paying debts as they became due); *In re* Arriola Energy Corp., 74 B.R. 784, 790 (Bankr. S.D. Tex. 1987) (examining nature and totality of involuntary debtor's financial affairs); *see also In re* Trans-High Corp., 3 B.R. 1, 3 (Bankr. S.D.N.Y. 1980) (interpreting § 303(h)(1) of Bankruptcy Code to mean that court order for relief is proper when debtor is not paying its debts "in the regular course of business" and dismissing petition for failure to establish deviation from regular course). *See generally* 2 COLLIER, *supra* note 74, § 303.12[4], at 303-64 (listing other criteria to be considered in applying "generally not paying standard," including debtor's other financial dealings, total debt compared with debtor's annual income, debtor's liquidity, debtor's voluntary business closure, and whether debtor has operated business and conducted financial matters with lack of good faith).

98. *See* Concrete Pumping Serv., Inc. v. King Constr. Co. (*In re* Concrete Pumping Serv., Inc.), 943 F.2d 627, 630 (6th Cir. 1991) (holding that single creditor may force debtor into involuntary bankruptcy when there is showing of fraud); Paradise Hotel Corp. v. Bank of Nova Scotia, 842 F.2d 47, 51 n.7 (3d Cir. 1988) (noting in dicta that nonpayment of single debt is insufficient proof of debtor's general default, absent "truly extraordinary circumstances"); Bankers Trust Co. v. Nordbrock (*In re* Nordbrock), 772 F.2d 397, 399 (8th Cir. 1985) (condemning use of bankruptcy courts as forum to collect single, isolated debt); First Florida Nat'l Bank, N.A. v. Smith (*In re* Smith), 129 B.R. 262, 265 (Bankr. M.D. Fla. 1991) (stating in dicta that unless special circumstances are proved, failure to pay single debt will not prove failure to pay debts generally); *In re* Causcus Distribs., Inc., 106 B.R. 890, 921 (Bankr. E.D. Va. 1989) (noting in dicta that while courts recognize exceptions to granting of involuntary petitions, no court has ever granted petition on basis of special circumstances alone); *In re* Gold Bond Corp., 98 B.R. 128, 130 (Bankr. D.R.I. 1989) (discussing order for involuntary petition where no allegation of fraud, trick, or scam arose); *In re* Charon, 94 B.R. 403, 406 (Bankr. E.D. Va. 1988) (upholding view that bankruptcy courts will dismiss claim of sole creditor when there is no showing of special circumstances); *In re* General Trading, Inc., 87 B.R. 216, 220 (Bankr.

Since 1984, courts have been statutorily directed to exclude debts that are subject to a "bona fide" dispute from the determination of whether a debtor is generally paying its debts as they come due.[99] The Code does not explicitly define the term "bona fide" dispute.[100] With minor variations, however, courts have concluded that a debt is subject to a bona fide dispute if an objective basis exists from which to infer that a debtor's disagreement as to the validity of a debt is supported by either a substantial question of fact or a meritorious issue of law.[101] This standard does not require the bankruptcy court to resolve the dispute, but only to identify its presence or absence.[102]

S.D. Fla. 1988) (dismissing claim where petitioning creditor failed to show right to relief); *In re* J.B. Lovell Corp., 80 B.R. at 255 (finding that where failure to pay single claim is so substantial, debtor will be deemed to be "generally" not paying debts on appraisal of that claim alone); *In re* B.D. Int'l Discount Corp., 15 B.R. at 763 (reiterating that nonpayment of single claim, which is large portion of total debt, can constitute general nonpayment); *In re* 7 H Land & Cattle Co., 6 B.R. 29, 34 (Bankr. D. Nev. 1980) (recognizing general rule that nonpayment of single debt does not constitute general default except in circumstances in which (i) debtor has only one creditor and that creditor would otherwise be without adequate remedy under either state or federal law; or (ii) petitioner can show special circumstances, such as fraud, trick, artifice, or scam on part of debtor); *id.* at 34 (denying motion to dismiss involuntary petition filed by single creditor on grounds that genuine issues of material fact existed as to whether petitioner had adequate remedy at state law and as to whether special circumstances warranted commencement of involuntary case); *In re* Hill, 5 B.R. at 83 (holding that although small monthly payments were being made to creditors, large portion of debt remained unpaid, thus qualifying debtor as "generally" not paying debt); *In re* Kreidler Import Corp., 4 B.R. at 260 (holding that failure to make payments on 97% of company's debt satisfied "generally not paying" standard).

99. *See supra* note 90 (providing text of 11 U.S.C. § 303(h)(l)).

100. *See* 11 U.S.C. §§ 101, 303(b)(1), 303(h)(1) (1988 & Supp. III 1991) (failing to provide definition of "bona fide dispute").

101. *See, e.g., In re* Rimell (Rimell v. Mark Twain Bank), 946 F.2d 1363, 1365 (8th Cir. 1991) (following Third, Seventh, and Tenth Circuits in maintaining that "bona fide dispute" exists when there is reasonable basis for dispute as to facts or law as related to debt), *cert. denied*, 112 S. Ct. 2275 (1992); LaScola v. US Sprint Communications, 946 F.2d 559, 563 (7th Cir. 1991) (defining "bona fide dispute" as situation in which dispute exists between parties as to some dispositive factual issue that can only be resolved by finder of fact); B.D.W. Assocs., Inc. v. Busy Beaver Bldg. Ctrs., Inc., 865 F.2d 65, 67 (3d Cir. 1989) (applying standard that requires dismissal of suit where there exists genuine issue of material fact or contention of law that is in dispute); Bartmann v. Maverick Tube Corp., 853 F.2d 1540, 1544 (10th Cir. 1988) (specifying that courts need not determine likely outcome of dispute, only fact that dispute exists); *In re* Busick, 831 F.2d 745, 750 (7th Cir. 1987) (formulating standard to determine if "bona fide dispute" exists which objectively considers whether legal or factual dispute exists regarding validity of debt). While courts of appeals have largely agreed on the definition of the term "bona fide dispute," bankruptcy court decisions have not been so uniform. *Compare In re* Johnston Hawks, Ltd., 49 B.R. 823, 828-31 (Bankr. D. Haw. 1985) (applying balancing approach that considered, *inter alia*, debtor's subjective good faith in raising dispute) *with In re* Lough, 57 B.R. 993, 997 (Bankr. E.D. Mich. 1986) (dismissing petitioner's complaint because there existed bona fide dispute as to known facts) *and In re* Stroop, 51 B.R. 210, 212 (Bankr. D. Colo. 1985) (applying same standard as applicable to motion for summary judgment). *See generally* 2 COLLIER, *supra* note 74, § 303.8[11][c], at 303-38 to -40 (highlighting various interpretations of "bona fide dispute," including disagreements as to law or facts, contrary claims made in good faith, and disputes arising from proper application of law).

102. *See Bartmann*, 853 F.2d at 1544 (confirming view that court is only required to determine whether bona fide dispute exists); *In re* Busick, 831 F.2d at 750 (treating determination

The second basis for involuntary commencement of a bankruptcy case focuses on the appointment of a custodian to oversee and take possession of the debtor's property. The Bankruptcy Code's definition of "custodian" includes situations in which an assignment of the debtor's assets is made for the benefit of its creditors,[103] as well as an appointment of an equitable receivership either for purposes of enforcing a lien against the debtor's property or for the general administration of such property.[104] Despite the seeming breadth of this definition,[105] courts have limited its application to instances in which the debtor has given up both possession and ownership of its property.[106] Moreover, section 303(h)(2) of the Code limits this ground for commencement of an involuntary bankruptcy case to instances in which the custodian was appointed or took possession of all or substantially all of the debtor's property[107] within 120 days before the filing date of the petition.[108]

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as to existence of bona fide dispute as paramount concern of court). Nonetheless, some courts appear unable to resist the temptation to resolve disputes determined to be without merit. *See In re* Tikijian, 76 B.R. 304, 316 (Bankr. S.D.N.Y. 1987) (finding that debtor's legal defenses to liability on guarantee were without merit); *In re* B.D.W. Assocs., Inc., 75 B.R. 909, 914 (Bankr. W.D. Pa. 1987) (determining that accusations between sister corporation and debtor were not indicative of bona fide dispute).

103. 11 U.S.C. § 101(11)(B) (Supp. III 1991) (defining "custodian" to include "assignee under a general assignment for the benefit of the debtor's creditors").

104. *See id.* § 101(11)(A) (defining "custodian" to include "receiver or trustee of any of the property of the debtor appointed in a case or proceeding not under this title"). The statute also explains that a custodian may be a:

> trustee, receiver, or agent under applicable law, or under a contract, that is appointed or authorized to take charge of property of the debtor for the purpose of enforcing a lien against such property, or for the purpose of general administration of such property for the benefit of the debtor's creditors.

Id. § 101(10)(C). Thus, although it appears to have been derived from the fifth "act of bankruptcy" under the former Act (appointment of receiver), § 303(h)(2) also subsumes the fourth "act of bankruptcy" (assignment for benefit of creditors) as well. *See infra* notes 116-23 and accompanying text (delineating "acts of bankruptcy").

105. *See* H.R. REP. No. 595, 95th Cong., 1st Sess. 310 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6267 (stipulating that definition of custodian was intended to include nonbankruptcy court officials having functions substantially similar to those of receiver or trustee, such as prepetition liquidator of debtor's property); *see also* S. REP. No. 989, 95th Cong., 2d Sess. 23 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5789 (indicating congressional intent to include other officers of court in definition of custodian if their functions are substantially similar to those of receiver).

106. *See In re* B.D. Int'l Discount Corp., 15 B.R. 755, 765 (Bankr. S.D.N.Y. 1981) (noting that attorney for debtor was not "custodian" although debtor had turned over all of its cash assets to attorney as escrow agent), *aff'd*, 24 B.R. 876 (Bankr. S.D.N.Y. 1982), *aff'd on other grounds*, 701 F.2d 1071 (2d Cir.), *cert. denied*, 464 U.S. 830 (1983); *In re* North County Chrysler Plymouth, Inc., 13 B.R. 393, 400 (Bankr. W.D. Mo. 1981) (finding that auctioneer hired by debtor to conduct sale of debtor's property and remit proceeds to debtor did not fall within definitional requirements of custodian).

107. 11 U.S.C. § 303(h)(2) (1988); *see* 2 COLLIER, *supra* note 74, § 303.13, at 303-66 (indicating that § 303(h)(2) does not permit involuntary bankruptcy cases when appointment of state court receiver and subsequent foreclosure amounts to significantly less than whole of debtor's real property).

108. 11 U.S.C. § 303(h)(2) (1988). *But see* 2 COLLIER, *supra* note 74, § 303.13, at 303-68

By contrast, under the former Bankruptcy Act, the commencement standard[109] for an involuntary liquidation proceeding[110] against an eligible[111] debtor[112] required that there be three or more petitioning creditors[113] whose provable claims,[114] fixed as to liability

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(indicating that failure to meet 120-day period does not preclude creditor from filing involuntary petition, as long as creditor proves that debtor does not pay debts as they come due); S. REP. No. 989, *supra* note 105, at 34, *reprinted in* 1978 U.S.C.C.A.N. at 5820 (indicating that intent of 120-day provision is to abolish concept of proving existence of "act" of bankruptcy and create instead irrefutable presumption that debtor is unable to pay debts as they become due).

109. Under the former Bankruptcy Act, Chapters I-VII governed liquidation cases. A liquidation case under Chapter VII of the Act should be distinguished from a reorganization case commenced under Chapters X, XI, XII, or XIII of the Act. An involuntary reorganization case could commence under former Chapter X against an insolvent corporate debtor or one unable to pay its debts as they matured, but only if (i) the debtor had committed an "act of bankruptcy," (ii) a receiver or trustee, or indenture trustee or mortgagee under a mortgage, had taken possession of the greater portion of the debtor's property, (iii) a proceeding to foreclose a lien against the greater portion of the property of the debtor had been brought, or (iv) the debtor had been adjudged a bankrupt in a case pending under another chapter of the Act. *See* Bankruptcy Act of 1898, ch. 541, § 131(1)-(5), 52 Stat. 840, 886 (codified as amended at 11 U.S.C. § 531(1)-(5) (1976), *repealed by* Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2682 (specifying contents of creditors' or indenture trustees' petitions for involuntary bankruptcy).

110. Under the former Bankruptcy Act, the filing of an involuntary petition differed distinctly from the adjudication of the debtor as a bankrupt. *See* MACLACHLAN, *supra* note 14, § 49, at 39-40 (explaining that adjudication of debtor as bankrupt may be entered over verdict for defendant due to supervisory powers of court, and indicating that such adjudication usually quickly follows filing of voluntary petition); *see also* 11 U.S.C. § 301 (1988) (distinguishing between filing of petition and entry of order for relief).

111. *See* Bankruptcy Act of 1898, ch. 541, § 4b, 30 Stat. 544, 547 (codified as amended at 11 U.S.C. § 22 (1976)) (repealed 1978) (declaring that certain types of debtors are not amenable to involuntary liquidation or reorganization: farmers, wage earners, corporations that are not moneyed, and business and commercial corporations owing debts amounting to $1000 or more). Otherwise, any person who was eligible for voluntary relief under the chapter that the petition was filed under could have been forced into a similar proceeding through the filing of an involuntary petition. *See* MACLACHLAN, *supra* note 14, § 36, at 27-28 (discussing types of debtors that were amenable to involuntary bankruptcy under Act).

112. The former Act generally referred to a "debtor" as a "bankrupt," but Congress removed this terminology with enactment of the current Bankruptcy Code as part of the effort to diminish the stigma associated with bankruptcy. *See* 11 U.S.C. § 101(13) (Supp. III 1991) (defining "debtor").

113. Bankruptcy Act of 1898, ch. 541, § 59b, 30 Stat. 544, 561 (codified as amended at 11 U.S.C. § 95(b) (1976)) (repealed 1978) (allowing three or more creditors with provable claims against debtor to file involuntary petition, but if debtor had less than 12 creditors, then involuntary petition could have been brought under Act by single creditor holding provable claim of $500 or more); *see id.* § 59e, 30 Stat. at 561 (codified at 11 U.S.C. § 95(e)) (repealed 1978) (delineating rules governing computation of number of debtor's creditors for purposes of determining whether three creditors were required to join in petition). Moreover, although fully secured creditors, employees, and relatives of a debtor were excluded from the count of creditors, they could have joined in the petition. *See* 2 COLLIER, *supra* note 74, § 303.06[3], at 303-14 (indicating that excluded creditors do not necessarily lack standing to join in involuntary petition).

114. *See* Bankruptcy Act of 1898, ch. 541, § 63a, 30 Stat. 544, 562 (codified as amended at 11 U.S.C. § 103(a) (1976)) (repealed 1978) (defining term "provable claim" as including fixed liability, taxable costs against bankrupt, expressed or implied contracts, right to recover damages, and breach of contract); *see also* MACLACHLAN, *supra* note 14, §§ 133-149, at 124-44 (providing general discussion of "provable claims"). The term "provable claim" has no continuing relevance under the current Bankruptcy Code.

and liquidated as to amount, aggregated $500 or more in excess of the value of liens held by the creditors.[115] Furthermore, this standard of commencement required proof by the petitioning creditors that the debtor had committed an "act of bankruptcy"[116] within four months prior to the filing of the petition.[117] The former Bankruptcy Act identified six different "acts of bankruptcy":

> (1) fraudulent transfers under §§ 67 or 70 of the Act (concerning avoidance of certain statutory liens and other fraudulent transfers);[118]
> (2) preferential transfers under § 60a of the Act;[119]
> (3) the failure to vacate a judicial lien in a timely manner, within the later of thirty days after imposition of the lien or five days before a scheduled judicial sale, if the debtor was insolvent during that period;[120]
> (4) making a state law assignment for the benefit of creditors;[121]
> (5) the appointment under state law of a receiver of property when the debtor was insolvent or unable to pay its debts;[122] and
> (6) the admission in writing of an inability to pay debts and a willingness to be adjudicated bankrupt.[123]

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115. Bankruptcy Act of 1898, ch. 541, § 59b, 30 Stat. 544, 561 (codified as amended at 11 U.S.C. § 95(b) (1976)) (repealed 1978).

116. *Id.* § 3a, 30 Stat. at 546 (codified as amended at 11 U.S.C. § 21(a) (1976)) (repealed 1978).

117. Chandler Act, Pub. L. No. 696, § 3(b), 52 Stat. 840, 844 (1938) (codified as amended at 11 U.S.C. § 21(a)(2) (1976)) (repealed 1978); *see* 1 WILLIAM M. COLLIER, COLLIER ON BANKRUPTCY §§ 3.701-.707, at 522-32 (James W. Moore et al. eds., 14th ed. 1976) (explaining measurement of four month filing period and delineating filing periods for six "acts of bankruptcy"). For a discussion of the complex tests imposed by the Act to determine when each of the various acts of bankruptcy occur, see MACLACHLAN, *supra* note 14, § 61, at 51-54.

118. Chandler Act, Pub. L. No. 696, § 3(a), 52 Stat. 840, 844 (1938) (codified as amended at 11 U.S.C. § 21(a)(1) (1976)) (repealed 1978); *see also* 4, 4A, 4B COLLIER, *supra* note 117, §§ 67, 70 (detailing avoidance of certain statutory liens and other fraudulent transfers); MACLACHLAN, *supra* note 14, §§ 221-246, at 252-82 (explaining various aspects of fraudulent conveyances); MACLACHLAN, *supra* note 14, §§ 282-287, at 327-37 (providing general discussion of transfers that actual creditors can avoid).

119. Chandler Act, Pub. L. No. 696, § 3(b), 52 Stat. 840, 844 (1938) (codified as amended at 11 U.S.C. § 21(a)(2) (1976)) (repealed 1978); 3 COLLIER, *supra* note 117, § 60, at 731-738.2; *see also* MACLACHLAN, *supra* note 14, §§ 247-277, at 283-318 (surveying preference law).

120. Chandler Act, Pub. L. No. 696, § 3(c), 52 Stat. 840, 844 (1938) (codified as amended at 11 U.S.C. § 21(a)(3) (1976)) (repealed 1978); *see* 2 COLLIER, *supra* note 74, § 101.36, at 101-120 to -121 (defining judicial liens as "lien obtained by judgment, levy, sequestration, or other legal or equitable process or proceeding").

121. Chandler Act, Pub. L. No. 696, § 3(d), 52 Stat. 840, 844 (1938) (codified as amended at 11 U.S.C. § 21(a)(4) (1976)) (repealed 1978); *see also supra* note 45 and accompanying text (offering general definition of state law collective insolvency remedy of assignment for benefit of creditors).

122. Chandler Act, Pub. L. No. 696, § 3(e), 52 Stat. 840, 844 (1978) (codified as amended at 11 U.S.C. § 21(a)(5) (1976)) (repealed 1978); *see also supra* note 69 and accompanying text (examining state law collective insolvency remedy of receivership).

123. Chandler Act, Pub. L. No. 696, § 3(f), 52 Stat. 840, 844 (1938) (codified as amended at 11 U.S.C. § 21(a)(6) (1976)) (repealed 1978).

Although it was widely assumed by practitioners, courts, and commentators alike that under the Bankruptcy Act only an insolvent[124] debtor could be involuntarily thrust into bankruptcy,[125] a debtor's solvency was actually a defense only to an involuntary petition grounded on the first act of bankruptcy.[126] The misconception arose because many of the acts of bankruptcy implicitly required a showing of the debtor's insolvency as an element of their proof. Thus, if petitioning creditors relied on the first act of bankruptcy and alleged the debtor's commission of a constructive rather than an actual fraudulent transfer,[127] they were required to prove the debtor's insolvency at the time of the alleged fraudulent transfer. Creditors were also required to prove insolvency as an element of the second (preferential transfers)[128] and fifth (appointment of receiver)[129] acts of bankruptcy.

C. *Voluntary Bankruptcy*

Under the Bankruptcy Code, an eligible debtor[130] generally need not allege or prove its insolvency or inability to pay debts in order to

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124. *See supra* note 14 (defining insolvency).

125. *Compare* H.R. REP. No. 595, *supra* note 105, at 323, *reprinted in* 1978 U.S.C.C.A.N. at 6279 (stating incorrectly that Act "requir[ed proof of] balance-sheet insolvency *and* an act of bankruptcy") *with* S. REP. No. 989, *supra* note 105, at 34, *reprinted in* 1978 U.S.C.C.A.N. at 5820 (stating correctly that "[p]roof of the commission of an act of bankruptcy has frequently required a showing that the debtor was insolvent on a 'balance-sheet' test when the act was committed").

126. *See* Bankruptcy Act of 1898, ch. 541, § 3(c), 30 Stat. 544, 547 (codified as amended at 11 U.S.C. § 21(c) (1976)) (repealed 1978) (stating that "[i]t shall be a complete defense to any proceedings in bankruptcy instituted *under the first subdivision of this section* to allege and prove that the party proceeded against was not insolvent as defined in this Act at the time of the filing of the petition against him") (emphasis added). In West Co. v. Lea, 174 U.S. 590 (1899), the Supreme Court interpreted the phrase underscored above as permitting a debtor to raise its solvency as a defense to an involuntary petition only when the petition had alleged the first act of bankruptcy. *Id.* at 597. In 1938, Congress codified this ruling by substituting "under the first act of bankruptcy" for the ambiguous underscored phrase. Chandler Act, Pub. L. No. 696, § 3(c), 52 Stat. 840, 845 (codified as amended at 11 U.S.C. § 21(a)(3) (1976)) (repealed 1978); 1 COLLIER, *supra* note 117, § 3.109[1], at 430 n.2. *See generally* Treiman, *supra* note 27, at 197-210 (discussing damaging effect of "act" of bankruptcy on form, theory, and operation of law).

127. *See* Bankruptcy Act of 1898, ch. 541, § 67d, 30 Stat. 544, 564 (codified as amended at 11 U.S.C. § 107(d) (1976)) (repealed 1978) (including insolvency among possible elements of constructive fraudulent transfer).

128. *Compare id.* § 60, 30 Stat. at 562 (codified as amended at 11 U.S.C. § 96) (repealed 1978) (requiring proof that transferee had reasonable cause to know of debtor's insolvency) *with* 11 U.S.C. § 547(f) (1988) (establishing rebuttable presumption that debtor is insolvent within 90 days preceding filing of petition for purposes of preference provision).

129. *But see* 1 COLLIER, *supra* note 117, § 3.505[1], at 504-06 (indicating that after 1938 amendment to fifth act of bankruptcy, petitioning creditors could commence involuntary case against debtor whose property was in possession of receiver when debtor was either insolvent or in general default).

130. *See* 11 U.S.C. § 109(a)-(g) (1988) (detailing characteristics of entities that constitute "debtors" for purposes of specific chapters under title 11).

commence a voluntary bankruptcy case.[131] A voluntary case may be initiated merely by the filing of a petition by the debtor.[132] Regardless of whether the petition is submitted by an individual or a Fortune 500 company, or whether the debtor is commencing a chapter 7 liquidation or a chapter 11 reorganization, a petition is extremely simple. It need only state the debtor's name, address, and other limited descriptive information.[133]

The simplicity of the current Bankruptcy Code provisions governing commencement of a voluntary case stand in contrast to the complex requirements of the former Bankruptcy Act. While section 4a of the former Act broadly provided that "[a]ny [eligible] person . . . shall be entitled to the benefits of this Act as a voluntary bankrupt,"[134] commencing a voluntary case under one of its reorganization chapters was more complex.[135] Under the Act, each reorganization petition required an allegation that the debtor was either insolvent or unable to pay its debts as they matured.[136] A Chapter X reorganization petition was required to include:

> 1. [a statement declaring] that the corporation was insolvent or unable to pay its debts as they matured;
> 2. the applicable jurisdictional facts requisite under the Chapter;
> 3. the nature of the business of the corporation;
> 4. the assets, liabilities, capital stock, and financial condition of the corporation;
> 5. the nature of all pending proceedings affecting the property of the corporation known to the petitioner or petitioners and the court in which they were pending;
> 6. the status of any plan of reorganization, readjustment, or liqui-

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131. *Compare* 11 U.S.C. § 301 (1988) (establishing sole requirement for commencement of voluntary bankruptcy case as filing of petition by debtor) *with id.* § 303(h)(1) (requiring evidence that debtor fails to pay debts as they come due as prerequisite for commencement of involuntary bankruptcy case); *see also* 2 COLLIER, *supra* note 74, § 301.13, at 301-26 (stating that voluntary petition of bankruptcy under chapters 7, 11, 12, and 13 does not require allegation of insolvency). *But see* 11 U.S.C. § 109(c) (1988) (requiring that municipality plead insolvency to be eligible for voluntary bankruptcy under chapter 9).

132. 11 U.S.C. § 301 (1988).

133. *See* FED. R. BANKR. P. Form 1 (setting out general form that debtors filing voluntary petition should follow).

134. Bankruptcy Act of 1898, ch. 541, § 4a, 30 Stat. 544, 547 (codified as amended at 11 U.S.C. § 22(a) (1976)) (repealed 1978); *see also id.* § 18f, 30 Stat. at 551 (codified as amended at 11 U.S.C. § 41(f)) (repealed 1978) (providing that filing of voluntary petition operates as adjudication of bankruptcy with same force and effect as decree of adjudication); *id.* § 59a, 30 Stat. at 561 (codified as amended at 11 U.S.C. § 95(a)) (repealed 1978) ("Any qualified person may file a petition [under Chapter VI] to be adjudged a voluntary bankrupt.").

135. *See supra* note 109 (discussing distinction between liquidation and reorganization chapters under Bankruptcy Act of 1898).

136. *See* Bankruptcy Act of 1898, ch. 541, §§ 130(1), 323, 423, 623, 52 Stat. 840, 881, 907, 918, 932 (codified as amended at 11 U.S.C. §§ 530, 723, 823, 1023 (1976)) (repealed 1978) (requiring debtor to allege insolvency or inability to pay debts under reorganization Chapters X, XI, XII, and XIII of former Act).

dation affecting the property of the corporation, pending either in connection with or without any judicial proceeding;
7. the specific facts showing the need for relief under this Chapter and why adequate relief could not be obtained under Chapter IX of the Act; and
8. the desire of the petitioner or petitioners that a plan be effected.[137]

Moreover, the court was required to determine whether the petition had been filed in good faith before entering an order approving the Chapter X petition.[138] A petition under Chapter IX, XI, or XIII was less cumbersome. In addition to alleging the debtor's insolvency or inability to pay its debts as they matured, the Chapters XI and XIII petitions needed only a statement of the debtor's intent to propose a plan under the applicable provisions.[139] Finally, a Chapter XII petition required the debtor to set forth the terms of the proposed arrangement.[140]

II. THE COMMON POOL PROBLEM AND CREDITORS' RIGHTS

A common pool problem can generally be described as a situation in which the self-interested actions of individuals fail to achieve a socially optimal result.[141] This general statement, however, does not distinguish a common pool problem from many other economic disequilibria.[142] Economists apply a more rigorous definition: A

137. *Id.* § 130(1-8), 52 Stat. at 886 (codified as amended at 11 U.S.C. § 530(1-8)) (repealed 1978).

