AMERICAN BANKRUPTCY INSTITUTE

New York City
Bankruptcy Conference

Is There a Bankruptcy Common Law?

Glenn E. Siegel, Moderator
Morgan, Lewis & Bockius LLP

Gianfranco Finizio
Kilpatrick Townsend & Stockton LLP

Hon. Craig T. Goldblatt
U.S. Bankruptcy Court (D. Del.)

Evan C. Hollander
Orrick Herrington & Sutcliffe LLP

Lucy F. Kweskin
Mayer Brown

Barbra R. Parlin
Holland & Knight LLP

Rachael L. Ringer
Kramer Levin Naftalis & Frankel LLP

Edward H. Tillinghast, III
Sheppard Mullin

CONCURRENT SESSION

2023


AMERICAN BANKRUPTCY INSTITUTE
NEW YORK CITY BANKRUPTCY CONFERENCE
New York Hilton
New York
MAY | 24 | 2023


AMERICAN BANKRUPTCY INSTITUTE
NEW YORK CITY BANKRUPTCY CONFERENCE
Is There a Bankruptcy Common Law or Is There No Necessity?
Glenn E. Siegel, Moderator
Morgan, Lewis & Bockius LLP
Hon. Craig T. Goldblatt
U.S. Bankruptcy Court (D. Del.)
Gianfranco Finizio
Kilpatrick Townsend & Stockton LLP
Evan C. Hollander
Orrick Herrington & Sutcliffe LLP
Lucy F. Kweskin
Mayer Brown
Rachael L. Ringer
Kramer Levin Naftalis & Frankel LLP
Barbra R. Parlin
Holland & Knight LLP
Edward H. Tillinghast, III
Sheppard Mullin

Is This a Code or Not?

- Should A Code Be Allowed To Develop Common Law?
- Is Applicable Law the Default Position?
- What About Section 105?
- What's the Rule of Necessity?
- Isn't this Just an In Rem Proceeding and Everything is About Determining Property of the Estate and Equality of Distribution?

When is Bankruptcy Common Law Appropriate?

- What Relief Is Being Requested?
- Is there a Specific Statutory Basis for the Relief?
- Is the Relief Necessary to Advance the Goals of Bankruptcy?
  - Does it maximize the value of the Estate?
  - Does it help save the business?
  - Does it promote equality of distribution to creditors by priority?

AMERICAN BANKRUPTCY INSTITUTE

NEW YORK CITY BANKRUPTCY CONFERENCE

Is Bankruptcy Common Law Just What Existed Pre-Code or Does It Continue To Evolve?

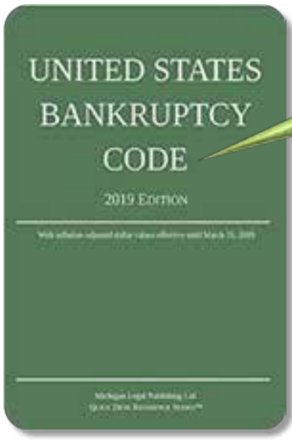
- First Day Orders
- DIP Milestones
- Restructuring Support Agreements
- Third Party Releases
- Substantive Consolidation
- Recharacterization
- Equitable Subordination
- Solvent Debtor Rule
- Rule 9019 Standards
- Who Can Bring Estate Causes of Action? Derivative Actions
- Role of the United States Trustee

AMERICAN BANKRUPTCY INSTITUTE

FIRST DAY ORDERS & THE "DOCTRINE OF NECESSITY"

First Day Motions & Orders

- ***Baseline***: Once a company files for bankruptcy, the debtor cannot pay prepetition claims outside of a chapter 11 plan.
- ***Exception***: To allow chapter 11 debtors to continue operating during the bankruptcy case and avoid major business disruptions, Bankruptcy Courts will often approve "first day" motions that authorize the payment of certain prepetition claims.



11 U.S. Code § 105 - Power of court

(a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

The "Doctrine of Necessity" or "Necessity of Payment Doctrine"

- Derived from longstanding Supreme Court precedent; "many circumstances may exist which may make it necessary and indispensable to the business of the road and the preservation of the property, for the receiver to pay pre-existing debts…" *Miltenberger v. Logansport*, 106 U.S. 286, 311 (1882)
- Bankruptcy Courts have applied the doctrine of necessity to certain "first day" relief relying on section 105(a) and 363(b) of the Bankruptcy Code

First Day Motions & Orders

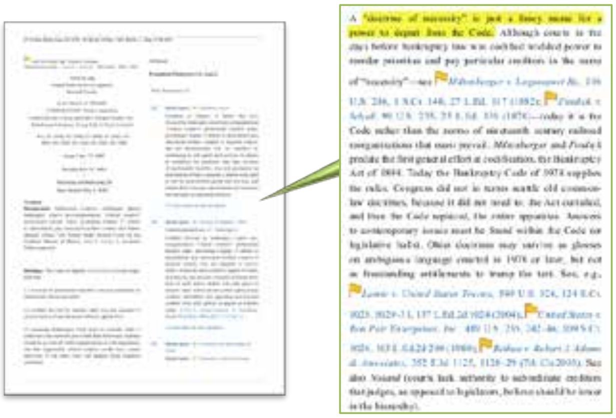
- While no specific authority is provided in the Bankruptcy Code, Courts have used section 105(a), section 363(b), and the "doctrine of necessity" to authorize the payment of certain types of prepetition claims at the outset of a case:
  - Critical Vendors
  - Foreign Vendors
  - Insurance Premiums
  - Customer Programs
  - Employee Wages
  - Lien Claimants
- ***Required Showing***: Most Courts will require that a debtor establish that payment of prepetition claims is **critical to the reorganization** or **essential to the continued operation of the debtor**
  - **E.g.,** *In re Quality Interiors, Inc.*, 127 B.R. 391, 396 (Bankr. N.D. Ohio 1991) ("The payment by a debtor-in-possession of pre-petition claims outside of a confirmed plan of reorganization is generally prohibited by the Bankruptcy Code," but "[a] general practice has developed . . . where bankruptcy courts permit the payment of certain prepetition claims, pursuant to 11 U.S.C. § 105, where the debtor will be unable to reorganize without such payment.")

AMERICAN BANKRUPTCY INSTITUTE

NEW YORK CITY BANKRUPTCY CONFERENCE

First Day Motions & Orders

- The ability to use the doctrine of necessity to facilitate payments of critical prepetition claims through first day relief has become routine practice in large bankruptcy cases in bankruptcy courts within the Second, Third, and Fifth Circuits as well as elsewhere.
  - *There have been recent disputes regarding the extent of the showing required for granting this relief even within these circuits* (e.g., Windstream)
- Not ***all*** courts agree, however, with the broad application of the doctrine of necessity – *see, e.g., In re Kmart Corp.*, 359 F.3d 866 (7th Cir. 2004)



AMERICAN BANKRUPTCY INSTITUTE

STANDING

Standing

- Constitutional Standing
  - Is a litigant authorized to invoke the jurisdiction of a federal court?
  - Must show: (1) a concrete and particularized injury in fact (2) that is "fairly traceable" to the defendant's conduct, and (3) that a favorable judicial decision would likely redress
  - Litigant also must satisfy statutory requirements (federal question or diversity) for a Federal Court to have jurisdiction to hear and determine a claim
- Bankruptcy Standing –
  - Not about the court's power to act, so not jurisdictional
  - Bankruptcy Code authorizes/permits certain parties, such as the UCC, US Trustee, DIP, Examiner, Creditors, Equity Holders, Lenders, other Parties in Interest, to appear and be seen and heard with respect to matters before the court –
    - Fairly liberal standard for appearances in Court
    - For appeals – must show Constitutional Standing
  - For litigation, standing depends on whether the claim relates to a direct injury or is derivative of harm to the debtor

Bankruptcy Standing – Litigation

- Outside of bankruptcy, litigation based on harm to another person/entity which in turn causes harm to the plaintiff (derivative standing) is permitted in certain circumstances
  - Common law causes of action arising out of harm to debtor that also harms third party plaintiff: e.g., wrongful death, loss of consortium, tortious interference, aiding and betting
  - Statutory causes of action specifically benefitting third party plaintiffs arising out of harm to/malfeasance by debtor: e.g., corporate derivative actions, fraudulent conveyance claims
- In Bankruptcy
  - Litigant must have statutory or other legal authority to assert a claim or raise and
  - Also asks if the litigant's claim seeks redress for direct harm done to the creditor by a defendant or is derivative of harm to the debtor
    - If claim is for direct injury, then the creditor may have standing to sue separately from estate
  - Trustee or DIP has exclusive authority to assert claims that belonged to the debtor as of the petition date, avoidance claims authorized by the Bankruptcy Code or state law, and other causes of action that could have been brought by any/all third-party creditors/shareholders outside of bankruptcy, e.g., derivative claims
  - Abandoned claims: creditor has constitutional standing to assert estate prepetition and avoidance claims that it otherwise had a right to assert pre-bankruptcy once they are abandoned by DIP/trustee, but claims are subject to preemption arguments (e.g., 546(e)) and any other defenses that otherwise may exist

Bankruptcy Standing, cont'd

- What happens if the Trustee/DIP cannot or will not assert claims?
  - Outside of bankruptcy, shareholders generally may assert claims belonging to a corporation if board refuses to do so or demand would be futile.
  - In case of insolvent corporation, creditors may assert derivative claims.
  - Traditionally, Bankruptcy Courts have held that they are authorized to appoint a party in interest (UCC, individual creditor, others) to litigate on behalf of estate when colorable claims exist but are not pursued by trustee/DIP; requires motion or stipulation ordered by the Court.
- Do/Should State Law Rules impact B. Court's Authority to grant derivative standing?
  - LLC and LP statutes state that derivative claims can only be asserted by a limited partner, member or assignee of a limited partner or member; Delaware Chancery Courts have held that this precludes derivative claims by creditors of an LP or LLC even in case of insolvency.
  - Delaware Bankruptcy Courts have held that if debtor is an LP or LLC, the Court is barred by the applicable statute from authorizing UCC or other creditors to bring claims derivatively -- unless parties in interest waive the standing defense.
  - Does Bankruptcy Court's equitable authority or fact that estate is separate entity provide alternative basis to appoint a representative to litigate derivatively even when Debtor is an LLP or LP?
  - Do LLC/LP standing rules prohibit creditors from being granted derivative authority to litigate claims pursuant to Section 544 (e.g., claims premised on state law) on behalf of the estate?
  - What about Bankruptcy Code avoidance claims (e.g., preference or 548 fraudulent transfer claims)?