138. *Id.* § 141, 52 Stat. at 887 (codified as amended at 11 U.S.C. § 541) (repealed 1978).

139. A petition under Chapter XI required the debtor to allege insolvency and to either declare its intention to reach an arrangement to pay its debts or set forth the provisions of such an arrangement to pay debts. *Id.* § 323, 52 Stat. at 907 (codified as amended at 11 U.S.C. § 723) (repealed 1978). A petition under Chapter XIII required the debtor to allege insolvency, as well as declare a desire to effect a composition, extension, or both, out of future earnings or wages. *Id.* § 623, 52 Stat. at 932 (codified as amended at 11 U.S.C. § 1023) (repealed 1978).

140. *Id.* § 423, 52 Stat. at 918 (codified as amended at 11 U.S.C. § 823) (repealed 1978).

141. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 10 n.9, 12-14 (describing common pool problems and situations in which each individual is motivated by self-interest).

142. Another example of a situation in which the self-interested actions of individuals do not achieve a socially optimal result is the prisoners' dilemma game. The prisoners' dilemma involves two coconspirators who are taken prisoner for committing a crime. In the course of events, the prosecutor solicits a confession from one or both of the prisoners. Before the arrest, the prisoners, having foreseen this eventuality, have sworn to remain loyal to each other by denying involvement. If only one prisoner confesses, then the authorities will strike a deal with the cooperative prisoner, prosecuting and in turn convicting the other. Under this scenario the cooperative prisoner goes free and the noncooperative prisoner receives a six-month jail term. If both prisoners confess, both will be held for three-month terms. These three-month terms result because the prosecutor cannot let both go free if both confess; instead, the prosecutor is likely to either strike a plea bargain or recommend leniency as a quid pro quo for the prisoners' cooperation. Of course, nothing prevents the prisoners from sticking to their nonbinding oath of loyalty. Their attorneys inform them that by sticking together and denying involvement, the prosecutor's case will be weakened by the lack of corroborative

common pool problem exists when negative production or con-

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testimony, resulting in a one-month term of imprisonment for each prisoner. A matrix of the games' possible results is provided in Table 1. The entries in each cell of the matrix represent the "utility" that prisoners *A* and *B* would assign to the various possible results. This "utility" is assumed to be the negative of the length of their prison terms.

Table 1

The Prisoners' Dilemma

		Prisoner *B*: Confess	Prisoner *B*: Deny
Prisoner *A*	Confess	$R = -3$, $R = -3$ Reward for mutual cooperation	$T = 0$, $S = -6$ Temptation to defect and sucker's payoff
	Deny	$S = -6$, $T = 0$ Sucker's payoff and temptation to defect	$P = -1$, $P = -1$ Punishment for mutual defection

Note: The payoffs to Prisoner *A* are listed first in each cell of the matrix.

To analyze Table 1, the reader should place him or herself in the position of prisoner *A*. If prisoner *B* denies involvement in the crime, prisoner *A* will be better off cooperating, and *A* will receive no prison term. If prisoner *B* cooperates, then prisoner *A* is still better off cooperating, because the prison term will be only three as opposed to six months. Thus, regardless of prisoner *B*'s action, prisoner *A* is better off cooperating. The same result follows from parallel analysis of prisoner *B*'s position. Game theorists describe this cooperative strategy as "dominant," meaning that there is only one optimal choice of strategy for each player, no matter what the other player does. But this result is Pareto inefficient because both prisoners would be better off if neither cooperated with the prosecution. *See* HAL R. VARIAN, INTERMEDIATE ECONOMICS: A MODERN APPROACH 15-16 (2d ed. 1990) (stating that Pareto efficiency occurs "if there is no alternative allocation that leaves everyone at least as well off and makes some people strictly better off"). Thus, a necessary characteristic of the prisoners' dilemma game is that it involves a dominant equilibrium that is Pareto inefficient.

There is no magic in the assumption that the prisoners will receive three-month terms if both cooperate with the prosecutor, as opposed to one-month terms if neither cooperates. Nearly any values can be assigned to these potential outcomes, so long as the temptation to defect (T) is greater than the reward for mutual cooperation (R), which in turn is worth more than punishment for mutual defection (P), which is finally worth more than the sucker's payoff (S). By definition, then, a prisoners' dilemma requires that the relative order of the payoff matrix must be such that $T > R > P > S$. This relationship must be true in order for the game result to be both dominant and Pareto inefficient. ROBERT AXELROD, THE EVOLUTION OF COOPERATION 9-10 (1984).

The "dilemma" in the prisoners' dilemma game results because in a noncooperative version of the game, there is no way for the two prisoners to coordinate their actions. The prosecutor has separated the prisoners and made it impossible for them to bind one another to the agreement not to confess. Either prisoner can deny involvement and hope that the other does the same, but, especially in the first go around, one prisoner denying involvement runs the risk that the other will confess. This risk may result in a six-month prison term. Because of the players' inability to coordinate their actions, the prisoners' dilemma is described by game theorists as a noncooperative game. *See generally* RUSSELL HARDIN, COLLECTIVE ACTION 138, 154 (1982) (describing prisoners' game as strategically rational because each player must take other's rationality into account); VARIAN, *supra*, at 465-68, 564-65 (setting out terms of prisoners' dilemma game and discussing conflict between collective action and self-interest).

Jackson initially described the decision between individual and collective collection remedies as analogous to the prisoners' dilemma in that "[e]ach creditor, unless assured of the sumption externalities[143] caused by the use of exhaustible resources cannot be resolved by the definition of property rights.[144] Examples of common pool problems abound. Baird and Jackson raise the example of a pond of fish owned in common.[145] Collective efforts to

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other's cooperation, has an incentive to take advantage of individual collection remedies, and to do so before the other creditor acts. Unless each creditor individually attempts to 'beat out' the other, that creditor will fare worse than the other." Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 5, at 862. But, like the prisoners' dilemma, both creditors would be better off if they cooperated with one another and commenced a collective proceeding. *See id.* at 866-67 (stating that it is in creditors' joint interest to act collectively). A matrix of the possible results of the creditors' dilemma game is given in Table 2. The entries in each cell of the matrix represent the utility that creditors *A* and *B* would assign to the various possible results; utility is assumed to be the negative of the amount they would receive in collecting claims against the debtor.

Table 2

The Creditors' Dilemma

		Creditor *B*	
		Collective	Individual
Creditor *A*	Collective	$R = Y/2,\ R = Y/2$	$T = 0,\ S = X$
	Individual	$S = X,\ T = 0$	$P = X/2,\ P = X/2$

Note: The payoffs to Creditor *A* are listed first in each cell of the matrix.

If creditor *B* pursues individual remedies against a debtor that owes both *A* and *B*, then creditor *A* will prefer to do the same, because under the assumptions inherent in the common pool model, *A* and *B* have an equal chance at winning the race to the courthouse. If *B* instead chooses collective action, then *A* will still prefer to pursue individual remedies because this enables *A* to recover the full amount of its debt against the debtor, as opposed to sharing pro rata with *B* and thus receiving a lesser amount. In this matrix, Y = the value of dividends from the bankruptcy estate; X = the value of dividends received pursuant to individual state remedies. Here, $X > Y/2 > X/2 > 0$. In the right lower cell (where both creditors *A* and *B* pursue individual remedies), the $X/2$, $X/2$ values are not certain, but rather represent the probability of recovery that each creditor faces before pursuing its individual remedy. Once this process is complete, either *A* or *B* will be paid in full (depending on the priority rule followed in the relevant state), while the other creditor receives nothing.

143. *See* VARIAN, *supra* note 142, at 537 (indicating that consumption externality occurs when one agent—individual consumer or business firm—is directly affected by another agent's production or consumption and similarly, that production externality arises when production possibilities of one agent are influenced by choices of another agent).

144. *See* VARIAN, *supra* note 142, at 552-55 (indicating that common pool problem characterized by production and consumption externalities arises where common resource is not protected by either property rights or by clear, cohesive legal system); Friedman, *supra* note 19, at 855 (describing common pool problem in natural resource development context of tendency toward overproduction that arises when competitors exploit exhaustible resources in which no one has protected rights).

145. BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 39-43 (using

mine for diamonds or drill for oil or natural gas also present consumption externalities.[146] The use of radio, television, and microwave frequencies similarly can create production externalities.[147] To say that a negative consumption externality exists means only that one's consumption prejudices another's ability to consume.[148] With respect to the mining of a single vein of minerals, each additional square foot mined by one spells less ground available for search by the others. In terms of a common pool of fish, each angler's catch represents a diminution of the pool that is available for those who fish later in the day.

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common pool of fish analogy to illustrate ways in which bankruptcy law encourages creditors to resist self-interest and instead act in concert); *see also* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 11 (explaining problems created by innate self-interest of individuals "fishing" in common pool). Much has been written about the common pool problems found in the fishing industry. *See, e.g.*, FRANCIS T. CHRISTY, JR. & ANTHONY SCOTT, THE COMMON WEALTH IN OCEAN FISHERIES; SOME PROBLEMS OF GROWTH AND ECONOMICS ALLOCATION 6-16 (1965) (providing overview of fishing as common pool problem); E.N. Anderson, Jr., *A Malaysian Tragedy of the Commons*, *in* THE QUESTION OF THE COMMONS: THE CULTURE AND ECOLOGY OF COMMUNAL RESOURCES 327, 328-29 (Bonnie J. McCay & James M. Acheson eds., 1987) (describing common pool problems encountered by West Malaysian fishing industry during 1970s); Frederick W. Bell, *Technological Externalities and Common Property Resources: An Empirical Study of the U.S. Northern Lobster Fishery*, 80 J. POL. ECON. 148, 148-51 (1972) (arguing for government regulation of fishing industry to cure economic inefficiencies resulting from common pool problems); H. Scott Gordon, *The Economic Theory of a Common-Property Resource: The Fishery*, 62 J. POL. ECON. 124, 124, 135-42 (1954) (applying theories of natural resource conservation to fishing industry); Ralph Turvey, *Optimization and Suboptimization in Fishery Regulation*, 54 AM. ECON. REV. 64, 72-76 (1964) (arguing that fishing industry should explore alternative methods of regulation rather than relying on restriction of access to resolve common pool problem).

146. *See, e.g.*, MORRIS A. ADELMAN, THE WORLD PETROLEUM MARKET 43, 44 (1972) (discussing "rule of capture" in oil fields of East Texas and asserting that such competition in petroleum industry is peculiar to United States); MELVIN G. DE CHAZEAU & ALFRED E. KAHN, INTEGRATION AND COMPETITION IN PETROLEUM INDUSTRY 61, 62 (1959) (describing competition in petroleum industry as speed race with success belonging to fastest participant); ANTHONY SCOTT, NATURAL RESOURCES: THE ECONOMICS OF CONSERVATION 3-39 (2d ed. 1973) (applying economic theory to conservation of natural reserves); Paul Davidson, *Public Policy Problems of the Domestic Crude Oil Industry*, 53 AM. ECON. REV. 85, 85-86 (1963) (proposing guidelines for conservation of domestic oil resources); Gary D. Libecap & Steven N. Wiggins, *Contractual Responses to the Common Pool: Prorationing of Crude Oil Production*, 74 AM. ECON. REV. 87, 87, 90-97 (1984) (analyzing ways in which number and heterogeneity of firms affect relative bargaining power of competing firms in petroleum industry).

147. *See* Arthur S. De Vany et al., *A Property System for Market Allocation of the Electromagnetic Spectrum: A Legal-Economic-Engineering Study*, 21 STAN. L. REV. 1499, 1499-1501 (1969) (proposing potential use of market mechanisms as alternatives to Federal Communications Commission (FCC) regulations and articulating system of property rights for spectrum usage).

148. Externalities can be either positive or negative. That is, the effect that one individual's consumption has on another's consumption may be either good or bad. With common pool problems, however, the externality is necessarily negative. *See* VARIAN, *supra* note 142, at 537 (citing air pollution or neighbor's loud music, as opposed to neighbor's flower gardens, as examples of negative and positive externalities, respectively).

Negative production externalities may cause common pool problems. Conflicting radio and television transmissions exemplify such production externalities. Bankruptcy, on the other hand, clearly resolves a consumptive-type common pool problem. *See id.* at 552-55 (defining negative externalities as occurring when choices of one firm are influenced by choices of another, and indicating that legal system may provide solution to many common pool problems).

Common pool problems necessarily involve exhaustible goods. In the case of inexhaustible goods, there are by definition always enough to "go around." With inexhaustible goods, one person's consumption cannot possibly affect another's; one individual's self-interested actions will not conflict either with another's self-interest or, for that matter, with the interest of the collective. For example, there can be no common pool problem with bottomless wells of oil or unlimited quantities of fish. The mere identification of exhaustible resources, however, does not mean that a common pool problem exists. Scarce resources indicate only the potential for such a problem. Until the use of scarce resources results in an externality, no common pool problem arises.[149]

Moreover, externalities caused by the use of exhaustible resources do not alone identify a common pool problem. If property rights to the resources can be defined, then the common pool problem is irrelevant because it is easily resolved through private ownership of the affected goods.[150] Thus, common pool problems must involve public goods.[151] Property interests in nonpublic goods may be easily defined and the externalities caused by use of those goods can be resolved through the market.[152]

Public goods are those goods for which consumption cannot be made exclusive; public goods must be provided in the same amount or at the same time to all affected consumers or not at all.[153] Classic examples of public goods include roads, lighthouses, and a system of national defense. A common pool of oil or of fish are quasi-pub-

149. For example, ten fish swimming in a restaurant aquarium do not pose a common pool problem, although the fish constitute an exhaustible resource, until eleven or more diners order fish. Even then no common pool problem results if there exists some way to define property rights in the fish other than by a rule of capture. *See infra* notes 150-56 and accompanying text (discussing use of property rights to define access to public goods and thereby prevent common pool problems).

150. *See* VARIAN, *supra* note 142, at 541, 552-55 (citing property rights as mechanism to cure inefficient use of common resources and contending that externalities cause common pool problems where property rights are poorly defined).

151. *See* VARIAN, *supra* note 142, at 559 (defining public goods as goods "that must be provided in the same amount to all affected consumers"). Russell Hardin refines this definition somewhat when he notes that "[p]ublic goods are defined by two properties: jointness of supply and impossibility of exclusion." HARDIN, *supra* note 142, at 17. Edith Stokey and Richard Zeckhauser provide a slightly different definition, suggesting that public goods are identified by three attributes: (i) nonprovision or gross underprovision by individuals if left to themselves; (ii) nonrivalry to the good in that one person's use does not reduce another's consumption; and (iii) nonexcludability. STOKEY & ZECKHAUSER, *supra* note 1, at 306-07.

152. *See* HARDIN, *supra* note 142, at 16-37, 50-66 (contrasting public and private goods in terms of collective action); Richard J. Sweeney et al., *Market Failure, the Common Pool Problem, and Ocean Research*, 17 J.L. & ECON. 179, 181 (1974) (arguing that regulation may be appropriate for fisheries but that private market is best solution for common pool problems in oil and manganese production).

153. *See supra* note 151 (providing several commentators' definitions of "public goods").

lic goods because ownership of these items is defined by a rule of capture. That is, no individual owns the oil in a commonly owned vein until the pool is tapped;[154] no individual owns fish until they are caught.[155] The simplest method of resolving these common pool problems is for the pool of oil or pond of fish to be owned by a single individual. This solution is unavailable with purely public goods such as radio wave frequencies, however, because it is not possible to exclude all interferences with this type of good.[156]

Baird and Jackson are correct in contending that bankruptcy may be relied upon to resolve common pool problems.[157] Jackson is wrong to suggest, however, that creditors' common pool problems arise, thus bankruptcy should be available, only when a debtor is balance-sheet insolvent. This criterion is both too narrow and too broad a description of the circumstances under which creditors' collection efforts can cause consumption externalities that cannot be resolved through the definition of property rights. The following section examines a number of common pool problems that Jackson, due to his focus on insolvency, has failed to consider.

A. *Mere Potential for Prejudice Among Creditors Does Not Create a Common Pool Problem*

A debtor's balance-sheet insolvency seemingly presents creditors with a common pool problem because the debtor has too few assets to repay all of its creditors in full. Insolvency alone, however, is not

154. *See, e.g.*, Brown v. Spilman, 155 U.S. 665, 671 (1895) (ruling that lease of 10 acres of land with mineral privileges is valid with respect to natural gas contained in part under adjacent real estate); Clark Oil Producing Co. v. Hodel, 667 F. Supp. 281, 290 (E.D. La. 1987) (defining "law of capture" as principle that landowner may legally take oil and gas from his or her land even if in so doing landowner takes oil and gas from neighbor's land); Anderson v. Beech Aircraft Corp., 699 P.2d 1023, 1028-29 (1985) (holding that non-native gas in underground reservoir, absent contract, must be reprocessed in order to separate from real estate and transform into personalty).

155. *See* Young v. Hichens, 115 Eng. Rep. 228, 229-31 (Q.B. 1844), *reprinted in* OLIN L. BROWDER, JR. ET AL., BASIC PROPERTY LAW 24-26 (4th ed. 1984) (finding for defendant in action for trespass where plaintiff had encircled fish in nets but failed to fully enclose them and then had left for many days; holding that capture had not occurred, possession was incomplete, and defendant had right to take fish).

156. *See* ROGER G. NOLL ET AL., ECONOMIC ASPECTS OF TELEVISION REGULATION 3-5 (1973) (examining spectrum allocation and FCC regulation of radio and television frequencies for public use).

157. *See* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 39-42 (suggesting that purpose of bankruptcy law is, in part, resolution of common pool problems). Federal bankruptcy law is not the exclusive method for resolving debtor-based common pool problems, however. Any collective creditors' remedy will suffice. *See* Carlson, *Creditors' Bargain*, *supra* note 31 (arguing that state law has communitarian elements of creditor equality and thus comparison of state law to "state of nature" or libertarian "zone of freedom" where "first in time is first in line" is inaccurate); Carlson, *supra* note 10, at 1346-47 (criticizing Jackson's assumption that state law remedies involve individual creditor's sale on ground that state law also provides creditors with collective remedies).

indicative of the problem. Although the existence of exhaustible resources identifies a potential for prejudice to creditors, it does not by itself indicate the occurrence of a common pool problem. Consider the following debtors in varying states of financial difficulty.

1. *Insolvent, but paying debts as they come due*

Assume a debtor that is insolvent, with liabilities exceeding its assets, but one that has kept current on its loan obligations by paying off indebtedness out of earnings. Many individual debtors are insolvent when their liabilities are compared to their assets, but at the same time, able to pay debts out of regular income. For example, an individual debtor may be insolvent in that the value of its nonexempt assets is small in comparison to its indebtedness, but nevertheless able to hold a job that pays enough to meet bills. In community property states, an individual debtor may be deemed insolvent because aggregate community and individual liabilities exceed aggregate community and individual property, but that debtor may still be able to pay individual obligations out of earnings.[158] In addition, a general partner of an insolvent partnership may also be found to be insolvent once its portion of the partnership's debts are added to its personal balance sheet.[159] If, however, the general partner is able to pay its individual obligations out of earnings, then it will not be considered unable to pay debts as they come due. It is also not uncommon for business debtors to be insolvent in the balance-sheet sense of the word but able to meet current obligations out of revenue. For example, firms in the business of providing services to their clients may be insolvent because they own only a few assets and owe more than the value of what they own. These firms may be able to pay current obligations out of earnings, however, because the business' success is unrelated to its asset base.

When an insolvent debtor is able to repay loan obligations out of current earnings, its creditors do not face a common pool problem. Under these circumstances, the debtor's exhaustible assets present only a potential for prejudice to creditors' rights.[160] If this insolvent

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158. *See* 11 U.S.C. § 101(7) (Supp. III 1991) (defining "community claim" as claim which arose before commencement of bankruptcy case and for which debtor's community property is liable, whether or not such property existed at commencement of case); 11 U.S.C. § 541(a)(2) (1988) (including community property in estate created by commencement of bankruptcy case).

159. 11 U.S.C. § 101(32)(B) (Supp. III 1991) (defining "insolvent" as applied to partnership debtor); *see also* 11 U.S.C. § 723 (1988) (providing trustee of partnership estate with right to proceed against general partners for unpaid debts of partnership estate).

160. *Cf.* Lynn M. LoPucki, *A General Theory of the Dynamics of the State Remedies/Bankruptcy System*, 1982 WISC. L. REV. 311, 325 (arguing that desirability of continued operation of business does not depend solely on business' profitability, ability to pay debts, amount of debt

debtor were to default on several of its obligations, a common pool problem would still not arise, so long as pursuit by the few wronged creditors did not affect the debtor's ability to repay other obligations out of earnings or otherwise cause the debtor's particularized default to become a general default.[161] Strategic behavior by creditors may, however, encourage them to "jump the gun" in their race to pursue individual collection remedies in advance of other creditors.[162] As a result, a debtor that is perceived by its creditors as unable to pay its debts as they come due may truly become unable to pay all of its creditors within a short period of time. Until that time, however, a debtor's balance-sheet insolvency creates the mere potential for a common pool problem. The current bankruptcy provisions are consistent with this analysis in that they do not permit

owed, or relationship between amount of debt and value of assets, but may instead be influenced by public policy justifications).

161. *See id.* at 372 (arguing that choice of pursuing individual or collective remedies should turn on whether or not debtor's business is "viable"). LoPucki defines "viable" as "the present value of the future excess of revenues over expenses other than interest on debt already incurred and depreciation on assets already owned exceeds the resale value of the assets." *Id.* LoPucki does not propose that the standard for commencement of an involuntary petition be changed to a viability standard from the current "general failure to pay" standard, which may or may not coincide with a debtor's viability. *See id.* at 329-31 (discussing situations in which issue of viability is relevant to creditors' decision to pursue individual remedies). Rather, LoPucki argues that creditors ought to be encouraged to file involuntary petitions through a bounty system that awards successful petitioners with a statutory priority in bankruptcy. *Id.* at 363-68. Because I have little confidence that creditors are able to assess a debtor's viability and am uncertain that the number of involuntary filings is too low, I have not embraced his proposal. *See* Block-Lieb, *supra* note 30, at 861 (arguing that number of involuntary bankruptcy petitions filed is not too small considering congressional intent to encourage creditors to resolve difficulties outside of bankruptcy where resolution is quicker and less expensive).

162. Commentators explain this phenomenon as presenting "a classic example of the game theorists' 'prisoner's dilemma.' " Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 5, at 862. Jackson notes:

> Unless each creditor individually attempts to 'beat out' the other, that creditor will fare worse than the other. Yet this race not only creates costs for the individual creditor (such as frequent checking of the courthouse records for evidence of actions against the debtor by other creditors), it is also likely to lead to a premature termination of a debtor's business, because each creditor will consider only that creditor's own advantage from racing, instead of the disadvantages imposed on creditors collectively.

Id. at 862; *see also* Baird, *World Without Bankruptcy*, *supra* note 6, at 183 ("Without a collective proceeding, each creditor will tend to rush towards the debtor's assets when the best course is patience."). William Whitford has also joined the debate, explaining:

> [P]riority rules encourage an unsecured creditor, faced with an insolvent, or potentially insolvent debtor, to resort to coercive execution more quickly than would be necessary if the priority rules did not favor the 'early bird.' . . . To creditors as a class, quick coercive execution is likely to be counterproductive. . . . Yet a particular creditor who for any of these reasons delays coercive execution runs the risk that another creditor will initiate coercive execution, collect what money can be collected and leave the other creditors with a considerably diminished opportunity to collect anything.

Whitford, *supra* note 33, at 1067-68. For a detailed discussion of the prisoners' dilemma game as applied to debtor/creditor law, see *supra* note 142.

creditors to commence an involuntary bankruptcy case based solely on a debtor's balance-sheet insolvency.

2. *Insolvent, and not paying debts as they come due*

Assume an insolvent debtor, but now assume that the debtor has defaulted on one or perhaps many of its loan obligations.[163] Because the debtor has defaulted, the wronged creditors may coerce repayment by forcing a sale of the debtor's assets. Because the debtor is insolvent, however, creditors will not be paid in full through pursuit of their individual collection remedies. As discussed in the sections that follow, pursuit by even one creditor of an individual collection remedy may prejudice the debtor's other creditors' rights to payment, depending on the nature of the debtor's assets and the cause of the default.[164] Irrespective of the composition of a debtor's assets and earning capacity, the creditors of an

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163. What of an insolvent debtor, whose ability to pay debts as they come due is sure to expire? Are creditors prejudiced by an insolvent debtor's payment of current obligations when the debtor is sure to default in the near future? Probably not. Creditors of an insolvent debtor in general default are prejudiced by pursuit of individual collection remedies because the potential for prejudice created by the debtor's balance-sheet insolvency becomes actual when multiple creditors proceed against these scarce assets. *See* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 39-41 (discussing need for self-restraint among creditors of insolvent debtor and explaining consequences when self-restraint fails). When the insolvent debtor has not yet defaulted generally on its obligations, this same prejudice does not exist. That the prejudice is probable or even imminent does not render this potential for prejudice a common pool problem, although the likelihood that the prejudice will be realized is heightened.

Under the current bankruptcy provisions, a debtor will be in general default only after its obligations mature and the debtor fails to pay some or all of them. *See* 11 U.S.C. § 303(h)(1) (1988) (requiring judge to determine that debtor is generally not paying debts as such debts become due and that debts are not subject to bona fide dispute before ordering relief against debtor in involuntary case). Thus, the current "general failure to pay" standard would not permit creditors to commence an involuntary bankruptcy case in the hypothesized instance of an insolvent debtor who is presently paying its debts. This is because the current standard measures a debtor's failure, not its inability, to pay debts as they come due. *Compare* REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. II, at 74-75 (proposing involuntary case commencement when debtor is "generally unable to pay his [or her] current liabilities as they become due" or "generally failed to pay his [or her] debts as they become due") *and* H.R. 8200, 95th Cong., 1st Sess. § 303(h)(1) (1977) (proposing that standard for commencement of involuntary bankruptcy case include allegation that "debtor is generally unable to pay such debtor's debts as such debts become due") *and* S. 2266, 95th Cong., 2d Sess. § 303(h) (1978) (proposing that grounds for commencement of involuntary case include fact that debtor "is generally unable to pay or has failed to pay a major portion [of its debts as they come due]") *with* 11 U.S.C. § 303(h)(1) (1988) (reflecting evolution in congressional thinking with respect to involuntary commencement standard by presenting "generally not paying such debtor's debts as such debts become due" test as new standard).