US Trustee Issues

- Section 307 provides that "the US Trustee may raise and may appear and be heard on any issue in any case or proceeding under this title but may not file a plan pursuant to 1121(c) of this title."
- US Trustee appears in all cases, but in chapter 11 cases may take a less active role in cases where there is an Unsecured Creditors Committee
- Even where there is a UCC, US Trustee often raise certain objections:
  - Section 345(b) waivers
  - Professional retentions/fee applications
  - Scope of third-party release/exculpatory clauses
  - Voting process issues
  - Critical vendor programs/payment of foreign creditors
  - DIP provisions

AMERICAN
BANKRUPTCY
INSTITUTE

SUBSTANTIVE CONSOLIDATION

NEW YORK CITY
BANKRUPTCY
CONFERENCE

AMERICAN BANKRUPTCY INSTITUTE

What Are the "Substantive Consolidation" Factors under Common Law in Various Circuits?

- **2nd Circuit**:
  - A determination of substantive consolidation is appropriate where one of two "critical factors" exists:
    - (i) the creditors reasonably dealt with the debtors as a single economic unit and did not rely on their separate identity in extending credit; or
    - (ii) the affairs of the debtors are so entangled that consolidation will benefit all creditors.
    - *See, e.g., In re Augie/Restivo Baking Co., Ltd.*, 860 F.2d 515 (2d Cir. 1988); *In re Adelphia Comm. Corp.*, 361 B.R. 337 (S.D.N.Y. 2007).
- **3rd Circuit**:
  - What must be proven by a proponent of substantive consolidation (absent consent) concerning the entities for whom substantive consolidation is sought is that:
    - (i) prepetition, they disregarded separateness so significantly their creditors reasonably relied on the breakdown of entity borders and treated them as one legal entity, or
    - (ii) post-petition their assets and liabilities are so scrambled that separating them is prohibitive and hurts all creditors.

    See, e.g., In re Owens Corning, 419 F.3d 195 (3d Cir. 2005).

AMERICAN BANKRUPTCY INSTITUTE NEW YORK CITY BANKRUPTCY CONFERENCE

What Are the "Substantive Consolidation" Factors under Common Law in Various Circuits?

- **5th Circuit**:
  - Although courts in the Fifth Circuit have not developed a universally accepted standard for substantive consolidation, they frequently consider the following factors:
  - (i) the degree of difficulty in segregating and ascertaining individual assets and liabilities,
  - (ii) the presence or absence of consolidated financial statements,
  - (iii) the profitability of consolidation at a single physical location,
  - (iv) the commingling of assets and business functions,
  - (v) the unity of interests and ownership between the various corporate entities,
  - (vi) the existence of parent and intercorporate guarantees on loans,
  - (vii) the transfer of assets without formal observance of corporate formalities, and
  - (viii) whether other remedies, such as the doctrines of alter ego and fraudulent conveyance, are available.
  - *See, e.g., In re Stanford Inter'l Bank, Ltd.*, No. 3:09-CV-0721-N, 2012 WL 13093940, (N.D. Tex. Jul. 30, 2012); *In re Permian Producers Drilling, Inc.*, 263 B.R. 510 (W. D. Tex. 2000).
- **8th Circuit**:
  - Factors to consider when deciding whether substantive consolidation is appropriate include:
    - (i) the necessity of consolidation due to the interrelationship among the debtors;
    - (ii) whether the benefits of consolidation outweigh the harm to creditors; and
    - (iii) prejudice resulting from not consolidating the debtors.

    See, e.g., In re Giller, 962 F.2d 796 (8th Cir. 1992).

AMERICAN BANKRUPTCY INSTITUTE NEW YORK CITY BANKRUPTCY CONFERENCE

What Are the "Substantive Consolidation" Factors under Common Law in Various Circuits?

- **9th Circuit**:
  - The 9th Circuit's prerequisite to ordering substantive consolidation is that two factors must be satisfied. That assessment requires that either:
    - (i) the creditors dealt with the consolidated entities as if they were the same, or
    - (ii) the affairs of the consolidated entities are so entangled that it would not be feasible to identify and allocate all of their assets and liabilities.
    - *See, e.g., In re Bonham*, 229 F.3d 750 (9th Cir. 2000).
- **11th Circuit**:
  - The proponent of substantive consolidation must show that:
    - (i) there is substantial identity between the entities to be consolidated; and
    - (ii) consolidation is necessary to avoid some harm or to realize some benefit.

    See, e.g., Eastgroup Properties v. Southern Motel Ass'n, Ltd., 935 F.2d 245 (11th Cir. 1991).

AMERICAN BANKRUPTCY INSTITUTE

EXCULPATION AND THIRD-PARTY RELEASES

Exculpation and Third-Party Releases

- **Exculpation** – Qualified immunity from creditor claims for professionals engaged in the restructuring process.
- **Third-Party Releases** – Release of claims and causes of action against third-parties in respect of prepetition conduct of such third-parties.
  - Consensual
  - Non-consensual

20

NEW YORK CITY BANKRUPTCY CONFERENCE

Exculpation and Third-Party Releases

- **Applicable Code Provisions**
  - **Section 524(e)** – ". . . discharge of a debt of the debtor does not affect the liability of any other entity on, or the property of any other entity for, such debt."
  - **Section 1123(b)(6)** – ". . . A plan may – include any other appropriate provision not inconsistent with the applicable provisions of this title."
  - **Section 105(a)** – "The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. . . ."
    - Generally viewed to facilitate the implementation of another substantive provision of the Bankruptcy Code and not as an independent basis to grant relief not otherwise embodied in the Bankruptcy Code.

21

NEW YORK CITY BANKRUPTCY CONFERENCE

Exculpation and Third-Party Releases

Circuit	Exculp.?	Release?	Notes
First	?	?	
Second	Yes	?	• *In re Metromedia* (2d Cir. 2005): "truly unusual circumstances render the [non-consensual] release terms important to the success of the plan" • *Purdue Pharma.* (S.D.N.Y. 2021, McMahon, J.): statutory authority lacking
Third	Yes	Yes	*In re PWS* (2000): "fairness" and "necessity to the reorganization"
Fourth	Yes	Yes	*In re A.H. Robins* (1989): "essential to the reorganization"; section 105(a) confers equitable powers.
Fifth	No	No	*In re Highland Capital* (2022): section 524(e) is a statutory bar Exculpation available only to debtor, creditors' committee, committee members, and Chapter 11 trustee
Sixth	Yes	Yes	• *In re Dow Corning* (2002): seven-factor "unusual circumstances"; authorized by section 105(a) and 1123(b)(6) • *Digital Media Solutions* (2023): authorization under section 105(a) alone?

22

AMERICAN BANKRUPTCY INSTITUTE NEW YORK CITY BANKRUPTCY CONFERENCE

Exculpation and Third-Party Releases

Circuit	Exculp.?	Release?	Notes
Seventh	Yes	Yes	*In re Airadigm* (2008): "necessary for the reorganization and appropriately tailored"; authorized by residual authority—sections 105(a), 1123(b)(6). Section 524(e) is not a prohibition on third-party releases
Eighth	?	?	
Ninth	Yes	No	*Blixseth* (2020): "relating only to [the plan approval] process"; authorized by residual authority—sections 105(a), 1123(b)(6)
Tenth	No	No	*In re Western Real Estate* (1990): section 524(e) is a statutory bar
Eleventh	Yes	Yes	*In re Seaside Engineering* (2015): borrows Sixth Circuit's 7 factor test from *Dow Corning* *In re Munford (1996) third-party releases may be* authorized under section 105(a)
D.C.	?	?	

23

AMERICAN BANKRUPTCY INSTITUTE NEW YORK CITY BANKRUPTCY CONFERENCE

Exculpation and Third-Party Releases

- **Second Circuit**:
  - *In re Metromedia Fiber Network, Inc.,* 416 F.3d 136 (2d Cir. 2005)"[T]ruly unusual circumstances render the [non-consensual] release terms important to the success of the plan . . ." but complaining creditors need not receive compensation in exchange for non-consensual release.
    - citing *SEC v. Drexel Burnham Lambert Group, Inc. (In re Drexel Burnham Lambert Group, Inc.),* 960 F.2d 285,293 (2d Cir. 1992).
  - *In re Purdue Pharma, L.P.*, 635 B.R. 26 (S.D.N.Y. 2021) *Drexel "is probably no longer good law . . . ". Metromedia* required a finding of a statutory basis for any substantive right under a plan of reorganization.