164. Whether creditors of an insolvent debtor will suffer from even the first collection effort will depend on both the nature of the debtor's assets (that is, whether the assets are replenishable or not) and the cause for the debtor's default (that is, whether the debtor is unable to pay debts because it has lost its job or ceased operations, or simply because creditors are depleting its scarce liquid resources more quickly than it can replace them). *See infra* notes 172-87 and accompanying text (discussing causes and composition of bankruptcy and their interrelationship with common pool problem that creditors will face).

insolvent debtor that is generally not paying its debts as they come due will be prejudiced by other creditors' collection efforts.[165] In the event of prejudice, all the debtor's creditors will be better off if the debtor's assets are liquidated in a collective proceeding in which the proceeds of the liquidation are divided equally among the creditors. Thus, creditors' pursuit of individual collection remedies in this instance presents a common pool problem.

The current bankruptcy provisions are consistent with this analysis. One of the standards for commencement of an involuntary case is a debtor's general failure to pay debts as those debts come due.[166] Courts have interpreted this standard flexibly, and in extraordinary circumstances have held that the debtor "generally is not paying its debts as they come due" as a result of the debtor's failure to pay a single debt.[167]

3. *Solvent, but not paying debts as they come due*

Under current Bankruptcy Code provisions, petitioning creditors are entitled to commence involuntary bankruptcy cases based solely on debtors' general default.[168] A debtor in general default need not be insolvent to be subject to a creditor's involuntary bankruptcy petition.[169] The question remains as to whether the creditors of a solvent debtor that is not paying debts as they come due face a common pool problem.

Consider a solvent debtor that owns assets in excess of its liabilities, but that, for one reason or another, cannot pay current obligations out of earnings. Perhaps the debtor is a business and is suffering from a seasonal cash-flow problem. Perhaps the debtor is an individual who has incurred an unexpected medical expense or lost a job. Creditors of a solvent debtor in general default are prejudiced by other creditors' pursuit of individual collection remedies, but not solely, as Jackson contends, because a debtor's cash poverty is indicative of balance-sheet insolvency.[170] Creditors of a solvent debtor in general default face a common pool problem, both

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165. *See infra* notes 191-245 and accompanying text (analyzing effect of collective versus individual creditors' remedies in relation to common pool problem).

166. 11 U.S.C. § 303(h)(1) (1988).

167. *See supra* notes 93-98 and accompanying text (describing courts' "totality of circumstances" test to be applied in determination of insolvency for purposes of involuntary bankruptcy proceeding).

168. *See* 11 U.S.C. § 303(h)(1) (1988) (describing debtor's failure to pay debts as they mature as valid basis upon which creditors may file involuntary petitions).

169. *Id.*

170. *Cf.* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 198 (stating that liquidity crisis, where assets exceed liabilities but cash is unavailable to pay debts as they come due, is merely another form of insolvency for bankruptcy purposes).

because the debtor's earnings represent a scarce resource and because the collection efforts of a single creditor can prejudice the ability of the debtor's other creditors to be repaid in full.

B. *When Are a Debtor's Assets Exhaustible Resources?*

Baird and Jackson refer to an insolvent debtor's situation as creating a common pool problem. When insufficient assets are available to repay an insolvent debtor's creditors in full, the balance-sheet insolvent debtor's assets plainly represent an exhaustible resource.[171] This is an incomplete description of a debtor's exhaustible resources, however. Baird and Jackson do not address the fact that creditors can be repaid either through a forced sale of the debtor's assets *or* by garnishing the debtor's earnings. For a debtor that has earnings accruing more slowly than debt obligations, earnings also constitute a scarce resource. By ignoring this point, Baird and Jackson fail to include an additional exhaustible resource in their bankruptcy model: the earnings of a debtor who is unable to repay its debts as they come due. Thus, a debtor's inability to pay debts as they come due can be described as itself causing a common pool problem, not merely evidence that a common pool problem has been caused by a debtor's balance-sheet insolvency.

C. *When Do Collection Efforts Involve Consumption Externalities?*

Baird and Jackson argue that an insolvent debtor's creditors face a common pool problem because the creditors have incentives to "try to catch as many fish as possible" from the debtor's pool of resources.[172] This analogy is too narrow a view of the circumstances surrounding creditor collection efforts, however. A closer look at the circumstances that create externalities for collecting creditors reveals additional reasons why creditors of a debtor in default are prejudiced by another creditor's collection efforts.

1. *Prejudice caused by creditors' levies against a debtor's replenishable assets*

The use of both oil and fish can create common pool problems, even though oil is not replenishable and fish are, because common pool problems exist whether or not the exhaustible resources are

171. *See supra* notes 157-67 and accompanying text (analyzing whether debtor's balance-sheet insolvency alone creates common pool problems, as opposed to potential for such problems).

172. BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 39.

replenishable.[173] In the mining example, an externality exists *because* the resources are not replenishable: one individual's mining today means that less mineral will be available for another to mine tomorrow. This sort of externality is termed a "pure consumption externality."[174] In the case of a common pool of fish, the externality is more subtle because fish reproduce. One individual's fishing today does not necessarily mean that fewer fish will be available for another individual at some later date, so long as a sufficient number of fish are born in the interim. An externality arises in this situation from a failure to coordinate the rate at which the different individuals fish, relative to the rate at which the fish reproduce. This sort of externality represents a "rate consumption externality."[175] If both anglers coordinated their efforts, they would catch fish no faster than the fish could reproduce, and as a result, they would be assured of having fish available forever. Working separately in their own self-interest, however, each has an incentive to catch fish faster than the other (and thus to fish as fast as they can), which over time will likely ensure extinction of the fish.

Rate consumption externalities may be further complicated when consumption involves both an asset and its product.[176] For example, assume a common herd of wild goats from which farmers seek to obtain either fresh milk or fresh meat. While milk is preferred, meat will suffice. Under these circumstances, the self-interested consumption of one farmer may run counter to that of another, but the calculus is more complex. One farmer's milking today may or

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173. *See* Friedman, *supra* note 19, at 856 n.8 (noting that replenishable stocks may be exhaustible and that optimal yield may be determined by calculating population size, reproduction rate, and recruiting rate).

174. Moreover, this "pure consumption externality" will exist regardless of whether a mining company has incurred nonrefundable expenses in its mining enterprise (which, in this context, economists refer to as "sunk costs"). *See* Friedman, *supra* note 19, at 856 n.8, 866-67 (describing finite, nonreplenishable resources as those which do not augment themselves before end of contemplated use, and describing "lift" and "storage" externalities as inherent to mining).

175. *See* Friedman, *supra* note 19, at 856 (describing fish, and biologic resources in general, as either replenishable or nonreplenishable depending on intersection of rate of use and rate of reproduction). This "rate consumption externality" may be affected by sunk costs, depending on the length of time during which the subject of the sunk cost remains valuable and whether the sunk cost relates to the capture itself or more generally to the processing or marketing of the subject of capture. If, for example, *A* spends $1 million on fishing bait that will turn sour within 24 hours, *A* will have increased incentive to fish as fast as possible and to thus ignore the rate at which the fish spawn. If, alternatively, *B* spends $1 million on a dock and fish processing plant, *B* may seek to maintain the fish population in perpetuity irrespective of the useful life of the improvements.

176. The term "product" is used in this Article to include all derivative assets, such as proceeds, offspring, profits, and rents. *Cf.* 11 U.S.C. § 552 (1988) (stating that security interest created by security agreement and attachable after commencement may extend to rents and profits). Necessarily, all replenishable assets beget product to some limited extent because the replenished asset will itself constitute a product.

may not mean that there will be insufficient milk for another farmer tomorrow. The potential for depletion will depend on the rate at which the first farmer milks, as compared to the rate at which the goats replenish their milk supplies. In the same manner, one farmer's hunting today may or may not mean that there will be insufficient meat for another farmer tomorrow. Once again the availability of goat meat is dependent on the rate at which the farmers hunt as compared to the rate at which the goats reproduce. In addition to these two rate consumption externalities, one farmer's hunting today will also affect the other's ability to gather milk because there will be fewer goats to supply that product. The effect that one farmer's hunting has on another farmer's milk supply is termed a "product consumption externality." This effect also can be reversed. By selling all the milk, rather than retaining enough of it to offer to the herd's offspring, the herd will not reproduce at its optimal rate. And opportunities for hunting will diminish as the herd diminishes in size. The effect that one farmer's milking has on another farmer's meat supply also is termed a "product consumption externality."[177]

Baird and Jackson do not explicitly address whether a debtor's assets are replenishable, despite the fact that a debtor is generally able to acquire or produce additional assets. Nor do Baird and Jackson consider the income producing qualities of some debtors' assets, despite the fact that many debtors' assets do generate a byproduct of some sort. Moreover, the debtor's ability to augment its pool of assets is often interrelated to its ability to earn wages or revenue. Identification of a debtor's assets as replenishable or related to earning capacity has no clear effect on the common pool model, but it does complicate the externalities caused by creditors' collection efforts.

a. Insolvent, with unreplenishable assets and no earning capacity

Consider an insolvent consumer debtor[178] with assets consisting solely of household goods.[179] Assume that the debtor cannot aug-

177. Sunk costs will influence product consumption externalities in the same way that they affect rate consumption externalities, because a product consumption externality is an indirect rate consumption externality.

178. This Article refers to an individual debtor whose assets are primarily household goods as a "consumer debtor." *Compare* 11 U.S.C. § 101(8) (Supp. III 1991) (defining "consumer debt" as debt incurred by individual primarily for personal, family, or household purposes) *with id.* § 101(9)(A)-(B) (defining "corporate debtor" for purposes of chapter 11 as including certain associations, joint-stock companies, and business trusts).

179. This Article uses the terms household goods and consumer goods interchangeably to refer to goods purchased or used primarily for personal, family, or household purposes. *Cf.*

ment this pool of goods, perhaps because the debtor has lost a job, and that as a result of the job loss the debtor defaults on a single debt and will inevitably default on all other debts. Under these circumstances, creditors forcing a sale of the debtor's household goods will cause the pure consumption externality identified by Baird and Jackson. That is, at any one point in time, only so many assets are available for distribution to creditors, and a single creditor's collection efforts will affect all others. This pure consumption externality arises at the time of the debtor's first default. Because the debtor's household good assets are not replenishable, the prejudice from a single default is irreversible.

This kind of common pool problem is not limited to consumer debtors. Consider instead an insolvent business debtor[180] holding noncash assets. Operations have ceased; the cessation of operations spells a cessation of revenue. As a result, the debtor defaults on one of its debts and will default on the remainder of its loan obligations. Although in the past this debtor's pool of assets may have been augmented by incoming revenue, in its current defunct state assets will not be replenished. Like the creditors of the out-of-work consumer debtor, this debtor's creditors face a common pool problem caused by a pure consumption externality.

b. Insolvent, with earning capacity unrelated to composition of replenishable assets

Recall the insolvent consumer debtor in the prior hypothetical, but instead assume that the debtor earns sufficient wages to be able to purchase additional household goods from time to time. The debtor's ability to earn wages does not depend upon the number or type of household goods that the debtor owns. If creditors commence collection efforts by levying against these household goods, their efforts may or may not prejudice the ability of the debtor's other creditors to be repaid in full, depending on whether the debtor can replenish its stock of household goods more quickly than the creditors can levy against them. Furthermore, because the debtor's earning capacity is assumed to be unrelated to the amount or type of household goods owned by the debtor, one creditor's collection efforts should not have adverse effects on the debtor's other creditors.[181] In this situation, prejudice may not occur with a first or

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U.C.C. § 9-109(1) (1981) (defining consumer goods as goods used or bought for personal, family, and household uses).

180. *See supra* note 39 (defining business debtor).

181. This assumption is roughly accurate but depends on the scope of the exemptions to which the debtor is entitled under state or federal law. Exemption statutes are a diverse con-

second default, because the debtor's assets are replenishable. The prejudice occurs when collection efforts occur more rapidly than replenishment. A rate consumption externality is sure to occur when the debtor has defaulted on most of its debts, but is likely to occur at an earlier point in time.

c. Solvent or insolvent, and earning capacity dependent on composition of assets

The concept of a rate consumption externality is further complicated when a debtor's earning capacity is contingent on the composition of its assets. Consider a viable business debtor.[182] The debtor's assets may include multiple types of resources such as inventory,[183] equipment,[184] and accounts receivable,[185] as well as proceeds[186] from these assets. Moreover, unlike the consumer debtor with earning potential unrelated to the household goods it acquired in the past, a business debtor's earning capacity directly depends on the quantity and type of assets it has accumulated. Inventory generally does not beget inventory, nor does equipment create additional equipment, but in the ordinary course of operations the debtor may use its equipment in combination with labor and raw materials to create a finished product. The debtor may then sell this completed product for cash or on credit. The profits that the debtor ultimately

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glomeration of state and federal laws that place certain types and amounts of assets beyond the reach of an individual debtor's creditors. *See, e.g.*, 11 U.S.C. § 522(d)(1)-(11) (1988) (exempting motor vehicles, jewelry, insurance, employee benefits, and real property from creditors' reach in bankruptcy, absent state law opting out of federal exemption scheme); CAL. CIV. PROC. CODE §§ 703.010-706.010 (West 1987 & Supp. 1992) (delineating exemptions applying to all procedures for enforcement of money judgments); MO. ANN. STAT. § 513.425-.470 (Vernon 1952 & Supp. 1992) (delineating exceptions such as wearing apparel, tools or implements of mechanics trade; 10 head each of choice hogs, sheep, cows, and products thereof; bibles and books of family; arms and military equipment, and certain real and personal property); N.Y. DEBT. & CRED. LAW § 282-84 (McKinney 1990) (citing permissible exemptions in bankruptcy as including motor vehicles, social security benefits, unemployment compensation, certain personal and real property, alimony, and payments from pension plans). *See generally* KING & COOK, *supra* note 43, at 439-534 (analyzing diverse body of state exemption laws). One important purpose of exemption provisions is to insulate from creditors those assets that peculiarly affect the earning capacity of an individual debtor. *See id.* (stressing importance of maintaining self-sufficiency of debtor as policy goal underlying exemption statutes).

182. *See supra* note 161 (discussing definition of "viable" in context of debtor/creditor law).

183. *See* U.C.C. § 9-109(4) (1981) (defining "inventory" as goods for sale or lease).

184. *See id.* § 9-109(2) (defining "equipment" as goods used or purchased primarily for business use but not falling within definition of inventory).

185. *See id.* § 9-106 (defining "accounts receivable" as any right to payment for goods sold or leased, or services rendered).

186. *See id.* 9-306(1) (defining "proceeds" as including whatever is received upon sale, exchange, collection, or other disposition of collateral or proceeds).

earns from the sale may be used to purchase new raw materials and possibly new equipment.

Collection efforts by the creditors of a viable business may generate externalities in multiple ways. Creditors that force a sale of an insolvent business debtor's assets will face a pure consumption externality only if operations cease and assets are not replenished. In this event, there are only so many assets available for distribution to creditors, and one creditor's collection efforts will affect all others'. If on the other hand the debtor's business continues to operate, the "grab" of assets may affect other creditors' abilities to be repaid in two ways. First, the grab may cause a rate consumption externality if the insolvent debtor cannot replace assets as fast as creditors levy against the assets. Second, the grab may cause a product consumption externality, even if the debtor is solvent at the time the collection efforts commence, by negatively affecting the debtor's ability to continue operations and thereby reducing the debtor's earning potential. Whether the grab of assets causes this product consumption externality will depend on the type and amount of assets that are affected by the grab, as well as on the sort of business engaged in by the debtor. A product consumption externality may occur as early as the initial default and the resulting collection effort if the debt is relatively large or the levied asset is particularly important to the debtor's operations.[187]

Assume a debtor in the business of renting video cassettes. Other than its inventory of cassettes, the debtor's assets consist only of the premises it has rented under a short-term lease, shelving, and a cash register. This inventory and equipment are valued at $1000. The debtor owes $100 to each of its ten suppliers, from whom it has purchased cassettes on credit. If this solvent debtor were to refuse to pay Supplier 1, Supplier 1's collection efforts may affect Suppliers 2 through 10, if, for example, Supplier 1 levied against the debtor's shelving, making it difficult for the debtor to remain in business without replacing this means of display. If, alternatively, Supplier 1 levied against 10 video cassettes worth $100, 1's collection efforts

187. Of course, if the debt is small enough, the debtor may simply redeem its property within the time permitted by state law. *See, e.g.*, ALASKA STAT. § 9.35.250 (1983) (allowing debtor right to redeem property before sale is confirmed by paying purchase amount); CAL. CIV. PROC. CODE § 2903 (West 1987) (allowing anyone with interest in property subject to lien right to redeem after claim is due but before right is foreclosed); KAN. STAT. ANN. § 60-2414 (1983) (providing debtor with right of redemption for real property for one year); KY. REV. STAT. ANN. § 355.960 (Baldwin 1981) (allowing debtor to redeem at any time before secured interest has disposed of, contracted to dispose of, or discharged debt); *see also* U.C.C. § 9-506 (1981) (providing debtor with right to redeem if secured party has not disposed of or contracted to dispose of collateral or discharged obligation).

may not affect the debtor's business, and thus the likelihood that Suppliers 2 through 10 are repaid in full and on time, if the remainder of the debtor's inventory of cassettes is sufficiently competitive with that of other local video stores.

2. *A debtor's repayment out of earnings as cause for prejudice*

In the cases of both the business and the consumer debtor, consumption externalities also are created when creditors are repaid out of earnings rather than out of assets. When a debtor has insufficient liquid assets to pay current liabilities, "consumption" of the debtor's scarce cash by creditors whose claims are due will directly affect, if not the likelihood, then at least the ease of subsequent collection efforts by creditors whose claims are not yet due. If the debtor is repaying creditors voluntarily out of earnings but earns too little to timely repay all creditors in full, then the debtor's payment of one creditor necessarily affects its ability to repay the others. Thus, payments out of scarce liquid assets, whether voluntary by the debtor or forced by creditors, can cause a rate consumption externality.[188]

Repayment out of earnings may also have indirect effects. For example, if one creditor is garnishing a debtor's wages, then the debtor's other creditors will be affected not only because there may not be enough money left over after the garnishment to repay them in full and on time, but also because the garnishment may itself affect the debtor's earning potential. The consumer debtor may quit or lose a job, and the business debtor may cease operations as a result of missed business opportunities, lost suppliers, or depleted sources of credit. This indirect effect is the result of a product consumption externality.[189]

3. *Creditors' collection options as a cause for externalities*

In identifying the circumstances under which creditors face common pool problems, Baird and Jackson do not recognize the differences between individual and collective collection remedies or between state and federal remedies. Irrespective of the type of debtor or the composition of the debtor's assets, consumption ex-

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188. *See supra* notes 175, 181-82 and accompanying text (defining rate consumption externality and applying term to insolvent consumer debtor whose earning capacity is unrelated to composition of her replenishable assets).

189. *See supra* notes 176-77, 182-87 and accompanying text (defining product consumption externality and applying term to solvent or insolvent business debtor whose earning capacity is dependent on composition of its replenishable assets). The product consumption externality involved in creditors' garnishment of a debtor's liquid assets is the effect that one farmer's milking has on another farmer's meat supply, and not the reverse.

ternalities are created when creditors pursue individual state law remedies of execution and levy rather than collective measures of relief such as assignment for the benefit of creditors under state law or federal bankruptcy protection.[190] Moreover, consumption externalities may result when creditors pursue state law collective remedies rather than the federal bankruptcy option.

a. Individual versus collective remedies

Recall the solvent debtor who cannot pay current obligations out of earnings.[191] Jackson suspects that in this situation a consumption externality results solely because the debtor's general default is indicative of its balance-sheet insolvency.[192] Creditors of a solvent debtor in general default may also be prejudiced by the pursuit of individual collection remedies because of the differences in the efficacy of the procedures for liquidation of the debtor's assets.[193] For example, if the potential proceeds from a sale of all a debtor's assets were essentially equal, regardless of whether the liquidation occurred in the context of an execution and levy or a sale in a bankruptcy case, then creditors of a solvent debtor in general default should be indifferent to pursuing either individual or collective remedies.[194]

Creditors should not be indifferent, however, because bankruptcy

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190. *See supra* notes 37-70 and accompanying text (discussing state law remedies for debtors).

191. It makes no difference here whether the debtor is a consumer or a business, or whether the debtor's assets are replenishable or related to its earning capacity.

192. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 198 (stating that solvent debtor that cannot pay debts as they become due is likely to be insolvent in bankruptcy sense and may be unable to borrow due to uncertainty of its financial status). A debtor's general default is probably evidence of its insolvency, but the default would not increase the probability of the debtor being insolvent. If the prejudice that follows from a debtor's general default were limited to an increase in the probability of the debtor's insolvency, as Jackson argues, then creditors' interests would be served by a standard for commencement of an involuntary case that assigned merely a rebuttable presumption of insolvency to the debtor's failure to pay its debts as they mature. *See* John C. McCoid III, *The Occasion for Involuntary Bankruptcy*, 61 AM. BANKR. L.J. 195, 217-18 (1961) (proposing that irrebuttable presumption of insolvency should attach to debtor's inability to pay debts as they come due because prejudice is not so limited); *cf.* Block-Lieb, *supra* note 30, at 854 n.236 (arguing that presumption of insolvency should be rebuttable by showing of payment of debts as debts become due).

193. *Cf.* Warren, *supra* note 12, at 782-89. Professor Warren writes:

> The state collection scheme occasionally deals with complete collapse, but overall it is rationalized in order to serve a wide variety of collection needs. The federal bankruptcy scheme, by contrast, reckons with a much more limited factual context, and with very different legal devices such as discharge of debt and distribution of unavoidable losses.

Id.

194. Except to admit that collective proceedings are better than individual ones in preserving the going concern value of a debtor's assets, JACKSON, LOGIC AND LIMITS, *supra* note 5, at 14; Jackson, *Bankruptcy, Non-Bankruptcy Entitlements*, *supra* note 5, at 864-65, Jackson appears to assume this relative efficacy. *Cf.* Jackson & Scott, *supra* note 7, at 156 n.2 (noting that

sales more often result in higher proceeds than do sales following an execution and levy. This difference arises for several reasons. First, the state law remedies of execution and levy proceed on a piecemeal basis, one creditor at a time.[195] Because of this, executing creditors cannot ensure that the assets of a business debtor are sold in a way that preserves the goodwill or "going concern" value of the assets.[196] Even if a single creditor's claim were to approach the going concern value of a firm's assets, thus justifying a sale of the entire business, an execution and levy would nonetheless result in the loss of going concern value because levying sheriffs are required either to take physical possession of the debtor's property or otherwise to render it unusable, thus ensuring the cessation of the debtor's business.[197]

Second, a bankruptcy sale of a debtor's business is far more likely to realize going concern value than is an execution sale of the business. The Code enables creditors to commence an involuntary chapter 11 reorganization case[198] as a remedy specially crafted to preserve the going concern value of a debtor's business.[199] And to a lesser extent even a chapter 7 liquidation case is calculated to preserve going concern value.[200] The automatic "stay," effective upon

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creditors' bargain model seeks "to minimize the distinctions in treatment of individual claimants between the two debtor-collection regimes").

195. *See* Warren, *supra* note 12, at 782-85 ("State law swings into action on the complaint of a single creditor .... In enforcing the rights of one creditor, state collection law does not address the possible consequences that the collection will render the debtor unable to pay its remaining creditors.").

196. *See* LoPucki, *supra* note 160, at 331 (noting that "state remedies subsystem will tend to close or fail to close businesses without regard to their viability").

197. *See, e.g.*, CAL. CIV. PROC. CODE § 700.030 (West 1987) ("[T]o levy upon tangible personal property in the possession or under the control of the judgment debtor, the levying officer shall take the property into custody."); N.J. STAT. ANN. § 2A:26-12 (West 1987) ("Personal property of a defendant attached as provided by this chapter shall remain in the safekeeping of the attaching officer to answer and abide the judgment of the court."); N.Y. CIV. PRAC. L. & R. 5232(b) (McKinney 1978) (stating that "[t]he sheriff shall levy upon any interest of the judgment debtor in personal property . . . capable of delivery by taking the property into his [or her] custody"); *see also* Knapp v. McFarland, 462 F.2d 935, 940 (2d Cir. 1972) (noting that when judgment debtor's property is deliverable, sheriff usually must levy by taking property into custody); LoPucki, *supra* note 160, at 317 (explaining that sheriff must take possession of subject property in most states in performing execution and levy).

198. *See* 11 U.S.C. § 303(a) (1988) ("An involuntary case may be commenced only under chapter 7 or 11 of this title, and only against a person, except a farmer, family farmer, or a corporation that is not a moneyed, business, or commercial corporation, that may be a debtor under the chapter under which such case is commenced.").

199. *See* Toibb v. Radloff, 111 S. Ct. 2197, 2201 (1991) (finding that congressional intent underlying chapter 11 was to maximize value of debtor's estate).

200. *See infra* notes 201-05 and accompanying text (detailing provisions protecting going concern value that are applicable to chapter 7 liquidation cases); *see also* LoPucki, *supra* note 160, at 331 (arguing that federal bankruptcy provisions expressly should consider business enterprise's "viability" to determine whether business should be closed and noting that interim trustee may be appointed upon filing of chapter 7 petition to operate business if it is in best interest of estate).

the filing of either a liquidation or reorganization petition, holds all the debtor's creditors in place while the debtor-in-possession, or the trustee-in-bankruptcy, negotiates a sale.[201] In addition, a debtor-in-possession or trustee can operate the debtor's business until a sale is consummated,[202] borrow funds if necessary to ensure continued operations,[203] and negotiate a sale free and clear of all liens, claims, and interests.[204] Finally, in the context of a bankruptcy case, individual creditors cannot defeat the preservation of going concern value by negotiating a clause that would effect an automatic termination of the contract or lease upon the debtor's filing of a petition in bankruptcy, the debtor's insolvency or other failure to meet some financial test, or the appointment of a receiver or other custodian.[205] No state law collection remedy, whether collective or individual, can claim the same measures for the preservation of going concern value.[206]

Bankruptcy also may yield greater returns than state individual collection remedies even when there is no going concern value to preserve, because the bankruptcy system is more effective than state

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201. 11 U.S.C. § 362(a)(1)-(8) (1988) (proscribing "all entities" from attempting or continuing to attempt to collect debts, enforce liens, or exercise control over property once petition filed under any chapter of title 11).