NEW YORK CITY BANKRUPTCY CONFERENCE

Exculpation and Third-Party Releases

- **Sixth Circuit** - Seven factor test for non-consensual releases *In re Dow Corning Corp.*, 280 F.3d 648 (6th Cir. 2002):
  1. Identity of interest between the debtor and the non-debtor third-party releasee;
  2. Non-debtor third-party releasee has contributed substantial assets to the reorganization;
  3. The injunction is essential to the reorganization;
  4. Each class of releasor has overwhelmingly voted in favor of the plan;
  5. Substantial recovery for creditor classes impacted by the injunction;
  6. The plan provides non-consenting creditors with the opportunity to "opt out"; and
  7. Establishment of good factual record supporting findings

AMERICAN BANKRUPTCY INSTITUTE

SOLVENT DEBTOR EXCEPTION

Solvent-Debtor Exception

- **<u>Issue</u>**: The solvent-debtor exception refers to where a debtor in a bankruptcy case is solvent, creditors may be entitled to more than what they might otherwise receive under the Bankruptcy Code.
- **<u>Source of Authority</u>**: "three centuries of bankruptcy law"
- **<u>Context</u>**: Issue has arisen lately in determining in solvent-debtor cases whether to use the contractual rate or the federal judgment rate in calculating post-petition interest and whether to allow make-whole claims that would otherwise be disallowed under specific provisions of the Bankruptcy Code

27

Solvent-Debtor Exception

- In latest decision in *Ultra Petroleum*, Fifth Circuit held:
  - The noteholders' "make-whole" claims are the economic equivalent of unmatured interest and are disallowed under section 502(b)(2) of the Bankruptcy Code;
  - **<u>However, because Congress has not clearly abrogated the "solvent-debtor exception," it applies to this case (and overrides 502(b)(2)) and the make-whole claim is allowed;</u>**
  - Given Ultra's solvency, postpetition interest on the noteholders' "make-whole" claims should be calculated according to the contractual default rate.

28

Solvent-Debtor Exception

- *Ultra* rationale
  - "For some three centuries of bankruptcy law, courts have held that an equitable exception in the usual rules applies in the unusual case of a solvent debtor… The reason for this **traditional, judicially-crafted exception** is straightforward: Solvent debtors are, by definition, able to pay their debts in full on their contractual terms, and absent a legitimate bankruptcy reason to the contrary, they should."
  - "Ultra assumes, not unreasonably, that Congress means what it says and that, when Congress says one things but not another, it means to exclude what it did not say."
  - "Creditors, meanwhile, assume that Congress legislates against a historical backdrop, and that when courts historically have fashioned an exception to a clear statutory provision, Congress is presumed to accept that practice unless it expressly says otherwise. these equally sensible presumptions are at loggerheads.'

29

AMERICAN BANKRUPTCY INSTITUTE
NEW YORK CITY BANKRUPTCY CONFERENCE

Solvent-Debtor Exception

- *Ultra* Dissent
  - "In my view, the solvent-debtor exception didn't survive the adoption of the Bankruptcy Code."
  - "The Code provides that all claims for unmatured interest are disallowed. The solvent-debtor exception provides that not all claims for unmatured interest are disallowed. That's a stark contradiction."
  - "Neither the solvent-debtor exception's historical pedigree nor its policy underpinnings-no mater how compelling-can overcome Congress's clear, and clearer-than-ever, command on this point."

30

AMERICAN BANKRUPTCY INSTITUTE NEW YORK CITY BANKRUPTCY CONFERENCE

Solvent-Debtor Exception

- On February 13, 2023, Ultra filed a petition for a writ of certiorari seeking Supreme Court review to resolve an "exceptionally important" question of bankruptcy law and statutory interpretation:
  - **"Whether an unwritten 'solvent-debtor exception' overrides the Bankruptcy Code's statutory text and allows creditors in solvent-debtor cases to recover amounts that the Code disallows"**
- Ultra argues the Fifth Circuit's ruling deviates from bedrock principles of statutory construction by elevating "judicial gloss" on superseded statutes (i.e., the "solvent-debtor exception") over the clear text of the Bankruptcy Code (i.e., 11 U.S.C. § 502(b)(2)).

31

AMERICAN BANKRUPTCY INSTITUTE NEW YORK CITY BANKRUPTCY CONFERENCE

Solvent-Debtor Exception

- *PP&E* 9th Circuit 2022 Decision: Under the long-standing "solvent-debtor exception," unsecured creditors had "equitable right" to receive post petition interest at the contractual rate
  - "[T[he scenario occurred frequently enough for the common law to develop a special rule for such cases. That rule, in short, is that a solvent debtor must generally pay post petition interest accruing during bankruptcy at the contractual or state law rates before collecting surplus value from the bankruptcy estate."
  - "E]ighteenth century English courts developed the solvent-debtor exception, which required bankrupts to pay interest that accrued during bankruptcy before retaining value from an estate… American courts imported this doctrine and applied it under the Bankruptcy Act of 1898—the predecessor of the current Bankruptcy Code… The solvent-debtor exception was not codified, instead existing as a common-law exception to the Bankruptcy Act's prohibition on the collection of post petition interest as part of a creditor's claim…Courts interpreted the exception as flowing from the purpose of bankruptcy law to ensure an equitable distribution of assets."
  - "No Code provisions —alone or together—unambiguously displace the long-established solvent-debtor exception or preclude supposedly unimpaired creditors from asserting an equitable right to contractual post petition interest."

32

Solvent-Debtor Exception

- Hertz Del. Bankruptcy Court 2022 Decision: No solvent-debtor exception applied to permit allowance of make-whole amount or post-petition interest at anything other than federal judgment rate
  - "The Bankruptcy Code did codify the solvent-debtor exception, but only in three limited circumstances…"
  - "Congress could have stated at the time it repealed section 1124(3) that the solvent-debtor exception had survived the passage of the Bankruptcy Code… but it did not."
  - "There is no controlling decision form the Third Circuit… The issue is one which has resulted in two Circuit decisions, both of which have dissenting opinions."

33

AMERICAN BANKRUPTCY INSTITUTE

9019 SETTLEMENTS

Background

- Although it seems an almost universal practice in bankruptcy cases to seek court approval of a settlement or compromise, the modern Bankruptcy Code has no explicit provision requiring such approval (unlike the old Bankruptcy Act).*
- Instead, settlements are governed by the Federal Rules of Bankruptcy Procedure promulgated by the Supreme Court: specifically, Federal of Bankruptcy Procedure 9019 ("Rule 9019").
- With no part of the Code specifically governing bankruptcy settlements, courts have been left to fashion their own body of law in this area, often drawing heavily on a *procedural* rule (Rule 9019) to drive a substantive result.

** Bankruptcy Act § 27 states, "The trustee may, with the approval of the court, compromise any controversy arising in the administration of the estate upon such terms as he may deem for the best interests of the estate."*

Federal Rule of Bankruptcy Procedure 9019

- (a) **Compromise**. On motion by the trustee and after notice and a hearing, the court may approve a compromise or settlement. Notice shall be given to creditors, the United States trustee, the debtor, and indenture trustees as provided in Rule 2002 and to any other entity as the court may direct.
- (b) **Authority to Compromise or Settle Controversies within Classes**. After a hearing on such notice as the court may direct, the court may fix a class or classes of controversies and authorize the trustee to compromise or settle controversies within such class or classes without further hearing or notice.
- (c) **Arbitration**. On stipulation of the parties to any controversy affecting the estate the court may authorize the matter to be submitted to final and binding arbitration.

Mandatory v. Permissive Approval

- Nothing in the Code or in Rule 9019 explicitly *requires* parties to seek court approval of their settlements and compromises.

- Whether court approval of settlements is mandatory or permissive is left to the courts to decide. Most (but not all!) courts hold that court approval is mandatory.

Mandatory v. Permissive Approval

- Majority Rule: Rule 9019 makes court approval of settlements mandatory.
  - Bankruptcy settlements affect the rights of all creditors and therefore must be approved by the court. *Reynolds v. Comm'r*, 861 F.2d 469, 473 (6th Cir. 1988).

- Minority Rule: A settlement may be binding despite lack of compliance with Rule 9019.
  - "Nothing within Rule 9019(a) actually prohibits a trustee from settling a claim for or against the estate outside the purview of the bankruptcy court." *In re Dalen*, 259 B.R. 586, 595 (Bankr. W.D. Mich. 2001).
  - "[U]nless the Bankruptcy Code requires court approval for the underlying action that the trustee seeks to accomplish, there should be no need for court approval of a settlement that effectuates that action." *In re Telesphere Commc'ns, Inc.*, 179 B.R. 544, 552 (Bankr. N.D. Ill. 1994).

Mandatory v. Permissive Approval: Circuit Overview

Mandatory:

Permissive:

Circuit	Mandatory/ Permissive	Case Cite
2nd		*Sears, Roebuck & Co. v. Spivey*, 265 B.R. 357 (E.D.N.Y. 2001)
3rd		*In re Martin*, 91 F.3d 389 (3d Cir. 1996)
6th		*Reynolds v. C.I.R*, 861 F.2d 469 (6th Cir. 1988)
		In re Dalen, 259 B.R. 586 (Bankr. W.D. Mich. 2001)
7th		*Levey v. Sys. Div., Inc. (In re Teknek, LLC)*, 563 F.3d 639 (7th Cir. 2009)
		In re Telesphere Commc'ns, Inc., 179 B.R. 544 (N.D. Ill. 1994)
8th		*American Prairie Construction Co. v. Hoich*, 594 F.3d 1015 (8th Cir. 2010)
10th		*In re Blehm Land Cattle Co.*, 859 F.2d 137 (10th Cir. 1988)
11th		*Matter of Cotton*, 127 B.R. 287 (Bankr. M.D. Ga. 1991), *aff'd sub nom. In re Cotton*, 136 B.R. 888 (M.D. Ga. 1992), *rev'd on other grounds*, 992 F.2d 311 (11th Cir. 1993)*

Approval Standards: Lowest Point in the Range of Reasonableness

- The majority of courts assess a proposed settlement to "see whether the settlement fall[s] below the lowest point in the range of reasonableness." *Cosoff v. Rodman (In re W.T. Grant Co.)*, 699 F.2d 599, 608 (2d Cir. 1983).
- [T]he court does not have to be convinced that the settlement is the best possible compromise, but only that the settlement falls within a reasonable range of litigation possibilities." *In re Wash. Mut., Inc.*, 442 B.R. 314, 328 (Bankr. D. Del. 2011)
- The Court should "canvass the issues and see whether the settlement falls below the lowest point in the range of reasonableness." In re World Health Alternatives, Inc., 344 B.R. 291, 296 (Bankr. D. Del. 2006)
- There is no need for "a mini-trial on the merits of the claims sought to be compromised." *Port O'Call Inv. Co. v. Blair* (*In re Blair*), 538 F.2d 849, 851 (9th Cir. 1976).
- Although tests to determine whether a settlement falls within the lowest point in the range of reasonableness (the "LPR") differ slightly throughout jurisdictions, there are two constants. To satisfy the LPR test, settlements must be:
  - In the best interest of the estate
  - Fair and equitable

Approval Standards: Circuit Overview

Courts in every circuit have adopted the LPR test.

Adopted: ■

Circuit	Adopted LPR Test	Case Cite
1st	■	*In re American Cartage, Inc.*, 656 F.3d 82 (1st Cir. 2011)
2nd	■	*In re W.T. Grant Co.*, 699 F.2d 599 (2d Cir. 1983)
3rd	■	*In re Capmark Financial Group, Inc.*, 438 B.R. 471 (Bankr. D. Del. 2010)
4th	■	*U.S. ex rel. Rahman v. Oncology Assoc's, P.C.*, 269 B.R. 139 (D. Md. 2001)
5th	■	*In re Idearc Inc.*, 423 B.R. 138 (Bankr. N.D. Tex. 2009)
6th	■	*In re Pugsley*, 569 B.R. 704 (Bankr. N.D. Ohio 2017)
7th	■	*In re Energy Cooperative, Inc.*, 886 F.2d 921 (7th Cir. 1989)
8th	■	*Ritchie Capital Mgmt., LLC v. Kelley*, 785 F.3d 273 (8th Cir. 2015)
9th	■	*Mooney v. C.I.R.*, 111 F.3d 138 (9th Cir. 1997)
10th	■	Kearney v. Unsecured Creditors Comm., 987 F.3d 1284 (10th Cir. 2021)
11th	■	*In re Martin*, 490 F.3d 1272 (11th Cir. 2007)

5th Circ. Ruling Highlights Split On Ch. 11 Exculpation

By **Evan Hollander, Daniel Rubens and David Litterine-Kaufman** (August 31, 2022)

Published by Law360 on August 31, 2022

Evan Hollander

Daniel Rubens

David Litterine-Kaufman

In the latest development in the extensive litigation arising from the bankruptcy of Highland Capital Management LP, the U.S. Court of Appeals for the Fifth Circuit recently imposed strict limitations on bankruptcy courts' statutory authority to exculpate third parties from claims relating to their roles in the bankruptcy proceedings.[1]

The court's precedential opinion, authored by U.S. Circuit Judge Stuart Kyle Duncan, expressly notes a split of authority among the federal courts of appeals as to the meaning of Title 11 of the U.S. Code, Section 524(e), leaving an uncertain landscape for parties that wish to include exculpatory provisions or nonconsensual releases in Chapter 11 plans.

Background

The Highland Capital restructuring has been particularly litigious, and one co-founder's, James Dondero, litigation conduct led the U.S. Bankruptcy Court for the Northern District of Texas to conclude it was appropriate to exculpate a broad range of actors from suits arising from their involvement in the bankruptcy. Exculpation provisions are common features of Chapter 11 plans.

They generally protect exculpated parties from legal claims related to their involvement in the bankruptcy proceedings, except to the extent those claims allege bad faith, fraud, gross negligence, or similar misconduct.[2]

The plan confirmed by the bankruptcy court in Highland Capital included an exculpation provision that applied to nearly all bankruptcy participants, including the debtor, its officers and employees, a general partner of the debtor, the creditors' committee and its members, the successor entities under the plan, an oversight board comprised of four creditors and a restructuring advisor, and a catchall class of all parties related to any of the enumerated exculpated parties.[3]

The provision also covered three independent directors whom the creditors' committee had selected and, with the bankruptcy court's approval, authorized to exercise the powers of a bankruptcy trustee on behalf of the debtor.[4]

The confirmed plan also included a so-called gatekeeping provision, requiring that bankruptcy participants bring all claims against the exculpated parties first to the bankruptcy court to determine whether they are colorable and can proceed.[5]

Several creditors, including Dondero, objected to the plan's exculpatory and gatekeeping provisions. The bankruptcy court overruled those objections and confirmed the plan.

The objectors then obtained permission to appeal directly to the Fifth Circuit to challenge these provisions and other aspects of the confirmed plan.

The Fifth Circuit's Decision

After concluding that the appeal was not equitably moot, the Fifth Circuit affirmed in part and reversed in part the bankruptcy court's order confirming the plan, holding that the bankruptcy court lacked the authority to exculpate several of the nondebtor parties covered by the plan's exculpation provision.

In so concluding, the Fifth Circuit looked to Section 524, which governs the effect of discharge. Subsection (e) states that, except as otherwise provided, "discharge of a debt … does not affect the liability of any other entity on, or the property of any other entity for, such debt."

Relying on existing circuit precedent interpreting Section 524(e), the Fifth Circuit concluded that this provision "categorically bars third-party exculpations absent express authority in another provision of the Bankruptcy Code."[6]

The Fifth Circuit concluded that in light of Section 524(e)'s bar and the lack of support elsewhere in the code, the exculpation provision was unlawful as it applied to certain of the nondebtor parties covered by the plan provision.

Surveying the rest of the code, the Fifth Circuit found no alternative statutory basis for providing exculpation under a plan to parties other than the debtor, the creditors' committee and its members, and the Chapter 11 trustee.

While the debtor had suggested that such alternative basis could be found in Title 11 of the U.S. Code, Section 105[7] and 1123(b)(6),[8] the Fifth Circuit concluded that neither provision provided a statutory basis for extending nondebtor exculpation.[9]

Based on a review of circuit precedent, the Fifth Circuit recognized only three potential sources of statutory authority:

1. "A limited qualified immunity to creditors' committee members for actions within the scope of their statutory duties";

2. "A limited qualified immunity to bankruptcy trustees unless they act with gross negligence"; and

3. The authority under Section 524(g) to channel asbestos-related claims, not relevant to the Highland Capital plan.[10]

Applying those principles, the Fifth Circuit concluded that the exculpatory provision could extend only to Highland Capital, as debtor, the creditors' committee and its members, and the independent directors for conduct in the scope of their duties.

The Fifth Circuit concluded that exculpation was permissible for the independent directors only because earlier orders in the bankruptcy proceedings had given those directors the power to act as the debtor's quasi-trustee, but the court took pains to limit its holding to that "unique governance structure," disclaiming any broader authority to exculpate nondebtors.[11]

Discussion

The Fifth Circuit's decision highlights a split of authority on bankruptcy courts' powers to exculpate nondebtors and raises questions about other protections like gatekeeping that may apply to such parties.

These concerns may well reach beyond exculpation provisions and extend to nonconsensual third-party releases,[12] like those approved by the bankruptcy court in the In re: Purdue Pharma LP bankruptcy case now on appeal to the U.S. Court of Appeals for the Second Circuit.[13]

The circuit courts are divided on the meaning of Section 524(e).

The Fifth Circuit acknowledged that its decision in Highland Capital — along with its earlier decision in In re: Pacific Lumber Co. — represents a contested view of the bankruptcy court's powers: "The simple fact of the matter is that there is a circuit split concerning the effect and reach of [Section] 524(e)."[14]

Cataloging the cases, the Fifth Circuit explained that the Second, Third, Fourth, Sixth, Seventh, Ninth and Eleventh Circuits "allow varying degrees of limited third-party exculpations."[15]

Only the U.S. Court of Appeals for the Tenth Circuit agrees with the Fifth that Section 524(e) is a categorical bar to such exculpation.[16]

Other circuits considering this issue have read the text of Section 524(e) to be more permissive of nondebtor exculpation. As the Ninth Circuit has explained, because Section 524(e) speaks only about "affect[ing] the liability ... on ... such debt," it could be read not to reach the claims covered by exculpation provisions, which represent liability for conduct in the bankruptcy process, rather than liability for the underlying debt.[17]

Moreover, Section 524(e) could be read as a floor rather than a ceiling, i.e., as providing that a plan does not automatically affect third-party liability, without constraining the bankruptcy court's power to eliminate third-party liability when it deems a third-party release appropriate.[18]

That would be consistent with other courts' conclusions that Section 524(e) should not "be literally applied in every case as a prohibition" on "the equitable power of the bankruptcy court."[19] But as U.S. District Judge Colleen McMahon detailed in the ongoing Purdue Pharma litigation, the legislative history of Section 524 may cut both ways.[20]

Notably, the Fifth Circuit rejected Title 11 of the U.S. Code, Section 1123(b)(6) as a residual source of authority to exculpate third parties. That provision authorizes bankruptcy plans to include "any other appropriate provision not inconsistent with the applicable provisions" of the code.

Other courts have concluded that an exculpation provision may be an appropriate provision to include in a plan pursuant to these powers, at least where unusual circumstances warrant.[21] But the Fifth Circuit did not address those holdings.