202. *Id.* §§ 721, 1108.

203. *Id.* § 364.

204. *Id.* § 363(f).

205. *Id.* § 365(b)(2)(A)-(C), (e)(1)(A)-(C). Under the former Act, these bankruptcy or "*ipso facto*" clauses were generally upheld, although courts stretched to invalidate them. *See, e.g.*, Queens Blvd. Wine & Liquor Corp. v. Blum, 503 F.2d 202, 204-07 (2d Cir. 1974) (declining to enforce *ipso facto* clause in lease due to possible injury such arrangement might cause to debtor and debtor's creditors); Weaver v. Huston, 459 F.2d 741, 742-44 (4th Cir. 1972) (denying enforcement of forfeiture provision in lease conditioned upon tenant passing any interest in premises to trustee or receiver on ground that enforcement would eviscerate chapter 11 and be unjust to tenant); Davidson v. Shivitz, 354 F.2d 946, 947-49 (2d Cir. 1966) (denying petition for order to surrender fractional interests in property because trustees for propertyholders were estopped from asserting right to terminate lease pursuant to *ipso facto* clause). Legislative history reflects that Congress invalidated *ipso facto* clauses in bankruptcy because such clauses often thwarted a debtor's reorganization efforts. H.R. REP. No. 595, *supra* note 105, at 348, *reprinted in* 1978 U.S.C.C.A.N. at 6304. This explanation, however, does not justify invalidation of these clauses in chapter 7 cases, nor does it justify invalidation where the debtor has not established the necessity of the subject lease or contract to its effective reorganization. *Cf.* 11 U.S.C. § 362(d)(2)(B) (1988) (allowing relief from stay because debtor has no equity in property or because such property is not pertinent to reorganization plan).

206. Nor could state law be improved simply by incorporating these protections. Individual state collection procedures are inherently incapable of preserving going concern value because they proceed on a piecemeal basis and require the levying sheriff to render the subject property unusable pending the execution sale. *See infra* notes 207-20 and accompanying text (summarizing differences between individual and collective remedies and concluding that individual remedies are less able to preserve going concern value). Moreover, state collective measures are also inherently less effective than the federal Bankruptcy Code in realizing going concern value. *See infra* notes 224-45 and accompanying text (summarizing differences between state and federal collective remedies and concluding that federal bankruptcy law is more efficient and effective).

remedies systems in maximizing the proceeds from a sale of a debtor's assets.[207] State law often requires sheriffs to make only perfunctory efforts to advertise the time and place of an execution sale[208] and to do little or nothing to assist prospective bidders in

207. *See infra* notes 208-20 and accompanying text. When there is no going concern value to preserve, creditors secured with a U.C.C. Article 9 security interest may not prefer that a liquidation of their collateral proceed in a bankruptcy forum. Secured lenders need not pursue state law remedies of execution and levy to collect on a delinquent obligation. *See* U.C.C. §§ 9-503, 9-504 (1981) (providing secured creditors with option of repossessing collateral without judicial process, and selling, leasing, or disposing of all or part of collateral). Moreover, the Article 9 requirements surrounding a secured party's sale of collateral after default may be better designed to maximize the proceeds from a sale of the debtor's assets than are the requirements of an execution sale. *See id.* §§ 9-501 to -506 (detailing secured creditor's power to take possession of and/or dispose of collateral). In addition, secured creditors enjoy little of the benefit that bankruptcy spells for other creditors, because their security interests would generally protect them from the common pool problems that bedevil unsecured creditors. *See* Bowers, *Loss Distribution*, *supra* note 23, at 57-68 (noting that secured interests are first to be paid upon liquidation of collateral in bankruptcy); Picker, *supra* note 23, at 669-75 (noting value that security interest provides by "minimiz[ing] the opportunities for end-of-game efforts to subvert the pro rata rule that defines common pool problems"). *But see infra* notes 254-91 and accompanying text (discussing circumstances in which grant of secured credit does not resolve common pool problems). Bankruptcy also contains disadvantages for secured creditors, however. Unless fully secured, postpetition interest will cease to accrue upon the filing of a bankruptcy petition. *See* 11 U.S.C. §§ 502(b)(2), 506(b) (1988) (prohibiting courts generally from allowing claims for "unmatured" interest, but specifically permitting secured claim to include claim for postpetition interest if collateral valued higher than debt outstanding on filing date). Nor will undersecured creditors be entitled to compensation for their "lost opportunity costs" as adequate protection for the debtor's use of their collateral. *See* United Sav. Ass'n v. Timbers of Inwood Forest Assocs., 484 U.S. 365, 369-82 (1988) (denying claim for compensation due to delay in foreclosure on collateral caused by stay). In addition, the automatic stay prevents exercise of the self-help remedies of repossession and sale, absent bankruptcy court permission. 11 U.S.C. § 362(a)(1), (3), and (d) (1988). Furthermore, the debtor may foreclose these remedies altogether by converting an involuntary chapter 7 case (as a matter of right) to a chapter 11 reorganization case. *Id.* § 706(a). Once in chapter 11, the debtor may be able to confirm a plan that reinstates the security interest and a schedule of repayment, even though the secured creditor does not consent to the arrangement. *Id.* § 1129(b)(1)-(b)(2)(A)(i).

208. *See, e.g.*, CAL. CIV. PROC. CODE §§ 700.010, 700.015 (West 1987) (requiring levying officer to place with county recorder property's location and notice of levy that describes property, as well as notice that debtor's interest has been levied and copy of execution); FLA. STAT. ANN. § 56.21 (West 1988) (requiring that notice of execution sale be placed in newspaper published in county in which sale is to take place, for four consecutive weeks prior to sale; that notice be mailed to attorney of record of judgment debtor or to judgment debtor's last known address if judgment debtor does not have attorney of record; and that provisions for other means of notice be made where no newspaper is published in affected county); KY. REV. STAT. ANN. § 426.160 (Baldwin 1991) (requiring posting of written notice of execution sale of personal property at three most public places in vicinity of place of sale for ten days preceding sale, and by newspaper in certain other circumstances); *id.* § 426.200 (compelling written notice of execution sale of real property to highest bidder to be posted on courthouse door, at three other places in vicinity of land for 15 days preceding sale, and by newspaper in certain circumstances); N.J. STAT. ANN. § 2A:17-33 (West 1987) (requiring posting of notice of execution sale of personal property for five days before time appointed for sale in office of sheriff in county in which property is located); N.Y. CIV. PRAC. L. & R. 5233 (McKinney 1978) (requiring posting of printed notice of execution sale six days before sale in three public places in town or city where sale is to take place, except that in City of New York notice may be advertised in auction columns of any morning paper published daily that appears on newsstands previous night and has circulation of at least 300,000 readers). *See generally* LoPucki, *supra*

assessing the worth of the property to be sold.[209] Moreover, state law generally does not protect bona fide purchasers at execution sales against defects in title, including preexisting encumbrances.[210] Many states provide judgment debtors with lengthy redemption periods during which the execution sale purchaser's right to remain in possession or to convey will be subject to question.[211] At worst, these deficiencies result in unfair bidding at execution sales.[212] At best, execution sales are not conducted in a manner intended to maximize the proceeds of the liquidation.[213]

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note 160, at 317 (describing state advertising process as perfunctory and formulated to satisfy formal requirements of procedure as opposed to attracting bidders).

209. *See* LoPucki, *supra* note 160, at 317-18 (opining that state sales usually do not allow prospective bidders to view or test property or equipment). *But see* KY. REV. STAT. ANN. § 426.200(3) (requiring that prior to execution sale, officer have real property appraised by two appraisers); N.J. STAT. ANN. §§ 2A:17-20 to -25 (directing that following levy, sheriff must inventory and procure appraisal of personal property).

210. *See, e.g.*, CAL. CIV. PROC. CODE § 701.640 (West 1987) (stating that purchaser at execution sale gains interest of judgment debtor); N.J. STAT. ANN. §§ 2A:17-41, :26-14 to -15 (stating that execution sale has same effect as voluntary sale of subject property by debtor as sheriff conveys all judgment debtor's title to such property); N.Y. CIV. PRAC. L. & R. 5233 (McKinney 1978) (providing that defects in notice of execution sale do not affect title of buyer); Flagship State Bank v. Carantzas, 352 So. 2d 1259, 1263 (Fla. Dist. Ct. App. 1977) (holding that buyer at invalid execution sale acquired only interest of judgment debtor whose interest was subject to appellant bank's liens), *cert. denied*, 361 So. 2d 830 (Fla. 1978); *see also* LoPucki, *supra* note 160, at 318 (noting that purchasers at execution sale buy property subject to all liens and title defects whether specified in sale notice or not). *But see* U.C.C. § 9-504(4) (1981) (stating that property disposed of by secured party conveys to purchaser title that is superior only to security interests or liens subordinate to reselling secured creditor).

211. *See, e.g.*, KY. REV. STAT. ANN. § 426.220 (stating that debtor holds right to redeem land sold at execution sale for less than two-thirds of appraised value for period of one year after sale; indicating that redemption is accomplished by payment of original purchase money plus 10% interest to purchaser); *id.* § 426.230 (providing that land sold at execution sale is subject to right of redemption and cannot be conveyed by purchaser during redemption period); ME. REV. STAT. ANN. tit. 14, § 3131(4) (West 1980 & Supp. 1991) (furnishing judgment debtor with 90-day right to redeem real property sold at execution sale). *But see* U.C.C. § 9-506 (1981) (limiting time period in which debtor may redeem collateral to "time before the secured party has disposed of collateral or entered into a contract for its disposition . . . or before the obligation has been discharged under [the provision governing retention of the collateral]," unless waived in writing by secured party after default).

212. *See* LoPucki, *supra* note 160, at 318 (noting that creditor is usually sole bidder at execution sale and, as result, is able to purchase property at nominal price).

213. *See, e.g.*, House v. Lalor, 462 N.Y.S.2d 772, 774-76 (N.Y. Sup. Ct. 1983) (upholding execution sale of $200,000 cooperative apartment for $15,000 to enforce $350 small claims court judgment); *see also* LoPucki, *supra* note 160, at 321 n.52 (noting that few states establish minimum prices for which property can be sold at execution sales); Whitford, *supra* note 33, at 1055 (stating that while private sales of repossessed collateral yield greater returns, states usually require execution sales in form of public auctions with resulting lower returns). Some courts permit the avoidance of nonjudicial foreclosure sales as constructive fraudulent transfers *because* the proceeds received in such sales are notoriously paltry. *Compare, e.g.*, Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201, 202-64 (5th Cir. 1980) (voiding nonjudicial foreclosure sale because amount paid did not qualify as "fair equivalent" for property under § 67(d) of former Bankruptcy Act and thus comprised constructive fraudulent conveyance) *with, e.g.*, Madrid v. Lawyers Title Ins. Corp. (*In re* Madrid), 725 F.2d 1197, 1199-1204 (9th Cir. 1984) (upholding nonjudicial foreclosure sale despite claims that sale constituted constructive fraudulent conveyance under current Bankruptcy Code, because transfer occurred at time of perfection of trust deed). *But see* ME. REV. STAT. ANN. tit. 14, § 3131(5) (requiring sheriff to

In contrast, the sales procedures of the federal bankruptcy system are generally perceived as "vastly superior to those employed in the state remedies subsystem."[214] A trustee rather than a sheriff is appointed[215] to sell the property of the estate in a bankruptcy case.[216] Before sale, the Federal Rules of Bankruptcy require extensive public notice of the terms and conditions of the sale.[217] The sale may be conducted either as a public auction or a privately negotiated transaction.[218] Moreover, the trustee is empowered to sell the property free and clear of interests, including encumbrances and claims to title.[219] Purchasers of property from a bankruptcy estate are pro-

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conduct commercially reasonable public or private execution sale of levied property, whether real or personal). By contrast, the sales procedures set forth in Article 9 of the U.C.C. are intended to maximize the proceeds of the liquidation. *See* U.C.C. § 9-504(3) (1981) (providing that "every aspect of the disposition including the method, manner, time, place and terms must be commercially reasonable").

214. LoPucki, *supra* note 160, at 320; *see* Whitford, *supra* note 33, at 1054 (contrasting consensual debtor payments with coercive execution and describing low prices usually obtained from execution sales). *But see* Carlson, *supra* note 10, at 1354-55 ("It is possible to imagine systems in which the sheriff has the motive to maximize the sales price, as where her poundage fee is directly related to the sales price. After all, how is the bankruptcy trustee's motive any different? Her fee too is based upon maximizing the sales price."). The point, however, is not that a sheriff has no incentives to maximize the proceeds of a forced sale, but rather that the trustee-in-bankruptcy is better equipped than her state law counterpart to bring those incentives to fruition.

215. 11 U.S.C. §§ 702, 1104 (1988).

216. *Id.* §§ 704(1), 1106(a)(1); *see* LoPucki, *supra* note 160, at 320 (discussing role of trustee in bankruptcy cases). Of course, in a chapter 11 reorganization case a trustee need not be appointed. Absent "cause," the debtor would remain in possession of the chapter 11 estate and perform the functions of a trustee, including conducting sales of assets of the estate. *See* 11 U.S.C. §§ 1104(a), 1107, 1123(b)(3)(B) (1988) (describing duties and limitations imposed on debtor-in-possession as akin to those of trustee).

217. *See* FED. R. BANKR. P. 6004(a) (requiring compliance with Federal Rule of Bankruptcy 2002 for use, sale, or leasing of property). Rule 2002 requires 20 to 25 days notice to parties of interest of any proposed use, sale, or leasing of property of the bankrupt estate. *See* FED. R. BANKR. P. 2002 (establishing timing and content requirements for notice to creditors of proposed uses of property outside of ordinary course of business of bankrupt estate). By contrast, the U.C.C. requires only that a repossessing secured creditor give notice of a public or private sale of repossessed collateral to the debtor (unless waived in writing after default, or unless the "collateral is perishable or threatens to decline speedily in value or is of a type customarily sold on a recognized market") and possibly to any other secured party from whom the secured party has received written notice of a claim of interest in the collateral. U.C.C. § 9-504(3) (1981).

218. FED. R. BANKR. P. 6004(f)(1); *accord* U.C.C. § 9-504(3) (1981) (permitting either public or private sale of repossessed collateral).

219. 11 U.S.C. § 363(f) (1988). The Bankruptcy Code is qualified, however, as follows:

> The trustee may sell property . . . free and clear of any interest in such property of an entity other than the estate, only if—
> (1) applicable nonbankruptcy law permits sale of such property free and clear of such interest;
> (2) such entity consents;
> (3) such interest is a lien and the price at which such property is to be sold is greater than the aggregate value of all liens on such property;
> (4) such interest is in bona fide dispute; or
> (5) such entity could be compelled, in a legal or equitable proceeding, to accept a money satisfaction of such interest.

tected by statute unless they have purchased in bad faith, or have participated in an agreement to control the course of the bidding.[220]

b. State versus federal remedies

Although state law provides for the appointment of an equitable receiver[221] or an assignment of assets for the benefit of creditors,[222] the Federal Bankruptcy Code currently permits creditors to commence an involuntary petition within 120 days of the appointment of a custodian over a substantial portion of the debtor's assets, without proof of the debtor's general default.[223] The Code's definition of "custodian" is broad enough to include the appointment of an equitable receiver or the appointment of an assignee for the benefit of creditors.[224] A question therefore arises as to whether creditors' interests may be prejudiced by the appointment of such a custodian under state law as opposed to federal bankruptcy law. The most probable answer to this question is that creditors' interests indeed may be prejudiced.

Creditors may be prejudiced through the state appointment of an equitable receiver because their interests are better served by coerced repayment through the federal bankruptcy scheme rather

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Id.

A sale of repossessed collateral under Article 9 of the U.C.C. similarly "discharges the security interest under which it is made and any security interest or lien subordinate thereto." U.C.C. § 9-504(4) (1981). Such a sale, however, does not affect superior security interests or liens. In the event that the superior secured creditor enforces its claim against collateral in the hands of the buyer from the subordinate secured creditor (that was first to repossess and resell), the buyer will have a cause of action against its seller for breach of the warranty of title. U.C.C. § 2-312 (1981).

220. 11 U.S.C. § 363(m) (1988) ("The reversal or modification on appeal of an authorization . . . of a sale or lease of property does not affect the validity of a sale or lease under such authorization to an entity that purchased or leased such property in good faith . . . ."); *see, e.g.*, Anheuser-Busch, Inc. v. Miller (*In re* Stadium Management Corp.), 895 F.2d 845, 847-49 (1st Cir. 1990) (holding objections to court-approved sale of debtor's assets moot because good faith purchasers are protected from sale reversal absent stay pending appeal under § 363(m) of Code); Gilchrist v. Westcott (*In re* Gilchrist), 891 F.2d 559, 560-61 (5th Cir. 1990) (stating that § 363(m) of Code protects good faith purchasers at authorized sale when sale not stayed pending appeal); *In re* Sax, 796 F.2d 994, 997 (7th Cir. 1986) (applying § 363(m) of Code to protect good faith purchaser by finding appeal of sale moot due to failure to obtain stay). The U.C.C. also protects purchasers at sales from the senior security interest and any interests and/or liens subordinate thereto under Article 9,

> even though the secured party fails to comply with the requirement of this Part [5 of Article 9] or of any judicial proceedings (a) in the case of a public sale, if the purchaser has no knowledge of any defects in the sale and if he does not buy in collusion with the secured party, other bidders or the person conducting the sale, or, (b) in any other case, if the purchaser acts in good faith.

U.C.C. § 9-504(4) (1981); *see also id.* § 1-201(19) (defining good faith as "honesty in fact").

221. *See supra* note 69 (discussing law of equitable receivership).

222. *See supra* note 45 and accompanying text (describing state law assignment for benefit of creditors).

223. 11 U.S.C. § 303(h)(2) (1988).

224. 11 U.S.C. § 101(11) (Supp. III 1991).

than through a state collective proceeding. Filing an involuntary petition under the federal bankruptcy laws better protects creditors' interests in bringing a collective proceeding than do state collective remedies.[225] While both the state and federal schemes distribute dividends to unsecured creditors on a pro rata basis, the federal law is better equipped to prevent prejudice to creditors.[226] Federal bankruptcy law derives from its state law counterparts,[227] but the federal remedy generally provides greater benefits to creditors.[228] For example, if a debtor continued to pay its debts after it became insolvent, these payments may be avoidable in bankruptcy as preferential transfers.[229] In contrast, only a handful of states permit assignees for the benefit of creditors to avoid preferential transfers,[230]

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225. *Id.*

226. *See* KING & COOK, *supra* note 43, at 604. Lawrence King and Michael Cook argue:

> General receiverships may, as a practical matter, no longer be important because of the flexible voluntary and involuntary reorganization procedure now available under chapter 11 of the Bankruptcy Code. . . . The major practical function of the receiver today is the enforcement of a real property mortgagee's rights in a state court mortgage foreclosure proceeding. Moreover, the motion for a receiver seeks only ancillary relief incidental to a request for more substantive relief, such as foreclosure.

Id. But see Carlson, *supra* note 10, at 1346 (doubting that federal bankruptcy law is superior to state collective remedies in absence of empirical proof, but nevertheless assuming for purposes of argument "that state courts today see relatively few receiverships or assignments for the benefit of creditors," which may indicate less-than-strenuous challenging of theory).

227. *See, e.g.*, BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 31-36 (describing historical development of federal bankruptcy law).

228. *See infra* notes 229-41 and accompanying text. That the federal remedy of bankruptcy currently provides greater remedies to creditors than state collective remedies does not necessarily mean that state laws could not be made more effective. *See infra* notes 229-34. For example, this could be achieved by expanding the powers of an assignee for the benefit of creditors or by expanding preference and other avoidance provisions. Even these changes would not wholly ameliorate the relative success of the state collective system as opposed to the federal collective system, due to the limited jurisdiction of state law. *See infra* notes 235-41 and accompanying text (discussing limits of state stay actions and other constraining characteristics of state creditor law based on jurisdictional constraints).

229. *See supra* note 42 (defining preference). Indeed, for purposes of the preference provision, the Code presumes that the debtor was insolvent during the 90-day period preceding the filing of the petition. *Id.* § 547(f). Of course, any single preference avoidance action may work to the detriment of the creditor-defendant, but collectively the debtor's preference actions serve to benefit all the debtor's creditors. *See* Levit v. Ingersoll Rand Fin. Corp., 874 F.2d 1186, 1194 (7th Cir. 1989) (stating that laws requiring creditors to "hold back" benefit all creditors by protecting debtor's aggregate value).

230. *See, e.g.*, CAL. CIV. PROC. CODE § 1800 (West 1982) (providing that assignee may recover any transfer of property made within 90 days of assignment); N.J. STAT. ANN. § 2A:19-3 (West 1987) (voiding preferential transfers made within four months of general assignment and allowing assignee to recover property); N.Y. DEBT. & CRED. LAW § 15(6-a) (McKinney 1990) (allowing assignee to recover preferential transfers made within four months of assignment); PA. STAT. ANN. tit. 39, §§ 151-154 (1990) (requiring preferential transfers to inure to benefit of all creditors if assignment of insolvency proceedings are commenced within four months). *But see* FLA. STAT. ANN. § 727.109 (West 1988) (omitting mention of power to avoid preferential transfers). *See generally* BURRILL, *supra* note 45, at 438-43 (failing to specify avoidance of preferential transfers as right of assignee). Moreover, an assignee's ability to avoid preferential transfers will be of little comfort to creditors that are unable to convince their debtor to commence an assignment for their benefit.

and only one state provides generally for avoidance of such transfers.[231] Other transfers made by an insolvent debtor may be avoided in bankruptcy[232] but generally are not avoidable under state law.[233] Finally, a trustee appointed under federal law may investigate the debtor's financial affairs and thereby chill prepetition transfers that work to deplete the debtor's assets.[234]

More importantly, federal bankruptcy law is a better coercive remedy than state law collective remedies because of the jurisdictional limitations that state laws face. For example, under federal law an automatic stay prevents creditors from coercing repayment outside

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231. PA. STAT. ANN. tit. 39, §§ 151-154 (stating that preferential transfers are avoidable by any creditor if assignment for benefit of creditor or insolvency proceedings are commenced under Pennsylvania law within four months after such transfer occurred). Under Pennsylvania law, standing to recover preferential transfers is not limited to equitable receivers, assignees for the benefit of creditors, or the like. *Id.*

232. *See* 11 U.S.C. §§ 544-553 (1988 & Supp. III 1991) (allowing avoidance of certain unperfected, improperly perfected security interests and other secret liens, statutory liens, preferential transfers, fraudulent transfers, and postpetition transactions).

233. Fraudulent transfers are avoidable under both state *and* federal law, however. *Compare* U.F.C.A. §§ 4-7 (1985) (describing conveyances considered fraudulent and avoidable) *and* U.F.T.A. §§ 4, 5 (1985) (allowing creditors to avoid certain transfers that are or are deemed fraudulent) *with* 11 U.S.C. § 548 (1988) (allowing trustee to avoid actual and constructive fraudulent transfers). Although both the U.F.C.A. and the U.F.T.A. expressly permit only creditors of the debtor standing to sue, many state statutes governing assignments for the benefit of creditors permit an assignee to assert fraudulent transfer actions on behalf of creditors. *See, e.g.*, FLA. STAT. ANN. § 727.109 (West 1989) (allowing assignee to bring action to avoid "any conveyance void or voidable by law"); KY. REV. STAT. ANN. § 379.070 (Baldwin 1981) (permitting assignee to institute proceedings to recover property fraudulently conveyed); OHIO REV. CODE ANN. § 1313.58 (Anderson 1979) (ordering assignees to commence suits to recover possession of property fraudulently conveyed). A receiver might also enjoy the same right. *See* ALDERSON, *supra* note 68, § 248, at 317 (stating that receiver is only party who may attack fraudulent conveyances on behalf of creditors). In addition, state assignees for the benefit of creditors have the same power as a trustee in bankruptcy to avoid unperfected security interests. *See* U.C.C. § 9-301(c) (1981) (stating that unperfected security interest is subordinate to interest of lien creditor, which includes interest of both assignee for benefit of creditors and trustee-in-bankruptcy); *see also* FLA. STAT. ANN. § 727.10(a)-(b) (West 1989) (allowing assignee to bring suit to avoid unperfected security interest).

234. 11 U.S.C. §§ 704(4)-(5), 1106 (1988). A trustee is appointed in every chapter 7 liquidation case. *See id.* §§ 701, 702 (requiring appointment of interim trustee and subsequent election of permanent trustee). Trustees are only appointed in chapter 11 reorganization cases "for cause," however, or if such an appointment is in the best interests of those with interests in the estate. *Id.* § 1104. Under state collective proceedings, an assignee for the benefit of creditors or an equitable receiver may be appointed and provided with statutory or common law powers akin to those that a trustee enjoys. *See generally* BURRILL, *supra* note 45, at 325-26 (stating that assignee can defeat levy attempts and that relationship is that of trustee); ALDERSON, *supra* note 69, § 249, at 317 (stating that receiver has rights of trustee, which could be retained by bankrupt estate to which receiver is assigned). The general rule is that the powers of a trustee in bankruptcy are far broader than those of his or her state law counterparts. BURRILL, *supra* note 45, at 325-26, 438-43 (stating that assignment will not defeat preexisting liens and operates as quitclaim conveyance to assignee); KING & COOK, *supra* note 43, at 604 (stating that receivers only provide relief that is ancillary to more substantive relief). For example, receiverships ordinarily are available only for corporate debtors, and not individuals. KING & COOK, *supra* note 43, at 604.

the bounds of the federal collective proceeding.[235] A federal bankruptcy court's power to enforce such a stay extends beyond state lines.[236] On the other hand, the commencement of a state collective remedy may stay individual collection efforts,[237] but such a stay can only enjoin measures subject to the state court's limited jurisdiction.[238] Similarly, assignees and receivers have little power to affect assets located beyond the jurisdiction of the state court that appointed the assignee or receiver.[239] Although the Full Faith and Credit Clause of the Constitution[240] may in theory provide extraterritorial effect to these state remedies, this theoretical benefit may prove too time consuming and expensive in implementation to be of practical assistance. Finally, federal bankruptcy law is a better collective remedy than state law because of the constitutional limitations that any state law insolvency scheme would face in attempting to mirror the provisions of the federal bankruptcy laws.[241]

Creditors may also be prejudiced through the state appointment

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235. *See* H.R. REP. No. 595, *supra* note 105, at 340, *reprinted in* 1978 U.S.C.C.A.N. at 6297 (stating that automatic stay prevents creditors from pursuing own remedies).