Instead, it disposed of Section 1123(b)(6) in a single sentence, concluding that it does not provide the independent statutory authorization that the court viewed as required by Section 524(e).[22]

The Fifth Circuit's approval of gatekeeping provisions and existing powers to combat vexatious litigation may provide a limited workaround to the prohibition

on third-party exculpation.

Although the Fifth Circuit significantly curtailed the bankruptcy court's ability to approve exculpation provisions protecting nondebtor participants in a bankruptcy case, the court nonetheless approved the bankruptcy plan's gatekeeping provisions as lawful under governing U.S. Supreme Court precedent.[23]

The gatekeeping provisions approved in Highland Capital require that parties asserting claims against the exculpated parties first establish to the satisfaction of the bankruptcy court that such claims are colorable before asserting them in another forum.

While the gatekeeping provisions of the Highland Capital plan apply by their terms only to the exculpated parties, the Fifth Circuit expressly noted that nothing in the opinion should be construed to hinder the distinct power of a bankruptcy court to enjoin or impose sanctions against vexatious litigants.[24]

Moreover, the opinion does not address the availability of a gatekeeping provision with broader application to protect parties not entitled to exculpation from the threat of vexatious litigation, although such a provision could not restrict plaintiffs to asserting only claims for bad faith, fraud, gross negligence or similar misconduct against nonexculpated parties.

The appellants in Highland Capital warned that the gatekeeping provision would extend to claims over which the bankruptcy court lacks subject-matter jurisdiction.[25]

While acknowledging this might be the case, the Fifth Circuit noted that precedent required that it leave this question to the bankruptcy court to consider in the first instance.[26]

This lingering jurisdictional question may reduce confidence in the protections afforded by gatekeeping until the issue is further developed in the courts.

Conclusion

The immediate impact of the Fifth Circuit's opinion is uncertainty about post-petition legal exposure for officers and directors of Chapter 11 debtors — and insurers providing insurance coverage for such parties — who might otherwise expect such parties to be protected by a plan's exculpation and general release provisions.

By excluding a debtor's officers and directors from the protection of exculpation provisions, the Fifth Circuit's approach may increase the costs of insurance coverage and deter important stakeholders from participating in the reorganization process.

The unavailability of exculpation to protect officers and directors may also add a level of complexity and reduce creditor recoveries in particularly litigious cases by encouraging parties who can no longer obtain exculpation to seek reserves for potential administrative claims for indemnification that would otherwise be discharged in accordance with Section 1141(d)(1)(A).[27]

The opinion may also encourage the use of other tools, like gatekeeping, to provide some level of protection short of exculpation, although the uncertainty surrounding the scope of the protections provided by gatekeeping make them, at most, only a partial substitute for exculpation.

Given the division in authority surrounding these issues and potential consequences of the Fifth Circuit's approach, the Highland Capital decision is unlikely to be the last word on the permissible scope of exculpation and gatekeeping under Chapter 11 plans.

Evan C. Hollander, Daniel Rubens and David Litterine-Kaufman are partners at Orrick Herrington & Sutcliffe LLP.

Orrick senior associate James Flynn contributed to this article.

[1] In re Highland Cap. Mgmt., L.P., No. 21-10449 (5th Cir. Aug. 19, 2022) ("Op.").

[2] Op. 7.

[3] Id.

[4] Id. at 4, 7, 26.

[5] Id. at 7-8.

[6] Op. 24 (citing In re Pac. Lumber, 584 F.3d 229, 252-53 (5th Cir. 2009)).

[7] 11 U.S.C. § 105(a) enables the bankruptcy court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."

[8] 11 U.S.C. § 1123(b)(6) allows a plan to "include any other appropriate provision not inconsistent with the applicable provisions of this title."

[9] Op. 25 (citing In re Oxford Mgmt., Inc., 4 F.3d 1329, 1334 (5th Cir. 1993); In re Zale Corp., 62 F.3d 746, 760 (5th Cir. 1995)).

[10] Id.

[11] Id. at 4, 26.

[12] See id. at 15 (analogizing between the two).

[13] See In re Purdue Pharma, L.P., 635 B.R. 26, 104 (S.D.N.Y. 2021), appeal pending, No. 22-110 (2d Cir. argued Apr. 29, 2022).

[14] Op. 23.

[15] Id. at 24.

[16] Id. at 23-24.

[17] Blixseth v. Credit Suisse, 961 F.3d 1074, 1082-83 (9th Cir. 2020), cert. denied, 141 S.

Ct. 1394 (2021).

[18] In re Airadigm Commc'ns, Inc., 519 F.3d 640, 656 (7th Cir. 2008); In re Dow Corning Corp., 280 F.3d 648, 657 (6th Cir. 2002) ("However, this [§ 524(e)] language explains the effect of a debtor's discharge. It does not prohibit the release of a non-debtor.").

[19] In re A.H. Robins Co., 880 F.2d 694, 702 (4th Cir. 1989).

[20] See Purdue, 635 B.R. at 92-94, 107-11 (suggesting that the enactment of § 524(g), concerning asbestos claims, weighs against non-consensual releases of non-debtors for other kinds of claims).

[21] Airadigm, 519 F.3d at 657; Dow, 280 F.3d at 658.

[22] Op. 25.

[23] Id. at 28-29 (citing Barton v. Barbour, 104 U.S. 126 (1881)).

[24] Id. at 30 n.19.

[25] Id. at 29 (citing In re Craig's Stores of Tex., Inc., 266 F. 3d 388, 390 (5th Cir. 2001) (explaining that the bankruptcy court's post-confirmation jurisdiction is limited to "matters pertaining to the implementation or execution of the plan")).

[26] Id.

[27] Courts have held that indemnification claims of officers and director arising exclusively from their post-petition conduct are entitled to administrative expense priority. In re Keene Corp., 208 B.R. 112, 116 (Bankr. S.D.N.Y. 1997); In re Heck's Props., Inc., 151 B.R. 739, 768 (S.D. W. Va. 1992). 11 U.S.C. § 1141(d)(1)(A) provides that confirmation of a plan discharges a debtor from any debt that arose prior to confirmation. Thus, absent the establishment of a reserve to satisfy potential administrative claims for officer and director indemnification, such claims would be discharged upon confirmation of a plan.

39-SEP Am. Bankr. Inst. J. 20

American Bankruptcy Institute Journal
September, 2020

First Glance

Feature

Mitchell P. Reich [a1]
Hogan Lovells US LLP
Washington, D.C.

*20 A SWAN SONG FOR FEDERAL COMMON LAWMAKING IN BANKRUPTCY COURTS

Bankruptcy disputes are often governed by two distinct sources of legal authority. The Bankruptcy Code is, of course, a federal statute, interpreted by federal courts and enacted pursuant to Congress's power to "establish ... uniform Laws on the subject of Bankruptcies." [1] By contrast, property rights in bankruptcy are generally determined by state law. Whether a debtor has established a valid trust, whether a creditor has an enforceable contractual lien, whether party A is a lessor of party B, these questions (and much more of the daily fare of bankruptcy courts) are usually answered by consulting the law of a particular state, not by recourse to a "uniform" federal rule.

Sometimes, determining whether state or federal law should govern a particular question is more difficult than it appears. This past term, in *Rodriguez v. Federal Deposit Insurance Corp.*, [2] the U.S. Supreme Court made an important statement on the line between federal and state law in bankruptcy cases. The Court unanimously invalidated the "*Bob Richards* rule," a federal common-law rule that bankruptcy judges have used for decades to determine ownership of consolidated tax refunds. The Court described the *Bob Richards* rule as a "cautionary tale," the product of judges "too quickly" attempting to fashion a federal law rule where state law should have governed. [3]

Rodriguez attracted little notice in a term of blockbuster decisions, but it carries the potential to upset far more than just Bob Richards and his namesake. A number of bankruptcy-law doctrines rest on just as dubious a federal law basis as the *Bob Richards* rule. Indeed, two of that rule's close cousins (the so-called "*IndyMac* factors" and the "*Prudential Lines* rule") are all but certain to fall in its wake. More than a few other bankruptcy doctrines might also be destined for the chopping block. Once courts begin to ask, with the skeptical eye that *Rodriguez* instructs, "Should federal law control here?," the cautionary tale that the Supreme Court described might be closer to its beginning than its end.

The Beginning of *Bob Richards*

The story of *Rodriguez* begins in another jurisprudential era. In 1966, a California car dealership, Western Dealer Management Inc., and its subsidiary, Bob Richards Chrysler-Plymouth Corp., filed a consolidated tax return, which permits a parent corporation and its subsidiaries to compute their taxes largely as if they were divisions of a single corporation. [4] The Internal Revenue Service (IRS) issued the companies a consolidated tax refund for roughly $10,000, attributable almost exclusively to the losses of the subsidiary. The parent corporation and the estate of its subsidiary, which had since filed for bankruptcy, both claimed that they were rightful owners of the refund. [5]

The dispute reached the Ninth Circuit in the case of *In re Bob Richards Chrysler-Plymouth Corp.* The panel began by explaining that it saw "nothing" in the pertinent federal statutes or regulations that addressed ownership of consolidated tax refunds. [6] The panel then proceeded to announce its own rule. The Ninth Circuit felt that "a tax refund resulting solely from offsetting the losses of one member of a consolidated filing group against the income of that same member in a prior or subsequent year should inure to the benefit of that member," unless the parties reach a "differing agreement." [7]

Although the Ninth Circuit identified no clear legal basis for this rule, it gradually caught on throughout the nation. A growing number of courts cited the "*Bob Richards* rule" as the rule governing any dispute over consolidated tax refunds. [8] As the rule became more popular, it became more potent, too. Courts began to assert that the *Bob Richards* rule governed not merely when an agreement was silent on the question of ownership, but also when an agreement "unambiguously" departed from the *Bob Richards* rule. [9]

*Bob Richard*s also had its critics. Some federal courts adopted a competing framework, dubbed by one court as the "*IndyMac* factors," under which courts used several criteria to determine whether the parties had agreed to make a parent corporation the owner of a tax refund or instead the agent of its subsidiary. [10] Other courts, such as the Sixth and Eleventh Circuits, held that state law governed all ***21** disputes over ownership of consolidated tax refunds, thus rejecting the *Bob Richards* rule as a "creature of federal common law." [11]

The End of *Bob Richards*

Bob Richards's reign started to unravel in the wake of the Great Recession. In 2010, a Colorado bank holding company, United Western Bancorp. Inc., and its subsidiary, United Western Bank, both fell on hard times. [12] The Office of Thrift Supervision closed the subsidiary and placed it under the receivership of the Federal Deposit Insurance Corp. (FDIC). The parent quickly went out of business and filed for chapter 11 (later converted to chapter 7). Before both companies collapsed, they filed a consolidated tax return with the IRS, which yielded them a $4.1 million tax refund. Both the parent's estate and the subsidiary's receiver eagerly claimed the refund as their own. [13]

The bankruptcy court initially held that the tax refund belonged to the parent's bankruptcy estate, relying on both the *IndyMac* factors and Colorado state law. [14] However, the Tenth Circuit ruled for the FDIC, holding that the *Bob Richards* rule constituted a rule of "federal common law." [15] Under that rule, it said, parties needed to "unambiguously address" how tax refunds are to be handled in order to "deviate from the general rule outlined in ... *Bob Richards*." [16] Applying that standard, the Tenth Circuit found that the tax refund belonged to the subsidiary, which was responsible for most if not all of the losses underlying the tax refund. [17]

The Supreme Court granted *certiorari* and vacated the Tenth Circuit's decision. Writing for the Court, Justice Neil Gorsuch stated that "[t]he cases in which federal courts may engage in common lawmaking are few and far between." [18] He added that this "is one of the cases that lie between," [19] noting that "Congress has generally left the determination of property rights in the assets of a bankrupt's estate to state law." [20]

Courts may make "exceptions" to this rule only where "necessary to protect ... uniquely federal interests." [21] However, courts had identified no such interest justifying the *Bob Richards* rule. "[S]tate law is well equipped to handle disputes involving corporate property rights" and is "replete with rules readymade" for resolving them. [22] Therefore, state law should govern disputes over tax refunds. [23]

The Supreme Court concluded with a warning: "We took this case only to underscore the care [that] federal courts should exercise before taking up an invitation to try their hand at common lawmaking." [24] In *Bob Richards*, the Ninth Circuit "made the mistake of moving too quickly past important threshold questions at the heart of our separation of powers." [25] The Court urged lower courts to heed this "cautionary tale." [26]

The Beginning of the End of *IndyMac* and *Prudential Lines*

Rodriguez was not heralded as a decision of great significance. One tax scholar wrote, the day after the decision was announced, that as "far as Supreme Court cases go, it's hard to get much narrower than this." [27] True enough, the impact of *Bob Richards*'s burial will be less than seismic for most. But the Court's decision has significance for more than the California car dealership whose namesake it interred and the Colorado bank whom it deprived (at least temporarily) of a tax refund.

***75** Like many doctrines that have endured for decades, the *Bob Richards* rule cast deep roots. During its 47-year lifespan, *Bob Richards* gave rise to several related doctrines that, like the rule itself, can only be understood as creatures of federal common law. Once courts are faced with questions about the validity of those doctrines, they are almost certain to meet the same fate as *Bob Richards* itself.

The first doctrine to fall is likely *Bob Richards*'s principal competitor in the lower courts: the *IndyMac* factors. Bankruptcy courts devised these factors as a methodology for determining whether a tax-allocation agreement makes a parent corporation the owner of a consolidated tax refund or the agent of its subsidiary. [28] However, no court has claimed that these factors are grounded in a federal statute or regulation, nor do those factors find any footing in state law. On the contrary, courts apply the *IndyMac* factors irrespective of which state's law governs, and those factors employ a considerably different method than most states to determine whether an agency relationship exists. [29]

Consequently, as the district court in *Rodriguez* observed, the only way to understand the *IndyMac* factors is as an exercise of "federal common law." [30] If there was no justification for *Bob Richards* to engage in federal common lawmaking to determine "the distribution of ... consolidated corporate tax refund[s]," then there is just as surely no valid basis for *IndyMac* to create federal common law for that same purpose. [31]

Next to go after *IndyMac* will, in all probability, be the *Prudential Lines* rule. This rule, named after a Second Circuit decision, is a close cousin of *Bob Richards*: It holds that a corporation filing a consolidated tax return has a right to offset its own income using any "net operating loss" attributable to its losses. [32] Although a mouthful to describe, this rule is used frequently by bankruptcy courts to allocate tax losses. [33] Given the frequency with which such losses are up for grabs at the time of bankruptcy, the *Prudential Lines* rule is arguably of greater economic significance than the *Bob Richards* rule itself.

Yet the only legal basis that *Prudential Lines* identified for its rule was-- *Bob Richards*. The Second Circuit cited that decision pervasively in its opinion. [34] It echoed the policy logic that the Ninth Circuit gave for the *Bob Richards* rule without identifying any positive legal basis for that intuition. [35] Similar to *Bob Richards* and *IndyMac*, *Prudential Lines* must stand or fall as a rule of federal common law, but it is difficult to conceive of what "uniquely federal interest" would justify federal common lawmaking to allocate net operating losses when such an interest was wholly absent when allocating tax refunds. [36]

The Next Doctrines to Fall

IndyMac and *Prudential Lines* are likely just the beginning. Bankruptcy courts have devised federal common law doctrines to address all manner of property-rights questions without engaging in the rigorous scrutiny that *Rodriguez* dictates. Some courts have crafted a federal common law rule ***76** governing ownership of "interline freight charges," [37] while others have created a federal common law for identifying "business trusts." [38] These doctrines--and many others like them--are unlikely to survive if placed under the harsh light of *Rodriguez*. Indeed, just one month after that decision, the Bankruptcy Appellate Panel of the Eighth Circuit rejected a presumption that several courts adopted for determining the interest rate payable to secured creditors, deeming it the sort of "judicial lawmaking" of which *Rodriguez* disapproved. [39]

Rodriguez will not spell a wholesale revision of how bankruptcy courts go about sorting federal law questions from ones of state law. But *Bob Richards* was far from the only decision that leapt to create federal law to allocate property rights in bankruptcy when state law was fully suited--and uniquely appropriate--for the task. If the Supreme Court's admonition in *Rodriguez* is taken seriously, a number of other bankruptcy doctrines will need to be retired from service along with the *Bob Richards* rule. Practitioners and bankruptcy judges alike should dust off their state law books to find, except in cases "few and far between," [40] the rules that govern property rights in bankruptcy.

Footnotes

a1 *Mitchell Reich is a senior associate with Hogan Lovells US LLP in Washington, D.C. Before joining the firm, he was an attorney at the Department of Justice Office of Legal Counsel and a law clerk for Associate Justice Elena Kagan and Chief Judge Merrick B. Garland of the D.C. Circuit.*

1 U.S. Const. art. I, § 8, cl. 4.

2 140 S. Ct. 713 (2020). The author represented the bankruptcy trustee who prevailed in the Court.

3 *Id.* at 718.

4 *In re Bob Richards Chrysler-Plymouth Corp.*, 473 F.2d 262, 263 (9th Cir. 1973); *see* 26 U.S.C. § 1501; 26 C.F.R. §§ 1:1502-0, *et seq.*

5 *Bob Richards*, 473 F.2d at 263.

6 *Id.* at 264 (citation omitted).

7 *Id.* at 265.

8 *See, e.g., Capital Bancshares Inc. v. FDIC*, 957 F.2d 203, 207-208 (5th Cir. 1992); *Barnes v. Harris*, 783 F.3d 1185, 1195 (10th Cir. 2015); *In re First Reg'l Bancorp*, 703 Fed. App'x 565 (9th Cir. 2017).

9 *Rodriguez*, 140 S. Ct. at 716-17.

10 *In re IndyMac Bancorp. Inc.*, No. 2:09-ap-01698, 2012 WL 1037481, at *13-17 (Bankr. C.D. Cal. March 29, 2012), *aff'd*, No. CV 12-02967, 2012 WL 1951474 (C.D. Cal. May 30, 2012), *aff'd*, 554 Fed. App'x 668 (9th Cir. 2014); *see also In re United W. Bancorp Inc.*, 574 B.R. 876, 886-90 (D. Colo. 2017) (discussing "*IndyMac* factors" and noting that "[m]any bankruptcy courts since *IndyMac* have adopted its analysis"), *aff'd*, 914 F.3d 1262 (10th Cir. 2019), *vacated*, 140 S. Ct. 713 (2020).

11 *FDIC v. AmFin Fin. Corp.*, 757 F.3d 530, 535-36 (6th Cir. 2014); *see also In re NetBank Inc.*, 729 F.3d 1344, 1347, n.3 (11th Cir. 2013).

12 *United Western Bancorp*, 914 F.3d at 1266.

13 *Id.* at 1266-67.

14 *In re United Western Bancorp Inc.*, 558 B.R. 409, 424-32 (Bankr. D. Colo. 2016).

15 *United Western Bancorp*, 914 F.3d at 1269 & n.3.

16 *Id.* at 1270.

17 *Id.* at 1274.

18 *Id.*

19 *Rodriguez*, 140 S. Ct. at 716.

20 *Id.* at 718 (citation omitted).

21 *Id.* at 717 (citations omitted).