236. 11 U.S.C. § 362(a) (1988); *see also* 28 U.S.C. § 1334(d) (1988) (providing that bankruptcy jurisdiction extends to "all of the property wherever located, of the debtor").

237. *See, e.g.*, FLA. STAT. ANN. § 727.105 (West 1989) (prohibiting levy, execution, or attachment against assets, excluding real estate, not in control of assignee, upon filing of state collective action); PA. STAT. ANN. tit. 39, § 77 (1990) (allowing stays for executions of liens or claims); *see also* ALDERSON, *supra* note 69, § 227, at 278-79 (positing that court may stay other proceedings at its discretion); BURRILL, *supra* note 45, at 325-26 (explaining that assignments are conveyances that are not subject to creditor's levy).

238. *See* Pusey & Jones Co. v. Hanssen, 261 U.S. 491, 497 (1923) (prohibiting creditor from bringing suit in federal court for appointment of receiver based on state statute); Shoemaker v. Wiley, 13 A.2d 212, 213 (N.J. Sup. Ct. 1940) (holding that creditor cannot challenge result of assignment made in Pennsylvania in courts of New Jersey even if subject property is located in New Jersey); Judd v. J.W. Forsinger Co., 186 A. 525, 526-27 (N.J. Sup. Ct. 1936) (declaring that assignment under insolvency statute is enforceable only as to property in state of assignment); Green v. Wallis Iron-Works, 23 A. 498, 499-501 (N.J. Ch. 1892) (finding that assignments in one state have no effect as to creditors and property in another); *see also* ALDERSON, *supra* note 69, § 228, at 279-87 (stating that discretion to recognize appointment of receiver in another state rests with court and will not be granted at expense of local creditors); BURRILL, *supra* note 45, at 334-45 (describing ways in which assignments of real and personal property in one state have effect in another); KING & COOK, *supra* note 43, at 604 (stating that receiver's powers are limited by state court's jurisdiction); Thomas J. Schwartz, *Termination of SEC Receiverships in the Federal Courts*, 43 FORDHAM L. REV. 163, 193-95 (1974) (describing limits on receiver's power as function of jurisdictional limit of appointing court). Of course, the appointment of an equitable receiver under federal common law would resolve this question of comity with regard to the collective remedy of receiverships, but there exists no federal common law assignment for the benefit of creditors.

239. *See* BEACH, *supra* note 69, at 203 (stating that receivers cannot represent creditors in foreign jurisdictions); KING & COOK, *supra* note 43, at 604 (explaining that receivers are officers of state court and are limited by its jurisdiction).

240. U.S. CONST. art. IV, § 1, cl. 1 (asserting that "Full Faith and Credit shall be given in each State to the public Acts, Records, and judicial Proceedings of every other State").

241. *See* U.S. CONST. art. I, § 10, cl. 1 (contracts clause); *id.* art. I, § 8, cl. 4 (bankruptcy clause); *see also* International Shoe Co. v. Pinkus, 278 U.S. 261, 263-68 (1929) (holding that bankruptcy clause invalidated state assignment for benefit of creditors that provided debtor with discharge from indebtedness); Denny v. Bennett, 128 U.S. 489, 491-99 (1888) (finding

of an equitable receiver or other custodian for a debtor's assets.[242] The appointment is indicative of a debtor's failure to pay debts as they come due, in part, because the standards for commencement of an assignment for the benefit of creditors[243] or receivership[244] often require proof of the debtor's general default. Moreover, under either remedy, the custodian is likely to freeze payments to creditors pending resolution of the equitable basis for the appointment. The custodian may even have been appointed to supervise the liquidation of some or all of the debtor's assets; indeed, Congress implicitly justifies this ground for the commencement of an involuntary case. Legislative history indicates that creditors waiting more than the statutory period after such an appointment should have little difficulty in filing an involuntary petition by proving equity insolvency.[245]

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that state cannot make or enforce law that impairs contracts or extends to person outside of state).

242. *See* H.R. REP. No. 595, *supra* note 105, at 323, *reprinted in* 1978 U.S.C.C.A.N. at 6280 (noting that if custodian has been appointed, irrebuttable presumption of debtor's inability to pay debts as they mature arises). Jackson questions the wisdom of this standard because it might serve as a substitute for determining insolvency, rather than as evidence of insolvency, unless the standard were rebuttable by the debtor with proof of its solvency. Jackson explains that:

> Instead of having bankruptcy follow suit [after commencement of a nonbankruptcy collective proceeding], it would be better to dismiss *both* kinds of proceedings [if the nonbankruptcy one was brought for suspicious reasons]. Perhaps the appropriate way to accomplish that is to have the proceeding transferred to the bankruptcy forum and then have it dismissed, on application of the insolvency tests—which suggests that the propriety of this path into bankruptcy should not be resolved without resort to bankruptcy's insolvency tests as well.

JACKSON, LOGIC AND LIMITS, *supra* note 5, at 201-02.

243. *See, e.g.*, ARIZ. REV. STAT. ANN. § 44-1031 (1989) (discussing only assignments by insolvent debtors); FLA. STAT. ANN. § 727.104 (West 1988) (providing assignment remedy for creditors that is based on allegation that debtor is unable to pay debts as they mature). Conversely, many state statutes do not find a debtor's inability to pay debts as they become due a criterion for a general assignment. *E.g.*, ARK. CODE ANN. §§ 16-117-401 to -407 (Michie 1987); CAL. CIV. PROC. CODE § 493-010 (West 1990); D.C. CODE ANN. § 28-2101 (1991); GA. CODE ANN. §§ 28-301 to -320 (Harrison 1988); MO. ANN. STAT. §§ 426.010-.410 (Vernon 1992); N.J. STAT. ANN. §§ 2A:19-1 to -50 (West 1987).

244. *See* BAXTER DUNAWAY, 1 THE LAW OF DISTRESSED REAL ESTATE § 7.02[8][a], at 7-9 (1988) ("Courts normally require some, if not all, of the following elements before an appointment of a receiver will be granted: (1) that there is a risk that the security will be inadequate to cover the loan balance upon foreclosure; (2) that there exists danger of physical waste; and/or (3) that the borrower be insolvent."); 75 C.J.S. *Receivers* § 18, at 683 (1952) ("It is a general rule that, in order to obtain the appointment of a receiver, applicant must show that the possession of the property by defendant was obtained by fraud, or that the property itself, or the income arising from it, is in danger of loss from neglect, waste, misconduct, or insolvency."); *see also* 75 C.J.S. *Receivers* § 27, at 690-91 (refining circumstances under which showing of insolvency entitles applicant to appointment of receiver).

245. H.R. REP. No. 595, *supra* note 105, at 324, *reprinted in* 1978 U.S.C.C.A.N. at 6280; S. REP. No. 989, *supra* note 105, at 34, *reprinted in* 1978 U.S.C.C.A.N. at 5820.

D. *When Are a Debtor's Assets Public Goods?*

Economists define common pool problems not just as negative consumption externalities caused by exhaustible resources, but also as externalities that cannot be resolved through the establishment of private property rights.[246] When resources in dispute involve public or quasi-public goods, private property rights by definition cannot resolve the common pool problem.[247] Thus, common pool problems involve only those externalities caused by exhaustible public or quasi-public goods.

This conclusion raises a question as to whether the assets of a debtor that is insolvent, but able to pay debts as they come due, are public goods. Such a debtor would create at least the potential for a consumption externality because by definition a balance-sheet insolvent debtor's assets are insufficient to satisfy all outstanding claims.[248] This potential may never result in an externality, however, for mere balance-sheet insolvency does not present the need or opportunity for any sort of collection remedy, whether individual or collective, because the debtor has not defaulted on its obligations.

This insolvent but cash-rich debtor does not pose a common pool problem for another reason.[249] Rather than inquire into whether the debtor holds exhaustible resources, which it does, the focus should be on whether the debtor's exhaustible resources involve public goods. The characterization of a balance-sheet insolvent debtor's assets as public goods is not readily obvious because a debtor owns its assets and can therefore exclude its creditors from the assets' possession or use.

1. *Default*

Upon default, however, a debtor loses this ability to exclude creditors' access to its assets. Once a debtor defaults, the holders of

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246. As used here, "property rights" refers to the right to exclude others. Under this definition, a rule of capture such as that applicable to wild animals, oil and gas, or debtor's assets under individual collection remedies is not viewed as creating a property right.

247. *See supra* notes 150-52 and accompanying text (explaining that public goods are those for which consumption may not be made exclusive).

248. *See supra* notes 158-67 and accompanying text (discussing potential common pool problems associated with insolvent debtor able to pay debts as they come due).

249. This same analysis regarding the resemblance of a defaulting debtor's assets to public goods applies whether the debtor is insolvent or not. This Article emphasizes an insolvent debtor only because Jackson focuses on a debtor's balance-sheet insolvency as creating the common pool problem. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 197-98 (stating that debtor's lack of assets to satisfy debts results in likelihood of claimants exercising individual collection remedies, thereby creating common pool problem).

delinquent unsecured[250] and secured claims are entitled to coerce repayment by forcing a sale of a sufficient amount of the debtor's assets to repay the claims.[251] But it is creditors' competing claims to collateral rather than a creditor's competition with the debtor that causes a debtor's assets to resemble public goods. Absent the existence of a contractual acceleration clause, the debtor's default on one claim does not provide other creditors access to the debtor's assets.[252] If the debtor were to default on multiple unsecured debts or on multiple debts secured by competing interests in the same collateral, these creditors could then proceed against the debtor's assets. None of the creditors, however, would have the right to exclude the others until the process was complete.[253] Thus, a debtor's assets become public goods only after a debtor defaults on more than one obligation. Until the debtor is in default, the assets are privately owned by the debtor and the debtor is able to exclude creditors from reaching the assets.

2. The effect of secured debt

In the abstract, it seems reasonable to argue that a debtor's assets are not public goods if they are encumbered by security interests, because secured creditors are entitled to exclude[254] other credi-

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250. *See supra* notes 50-62 and accompanying text (discussing individual collection remedies of attachment, garnishment, execution, and levy). Unsecured creditors may not be entitled to reach even a defaulting debtor's assets if the assets are encumbered by a security interest. *See* U.C.C. § 9-201 (1981) (stating that even unperfected security interests are effective against unsecured creditors).

251. *See id.* §§ 9-501 to 9-505 (establishing right of secured creditors to take possession of property and to sell, dispose, or lease property upon debtor's default).

252. *See* LYNN M. LOPUCKI, STRATEGIES FOR CREDITORS IN BANKRUPTCY PROCEEDINGS § 16.4.10 (1985) (explaining that acceleration clause allows creditor to declare entire balance due and owing). Use of this type of clause would allow a creditor to claim that a debtor is not paying its debts as they are becoming due (in accelerated form) and consequently, the creditor could join with other creditors to institute an involuntary bankruptcy case.

253. *See supra* note 62 and accompanying text (discussing characterization of individual collection remedies as "grab laws"); *infra* notes 279-91 and accompanying text (discussing inability of competing secured creditors to exclude each other from their share of collateral).

254. *See* U.C.C. § 9-201 (1981) (mandating enforcement of security interests as against unsecured creditors).

tors[255] from reaching their collateral until they are paid in full.[256] The common pool problems of collecting creditors are not wholly resolved, however, by the grant of a security interest. A secured creditor's right to exclude others from its collateral does not extend to the debtor's surplus in the collateral.[257] Moreover, where more than one secured creditor holds a competing claim to the same collateral, one secured creditor may not be able to exclude the other.[258] Whether encumbered assets constitute public goods will depend on the value of the assets as compared to the value of the secured debt or, in other words, on whether the assets are fully or only partially encumbered, as well as on the number of secured creditors and the structure of the secured transaction.

a. Fully encumbered assets—one secured creditor

If the defaulting debtor is indebted to a creditor holding a lien against all the debtor's assets and the debt owed to this creditor equals or exceeds the value of these assets, then the debtor's fully encumbered assets are not public goods. The secured creditor can exclude all others from collecting against its collateral.[259] Thus, if there are no unencumbered assets, then there are no public goods and no common pool problem.[260]

Imagine a debtor who holds $1000 in assets. The debtor's assets consist of 1000 widgets, each worth one dollar. On day 1, the debtor grants a security interest in all its assets to secured creditor *A* in exchange for *A*'s loan to the debtor of $1000. The debtor agrees to repay *A* in ten equal installments of $100 plus accrued interest.

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255. Often, secured creditors permit their debtors to remain in possession of, and possibly even to sell, encumbered collateral. *Cf. id.* § 9-306(2) (explaining that security interest in property remains, notwithstanding sale or other disposition of property). This right would lapse after default when a secured creditor has the right of self-help repossession. *Id.* § 9-503. The Bankruptcy Code continues a debtor's right to use, sell, or lease collateral in the ordinary course of business. *See* 11 U.S.C. § 363 (1988) (allowing trustee to use, sell, or lease property other than that used in "ordinary course of business"). If the secured creditor wishes to repossess collateral during the pendency of a bankruptcy case, it must show justification for relief from the automatic stay. *See id.* § 362(d) (allowing relief from stay for cause, or upon showing of cause that debtor has no equity in property and that property is not needed for bankruptcy reorganization).

256. *See* Bowers, *Loss Distribution, supra* note 23, at 57-68 (discussing secured creditor's scope of control over secured collateral).

257. *See* U.C.C. § 9-504(2) (1981) (stating that secured creditor must account to debtor for surplus). Unsecured creditors, however, will be forced to await a repossession and resale by the affected secured creditor before gaining access to this equity.

258. *See infra* notes 279-91 and accompanying text (discussing inability of competing secured creditors to prevent each others' efforts to repossess and sell collateral as distinct from issue of secured creditors' relative priority).

259. U.C.C. § 9-201 (1981).

260. *See* Picker, *supra* note 23, at 669-75 (discussing ways in which security interests obviate need to supplant pro rata rule that is hallmark of common pool problem).

On day 30, the first installment falls due but the debtor defaults. At the same time, *A* is told that the debtor's business is sound, that default should not recur in future months, and that the collateral has diminished in value by $100 so that $900 in assets now secures *A*'s $1000 loan.

What should *A* do? Should it do nothing? Should *A* repossess a sufficient number of widgets to satisfy the $100 delinquent debt? Or would *A* be better off accelerating the entire debt and repossessing all $900 in assets? The answer will depend on *A*'s determination of the likelihood that the debtor will earn sufficient wages or revenue to repay its obligations in subsequent periods[261] and that the value of the debtor's assets will increase or at least remain stable.[262] Although the debtor is insolvent, *A* need not worry about other creditors' responses to the debtor's financial difficulties because, by virtue of its secured status, *A* is assured priority in the debtor's assets.[263]

To a limited extent, however, a defaulting debtor's assets may involve public goods even where the debtor has granted a blanket lien to a single secured creditor. First, it is never perfectly clear whether the debtor has equity in the collateral until after a commercially reasonable sale of the collateral by the secured creditor or after some judicial determination of the value of the debtor's assets. If the debtor has equity in the collateral and more than one unsecured creditor, a common pool problem may arise.[264] Second, the debtor's unencumbered collateral may be its earning potential as opposed to its existing store of assets, and neither a consumer nor a business debtor can grant a foolproof security interest in all its future income. Business debtors can approach a complete encumbrance of their earning capacity by granting a security interest in

261. The debtor's obligations to the secured creditor are two-fold: the debtor must repay both principal and accrued interest. Secured lenders are, of course, in the business of lending money, with their "profit" measured by the interest owed by the debtor. Thus, if the collateral used to secure a loan is sufficiently valuable to protect the loan amount or is at least stable in value, a lender may be willing to delay repossession of the collateral based on the debtor's ability to keep current on its obligation and pay accrued interest.

262. Valuation of the collateral at any given point in time is inherently difficult because, ultimately, value is assigned either by a buyer at a commercially reasonable resale of the collateral or by a court with jurisdiction over the property.

263. *See* U.C.C. § 9-201 (1981) (stating that security agreements are effective "between the parties and . . . against creditors").

264. *Cf. infra* notes 278-79 and accompanying text (discussing common pool problem created by partially encumbered assets).

accounts,[265] chattel paper,[266] and general intangibles,[267] by assigning contractual rights excepted from the scope of Article 9 of the U.C.C.,[268] and by agreeing that all cash receipts flow through a "lockbox" arrangement[269] or a special purpose finance subsidiary.[270] Even then, however, some income may slip through and accrue to the business debtor.[271]

In the case of consumer debtors, an encumbrance of earnings is even more difficult to ensure. Many states scrutinize an assignment of future income;[272] important sources of income are often either nonassignable or exempt.[273] Moreover, federal law limits the por-

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265. *See* U.C.C. § 9-106 (1981) (defining account as "any right to payment for goods sold or leased, or for services rendered which is not evidenced by an instrument or chattel paper, whether or not it has been earned by performance").

266. *See id.* § 9-105(1)(b) (defining chattel paper as "writing or writings which evidence both a monetary obligation and a security interest in or a lease of specific goods").

267. *See id.* § 9-106 (defining general intangibles as "any personal property [including things in action] other than goods, accounts, chattel paper, documents, instruments, and money," as well as contract rights).

268. *See id.* § 9-104 (excluding certain transactions such as leases and government contracts from scope of Article 9); *see also* 41 U.S.C. § 15 (1988) (establishing requirements for assignment of governmental contracts); RESTATEMENT (SECOND) OF CONTRACTS § 317 (1981) (defining assignment of contractual rights; rights may be assigned unless: (1) assignment would impair third party's contractual right; (2) assignment is forbidden by statute or public policy; or (3) terms of contract preclude assignment).

269. Because the U.C.C. requires that a security interest in money be perfected by possession, U.C.C. § 9-304(1) (1981), lenders have devised "lockbox" arrangements to perfect security interests in the cash receipts of a debtor. In a lockbox arrangement, the debtor is required to deposit all cash receipts, or all cash receipts of a certain sort, in a particular location under the lender's control such as a deposit account with the lender banking institution. *See* Jeremy W. Dickens, Note, *Equitable Subordination and Analogous Theories of Lender Liability: Toward a New Model of "Control"*, 65 TEX. L. REV. 801, 832 n.173 (1987) (describing accounts receivable lockbox collection established at creditors' bank for purposes of controlling debtor's cash flow).

270. *See* Richard E. Mendales, *The New Junkyard of Corporate Finance: The Treatment of Junk Bonds in Bankruptcy*, 69 WASH. U. L.Q. 1137, 1169-70 (1991) (describing ways in which corporation can structurally subordinate claims of unsecured creditors by creating subsidiary whose creditors are superior in right to creditors of parent company).

271. Usually, the income that will "slip through" is that which is derived from transactions ungoverned by Article 9 of the U.C.C. Some of the assets excluded from the scope of Article 9 remain subject to the creation of a voluntary encumbrance under state law, but state law may preclude the creation of a lien against certain of such assets either by prohibiting an assignment of the asset or by exempting it from the reach of creditors. *See generally* KING & COOK, *supra* note 43, at 515-34 (describing assets that are immune to creditors because not subject to assignment or transfer). Federal bankruptcy law broadly reaches the same result regarding certain income earned by a debtor after the filing of a bankruptcy petition. *See* 11 U.S.C. § 552 (1988) (invalidating security interests in property of estate acquired after filing of petition, so long as property is not proceeds, profits, or rents from property acquired by debtor prior to filing of petition).

272. *See, e.g.*, CAL. LAB. CODE § 300 (West 1989) (listing prerequisites for assignment of wages, including spousal or parental consent and limitations on assignments of wages to 50% per pay period); MASS. GEN. LAWS ANN. ch. 154, § 2 (West 1992) (exempting debts under $3000 from assignment, as well as limiting wage assignment agreements to one year); N.J. REV. STAT. § 34:11-25 (1988) (prohibiting assignments of wages that reflect usurious interest rate).

273. *See, e.g.*, 5 U.S.C. § 8346 (1988) (prohibiting assignment of civil service retirement benefits); 10 U.S.C. § 1035(d) (1988) (prohibiting assignment of military personnel's savings

tion of an individual's wages that can be garnished after default,[274] and many states impose even more stringent limitations on creditors' abilities to garnish wages.[275] In addition, an assignment or garnishment of an individual debtor's wages probably will not survive the bankruptcy discharge, even if it would have been effective outside of bankruptcy.[276] Finally, courts have uniformly invalidated, on public policy grounds, any waivers of the right to file a voluntary petition in bankruptcy.[277]

b. Partially encumbered assets

Assume the same debtor that grants a security interest to creditor *A* in exchange for a $1000 loan. On day 2, when the debtor defaults, *A* is told that the debtor has incurred $500 in unsecured trade debt to suppliers *B* and *C*.[278] Do *A*, *B*, and *C* face a common pool problem? The answer depends in part on the value of the debtor's assets, because as a practical matter, the debtor's assets are not pub-

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deposits); 33 U.S.C. § 916 (1988) (prohibiting assignment of longshoremen's benefits); 38 U.S.C. § 3101(a) (1988) (prohibiting assignment of veterans' benefits); 45 U.S.C. § 352(e) (1988) (prohibiting assignment of railroad employees' benefits); 42 U.S.C. § 407 (1988) (prohibiting assignment of social security benefits); 46 U.S.C. § 11109(a) (1988) (prohibiting assignment of sailors' wages).

274. *See* Consumers Credit Protection Act, 15 U.S.C. § 1673 (1988) (providing that no more than 25% of aggregate disposable earnings for any workweek or other pay period may be garnished).

275. *See, e.g.*, CAL. CIV. PROC. CODE § 706.051 (West 1987) (exempting from garnishment that portion of debtor's wages necessary to support debtor or debtor's family); N.Y. CIV. PRAC. L. & R. 5231(B) (McKinney 1992) (allowing maximum of 10% of wages to be garnished absent special application of garnishing creditor).

276. *See* Local Loan Co. v. Hunt, 292 U.S. 234, 243-45 (1934) (holding that federal bankruptcy filing discharges individual debtor's assignment of future wages even if assignment is considered lien under state law); *see also In re* Miranda Soto, 667 F.2d 235, 237 (1st Cir. 1981) (applying *Local Loan* and ruling that assignment of wages only creates bankruptcy lien if wages have already been earned by individual debtor).

277. *See, e.g.*, Klingman v. Levison, 831 F.2d 1292, 1296 n.3 (7th Cir. 1987) ("For public policy reasons, a debtor may not contract away the right to a discharge in bankruptcy."); *In re* DiPierro, 69 B.R. 279, 282 (Bankr. W.D. Pa. 1987) ("A debtor cannot contract away the right to a bankruptcy discharge in advance of the bankruptcy filing."); *In re* Markizer, 66 B.R. 1014, 1018 (Bankr. S.D. Fla. 1986) ("An agreement to waive the benefit of a discharge in bankruptcy is wholly void, as against public policy."). Baird and Jackson question the wisdom of these cases as applied to debtors that are not individuals. *See* BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 756-62 (arguing that individuals need protection from impulsive decisions, while marketplace promotes rational decisionmaking for businesses); JACKSON, LOGIC AND LIMITS, *supra* note 5, at 253-79 (describing "fresh-start policy" for individuals as being rooted in desire to protect human capital that is threatened by impulsive behavior, incomplete heuristics, and externalities that are common to all individuals and can be addressed by uniform rule).

278. The same common pool problem would exist with one supplier if the secured creditor were undersecured, because the undersecured creditor will hold both a secured and an unsecured claim against the debtor. In effect, the undersecured creditor will be secured up to the value of the collateral and unsecured as to the deficiency amount. *See* 11 U.S.C. § 506 (1988) (declaring that creditor holding either lien on debtor's property or offset due to debt owed by creditor is secured creditor for value of property or offset, and unsecured creditor for remaining amount of claim).

lic goods until the secured creditors have been paid in full. Until that time, the debtor's assets are not available for unsecured creditors to exclude each other from reaching.

If as in a prior example the widgets decrease in value, then *A* holds a secured claim equal to the entire value of the widgets, and it is irrelevant that *B* and *C* each hold unsecured claims against the debtor because there are no unencumbered assets to support this debt. On the other hand, if the widgets have increased in value to $1100, then *B* and *C* face a common pool problem with regard to their efforts to levy against the $100 in unencumbered assets. *A* is generally not affected by this common pool problem because, as a secured creditor, *A*'s interest in the first $1000 of widgets cannot be adversely affected by the unsecured claims of *B* and *C*.[279]

c. *Fully encumbered assets—more than one secured creditor*

Assume instead that the debtor granted ten security interests to secured creditors *A* through *J* in exchange for these creditors' extensions of credit to the debtor. Together, *A* through *J* loan the debtor $1000. The debtor agrees to repay *A*, with interest, at the end of the first month, *B* at the end of the second month, and so on. In each creditor's agreement with the debtor, the parties agree that the debtor's default on any single debt amounts to a general default. At the end of the first month, however, the debtor is insolvent, fails to repay *A* on time, and thus is in general default. The creditors are assured by the debtor that its business is sound and that the default will not recur.

Do *A* through *J* face a common pool problem? The answer depends on the composition of the collateral and the structure of the loans. If each creditor holds a security interest in the same body of widget collateral, distinguished only by the priority in which their collateral interest is recoverable,[280] then one creditor's repossession and resale of the widgets will directly affect only the claims of subordinate creditors. This is so because collateral is conveyed free from the claim of the selling creditor and all subordinate claims,[281]

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279. *A* may be indirectly affected by *B* and *C*'s garnishment of the debtor's liquid assets, however. *See supra* note 189 and accompanying text (describing debtor's repayment out of earnings as cause for product consumption externality).

280. Priority generally will be governed by the order in which the financing statements were filed or the security interests perfected, whichever is earlier. U.C.C. § 9-312(5)(a) (1981). Of course, creditors can alter this general rule by agreement. *See* U.C.C. § 9-316 (1981) ("Nothing in this article prevents subordination by agreement by any person entitled to priority."); *see also* 11 U.S.C. § 510(a) (1988) (validating subordination agreements under Bankruptcy Code when such agreements would be enforceable under nonbankruptcy law).

281. *See* U.C.C. § 9-504(4) (1981) ("When collateral is disposed of by a secured party after default, the disposition transfers to a purchaser for value all of the debtor's rights therein,

although senior security interests in the collateral continue despite the sale.[282] If, on the other hand, each creditor holds a security interest in a specific widget rather than in the widgets as a group, then an individual creditor's concern about the actions of fellow creditors will depend on factors such as whether the debtor's earning capacity is related to the assets it retains, whether the resale captured the going concern value of the assets, and so on.

For example, assume that the debtor is an individual who owns ten video cassette tapes. If the debtor granted ten security interests in the tape collection to creditors *A* through *J*, and if *A* through *J* each file financing statements on ten consecutive dates (*A* first, *B* second, and so on) describing the collateral as "ten video cassette tapes," then *A* would hold a first priority security interest in the collection, *B* a second priority security interest in the collection, and so on.[283] If the debtor defaults on her obligations to *C*, *C* would be entitled to repossess the ten video cassette tapes[284] and resell them after notice to the debtor and to "any other secured party from whom [*C*] has received . . . written notice of a claim of an interest in the collateral."[285] Even if *A* and *B* do not receive or are not entitled to receive notice of the sale from *C*, however, their senior interests are not expunged as a result of the sale; the sale is subject to these prior security interests.[286] Therefore, *A* and *B* can repossess the collateral in the hands of *C*'s buyer.[287] *D* through *J* have some protec-

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discharges the security interest under which it is made and any security interest or lien subordinate thereto.").

282. *Id.* § 9-306(2) (providing that security interest continues unless senior secured party authorized disposition of collateral).

283. *Id.* § 9-312(5)(a); *see also supra* note 280 (delineating Article 9 rule of priority for security interests).

284. This claim assumes that the repossessing secured creditor repossesses and sells the entire body of widget collateral. Nothing in Article 9 of the U.C.C. requires this result. *See* U.C.C. § 9-504(1) (1981) ("A secured party after default may sell, lease or otherwise dispose of *any or all of the collateral* in its then condition or following any commercially reasonable preparation or processing.") (emphasis added). And the possibility of proceeding against only a portion of the collateral admits of the possibility of the externalities discussed below. *See infra* notes 290-91 and accompanying text (describing product consumption externalities that may be caused by repossession and resale of portion of debtor's assets).

285. *Id.* § 9-504(3).

286. *See id.* § 9-504(4) (providing that purchaser from second creditor takes free of rights and interests of secured creditor and any subordinate security interests); *see also* Chadron Energy Corp. v. First Nat'l Bank, 459 N.W.2d 718, 731-33 (Neb. 1991) (finding that junior secured party rightfully may dispose of collateral and need not retain proceeds for senior party, but that senior secured party retains security interest in collateral in hands of purchaser); JAMES J. WHITE & ROBERT S. SUMMERS, UNIFORM COMMERCIAL CODE § 25-9 (3d ed. 1988) (interpreting U.C.C. § 9-504(4) as preserving senior secured party's claim on collateral sold by junior secured party and in possession of purchaser).

287. *C*'s buyer would of course have a right of action against *C*, presumably for breach of the warranty of title. *See* U.C.C. § 2-312 (1981) (providing that contract for sale includes implied warrant of title that guarantees title is free of any security interest, lien, or encumbrance of which buyer had no actual or constructive knowledge).

tion, although their subordinate security interests will have been released in the event of a sale.[288] *D* through *J* no longer can look to the collateral for repayment, but they are entitled to receive satisfaction out of the proceeds of the sale if the proceeds are sufficient and if the remaining creditors notify *C* before the distribution of the proceeds is complete.[289] Of course, if *A* and *B* cannot locate *C*'s buyer or if *D* through *J* do not notify *C* in time, then these creditors will be adversely affected by *C*'s repossession and resale of the collateral. These creditors may be able to prevent this contingency from occurring by sending *C* and every other secured creditor "written notice of a claim on an interest in the collateral," which in turn requires *C* to notify the other creditors of its intent to sell the collateral.[290]

A more effective way for creditors to avoid this thicket of externalities is to structure the transaction differently. For example, *A* could have been granted a security interest in *Gone with the Wind*, *B* could have been granted a security interest in *E.T.*, *C* a security interest in *Ghost*, and so on. When *C* repossesses and resells *Ghost*, *A*, *B*, and *D* through *J* may be indifferent to the transaction. But even when the transaction is structured as ten distinctly collateralized loans, there still are circumstances under which creditors other than *C* will be affected by *C*'s repossession and resale of *Ghost*. First, *C*'s actions may impinge on the going concern value of the debtor's assets if, for example, the debtor's video cassettes comprise a collection that is more valuable when sold as a group than when sold individually. Second, *C*'s actions may impinge on the debtor's earning capacity. If the debtor were in the business of renting the video cassettes, *C*'s repossession of *Ghost* may cause the debtor's customers to take their business to another establishment with a more complete collection. Both the effect that *C*'s actions may have on the going concern value of the debtor's assets, and on the debtor's earning capacity, are product consumption externalities.[291]

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288. *Id.* § 9-504(4) (providing that disposition of collateral by secured party discharges secured party's interest and any interest "subordinate thereto").

289. *Id.* § 9-504(1)(c) (describing secured party's obligation to apply surplus proceeds of sale of collateral to claims of subordinate creditors that have notified senior party of their claims in writing).

290. *Id.* § 9-505. Upon notice, the nondisposing secured creditors can protect their interests by bidding at the sale. *Id.* § 9-504 cmt. 5. On the other hand, this protection may be of limited usefulness to *A*, *B*, and *D* through *J*. The notification of sale requirement does not exist when the collateral involves consumer goods. *See id.* § 9-504(3) (declaring that for consumer goods, only debtor need be notified of sale of collateral).

291. *See supra* notes 176-77, 182-87, 189 and accompanying text (defining product consumption externality and applying term to unsecured creditors' collection efforts against replenishable assets of debtor whose earning capacity depends on composition of its assets, and to unsecured creditors' garnishment of debtor's earning or debtor's repayment of unsecured creditors out of earnings).

E. Summary

Baird and Jackson have developed a powerful metaphor by comparing creditors of an insolvent debtor to anglers in a common pool of fish. With this analogy, they focus on the need for bankruptcy as resulting from competition among creditors rather than from competition between a debtor and its creditors.[292] This focus has important normative implications for the circumstances under which bankruptcy becomes a necessary remedy, as well as for the scope of actions appropriately pursued in the context of a bankruptcy case.

Baird and Jackson's description of the circumstances under which the common pool problem arises needs refinement. Their assertion that insolvency gives rise to this problem is too broad a view; a debtor's balance-sheet insolvency alone does not create a common pool problem.[293] Insolvency by definition presents an example of exhaustible resources[294] but creates merely the potential for a consumption externality to arise among creditors.[295] Balance-sheet insolvency creates a common pool problem only when the insolvent debtor defaults and creditors are entitled to pursue collection efforts against its unencumbered, nonexempt assets.[296]

Their reference to a debtor's insolvency as generating common pool problems is also too narrow a view, because a solvent debtor's financial difficulties may create a common pool problem for several reasons. First, a debtor's illiquid assets do not represent the only exhaustible resource to which creditors can look for repayment. Creditors are more likely to be repaid out of a debtor's liquid assets, such as wages earned by a consumer debtor or revenue earned by a business debtor.[297] Because debtors can only earn a limited amount of money in a given period of time, these liquid assets similarly represent an exhaustible resource. A debtor's voluntary or involuntary payments out of earnings to some but not all of its creditors causes a consumption externality if either the solvent or insolvent debtor is

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292. *See supra* notes 8-11 and accompanying text (describing Jackson's model of bankruptcy as *ex ante* agreement that creditors would make among themselves).

293. *See supra* notes 157-62 and accompanying text (describing situations in which balance-sheet insolvency exists but in which no common pool problem arises, such as where debtor is able to pay debts out of earnings as such debts come due).

294. *See supra* notes 15-21 and accompanying text (outlining common pool problem associated with competing claims to exhaustible resources such as fish and analogizing problem to situation presented by insolvent debtor).

295. *See supra* notes 157-70 and accompanying text (distinguishing mere potential for common pool problems from problem itself).

296. *See supra* notes 163-67 and accompanying text (discussing prejudice to creditors of insolvent debtor that is not paying debts as they come due).

297. *See supra* notes 158-60 and accompanying text (identifying situations in which insolvent consumer debtors meet debts out of income, and businesses that are balance-sheet insolvent meet debts out of operating revenue).

generally unable to pay its debts as they come due.[298] This externality is much more difficult to resolve *ex ante* by the grant of a security interest for reasons of public policy.[299] Thus, a debtor's inability to repay debts as they come due creates a common pool problem whether or not the debtor has sufficient assets out of which to repay its liabilities.[300]

Second, a solvent debtor's assets will present a common pool problem if the debtor is viable and its assets are replenishable because both levy and garnishment can affect a debtor's earning capacity. Depending on the type of debtor and the nature of the assets, levy may limit or incapacitate a business debtor's ability to continue operations.[301] Even in the case of an individual debtor, collection efforts, such as garnishment, may make it difficult for a debtor to retain its employment position.[302]

Finally, unsecured creditors' collection efforts against a solvent debtor's assets cause consumption externalities because of the differences between state individual collection remedies and the federal collective remedy of bankruptcy. Bankruptcy is able to preserve a debtor's going concern value, whereas this value is very nearly always lost in a levy.[303] Even where there is no going concern value to preserve, the Bankruptcy Code is better at maximizing the proceeds of dispositions than are state remedies.[304]

Baird and Jackson's analogy comparing an insolvent debtor's assets to a common pool of fish is further flawed in its failure to con-

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298. *See supra* notes 163-70 and accompanying text (describing both situations as common pool problems because both illiquid and liquid assets are exhaustible resources and are subject to competition among unsecured creditors).

299. *See supra* note 277 and accompanying text (reviewing case law setting aside prebankruptcy agreements between creditor and debtor as void on public policy grounds).

300. *See supra* notes 168-72 and accompanying text (arguing that inability to pay debts as they come due rather than balance-sheet insolvency is proper starting point for common pool problem analysis, because such inability to pay maturing debts reflects scarcity of earnings, which are most likely source of debt extinguishment).

301. *See supra* notes 182-87 and accompanying text (discussing situation where debtor's earning capacity is dependent on certain assets, which when seized by one creditor cause common pool problem for other creditors dependent on future earnings for repayment).

302. *See supra* notes 188-89 and accompanying text (discussing prejudicial effect garnishment of debtor's income may cause to other creditors dependent on this income for repayment).

303. *See supra* notes 195-206 and accompanying text (noting that levy normally requires physical seizure or incapacitation of debtor's assets, which results in cessation of business, while bankruptcy allows debtor or bankruptcy trustee to continue operation of business if to do so would increase going concern value and thus pool of assets available to creditors).

304. *See supra* notes 207-20 and accompanying text (detailing superiority of Bankruptcy Code to state collection remedies in liquidation situation, which results in part because state laws require only perfunctory efforts to advertise sale and make potential bidders aware of value of auctioned property, whereas federal bankruptcy laws require "extensive public notice of the terms and conditions of the sale").

sider resolution by definition of property rights.[305] In the case of a debtor, the potential for prejudice caused by a debtor's insolvency or general default might be resolved *ex ante* by the debtor's grant of a blanket security interest. While the creation of a security interest does not always assure that common pool problems will not occur, it does make such problems less likely.[306]

A focus on a debtor's insolvency as the cause of creditors' common pool problems is more than an imperfect description, however; it reflects a limited view of bankruptcy. Baird and Jackson ignore the fact that a debtor's resources are of two types, earnings and assets, that both types of assets are replenishable, and that the ability of a debtor to replenish its wealth depends on its continuing ability to earn income. As a result, Baird and Jackson picture a lifeless debtor and a still pool. Their analysis is static; it ignores the effect of time. It also ignores the complexity of events that may unravel through the course of time. By failing to address replenishable assets in their model, Baird and Jackson seem to assume either that the insolvent debtor has no financial viability or that bankruptcy necessarily spells a liquidation of the debtor's assets. This picture is inaccurate as applied to the determination of the proper standard for commencement of an involuntary bankruptcy case. When their model is applied to the standard for voluntary commencement, however, the results are analogous to legs growing out of a stick figure's ears.

III. THE PROPER STANDARD FOR COMMENCEMENT OF BANKRUPTCY

Jackson identifies only a debtor's balance-sheet insolvency as creating common pool problems for its creditors, and thus opines that the standard for commencement of both involuntary and voluntary bankruptcy cases (at least those voluntary cases commenced by debtors that are not individuals) should be one of insolvency.[307] The prior section argued that Jackson's vision of the circumstances in which a debtor's financial difficulties create a common pool prob-

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305. *See supra* notes 149-57, 246-53 and accompanying text (arguing that by definition common pool problems must involve allotment of public goods because goods that can be made exclusive may be removed from common pool by assigning ownership to specific individual).

306. *See supra* notes 254-91 (discussing ways in which security interests and Article 9 of U.C.C. may eliminate common pool problems by making secured creditors' claims to collateral exclusive, but indicating that common pool problems may continue to exist between either competing secured creditors or competing unsecured creditors).

307. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 199-203 (discussing various possible tests for commencement of bankruptcy case and concluding that "most cases can be handled reasonably well by creating a rebuttable presumption of appropriateness upon showing that there are multiple creditors and a reasonable prospect of insolvency").

lem is both too narrow and too broad.[308] The section showed that for a variety of reasons, common pool problems may exist when a solvent debtor defaults on multiple claims.[309] If the only goal of bankruptcy legislation was to resolve the common pool problems identified in Part II of this Article, how would the Bankruptcy Code fare?

The Code currently does not require a showing of balance-sheet insolvency for either an involuntary or voluntary bankruptcy filing. In the case of a voluntary commencement, the debtor need not show any financial need.[310] Debtors need not establish their own insolvency or the occurrence of their own general default in order to file a voluntary petition under the Code.[311]

With an involuntary petition, petitioning creditors are required to show either that the debtor generally is not paying its debts as they come due, leaving aside the nonpayment of debts subject to bona fide disputes, or that a custodian has been in possession of all or

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308. *See supra* notes 157-70 and accompanying text (rejecting notion that common pool problem in bankruptcy only exists in cases of balance-sheet insolvency).

309. *See supra* notes 168-245 and accompanying text (arguing that solvent debtors in default may present common pool problems because (1) earnings are exhaustible resource; and (2) single creditor's collection effort may prejudice chances of other creditors to be repaid depending on composition of assets and nature of collection effort).

310. 11 U.S.C. §§ 109, 301 (1988). *But see* 11 U.S.C. § 707(b) (1988) (permitting dismissal of chapter 7 case filed by individual debtor owing primarily consumer debts upon finding that granting of relief "would be a substantial abuse of the provisions of the chapter"). Courts have interpreted this provision to permit dismissal of a chapter 7 case if an individual debtor's future income would be sufficient to permit repayment of its debts. *See, e.g.*, *In re* Krohn, 886 F.2d 123, 126 (6th Cir. 1989) (affirming bankruptcy court holding that debtor with ample future income that exceeds monthly debt payments may be denied chapter 7 relief); *In re* Walton, 866 F.2d 981, 985 (8th Cir. 1989) (holding that debtor with yearly surplus of $5964 and unsecured debts of $26,484 could be denied chapter 7 relief because all debts could be extinguished in five years); *In re* Kelly, 841 F.2d 908, 915 (9th Cir. 1988) (deciding that couple who could repay 99% of their unsecured debt out of disposable income within three years had substantially abused chapter 7).

311. 11 U.S.C. §§ 109, 301 (1988). Only individual debtors seeking access to chapters 12 and 13 are required to allege financial criteria, and then not as to a particular form of financial distress but rather as to unsecured and secured debt limitations. *See* 11 U.S.C. § 101(18)-(20) (Supp. III 1991) (defining financial criteria for qualifying as "family farm" as farming operation with less than $1.5 million in debts, 80% of which must arise from farming operations); 11 U.S.C. § 109(e) (1988) (setting unsecured debt limitation of $100,000 and secured debt limitation of $350,000 for individuals filing under chapter 13); *id.* § 109(f) (delineating that one must be "family farmer" to file under chapter 12).

Indeed, consumer finance groups have criticized the Code as insufficiently restrictive, contending that only insolvent individuals, individuals in general default, or individuals that flunk some other financial test should enjoy access to bankruptcy protection. *See House Comm. on the Judiciary, Subcomm. on Monopolies and Commercial Law, Oversight Hearings on Personal Bankruptcy*, 97th Cong., 1st & 2d Sess. 274-321, 404-13, 4145-58 (1984) (providing testimony of various consumer finance groups that bankruptcy is too readily available to individuals who are able to pay off large percentages of their debts, and that not enough disincentives exist to motivate people to avoid bankruptcy). By contrast, a municipality seeking access to chapter 9 of the Code must allege, among other things, that it is "insolvent." 11 U.S.C. § 109(c) (1988).

substantially all of the debtor's assets for less than 120 days.[312] Common pool problems exist under both of these standards. Even creditors of a solvent debtor in general default face consumption externalities because a debtor's liquid assets are exhaustible resources.[313] Although the preceding section concluded that a common pool problem may arise before a debtor defaults on a majority of its debts, and possibly as early as when the debtor defaults on more than one obligation,[314] the current "general failure to pay" standard[315] is flexible enough to sanction creditors' efforts to avoid any common pool problem. This is so because courts have interpreted the standard on a case-by-case basis[316] and have in limited

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312. 11 U.S.C. § 303(h) (1988).

313. *See supra* notes 170-72 and accompanying text (arguing that debtor's assets and earnings potential both represent exhaustible resources).

314. *See supra* notes 172-245 and accompanying text (discussing externalities caused by creditors' collection efforts and noting affect of composition of debtor's assets, and differences between state and federal bankruptcy remedies, on such occurrences).

315. 11 U.S.C. § 303(h)(1) (1988); *see also supra* note 90 and accompanying text (quoting general failure to pay standard).

A simpler mechanism for permitting commencement of an involuntary case as early as the first or second default by the debtor would be to permit creditors to thrust a debtor into bankruptcy upon proof that the debtor has failed to pay petitioning creditors' obligations, or that petitioning creditors' efforts to collect on their delinquent debts have been unsuccessful. Some civil law countries provide for the commencement of an involuntary case in such circumstances. *See* John Hansberger, *Failure to Pay One's Debts Generally As They Become Due: The Experience of France and Canada*, 54 AM. BANKR. L.J. 153, 154-55 (1980) (describing French standard for involuntary proceeding as cessation of payments combined with act or acts consistent with refusal of debtor to meet financial obligations); Joachim Kilger, *Bankruptcy Laws Under Review: Germany*, 8 INT'L BUS. LAW. 24, 24-25 (1980) (noting that current as well as proposed German bankruptcy law is based on proof of debtor's inability to meet financial obligations). While this type of standard would be easiest for creditors to prove because petitioning creditors will always know whether the debtor is in default on their loans and whether collection efforts have been unsuccessful, it suffers from other problems. Requiring creditors to show that they have pursued individual collection remedies and that these efforts have been unavailing will give creditors even greater incentives to race to the courthouse and "grab" assets out of the debtor's estate. These incentives run counter to congressional intent, *see infra* note 336 (discussing Congress' rejection of notion that creditors must exhaust nonbankruptcy remedies before filing involuntary petition), and encourage creditors to file petitions before these destructive races begin. For these reasons, courts that refuse to permit involuntary cases to be commenced before petitioning creditors have pursued their individual state remedies should not be followed. *See supra* note 77 (discussing split in bankruptcy courts over requiring creditors to pursue state collection remedies before filing for bankruptcy proceedings). Requiring petitioning creditors to show their own default is more defensible in terms of the incentives it creates, because the current standard requires creditors to show that the debtor has generally defaulted on its obligations. But because there can be no assurance that creditors suffer a common pool problem after the debtor has defaulted on three claims (even if some dollar floor were specified, such as the debtor's default on three claims in excess of $5000), *see supra* notes 173-87 (describing relationship of composition of debtor's assets to occurrence of common pool problem and noting that in some instances such problem may arise with single creditor's collection effort), this standard would, in some instances, permit creditors to commence a bankruptcy case too soon.

316. *See supra* notes 92-98 and accompanying text (describing flexible "totality of circumstances" standard that courts use to determine "general failure to pay" as concentrating on both quantity and magnitude of claims, as well as debtor's general handling of financial affairs).

circumstances found the standard satisfied by the nonpayment of a single obligation.[317] Moreover, creditors of a debtor with assets in the possession of a custodian are likely to face consumption externalities either because the debtor is insolvent in some respect, or because state remedies are less effective than federal ones.[318]

Commencement of an involuntary petition is more complicated, however, than simply showing that the debtor is either in general default or ousted from possession of the bulk of its assets. Petitioning creditors also must show their own standing.[319] Here, the Code is less defensible because it prohibits commencement of an involuntary case unless petitioning creditors' unsecured claims aggregate at least $5000.[320] An involuntary petition brought only by fully secured creditors will be dismissed.[321] The preceding section showed that common pool problems exist when multiple creditors claim security interests in the same body of collateral, or when multiple secured creditors claim interests in separate but interrelated parcels of collateral, whether or not there also exist unsecured creditors or unencumbered collateral.[322] Moreover, the Code generally requires that three or more creditors join in an involuntary petition.[323] Common pool analysis alone cannot explain the three creditor requirement. Common pool problems can arise with as few as two creditors.[324]

Clearly, more than mere resolution of common pool problems is

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317. *See supra* note 98 and accompanying text (citing circumstances where involuntary petition, which alleged only one default, was allowed to continue, including cases in which (1) debtor had only one creditor who otherwise would be without remedy; or (2) creditor can show extraordinary circumstances, such as fraud).

318. *See supra* notes 224-45 and accompanying text (describing advantages inherent in collective nature of federal proceeding, including recovery of prebankruptcy payment to preferred creditors and nationwide federal court jurisdiction).

319. 11 U.S.C. § 303(b)(1)-(4) (1988).

320. *See id.* § 303(b)(1) (requiring three or more petitioning creditors whose claims are more than $5000 in excess of any lien held by same creditors). Proposed amendments to this provision would increase this threshold figure to $10,000. S. 1985, 102d Cong., 1st Sess. § 402(a)(1) (1991).

321. *See supra* note 80 (citing cases in which involuntary petition brought by one fully secured creditor and two unsecured creditors was upheld, and petition brought by single fully secured creditor was dismissed).

322. *See supra* notes 279-91 and accompanying text (discussing common pool problems created by competing secured creditors' claims to pool of collateral and suggesting possible solution to this problem).

323. 11 U.S.C. § 303(b)(1) (1988); *see supra* note 76 (discussing circumstances under which single creditor is permitted to commence bankruptcy case).

324. *See supra* notes 173-87 (discussing circumstances under which single creditor's collection effort could cause common pool problem). Case law dismissing involuntary petitions filed in the context of a single-creditor dispute with a debtor seems justifiable on this ground. *See supra* note 98 and accompanying text (noting courts' reluctance to find "general default" standard met where only one creditor alleges default but citing examples of cases in which standard satisfied by debtor's default on single claim).

involved in defining the proper standards for commencement of a bankruptcy case. The remainder of this section develops some of the other policy purposes Congress legitimately identified in establishing bankruptcy commencement standards. The examination first reviews the policies behind the standard for commencement of an involuntary case and then for a voluntary one.

A. *Involuntary Bankruptcy*

1. *Congress' diverse policy purposes*

Although it may not have been thinking in precisely these terms, Congress certainly intended to alleviate the common pool problem that confronts creditors of a financially troubled debtor.[325] The resolution of this common pool problem, however, was not Congress' only policy purpose in structuring the standard for commencement of an involuntary case. Other goals included: (i) an intent to simplify creditors' evidentiary burdens in establishing cause for commencement; (ii) an effort to create incentives for creditors to commence an involuntary case sooner so distributions would exceed historically low levels; and (iii) a desire that debtors and creditors would pursue nonbankruptcy resolution of collection disputes, unless prejudicial.[326]

a. *Recognizing creditors' informational disadvantages*

Under the former Bankruptcy Act,[327] creditors were required to show that a debtor had committed an "act of bankruptcy" in order to bring an involuntary case.[328] Recognizing that this former standard, often based on proof of the debtor's balance-sheet insolvency, was very difficult for creditors to establish,[329] Congress sought to

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325. *See* REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. I, at 188 (noting preference for proceedings that benefit all creditors, as compared to individual creditor actions that benefit only aggressive creditors).

326. REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. I, at 14-15; *see also* Block-Lieb, *supra* note 30, at 805-06, 835-37 (arguing that congressional goals underlying enactment of § 303 include facilitating procedure for commencement of involuntary cases while discouraging bad faith involuntary filings).

327. *See supra* note 34.

328. *See supra* notes 116-23 and accompanying text (detailing six acts of bankruptcy under former Bankruptcy Act).

329. *See* REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. I, at 14 (noting that smallness of distributions to creditors in bankruptcy can be explained by delay in institution of cases, and opining that creditors delayed bringing involuntary petition because elements of acts of bankruptcy, including debtor's insolvency, were difficult to prove and because debtor is entitled to jury trial on these questions); *see also* Block-Lieb, *supra* note 30, at 813-15 (noting that insolvency, as defined under former Bankruptcy Act, was difficult to prove because it described internal financial condition, depended on ambiguous statutory definition, and permitted jury to decide this issue).

simplify this burden of proof.[330] With the enactment of the 1978 Bankruptcy Reform Act,[331] Congress repealed the "litigation-producing" acts of the bankruptcy standard and replaced the acts with the "general failure to pay" standard, which Congress determined would be easier to prove.[332]

b. Increasing dividends to creditors by encouraging early filings

Not content merely to streamline the standard for commencement of an involuntary case, Congress also hoped that by adopting the "general failure to pay" standard, creditors would be encouraged to file involuntary petitions earlier than under the prior standard, before the debtor's financial situation deteriorated further.[333] In creating incentives for creditors to commence an involuntary case sooner, Congress hoped to increase the total distributions available to creditors.[334]

c. Increasing dividends to creditors by encouraging informal resolution of disputes

Bankruptcy is costly and time-consuming, and not every debtor's financial difficulties require this extreme measure. Indeed, more assets may be made available to creditors if a formal proceeding is avoided. Congress sought to increase dividends to creditors by encouraging informal resolution of a debtor's financial difficulties,[335] either through a voluntary workout arrangement or through non-bankruptcy collective remedies like receivership or assignment.[336]

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330. *See* REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. I, at 188 ("It is time to abandon the complex, litigation-producing constraints and substitute the test of inability to pay debts as the basis for initiating voluntary bankruptcy."); *see also* Block-Lieb, *supra* note 30, at 815-18 (noting Congress' acceptance of view that information required to prove old standard was not easily available to creditors).

331. *See supra* note 22.

332. REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. I, at 188; *see also* Block-Lieb, *supra* note 30, at 816 (detailing how "general failure to pay" standard may be proven by information available to creditors, while proving insolvency often depends on debtors' internal information that is unavailable to creditors).

333. *See* REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. I, at 14 (describing, as commonplace under old Bankruptcy Act, debtors' reluctance and creditors' inability to file bankruptcy petition before assets were largely depleted).