22 *Id.* at 716, 718.

23 *Id.* at 718.

24 *Id.*

25 *Id.*

26 *Id.* at 718.

27 Daniel Hemel, "Opinion Analysis: In Tax Refund Case, Justices Decide a Narrow Question but Leave Much Unresolved," *SCOTUSblog* (Feb. 26, 2020), *available at* scotusblog.com/2020/02/opinion-analysis-in-tax-refund-case-justices-decide-a-narrow-question-but-leave-much-unresolved (last visited July 23, 2020).

28 *See IndyMac*, 2012 WL 1037481, at *13-17.

29 *Compare id.* (determining whether parent is agent by asking whether contract uses terms such as "reimbursement" or "payment" requires parent to "segregate or escrow any tax refunds," or gives parent "sole discretion to prepare and file consolidated tax returns"), *with Restatement (Third) of Agency* §§ 1.01-1.02 (Am. Law Inst. 2006) (explaining that "[a]n agency relationship arises *only* when" entity is "subject to the principal's control" and agrees to "act on the principal's behalf") (emphasis added).

30 *United W. Bancorp*, 574 B.R. at 890.

31 *Rodriguez*, 140 S. Ct. at 718. *continued on page 76*

32 *In re Prudential Lines Inc.*, 928 F.2d 565, 569-71 (2d Cir. 1991).

33 *See, e.g., In re Conex Holdings LLC*, 518 B.R. 792, 802, n.52 (Bankr. D. Del. 2014); *In re Cumberland Farms Inc.*, 162 B.R. 62, 67 (Bankr. D. Mass. 1993); *see generally* Michael J. Holleran, *et al.*, *Bankruptcy Code Manual* § 541:10 (May 2020 Update) (describing this rule as "settled").

34 *Prudential Lines*, 928 F.2d at 570-71.

35 *Id.* at 570 (quoting *Bob Richards*, 473 F.2d at 264).

36 *Rodriguez*, 140 S. Ct. at 717 (citation omitted).

37 *In re Bangor & Aroostook R.R.*, 320 B.R. 226, 234-40 (Bankr. D. Me. 2005) (discussing sharp split over rule's validity).

38 *In re Dille Family Tr.*, 598 B.R. 179, 191-94 (Bankr. W.D. Pa. 2019) (surveying cases).

39 *In re Family Pharmacy Inc.*, 614 B.R. 58, 66 (B.A.P. 8th Cir. 2020) (citing *Rodriguez*, 140 S. Ct. at 718).

40 *Rodriguez*, 140 S. Ct. at 716.

39-SEP AMBKRIJ 20

End of Document

80 Am. Bankr. L.J. 1

American Bankruptcy Law Journal
Winter, 2006

Article
Adam J. Levitin [a1]

*1 TOWARD A FEDERAL COMMON LAW OF BANKRUPTCY: JUDICIAL LAWMAKING IN A STATUTORY REGIME

A basic tenet of bankruptcy practice is that "the bankruptcy court is a court of equity." [1] Judges and litigants regularly cite the "court of equity" maxim to justify a particular conclusion or result that lacks specific statutory authorization. [2] Bankruptcy courts' equitable powers are routinely cited as the authority for common, if contested, non-Code Chapter 11 practices such as critical vendors motions (the pre-plan payment of pre-petition debts to certain suppliers of the debtor as a condition of further supply); [3] substantive consolidation of separate entities; [4] cross-collateralization (securing pre-petition ***2** debt with pre- and post-petition collateral as part of a post-petition financing arrangement); [5] and discharges or releases of debtors' officers, directors, owners, professionals, or of other third parties, such as affiliates or insurers. [6]

Bankruptcy, though, is a statutory system. Bankruptcy proceedings in the Anglo-American tradition have always existed only as a matter of statute. [7] The tension between the adjudicative processes implied in the "court of equity" maxim and the statutory provisions of the Bankruptcy Code exists at the heart of bankruptcy.

Equity and statute are fundamentally different legal systems. The very nature of complex statutory structures is to create clear, one-size-fits-all rules that lack the fact-intensive flexibility and individualized justice of equitable discretion. [8] It is hard to reconcile equity's discretion to do substantial justice through creative remedies *ex-post* with a statutory regime that prescribes *ex-ante* precise rights and remedies. This is the fundamental struggle in bankruptcy: how to reconcile the predictable rule of law with creative, flexible, practical, individualized justice that is sometimes necessary for effective reorganizations of debtors in order to maximize value for all constituencies.

Effective reorganization is the point of Chapter 11 bankruptcy law, but it is *law* after all, not a simple directive to fix a problem at any cost. The ***3** Bankruptcy Code involves a complex political balancing of debtor and creditor interests. It represents a political compromise, the terms of which should be respected, like any other piece of legislation. Yet, what sense does it make to adhere to the strictures of the Code when doing so prevents the goal of the Code from being fulfilled? The rule of law wins but a Pyrrhic victory when it defeats the purpose of the law. To fetishize the text over intent is dangerous, but so too is lawmaking without the prophylactic limitations of statutory text. Thus, the debate over the balance of equity and statute in bankruptcy is in some measure a debate between purposivist and textualist methods of statutory interpretation. [9] The struggle between equity and statute is reflected throughout the case law on the authorization of non-Code practices and throughout the academic literature on bankruptcy. [10] So how can equity be reconciled with a Code-based legal system like bankruptcy? [11]

This article argues that because American courts are uncomfortable with unguided equitable discretion, they have tried to limit their equitable powers to those authorized by statute or grandfathered in under the pre-Code practices doctrine. These limitations are problematic both conceptually and in terms of the results they produce. Although there was once statutory authorization for bankruptcy courts' equitable powers, the relevant statutory section appears to have been repealed. [12] The statutory section to which courts now look for the authorization of bankruptcy equity powers, 11 U.S.C. § 105(a), is inapplicable, and its use as an analytical framework for evaluating non-Code practices has led to questionable decisions. Likewise, the pre-Code practices doctrine is an unsatisfactory limitation on non-Code practices that has produced contradictory decisions from the Supreme Court and is incapable of recognizing modern analogs to pre-Code practices.

Judging always involves some measure of discretion; the question is how that discretion is to be channeled. Instead of attempting to reconcile equity and statute through inapplicable statutory or historical constraints, this article proposes using federal common law as an alternative framework for analyzing non-Code practices. Federal common law is judge-made law that depends on precedent and judicially-devised tests rather than unpredictable discretion or rigid application of statute. Federal common law allows for the development of bankruptcy law outside the Code, but its constraints of precedent ***4** and judge-made tests allow for predictable and consistent judgments. Federal common lawmaking has long quietly existed in bankruptcy, but it has been a clunking sort of common lawmaking because it has never been recognized as such. Instead, it has always been analyzed in terms of equity, which has led to the inappropriate statutory and historical limitations.

It is unclear at present whether federal courts have common lawmaking powers in bankruptcy. The Supreme Court has never addressed the issue, and the few circuits that have are split. [13] This article argues that federal courts do have such a power because of the uniquely federal interest in bankruptcy due to the uniformity power of the Bankruptcy Clause of the Constitution, [14] as implied by the Supreme Court's recent bankruptcy sovereign immunity decision in *Central Virginia Community College v. Katz*. [15] This article further argues that federal common lawmaking is proper in bankruptcy because there is an implicit Congressional authorization of common lawmaking power in the Bankruptcy Code, as indicated by its legislative history and Congressional and judicial ratification of common lawmaking powers. Finally, this article demonstrates that analysis of non-Code practices as part of a federal common law of bankruptcy strikes a balance between the needs for flexibility and for the predictable rule of law and would result in more sensible rulings on non-Code practices.

In arguing for a federal common law approach to bankruptcy, this article also attempts to stake out a middle ground between the two major camps in bankruptcy scholarship, which Douglas G. Baird has termed “traditionalists” and “proceduralists,” [16] but which might better be termed “practicalists” and “proceduralists.” Practicalists, who have what might be called a more “liberal” view of bankruptcy, believe that “bankruptcy law plays a special role in our legal system and advances substantive goals that are both important and distinctive.” [17] They emphasize rehabilitation of debtors [18] and, in the Holmesian ***5** tradition, emphasize the factual individuality of each case. [19] Therefore, they believe that bankruptcy judges must have broad discretion and powers to implement bankruptcy policy. [20] Bankruptcy law must be flexible enough to carry out its underlying policies.

Proceduralists, on the other hand, do not see bankruptcy as at all special or different from any other legal regime. They favor clear rules and rule of law over judicial flexibility and discretion. They also tend to associate with the conservative law-and-economics school of legal thought. Proceduralists do not see the survival of the debtor as an independent good [21] and emphasize that firms must “live or die in the market.” [22] Instead, they are generally concerned with the *ex-ante* incentive-setting effects of clear legal rules on creating efficient markets. [23] Accordingly, proceduralists believe that the bankruptcy judge should play a more passive role and exercise less discretion. [24]

Non-Code practices, usually authorized under the rubric of bankruptcy equity, are a particular flash point for these scholarly camps. For practicalists, non-Code practices represent the flexibility and realism of the bankruptcy courts at their best, while for proceduralists, non-Code practices represent unnecessary, overreaching, and even harmful displays of judicial discretion and activism. [25] In particular, the traditional analysis of non-Code practices through the lens of equity has only sharpened these divisions, as equity has become the byword for the creation of non-statutory rights in bankruptcy. A federal common law approach to non-Code practices strikes a middle ground between the practicalist concerns of individualized justice and proceduralist concerns about rule of law.