334. *See* REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. I, at 186 (reporting findings of 1930s bankruptcy study that concluded that Bankruptcy Act had ceased to present any benefit to creditors seeking payment in all but small percentage of cases); *see also* Block-Lieb, *supra* note 30, at 816-17 (describing payments to creditors under prior bankruptcy laws as "abysmally low").

335. *See* 11 U.S.C. § 305(a) (1988) (allowing court to dismiss bankruptcy claim where interests of debtors and creditors would be better served by dismissal); *see also* Block-Lieb, *supra* note 30, at 827-29, 835-36 (citing disincentives in 1978 law to filing of premature or abusive involuntary claims, with effect of promoting settlement of claims).

336. *See* H.R. REP. No. 595, *supra* note 105, at 325, *reprinted in* 1978 U.S.C.C.A.N. at 6281 (discussing situations where courts should abstain from hearing bankruptcy case, such as

Congress also indicated that courts may properly abstain from a case brought by recalcitrant creditors to upset an ongoing negotiation or collective proceeding,[337] and courts have followed this directive.[338]

d. Tempering strategic behavior

Cautious of its interest in encouraging creditors to file early petitions or to obviate the need for petitions by resolving disputes informally, Congress in 1984 added several provisions to the reforms enacted in 1978 that were designed to prevent creditors from using involuntary petitions for unfair advantage in negotiations. These provisions included prohibiting creditors from filing an involuntary petition if the debtor could raise a bona fide dispute as to their claim[339] and excluding all debts arising from a bona fide dispute from the calculation of whether a debtor is generally failing to pay its debts.[340] Congress also granted bankruptcy courts discretion to require petitioning creditors to post a bond pending a hearing on a contested involuntary petition,[341] and to award damages in the event an involuntary petition is dismissed.[342] Congress' intent to temper creditors' strategic use of involuntary petitions is consistent with its intent to encourage informal resolution of a debtor's finan-

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when less expensive workout would better serve interests of creditors and debtors). This last purpose is not inconsistent with a recognition that a debtor's financial difficulties can cause a common pool problem among creditors. Congress sought to encourage only those nonbankruptcy debt collection measures that are collective in nature. *See id.* (stressing that courts should abstain from involuntary proceedings only where rights of creditors are not prejudiced by nonbankruptcy workouts). Congress did not seek to encourage creditors to pursue individual remedies of execution and levy before commencement of an involuntary case. *Cf. In re* Win-Sum Sports, Inc., 14 B.R. 389, 392-93 (Bankr. D. Conn. 1981) (declaring that requiring foreign creditors to pursue individual collection remedies before allowing bankruptcy filing would "unnecessarily chill" creditors' aid to debtors). And although several courts have required creditors to exhaust their individual remedies before commencing an involuntary case, this precedent is questionable. *See supra* note 77 and accompanying text (discussing lack of requirement that creditors exhaust state remedies before seeking federal relief).

337. *See* H.R. REP. No. 595, *supra* note 105, at 325, *reprinted in* 1978 U.S.C.C.A.N. at 6281 (empowering courts to abstain from bankruptcy case brought by "recalcitrant" creditors seeking to undermine ongoing debtor-creditor negotiating in order to receive full payment of debts in future).

338. *See, e.g.*, *In re* Bioline Lab. Inc., 9 B.R. 1013, 1022 (Bankr. E.D.N.Y. 1981) (ruling that where 60% of unsecured creditors agreed to negotiated settlement, involuntary proceeding brought by remaining creditors should be dismissed); *In re* Luftek, 6 B.R. 539, 547-48 (Bankr. E.D.N.Y. 1980) (holding that where most creditors agreed to negotiate settlement and where administrative costs of involuntary proceedings would consume debtors' assets, best interests of debtors' and creditors' would be served by dismissal of involuntary proceeding).

339. 11 U.S.C. § 303(b)(1) (1988) (disallowing creditors whose claims were subject to bona fide dispute from joining in involuntary petition).

340. *Id.* § 303(h)(1).

341. *Id.* § 303(e).

342. *Id.* § 303(i)(1), (2); *see also* Block-Lieb, *supra* note 30, at 828-30 (contrasting damages permissable under 11 U.S.C. § 303(i)(1), which does not require showing of bad faith, with 11 U.S.C. § 303(i)(2), which does).

cial difficulties, but its policy may chill creditors from filing petitions at an early stage in these difficulties.

Even if Jackson is correct in identifying a debtor's balance-sheet insolvency as the occasion for creditors' common pool problems, his proposal that insolvency constitutes the primary standard for commencement of an involuntary case nevertheless fails to address Congress' alternative goals in formulating the proper standard, which include ease of proof,[343] temperance of creditors' strategic use of bankruptcy,[344] and increased bankruptcy dividends to creditors.[345] Of course, Jackson could be right and Congress wrong about the purposes for bankruptcy. It all depends on the robustness of Jackson's model; it depends on whether the creditors' bargain model analogizing a debtor's financial difficulties to a common pool problem can withstand the relaxation of some of its basic premises.

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343. In some circumstances, depending on the definition of insolvency, creditors may have fewer problems of proof with an insolvency standard than they would with a standard that requires them to show that the debtor has generally failed to pay its debts as they come due. *See* Block-Lieb, *supra* note 30, at 856-57 (discussing external signs of insolvency that would be detectable through public filings and proposing that this new definition of insolvency be added to grounds for filing involuntary petition). Jackson does not address these necessary issues in proposing that insolvency be made the standard for commencement of involuntary cases, however.

344. *See supra* notes 339-42 and accompanying text (discussing congressional intent to prevent creditors from using filing of involuntary petition to gain unfair advantage in negotiations with debtor). Interestingly, Jackson does propose that insolvency be made a rebuttable standard for commencement of a bankruptcy case. He would rebut the presumption of insolvency when creditors' motives were strategic and not in good faith, which would occur when creditors file an involuntary petition solely to secure some benefit of bankruptcy law that would not be available under state law. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 197-203. Jackson's willingness to rebut the presumption of the existence of a common pool problem in this event is inconsistent with his assumption that creditors act out of self-interest because they may perceive their self-interest furthered by strategic behavior. Moreover, it is this pursuit of strategic behavior that creates the common pool problem in the first place. *See* Picker, *supra* note 23, at 647-48 (comparing common pool problem to strategic prisoners' dilemma game where actions that are in interest of one party run contrary to interest of group, and parties have ability to structure relationship with each other but must implement relationship agreements without information as to each others' activities).

345. *See supra* notes 333-38 and accompanying text (describing Bankruptcy Code provisions that allow courts to dismiss or abstain from hearing claims in situations where parties' interests would be better served by negotiated settlement). Jackson contends that bankruptcy dividends are greater than dividends under the state law system because the costs of administration are greater in the state law system than in bankruptcy. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 16. *But see* Carlson, *supra* note 10, at 1354-55 (discussing legal costs, such as those incurred in challenges to secured creditors by junior creditors, which exist in federal but not state proceedings). Whether or not administrative costs are greater in the federal or state system, Jackson does not consider the effect this disparity has on costs except as it relates to the willingness of creditors to enter into *ex ante* agreements to create the remedy of bankruptcy. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 17. In identifying the externalities that creditors face, for example, he ignores this disparity. *Id.* *But see supra* notes 190-245 and accompanying text (discussing externalities caused by differences in federal and state collection laws).

2. *Relaxing the premises of the model*

Part II already relaxed several implicit premises of Jackson's creditors' bargain model by discussing the implications of identifying a debtor's exhaustible resources as both its assets and its earning capacity, the interaction of assets and earning capacity with some debtors, and the incapacity of individual collection remedies to protect the value associated with earning capacity. The relaxation of these premises indicates that Baird and Jackson's model is unnecessarily static due to its failure to recognize the complexities associated with different types of debtors, the sorts of assets they own, the types of creditors they owe, and the variety of collection options that debtors and their creditors enjoy. When Congress identified multiple reasons for reforming the standard for commencement of an involuntary bankruptcy case, it implicitly relaxed two other premises of Baird and Jackson's model: creditors' perfect access to information and creditors' incentives to execute and levy against a defaulting debtor's assets.

a. *Relaxing the assumption of perfect information*

First, creditors often do not have ready access to the information necessary to determine whether a debtor is insolvent in the balance-sheet sense of the term.[346] Because insolvency describes an internal financial condition of the debtor, most creditors have no way of knowing whether the debtor will have sufficient assets to cover the defaulted liabilities. Such knowledge would require the creditors to be cognizant of what property belonging to the debtor is exempt or the degree to which a debtor has encumbered its most valuable assets, as well as assessing whether the collateral is more valuable than the indebtedness owed to the lien creditors.[347] As a result, Congress explicitly recognized the difficulty creditors have in gaining access to the sort of information necessary to prove a debtor's balance-sheet insolvency, and therefore chose to repeal the "acts of bankruptcy" as the standard for commencement of an involuntary case precisely because it often required proof of this internal financial condition.[348]

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346. *See* Block-Lieb, *supra* note 30, at 811-12, 837-44 (describing creditors' problems of proof as resulting from internal nature of conditions necessary to demonstrate insolvency); *see also* Baird, *Initiation Problem*, *supra* note 24, at 226 ("The collective action problem that the creditors face is largely an informational one. Each creditor individually has no way of knowing that the debtor has no assets and cannot meet its obligations.").

347. While a creditor's claim of a security interest is generally public knowledge, U.C.C. § 9-302, the value of the collateral claimed by the secured creditor is not.

348. *See* REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. I, at 186-87 (discussing difficulty creditors face in proving old bankruptcy "act" standard and explaining need for newer, easier

b. Relaxing the assumption that collection efforts are costless to creditors

Congress also recognized that creditors often prefer not to seek the aid of the courts and their officers to coerce repayment of delinquent debts.[349] This preference for extralegal solutions to resolve a debtor's nonpayment may follow from the simple fact that collection efforts are not without expense. Creditors may reasonably determine not to pursue judicial remedies simply because it may be cheaper and easier to collect a debt informally than to sue the debtor in court.[350] In addition, any coercive collection method that relies on repayment from proceeds of a forced sale of the debtor's assets will be less efficient and effective than a method that relies on repayment out of liquid funds, because forced sales of assets generally result in a loss of value.[351] Finally, creditors' preferences for extrajudicial resolution of payment disputes also may be explained by recognizing that litigation may have costly effects on the relationships between debtors and creditors.[352] All collection remedies are likely to harm the profitability of a debtor's firm and except in invol-

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standard to promote bankruptcy filings before depletion of debtor's assets occurs); *see also supra* notes 326-34 and accompanying text (describing Bankruptcy Commissioners' conclusions that old Bankruptcy Act was not useful in distribution of debtors' assets to creditors, and that new Code would reduce litigation, increase payments to creditors, encourage negotiation, and discourage bad faith filings).

349. *See* S. REP. No. 989, *supra* note 105, at 35-36, *reprinted in* 1978 U.S.C.C.A.N. at 5821-22 (allowing courts under § 305 of Bankruptcy Code to decline jurisdiction when less expensive out-of-court workout would better serve interests of creditors and debtors); *see also* Block-Lieb, *supra* note 30, at 827-36, 844-49 (examining congressional reform of standard for commencement of involuntary cases that discourages bad faith filings and encourages creditors to pursue less expensive and more expeditious nonbankruptcy solutions for debtors' financial problems).

350. *See* Block-Lieb, *supra* note 30, at 844 (suggesting that creditors may prefer not to pursue coercive collection remedies because debtors' assets are mostly exempt or subject to liens); *see also* 11 U.S.C. § 522(b)(2)(A) (1988) (permitting individual debtors benefits of state and federal exemption laws); U.C.C. §§ 9-110, 9-203 (1981) (validating grant of "blanket lien" against all of debtors' assets).

351. *See* Whitford, *supra* note 33, at 1060, 1097 ("This 'lost value' phenomenon is a result both of the inadequate prices typically obtained at execution sales and of the underdeveloped state of most used goods markets."); *see also* Block-Lieb, *supra* note 30, at 844-46 (stating that creditors may be reluctant to rely on repayment from receipts of foreclosures of debtor's nonexempt, unencumbered assets due to small proceeds generally received from forced sales).

352. *See* Stewart Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465, 467-68 (suggesting that business persons often perform disadvantageous contracts because performance is beneficial to maintenance of relationship, and that relatively few contract cases are litigated because litigation generally ends relationship); William C. Whitford, *Ian MacNeil's Contribution to Contracts Scholarship*, 1985 WIS. L. REV. 545, 546, 550 (commenting that relational contract theory is based on idea that contracting takes place not at single point in time, but rather "emerges over time in the context of ongoing relationships" and that parties to relational contracts try to preserve relationships as way of maximizing wealth); *see also* Block-Lieb, *supra* note 30, at 849-52 (suggesting that when creditors and debtors are involved in complex or long-standing relationship they will tend to resolve their disputes through informal means such as negotiation rather than through courts).

untarily commenced chapter 11 cases, often result, at least by the conclusion of the proceeding, in the cessation of the business.[353] Thus, a creditor with a long-term or otherwise important relationship with a debtor, be it contractual or otherwise, is even less likely to coerce repayment through a collective remedy than through an individual one and is less likely to coerce repayment through a court sanctioned collection remedy than through negotiation.[354]

B. *Voluntary Bankruptcy*

1. *Congress' diverse policy purposes*

In contrast to the standard for commencement of an involuntary bankruptcy case,[355] the Code permits debtors virtually unfettered discretion to commence a voluntary case.[356] Congress clearly envisioned distinct policy purposes for these two standards. When examined in light of these goals, the congressional distinction between the standards for commencement of involuntary and voluntary cases makes sense.

a. *Recognizing debtors' informational advantages*

Debtors do not suffer from the same informational difficulties that creditors do because debtors are in a much better position than creditors to determine their own risk of general default or insolvency.[357] Elimination of financial tests for purposes of a debtor's

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353. *See* Block-Lieb, *supra* note 30, at 849-52 (stating that collection remedies may not only hurt debtor's business operations, but may also impact on individual debtor's earning capacity). Macaulay makes a similar point when he states, with regard to contract law, that "there are relatively few contracts cases litigated and . . . [w]hen final judgments are won, often they cannot be executed because of insolvency." Macaulay, *supra* note 352, at 468.

354. *See* Block-Lieb, *supra* note 30, at 849-52 (stating that creditors with long-term, important relationships with debtors are less likely to seek repayment of delinquent debts through collective remedies than through individual remedies because collection remedies often harm profitability of debtors' firms and result in cessation of business); *cf.* Whitford, *supra* note 352, at 550 (discussing emotional and wealth costs of cessation of business relationship).

355. *See* 11 U.S.C. § 303(b), (h) (1988) (stating that involuntary bankruptcy cases may be commenced against debtor only after petitioning creditors fulfill complex standing requirements, and show either that debtor is generally failing to pay debts as they come due or that custodian appointed within preceding 120 days possesses all or substantially all of debtor's assets).

356. *See id.* §§ 109, 301 (stating generally that voluntary cases can be brought by any eligible debtor).

357. *But see supra* notes 327-32 and accompanying text (noting that Congress understood that Bankruptcy Code's "general failure to pay" standard was easier for creditors to prove than "acts of bankruptcy" standard required by Bankruptcy Act). At times, however, even debtors can make mistakes. When a debtor fails to dispute any of its obligations, the debtor should not be mistaken as to whether it satisfies the "generally failing to pay" standard. On the other hand, when the debtor disputes a significant portion of these obligations, the debtor may not be able to determine whether a court would find that these disputes are bona fide as a matter of law, because the existence of bona fide disputes is governed by an objective standard and not by what the debtor represents to be its state of mind. *See supra* notes 100-02 and

eligibility simplifies the bankruptcy petitioning process and eliminates the need for a hearing before entry of an order for relief. This streamlines the process and provides voluntary debtors with few procedural impediments to the protections offered them by the Bankruptcy Code.[358] Debtors' access to information, however, does not alone indicate the proper standard for commencement of a voluntary case. Indeed, a recognition that debtors do not face the same problems of proof as creditors might support Jackson's recommendation that insolvency act as the standard for commencement of voluntary cases.[359] Certainly, other policy purposes are at work.

b. Increasing dividends to creditors by encouraging early filings

Congress' concern about paltry distributions to creditors influenced not only its choice to liberalize the standard for commencement of an involuntary bankruptcy case, but also affected its decision to leave the commencement of voluntary cases within the discretion of debtors.[360] By streamlining the relevant standard and permitting debtors to seek the protection of the Bankruptcy Code whenever they deem it necessary, Congress intended to encourage debtors to file petitions before they became insolvent or suffered a general default. By allowing debtors to file at this earlier stage of financial difficulty, Congress hoped that bankruptcy proceedings would come early enough to arrest and resolve debtors' financial deterioration.[361]

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accompanying text (stating that courts apply objective standard to determine whether debts are "bona fide"). In addition, unless its assets are peculiarly liquid, the debtor may calculate its balance sheet differently than would a creditor or a bankruptcy court. *Cf.* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 197 ("The value of assets depends on their value in use which, in a world of imperfect information, is itself a 'best guess' about the likelihood of future courses of action.").

358. *See* Baird, *Initiation Problem*, *supra* note 24, at 226 (arguing that creditors' informational disadvantages justify Code's reliance on debtors to commence voluntary cases because bankruptcy petitions allow debtors to "surrender" and tell creditors to "stop their pursuit" of debtor). Baird states further that "[a] Chapter 7 petition is the easiest way for the managers who are being constantly harassed to convince creditors that the firm has no assets and that their lawsuits are pointless. The filing of a Chapter 7 petition sends creditors an effective signal." *Id.* at 226.

359. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 200 (stating that most bankruptcy cases "can be handled reasonably well by creating a rebuttable presumption of appropriateness upon showing that there are multiple creditors and a reasonable prospect of insolvency").

360. 11 U.S.C. § 301 (1988).

361. *See* REPORT ON BANKRUPTCY LAWS, *supra* note 30, pt. I, at 14, 187, 188 (arguing that dividends to creditors would be increased if bankruptcy cases were brought earlier in debtors' downward financial spiral); Block-Lieb, *supra* note 30, at 816, 835 (commenting on Congress' intent to encourage ealier filings). Although Congress does not talk in economic jargon in the legislative history when explaining changes to the voluntary standard, the legislators can be described as intending to encourage debtors to file for bankruptcy even before a common pool problem arises.

c. Increasing dividends to creditors by encouraging informal resolution of disputes

Consistent with its intent to increase dividends to creditors, Congress sought not only to encourage debtors to commence bankruptcy cases before their financial difficulties became irreversible, but also tried to reduce bankruptcy administration costs by ensuring that the difficulties become resolved, where reasonable, through informal means.[362] For example, the Code permits bankruptcy courts to abstain from hearing voluntary cases where the interests of the debtor and its creditors would be best served by dismissal.[363] Following Congress' policy, courts often actually do abstain in these circumstances.[364]

d. Little fear that debtors' filings are strategic

Congress' desire to encourage creditors to file involuntary petitions at an earlier time when debtors are suffering financial difficulties was countered by fear that creditors would unfairly use such filings to gain negotiating leverage or a competitive edge, or simply out of spite.[365] This fear arose from the fact that the mere filing of an involuntary petition may have a devastating effect on the debtor's reputation as a sound credit risk. This fear, however, is irrelevant as applied to voluntary filings.[366] If anything, insolvent debtors proba-

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362. *See* S. REP. No. 989, *supra* note 105, at 35, *reprinted in* 1978 U.S.C.C.A.N. at 5821-22; H.R. REP. No. 595, *supra* note 105, at 325, *reprinted in* 1978 U.S.C.C.A.N. at 6281 (allowing courts under Code § 305 to decline jurisdiction when less expensive out-of-court workout may better serve interests of creditors and debtors).

363. *See* 11 U.S.C. § 305 (1988) (permitting courts to decline jurisdiction in some cases); *see also* Block-Lieb, *supra* note 30, at 832 n.148 (stating that courts have dismissed chapter 11 filings on grounds of bad faith and when there is no hope of reorganization relief).

364. *See, e.g.*, Carolin Corp. v. Miller, 886 F.2d 693, 700-01 (4th Cir. 1989) (holding that to warrant dismissal of voluntary chapter 11 petition for lack of bad faith in filing, both objective futility of any possible reorganization and subjective bad faith of debtor must be considered); Phoenix Piccadilly v. Future Fed. Sav. Bank (*In re* Phoenix Piccadilly, Ltd.), 849 F.2d 1393, 1393-95 (11th Cir. 1988) (dismissing voluntary chapter 11 petition as filed in bad faith where there was intent to delay or frustrate creditors' efforts to enforce liens); Natural Land Corp. v. Baker Farms, Inc. (*In re* Natural Land Corp.), 825 F.2d 296, 297-99 (11th Cir. 1987) (dismissing chapter 11 petition due to bad faith filing); Albany Partners, Ltd. v. Westbrook (*In re* Albany Partners, Ltd.), 749 F.2d 670, 674-75 (11th Cir. 1984) (dismissing chapter 11 petition for bad faith filing upon showing that there existed no realistic prospect of effective reorganization for debtor and that debtor sought reorganization relief to delay or frustrate creditors' efforts to enforce their rights); *see also* Block-Lieb, *supra* note 30, at 832 n.148 (suggesting that courts have regularly dismissed voluntary petitions under chapter 11 for bad faith and on ground that no realistic prospect of effective reorganization exists for debtor).

365. *See supra* notes 339-42 and accompanying text (discussing congressional concern that creditors will use involuntary petitions as unfair advantage in negotiations). Creditors of individual debtors are not likely to file an involuntary petition out of spite because these creditors have much to lose by filing, including the exclusion of postpetition wages from property of the bankruptcy estate and a debtor's discharge. 11 U.S.C. §§ 541(a)(6), 727(a)(1) (1988).

366. Recall the joke involving the thief who holds a gun to his head and says, "Give me all of your money or I'll shoot."

bly face greater incentives to postpone the decision to file a bankruptcy petition than to jump the gun. Roughly speaking, an insolvent debtor that is not an individual should be indifferent to voluntary preferential repayment versus coerced repayment through either individual or collective collection remedies,[367] because a debtor is entitled to claim only the surplus that exists after full payment is made to all creditors.[368] Indeed, an insolvent debtor

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367. An individual debtor would never be so completely indifferent because only the federal collective remedy of bankruptcy can provide a debtor with a discharge from its unpaid liabilities. 11 U.S.C. §§ 524, 727(a)(1) (1988). *See* International Shoe Co. v. Pinkus, 278 U.S. 261, 265 (1929) (holding that Supremacy and Bankruptcy Clauses of U.S. Constitution preclude state insolvency laws from providing for discharge of indebtedness). In addition, only in the context of bankruptcy can individuals protect their postpetition earnings from creditors. 11 U.S.C. § 541(a)(6) (1988); *see id.* § 727(a)(1) (stating that only individual debtors are entitled to discharge in chapter 7 liquidation case); *cf.* Toibb v. Radloff, 111 S. Ct. 2197, 2199-2202 (1991) (holding that protection of postpetition earnings and availability of discharge in context of chapter 11 reorganization applies to both nonbusiness and business debtors alike). *Compare* 11 U.S.C. § 727(a)(1) (1988) (limiting discharge in chapter 7 case to individuals) *with id.* § 1141(d) (providing generally for discharge as result of confirmation of chapter 11 plan, whether debtor is individual or not).

Individual debtors are unlikely to be motivated to file for bankruptcy in order to enjoy the benefits of exemption laws because exemption laws are largely creatures of nonbankruptcy law. *See, e.g.*, CAL. CIV. PROC. CODE §§ 703.010-706.010 (West 1987 & Supp. 1992) (delineating exemptions applying to all procedures for enforcement of money judgments); MO. ANN. STAT. §§ 513.425-.470 (Vernon 1952 & Supp. 1992) (allowing exemptions for such things as tools or implements of mechanics' trade, wearing apparel, family books and bibles, arms and military equipment, and certain other personal and real property); N.Y. CIV. PRAC. L. & R. § 5205 (McKinney 1978 & Supp. 1992) (citing permissible exemptions from satisfactions of money judgments as including stoves, family bibles, wearing apparel, and certain other personal property). True, Bankruptcy Code § 522 permits debtors to choose between their state exemptions and the federal scheme set forth in that provision, but any state legislature that determines that the federal exemptions are more generous than those provided by state law can opt out of the federal exemptions by passing a law to that effect. 11 U.S.C. § 522(b)(1) (1988); *see also* WARREN & WESTBROOK, *supra* note 58, at 204 (stating that 39 states have opted out of federal scheme so that debtors filing for bankruptcy in most states can only exempt property under that state's laws).

368. A debtor's entitlement to only the surplus that remains after payment of creditors' claims in full exists regardless of whether the debtor is an individual or not. *See* 11 U.S.C. § 726(a)-(b) (1988) (stating that any surplus after all claims are paid out is paid to debtor). This point is clearest in the case of a corporate debtor. In that case, the insolvent corporate debtor's owners will not be repaid their equity investments because their investments are subordinate in priority to the claims of all the debtor's creditors. As a result, directors and managers of a corporate debtor may try to influence bankruptcy decisions as a way of keeping their jobs and maintaining continued control over the corporation. *See* Lynn M. LoPucki & William C. Whitford, Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies, 17-18 (Jan. 29, 1992) (unpublished manuscript, on file with author) ("[S]enior interests are often in sharp conflict with juniors as to the level of risk the company should accept in its investment policy."); *see also* Bradley & Rosenzweig, *supra* note 23, at 1045 (stating that managers of corporations prefer chapter 11 reorganizations to chapter 7 liquidations because chapter 11 allows them continued control, as well as continued operation of business, without constraints ordinarily imposed by creditors); Jeremy I. Bulow & John B. Shoven, *The Bankruptcy Decision*, 9 BELL J. ECON. 437, 437-56 (1978) (arguing that before making bankruptcy choices, several variables must be taken into account, including structure of firm, priority structure, and ownership of firm's debt, all of which influence division of proceeds of firm between negotiating coalition and unnegotiating creditors); Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 334 (1976) (providing that owner-managers of firms will have strong

may delay filing for bankruptcy through whatever means necessary on the slim chance that as assets increase in value, revenue will also increase, or a high-risk investment will pan out, because creditors rather than debtors bear all the downside risk.

This generalization is not without exception, however, largely due to the distinctions between state and federal collection schemes.[369] For example, even insolvent debtors may prefer bankruptcy if bankruptcy is better able to maximize the proceeds of a sale of its assets. The insolvent debtor may prefer to maximize the amount of proceeds received in the disposition of its assets, if insiders[370] of the debtor have guaranteed all or some of the debtor's indebtedness. Insiders of the debtor, and thus the debtor as well, will prefer to maximize the proceeds received from a liquidation sale, because the more indebtedness the debtor's assets cover, the less indebtedness for which they will be personally liable. Moreover, a business debtor may file a chapter 7 petition because it knows that it cannot make the business run profitably but does not know whether or not it is insolvent. Utilizing bankruptcy's superior ability to dispose of assets, the debtor may harbor a realistic hope of providing some return on the investments of the shareholders, partners, or others holding ownership interests in the debtor. Other distinctions between the state and federal systems exist. Debtors of all types prefer bankruptcy due to the benefits of the automatic stay.[371] Furthermore, individual and business debtors benefit from their ability to use, sell, or lease property of the estate.[372] Similarly, both individuals and firms may be motivated to file for bankruptcy by the possibility of a discharge, although corporate and partnership debtors are unable to obtain a discharge in a liquidation case.[373] Business debt-

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incentives to engage in investments that promise very high payoffs even if there is less probability of success); LoPucki, *supra* note 160, at 321-22, 333 (suggesting that when debtors have liabilities in excess of their assets they will be motivated to make high-risk investments and will more than likely be unable to keep current in their debt repayment, forcing debtors to liquidate their assets for less than their market value; and that similarly, many debtors utilize "bankruptcy planning" to remove as many assets as possible from pools available to pay creditors); Bruce M. Stiglitz, *Some Aspects of the Pure Theory of Corporate Finance: Bankruptcies and Takeovers*, 3 BELL J. ECON. MGMT. SCI. 458, 460 (1972) (noting that firms may choose debt-equity ratio that avoids high probabilities of bankruptcy and that firms approaching insolvency may consider takeovers and mergers over high costs associated with bankruptcy).

369. *See supra* notes 191-245 and accompanying text (discussing differences between state and federal collection schemes).

370. *See* 11 U.S.C. § 101(31) (Supp. III 1991) (defining "insiders").

371. *See id.* § 362(a)-(b) (1988) (allowing stays in bankruptcy for enforcement of judgments or liens against debtors and property of their estates).

372. *See id.* § 363 (providing that trustees may use, sell, or lease property of estate in ordinary course).

373. *See id.* § 727(a)(1) (granting discharge in liquidation cases to individuals only). The legislative history indicates that "individual" does not include corporations or partnerships, but only includes natural persons. S. REP. No. 989, *supra* note 105, at 98, *reprinted in* 1978

ors are more likely than individual debtors to benefit from the ability to reject executory contracts and unexpired leases[374] and obtain postpetition financing.[375] Consumer debtors, on the other hand, are exclusively benefitted by the stay of collection actions against co-debtors,[376] the federal exemptions,[377] the right to redeem certain property,[378] and the ability to avoid certain liens against household goods.[379]

Jackson argues that voluntary filings should be dismissed if they are made for strategic purposes.[380] To support this argument, he refers to case law in which petitions have been dismissed as having been submitted in bad faith when the debtor filed in order to obtain some advantage from bankruptcy but did not actually suffer from serious financial difficulty.[381] Jackson provides no economic explanation for this departure from his reliance on the actions of self-interested debtors and creditors. Why should debtors' self-interested actions be trusted as less strategic than creditors'? In addition, why should some self-interested actions be viewed as strategic while others are commended as consistent with the good of the collective body? Reference to the metaphor of the common pool does not alone justify dismissal of strategic filings. Instead, courts are relying on diverse policy purposes when they dismiss either voluntary or involuntary petitions that are filed in bad faith. Sometimes, the dismissals can be justified on the grounds that creditors did not

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U.S.C.C.A.N. at 5884; H.R. REP. No. 595, *supra* note 105, at 384, *reprinted in* 1978 U.S.C.C.A.N. at 6340. *But see infra* notes 398-400 and accompanying text (describing ability of nonindividual debtor and nondebtor to obtain discharge through chapter 11 plan of reorganization).

374. *See* 11 U.S.C. § 365 (Supp. III 1991) (stating that subject to court's approval, trustees may assume or reject any executory contracts or expired leases of debtors).

375. *See id.* § 364 (limiting circumstances under which trustees are able to incur unsecured and secured debt after commencement of bankruptcy case).

376. *See id.* § 1301 (stating that creditors may not commence civil action to collect any part of debtor's consumer debts from any other party liable on such debt or securing such debt).

377. *See id.* § 522(d) (providing limited exemption for individual debtors' property, including residences, motor vehicles, and household goods).

378. *See id.* § 722 (providing individual debtors with right to redeem tangible personal, family, or household use items from liens securing dischargeable consumer debts).

379. *See id.* § 522(f)-(h) (allowing individual debtors to avoid nonpossessory, nonpurchase-money liens against certain exempt property); *see also id.* § 522(e) (invalidating certain waivers of exemptions).

380. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 193-97.

381. *See, e.g.*, *In re* 2218 Bluebird Ltd. Partnership, 41 B.R. 540, 544 (Bankr. S.D. Cal. 1984) (finding that debtor acted in bad faith when created entity to receive property from existing entity for sole purpose of avoiding foreclosure); *In re* Thirteenth Place, Inc., 30 B.R. 503, 505 (Bankr. 9th Cir. 1983) (holding that purpose of creating corporation and filing bankruptcy was to delay seizure of assets by secured creditors); *In re* Tinti Constr. Co., 29 B.R. 971, 974 (Bankr. E.D. Wis. 1983) (dismissing voluntary petition as filed in bad faith when debtor's sole purpose was to reject collective bargaining agreement); *see also In re* Johns-Manville Co., 36 B.R. 727, 732-43 (Bankr. S.D.N.Y. 1984) (denying motion to dismiss petition for bad faith filing because debtor was found to suffer from financial problems).

face a common pool problem, and consequently no need for bankruptcy existed.[382] At other times, the dismissals can be justified more broadly on grounds of equity, fairness, and fair play or, in other words, on the notion that self-interested actions cannot always be trusted.[383]

e. Encouraging the rehabilitation of business debtors

By encouraging creditors to file involuntary petitions before a debtor becomes insolvent, Congress sought to maximize distributions to creditors.[384] By encouraging debtors to file voluntary petitions before they either become insolvent or are unable to pay debts as they come due, Congress sought to do more than merely increase dividends to creditors: it also hoped to facilitate the rehabilitation of financially troubled business debtors.[385] The goal of rehabilitation is distinct from that of increasing distributions to creditors, but not necessarily inconsistent. Dividends to creditors will increase when the Code succeeds in preserving the going concern value of a business debtor by facilitating the rehabilitation of its ailing operations. Even if creditors receive no more than they would have received in a chapter 7 liquidation case,[386] this goal of rehabilitation will have been fulfilled if a business debtor's reorganization facilitates the preservation of jobs, specialized expertise, and other goodwill.[387]

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382. *See supra* note 98 and accompanying text (noting that majority of courts do not find that debtor's failure to pay single debt constitutes failure generally to pay debts as they come due).

383. *See supra* notes 94-98 (listing cases that have been dismissed for reasons of equity and fairness).

384. *See* S. REP. No. 989, *supra* note 105, at 32-35, *reprinted in* 1978 U.S.C.C.A.N. at 5818-21; H.R. REP. No. 595, *supra* note 105, at 321-24, *reprinted in* 1978 U.S.C.C.A.N. at 6278-81 ("Because the assets of an insolvent debtor belong equitably to his [or her] creditors, . . . involuntary cases [should be permitted] in order that creditors may realize on their assets through [chapter 11] reorganization as well as through [chapter 7] liquidation.").

385. *See* S. REP. No. 989, *supra* note 105, at 31, *reprinted in* 1978 U.S.C.C.A.N. at 5817; H.R. REP. No. 595, *supra* note 105, at 321, *reprinted in* 1978 U.S.C.C.A.N. at 6277 (making no distinction between individual debtors and business debtors as to who may commence chapter 11 reorganization cases). Like a business debtor, an individual debtor may file for bankruptcy in order to rehabilitate itself and thereby preserve its standing in the financial community. If the debtor believes that its financial troubles are short-term, or if it has substantial nonexempt assets it wants to protect, it will be motivated to file either a chapter 12 or 13 petition and adjust its indebtedness by making reduced payments to creditors out of its regular income. *See supra* note 74 and accompanying text (delineating differences between chapters 12 and 13).

386. *See* 11 U.S.C. § 1129(a)(7)(A)(ii) (1988) (stating that each impaired class of claims or interests will receive or retain property or value that is not less than amounts that such holders would receive or retain if debtor's assets were liquidated under chapter 7).

387. *See* Korobkin, *Jurisprudence of Bankruptcy*, *supra* note 31, at 763-66 (concluding that business debtor's financial distress not only affects company's bottom line, but also affects management, employees, and community). In economic terms, Congress' rehabilitative goal can be described as an effort to account for some of the costs of a liquidation that are not

Congress' goal of encouraging the rehabilitation of business debtors cannot be accomplished through creditors' involuntary filings, for several reasons. First, creditors may be indifferent to a debtor's rehabilitation[388] and may prefer to avoid the time and expense of the rehabilitation process unless it is clear at the commencement of the case that they will receive greater dividends under an alternative plan than they would in a chapter 7 liquidation.[389] Second, while debtors are imperfect in their ability to determine whether and at what point in time their business difficulties should be resolved under the protection of a bankruptcy court, creditors' abilities to make this determination are far worse. Creditors often do not enjoy access to the sort of information necessary to evaluate whether a debtor is insolvent or whether it generally has failed to pay its debts as they have come due.[390] Determinations as to a debtor's financial viability are qualitatively quite difficult for creditors and other outsiders to make.[391] Once information about the debtor's cash flow is made available to creditors and the court determines whether any of

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borne directly by either the debtor or its creditors, but which are incurred by others related to the debtor such as its employees and the community in which the debtor is located. *Id.*

388. This is true barring the existence of other factors such as a long-term relationship between debtors and creditors that creditors have an interest in preserving. *See supra* notes 350-54 and accompanying text (stating that creditors may prefer extralegal solutions because of desire to minimize costs and preserve long-standing relationships).

389. Creditors of an individual debtor usually can make this calculation fairly simply and would probably prefer a chapter 12 (debt adjustment of a family farmer) or 13 (debt adjustment of an individual with regular income) filing to that of a chapter 7 liquidation, but they are prohibited from commencing an involuntary petition under these chapters. *See* 11 U.S.C. § 303(a) (1988) (permitting commencement of involuntary cases only under chapters 7 or 11). Legislative history indicates that although a creditor may want to commence an involuntary chapter 12 case against a farmer for delinquent debts, the nature of a farmer's business, where one drought year or one year of low prices may result in a farmer's temporarily being unable to pay his or her creditors, should not subject the farmer to involuntary bankruptcy. S. REP. No. 989, *supra* note 105, at 32, *reprinted in* 1978 U.S.C.C.A.N. at 5818; H.R. REP. No. 585, *supra* note 105, at 322, *reprinted in* 1978 U.S.C.C.A.N. at 6278. Also, a creditor may prefer a repayment plan to adjust the debts of an individual with regular income by commencing an involuntary chapter 13 case, with hopes of getting paid back in full, rather than by commencing a chapter 7 case that reduces a debtor's assets to cash and then allows a debtor, if eligible, a fresh start through discharge. S. REP. No. 989, *supra* note 105, at 98, *reprinted in* 1978 U.S.C.C.A.N. at 5884; H.R. REP. No. 595, *supra* note 105, at 384, *reprinted in* 1978 U.S.C.C.A.N. at 6340. Legislative history, however, indicates that "chapter 13 only works when there is a willing debtor that wants to repay his [or her] creditors. Short of involuntary servitude, it is difficult to keep a debtor working for creditors when he [or she] does not want to pay them back." S. REP. No. 989, *supra* note 105, at 32, *reprinted in* 1978 U.S.C.C.A.N. at 5818; H.R. REP. No. 585, *supra* note 105, at 322, *reprinted in* 1978 U.S.C.C.A.N. at 6278.

390. *See supra* notes 329-32 and accompanying text (indicating that Bankruptcy Reform Act of 1978 has made it easier for creditors to prove debtor's bankruptcy using "general failure to pay" standard rather than proving specific "acts of bankruptcy" as required under 1898 Act).

391. *See* Baird, *Initiation Problem*, *supra* note 24, at 228 ("Those best positioned to know both the financial condition of the firm and the likelihood that creditors will assert their nonbankruptcy rights are the managers of the firm. Individual creditors lack a sense of the overall, day-to-day health of the firm.").

the debtor's obligations are the subject of a bona fide dispute, there would be little dispute among experts about whether the debtor was generally paying its debts as they came due. Similarly, once information about the debtor's assets and liabilities becomes known, experts might quibble about how best to assign values to the assets and liabilities, but there would be no dispute about whether the value of assets exceeds liabilities, or vice versa. An analysis of the desirability of the debtor's continued operations is altogether different, however, because it requires not only a projection of the debtor's future revenue and expenditures, but also judgments about how the debtor's future operations are best pursued. Corporate law defers to the judgment of management and boards of directors in this regard, and there exists no convincing reason for a departure from the "business judgment" rule[392] simply because three of the debtor's creditors determine to file an involuntary chapter 11 petition.

Finally, a standard that encourages creditors to force a debtor into chapter 11 in order to rehabilitate the debtor is probably unworkable because the success of a reorganization plan often depends on the debtor's commitment to the rehabilitation effort. Congress apparently understood the importance of a debtor's commitment when it precluded creditors from filing involuntary chapter 12 or 13 petitions against family farmers or individuals earning regular income.[393] The rule permitting creditors to commence an involuntary chapter 11 case is not inconsistent with this basic notion because creditors can effect a liquidation of all or substantially all of a debtor's assets pursuant to a chapter 11 reorganization plan.[394]

f. Promoting the debtor's fresh start

Although Congress generally favors a negotiated resolution of a debtor's financial difficulties, this goal may, in the case of individual debtors, run counter to the legislature's desire to promote a

392. *See* Auerbach v. Bennett, 393 N.E.2d 994, 996-1005 (N.Y. 1979) (discussing "business judgment" rule as applied to decision of corporate board of directors). *See generally* BLACK'S LAW DICTIONARY 200 (6th ed. 1990) (defining "business judgment rule" as rule that "immunizes management from liability in corporate transaction undertaken within both power of corporation and authority of management where there is reasonable basis to indicate that transaction was made with due care and in good faith").

393. *See* 11 U.S.C. § 303(a) (1988) (permitting commencement of involuntary cases only under chapters 7 and 11 of Bankruptcy Code); *see also supra* note 74 (describing inability of creditors to commence involuntary chapter 12 or 13 cases).

394. *See* 11 U.S.C. §§ 1121(c), 1123(b)(4) (1988) (permitting any party in interest to file reorganization plan after expiration of 120-day period during which only debtor may file plan; providing that reorganization plan may effectuate sale of all or substantially all of debtor's assets).

debtor's fresh start after bankruptcy, because a discharge is available only through participation in bankruptcy. The two goals are reconcilable. The Code provides numerous ways for debtors to repay obligations voluntarily even after a bankruptcy petition has been filed.[395]

2. *Reassessing the relevance of the model*

Jackson's contention that voluntary cases should not be commenced unless the business debtor shows its insolvency takes the analogy of the common pool beyond its useful limits. With involuntary bankruptcy cases, one could reasonably argue that the primary explanation for the existence of the remedy is the need to resolve the common pool problem created by a debtor's financial difficulty. One could quibble about whether the common pool problem arises at the time of the debtor's balance-sheet insolvency or at some other time depending on a multiplicity of complex factors. One could tinker with the standard of commencement by looking at other secondary goals associated with the remedy of bankruptcy: ensuring ease in proof, encouraging earlier access to the remedy, facilitating negotiated resolution of financial disputes, and creating disincentives for harmful strategic behavior. But in the end, our understanding of the need to thrust a debtor into bankruptcy against its wishes would have been advanced by our reliance on economic theory and the metaphor comparing creditors' collection efforts to a common pool problem. Congress' policy goals regarding voluntary cases, however, go far beyond mere resolution of the harm caused by competition among collecting creditors. With voluntary cases, it is not enough simply to relax the assumptions lurking behind the analogy of the common pool. The analogy itself is of limited usefulness in assessing the circumstances in which debtors should be encouraged to seek voluntary bankruptcy relief.

Jackson limits his discussion of the standard for commencement of voluntary cases to cases that do not involve individual debtors, explicitly admitting that as to individual debtors there exists an "independent social policy," namely the right to a fresh start through a discharge in bankruptcy.[396] As to nonindividual debtors, Jackson

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395. *See id.* § 524(c) (permitting but regulating reaffirmation agreements, which are private agreements between holders of claims and debtors, consideration for which, in whole or in part, is based on debts that are dischargeable under Code); *id.* § 524(d) (requiring bankruptcy court to scrutinize reaffirmation agreements and inform debtors that such agreements are optional); *id.* § 524(f) (providing that nothing in Code precludes debtor from voluntary repayment); *see also id.* § 722 (permitting redemption of certain collateral by consumer debtors).

396. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 201 (suggesting that individuals seek

contends that there exists "no independent social policy . . . being served by bankruptcy," other than resolution of creditors' common pool problems.[397] This contention crisply focuses Jackson's very limited view of bankruptcy because in making this remark he ignores two interrelated policy purposes of federal bankruptcy law as it applies to businesses.

First, while Jackson technically is correct to note that only individuals are entitled to a discharge in bankruptcy, he neglects to acknowledge that the correctness of this remark depends on narrowly defining bankruptcy as a chapter 7 liquidation, or "straight bankruptcy," case.[398] In a chapter 11 reorganization case, however, both individuals and nonindividuals generally are entitled to receive a discharge upon the confirmation of the reorganization plan.[399] And the principals of a debtor-corporation or partnership may be able to structure the plan so that the principals will be discharged from their secondary liability on the debtor's liabilities to creditors.[400]

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bankruptcy in order to obtain right of fresh start). Indeed, in justifying the fresh start goal on economic grounds, Jackson does not rely on common pool analysis. *See id.* at 225-52 (suggesting that individuals' right to discharge "raises a series of questions that the notion of bankruptcy as a response to a common pool problem will not answer," and justifying right of discharge on other grounds); *see also* Carlson, *supra* note 10, at 1356-76 (criticizing Jackson's contractarian model of bankruptcy as unable to account for individual debtors' right to discharge).

397. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 201.

398. *See* 11 U.S.C. § 727(a)(1) (1988) (providing that debtor shall not be granted discharge in chapter 7 case if "debtor is not an individual"). Legislative history explains that this limitation was intended to "avoid trafficking in corporate shells and in bankruptcy partnerships." S. REP. No. 989, *supra* note 105, at 98, *reprinted in* 1978 U.S.C.C.A.N. at 5884; H.R. REP. No. 595, *supra* note 105, at 384, *reprinted in* 1978 U.S.C.C.A.N. at 6340.

399. 11 U.S.C. § 1141(d) (1988). The Code does specify narrow circumstances under which debtors are not entitled to receive a discharge in the context of a chapter 11 case. An individual debtor is not entitled, pursuant to a chapter 11 plan, to obtain a discharge from debts excepted from discharge under § 523. *Id.* § 1141(d)(2). Moreover, a business debtor that is not an individual is not entitled to obtain a discharge pursuant to a chapter 11 plan of reorganization if (i) the plan provides for the liquidation of all or substantially all of the debtor's assets and (ii) the debtor does not engage in business after consummation of the plan. *Id.* § 1141(d)(3). Like § 727(a)(1)'s prohibition against discharging debtors that are not individuals in a chapter 7 case, § 1141(d)(3)'s prohibition against discharging debtors that are not individuals in a liquidating chapter 11 case was intended to preclude debtors from trading in corporate shells.

400. Discharge generally only applies to debts owed by the debtor. *Id.* § 524(e). *But compare* Republic Supply Co. v. Shoaf, 815 F.2d 1046, 1050 (5th Cir. 1987) (holding that even though bankruptcy laws generally preclude discharge of guarantor's liabilities, creditor is foreclosed under doctrine of res judicata from questioning legality of bankruptcy court's decision to discharge guaranty when such terms were accepted without objection as part of reorganization plan) *with* Underhill v. Royal, 769 F.2d 1426, 1432 (9th Cir. 1985) ("The bankruptcy court has no duty to discharge the liabilities of a nondebtor pursuant to the consent of creditors as part of a reorganization plan.") *and* Union Carbide v. Newboles, 686 F.2d 593, 595 (7th Cir. 1982) (holding that "creditor's approval of the bankruptcy plan does not discharge the bankrupt's guarantors"). In other appropriate circumstances, the bankruptcy court may enjoin creditors from proceeding against certain nondebtor entities. *See, e.g.*, Manard-Sanford v. Mabey (*In re* A.H. Robins, Inc.), 880 F.2d 694, 704 (4th Cir. 1989) (permitting, in large tort case, bankruptcy court to enjoin creditors from proceeding against certain

Moreover, although in a chapter 7 case only the postpetition wages of an individual debtor are excluded from the property of the estate and thus are beyond the reaches of creditors, in chapter 11, 12, and 13 "reorganization-type" cases, postpetition earnings are expressly or impliedly subject to the reaches of creditors whether or not the debtor is an individual.[401] The fresh start of all debtors, even those debtors who are not individuals, is a consistent and important policy goal in the Bankruptcy Code.[402]

In addition, by narrowly describing the fresh start policy as limited to individuals,[403] Jackson ignores another important "independent social policy" purpose of the reorganization chapters of the Bankruptcy Code. More than the simple maximization of distributions to creditors and the resolution of common pool problems, Congress also intended to encourage the rehabilitation of debtors. In the case of individual debtors, Congress furthered this rehabilitative goal by permitting debtors to bring a chapter 12 or 13 case to adjust the debts of individuals with regular income or of family farmers with regular annual income.[404] In the case of all debtors, Congress sought to encourage their rehabilitation through the filing of chapter 11 reorganization cases.[405]

Both on theoretical grounds and in light of statistics that show the infrequency of successful chapter 11 reorganizations, Baird, Jackson, and other commentators have expressly questioned the wisdom of the goal of rehabilitation.[406] As a result, these commentators

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nondebtor entities); MacArthur Co. v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 837 F.2d 89, 93-94 (2d Cir. 1988) (holding that bankruptcy court did not exceed its authority when, in approving settlement of debtor's claims against insurers, it enjoined further suits against insurers).

401. *See* Toibb v. Radloff, 111 S. Ct. 2197, 2199 (1991) (holding that protection of postpetition earnings in context of chapter 11 reorganization applies to both nonbusiness debtors and business debtors).

402. *See* S. REP. No. 989, *supra* note 105, at 98, *reprinted in* 1978 U.S.C.C.A.N. at 5884; H.R. REP. No. 595, *supra* note 105, at 384, *reprinted in* 1978 U.S.C.C.A.N. at 6340 (delineating availability of fresh start provisions to debtors who qualify).

403. *See* JACKSON, LOGIC AND LIMITS, *supra* note 5, at 225 (contending that right of discharge and fresh start is limited to individual debtors).

404. *See supra* note 74 and accompanying text (delineating differences between chapter 12 and 13 filing provisions).

405. S. REP. No. 989, *supra* note 105, at 9-10, *reprinted in* 1978 U.S.C.C.A.N. at 5787, 5795-96 (describing chapter 11 as providing for rehabilitation of debtors by adjustment of debt and equity in plan of reorganization). Although there previously existed a division among the circuits as to whether chapter 11 was intended by Congress to be limited to business debtors, the Supreme Court resolved this split in the circuits in 1991 when it held in Toibb v. Radloff, 111 S. Ct. 2197, 2199 (1991), that an individual with no business was eligible to commence a chapter 11 reorganization case.

406. *See* Bowers, *Bankruptcy Theory*, *supra* note 23, at 2098 n.2 (concluding that creditors in both chapter 7 and chapter 11 filings do not recover much from bankrupt debtors); Bowers, *Loss Distribution*, *supra* note 23, at 29 n.6 (stating that in more than 90% of all bankruptcies, creditors receive nothing); *supra* note 23 and accompanying text (noting that commentators

propose to repeal or substantially limit chapter 11.[407] The debate on the efficiency of encouraging debtors to rehabilitate their businesses by filing a chapter 11 petition will continue. The point here is simply that the analogy comparing bankruptcy to a common pool problem adds little to the rehabilitation debate. Jackson candidly admits that common pool analysis provides no assistance in normatively assessing the social policy of promoting fresh starts to individual debtors by providing them with discharges in bankruptcy.[408] He should candidly admit the same with regard to the normative debate surrounding the social policy of promoting a business debtor's rehabilitation.

CONCLUSION

All models are flawed. In trying to capture merely the essence of a problem rather than the problem's complexity, models suffer from incompleteness. But depending on the assumptions made in simplifying a complex reality, a model need not be inaccurate. A good model can stand a relaxation of its premises. A good model may be successful if after stripping away the innumerable details involved in any real-life situation, a basic truth appears that was previously obscured by the complexity. Model building is difficult because it is difficult to strip away enough of the right details to disclose this basic truth, but not so many of the details that the conclusion of the model is only basic but not true. And the best way to determine whether a model is successful or not is to relax its assumptions and critically assess the results in comparison to the results that follow from other less stylized sorts of analyses.

Baird and Jackson's comparison of a financially troubled debtor to a common pool problem is a strong model when it is used to assess the proper standard for commencement of an involuntary bankruptcy case. This Article refines that model and, after relaxing some of its assumptions, concludes that the analogy is sound and useful as applied to this limited context. As applied to the standard for commencement of a voluntary bankruptcy case, however, the model strips away too much and as a result leads Jackson to assert that the model supports a requirement that only insolvent business debtors

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such as Baird, Jackson, Bradley, and Rosenzweig have contested notion that bankruptcy theory justifies reorganization provisions).

407. *See, e.g.*, BAIRD & JACKSON, CASES, PROBLEMS AND MATERIALS, *supra* note 6, at 952 (stating that "premises that underlie chapter 11 are controversial, and in many cases chapter 11 may do more harm than good"); JACKSON, LOGIC AND LIMITS, *supra* note 5, at 209-24 (questioning usefulness of corporate reorganization process); *see also supra* note 23 (discussing these and other commentators' proposals for repeal of chapter 11 reorganization provisions).

408. JACKSON, LOGIC AND LIMITS, *supra* note 5, at 225.

enjoy access to voluntary bankruptcy relief. Jackson and others may or may not have the better argument in the dialogue over the futility of encouraging debtors to rehabilitate businesses in the context of a chapter 11 reorganization case, but the analogy of an insolvent debtor to a common pool of fish is itself irrelevant to this debate.