This article begins with a consideration of what “a court of equity” might mean in the bankruptcy context. It then turns to the problems of discretion within the American judicial system. Next, it examines the two principal ways in which courts have attempted to limit equitable discretion--statutory authorization and historical practice--and the problems with each method, both conceptually and in terms of results. The article then considers whether federal common lawmaking is possible in bankruptcy, and concluding that it is, appraises the advantages to such an analytical framework for non-Code practices.

*6 I. WHAT DOES IT MEAN TO BE A "COURT OF EQUITY"?

A. EQUITY JURISDICTION, PROCEDURE, AND POWERS

The term "equity" is particularly confusing in bankruptcy because of its multiple meanings. Depending on context, "equity" refers to jurisdiction, procedures, court powers, justice, an ownership interest, or type of right. The last two of these meanings are distinct, and their use is readily discernable from context. The first four meanings, however, have often been confused and conflated in the description of bankruptcy courts as "courts of equity."

Surprisingly, the origins of the "court of equity" maxim are unknown. No reported case has considered the history of the maxim, and only two articles, by Bankruptcy Judges Marcia Krieger (now a judge on the district court) and Alan Ahart respectively, have addressed the meaning and history of the "court of equity" maxim. [26] Neither Krieger nor Ahart pinpoints an origin for the "court of equity" maxim. Instead, they argue that the designation is purely a judicial creation. [27] The earliest reported use of the phrase "the bankruptcy court is a court of equity" is from 1876, [28] but cases going back as far as 1842 use similar language, [29] and the Bankruptcy Act of 1841 provided that district courts' jurisdiction in bankruptcy was "to be exercised summarily, in the nature of summary proceedings in equity." [30]

Krieger and Ahart both conclude that 19th and early 20th century references to bankruptcy courts as courts of equity dealt only with questions of procedure and the distinction between the original (or summary) and plenary jurisdiction of district courts sitting in bankruptcy, a distinction similar to the current divide between core and non-core proceedings in bankruptcy. [31] As Krieger noted, "[r]eferences to the bankruptcy court as a court of equity were most often used in a technical context to define the scope of exclusive ***7** or original bankruptcy jurisdiction." [32] Broader characterizations of bankruptcy courts as courts of equity, according to Krieger and Ahart, are the result of later judicial misreading of dicta in these early cases. [33]

Nonetheless, a significant number of early cases indicate that bankruptcy equity is more than procedural or jurisdictional. These cases indicate that at the very least bankruptcy courts exercised the powers of courts of equity, particularly the injunction. [34] Indeed, the 1841 and 1867 Bankruptcy Acts specifically gave bankruptcy courts enforcement powers equal to those of the circuit courts sitting in equity. [35]

Under the 1978 Code, bankruptcy courts arguably exercise equity powers through the All-Writs Act, [36] 11 U.S.C. § 105(a), and 28 U.S.C. § 1481. [37] Moreover, the 1978 Code incorporated many of the principles and rules of equity jurisprudence in statutory form, albeit through the filter of earlier Bankruptcy Acts. For example, the automatic stay [38] and the discharge ***8** [39] incorporate the injunction. The strong-arm power of the trustee, [40] the Code's broad definition of the estate, [41] and the very nature of bankruptcy proceedings as involving multiple parties attempting to recover from a limited fund effectuate the marshalling of assets. The requirement of timely filing of claims bears the imprint of the doctrine of laches. [42] The treatment of the estate as a trust invokes the equitable corpus of the trust. Equitable subordination [43] of claims is, of course, equitable, deriving from the "clean hands" maxim. Core contested matters in bankruptcy cases (as opposed to adversary proceedings) are also less formal and more summary in nature than trials at law. [44] Indeed, the priority scheme of the Code [45] and the requirement of equal treatment of creditors within the same class [46] is an implementation of the equity maxim that "equity is equality" [47] --like creditors are to be treated alike. Many of the statutory powers of bankruptcy courts are themselves derived from equity powers.

Moreover, even to the extent that the "court of equity" designation contains a procedural element, it cannot be divorced from the substantive component. While bankruptcy cases historically had a more summary nature than trials at law, they have never been governed by Equity Rules, [48] but by their own rules of procedure. [49] The summary nature of equity proceedings is in keeping with equity's emphasis on substance over form and the pursuit of justice over technical requirements. [50] Thus, being a "court of equity" is a procedural designation only in indicating the bankruptcy proceedings are not bound by the procedures of a court of law.

Courts have often seen bankruptcy equity affecting not just jurisdiction or enforcement of orders, but also rules of decision and dictating how courts should apply their equitable powers. [51] Historically, this often meant that the ***9** court looked beyond technical requirements to substantive justice, particularly regarding pleadings, respected substance over form, [52] or balanced competing equities. [53] The designation of bankruptcy courts as "courts of equity" is an indication not only of bankruptcy courts' powers, but also of a manner of decision-making that involves a considerable exercise of discretion.

B. DOING EQUITY: *PEPPER V. LITTON*

The elements of equity jurisdiction, equity principles and rules, equitable administration, substance over form, waiving of technical requirements, and substantial justice coalesced in *Pepper v. Litton*, the Supreme Court's most extensive discussion about what it means to be a "court of equity." Writing for a unanimous Court, Justice Douglas declared:

> Courts of bankruptcy are constituted by §§ 1 and 2 of the Bankruptcy Act [of 1898] (30 Stat. 544) and by the latter section are invested "with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings." Consequently this Court has held that for many purposes "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." *Local Loan Co. v. Hunt*, 292 U.S. 234, 240 (1934). By virtue of §2[,] a bankruptcy court is a court of equity at least in the sense that in the exercise of the jurisdiction conferred upon it by the Act, it applies the principles and rules of equity jurisprudence. Among the granted powers are the allowance and disallowance of claims; the collection and distribution of the estates of bankrupts and the determination of controversies in relation thereto; the rejection in whole or in part "according to the equities of the ***10** case" of claims previously allowed; and the entering of such judgments "as may be necessary for the enforcement of the provisions" of the Act. In such respects the jurisdiction of the bankruptcy court is exclusive of all other courts. [Citation omitted.]
>
> The bankruptcy courts have exercised these equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates. They have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done. [54]

Pepper v. Litton emphasized the application of principles and rules of equity jurisprudence, rather than equity procedure. It also emphasized that these principles were to be applied to achieve substantial justice that was not limited by technical considerations and forms. Whatever it might have meant in the 19th century for a bankruptcy court to be a "court of equity," it has been an unchallenged axiom of bankruptcy law since *Pepper v. Litton* that bankruptcy courts are to apply bankruptcy law in accordance with the principles and rules of equity jurisprudence.

When Congress enacted the Bankruptcy Code in 1978, it did so with *Pepper v. Litton* in mind. The legislative history of the Code shows that Congress thought of bankruptcy equity existing in a substantive, not merely procedural, sense. The House Report on the Bankruptcy Act of 1978 emphasized that "[t]he bankruptcy court will remain a court of equity." [55]

The House Report made this comment in the context of an explanation of a substantive, not procedural equity component of the Code, § 510(b) (enacted as 11 U.S.C. § 510(c)), which allows for equitable subordination of claims. Equitable subordination is a procedure in which a creditor's claim on the bankruptcy estate is assigned lower priority than other claims on the estate because of some improper or inequitable behavior by the creditor. Equitable subordination matters when the estate's assets are inadequate to cover all creditors' claims, as an equitably subordinated creditor's recovery will be limited. The House Report observed that § 510(b) was intended to codify *Pepper v. Litton* and that "[t]he court's power is broader than the general doctrine of equitable subordination, and encompasses subordination ***11** on any equitable grounds." [56] The legislative history also cited proposed 28 U.S.C. § 1481 as enacting this proposition. [57]

From the legislative history, then, one could read Congress's codification [58] of *Pepper v. Litton* in § 510(c) of the Code [59] as allowing for substantive equity, but only in a particular situation, rather than providing a general guideline for decision-making throughout the Code. If this were the case, however, it would seem odd to emphasize that the bankruptcy court would “remain a court of equity” merely by virtue of the power of equitable subordination, a single tool in equity's toolbox, rather than a panoply of equity powers, especially as *Pepper v. Litton* made clear that bankruptcy equity is about a larger jurisprudential ethos of “substantial justice.” Exactly what that ethos means, though, was not spelled out in *Pepper v. Litton*.

Pepper v. Litton's discussion of equity was painted in broad strokes. It also involved a very clear-cut set of facts pointing to inequitable behavior by the debtor. The debtor corporation and its sole shareholder were in cahoots in a “planned and fraudulent scheme.”[60] Although complex, the “scheme followed an ancient pattern” with the aim of “defraud[ing] creditors [in a manner] reminiscent of some of the evils with which 13 Eliz. C. 5 was designed to cope.”[61] The sole shareholder secured a sham default judgment against the debtor corporation for back wages in order to outmaneuver an adverse judgment creditor.[62] Then, through a series of corporate transfers, the sole shareholder arranged for the judgment creditor to be the only general unsecured claim in bankruptcy against the debtor corporation, which conveniently had sufficient assets to pay off only the other creditors, including the shareholder's sham default judgment.[63] Bankruptcy relief was being sought inequitably to avoid the claims of one creditor.[64]

Because *Pepper* dealt with such an obvious abuse of process, it is not ***12** particularly instructive about how to resolve cases in which the equities are not so clear-cut. *Pepper* speaks in generic terms of “substantial justice” triumphing over “technical considerations.” Just how far can that go as a principle guiding decisions? Is the power to pursue “substantial justice” the power to ignore the explicit provisions set forth by Congress as “technical considerations”? Equity jurisprudence is necessarily one of discretion; equitable relief is never mandatory. However broad a bankruptcy court's discretion might be, it is clearly not absolute.[65] The next sections probe the limits of that discretion.

C. BALANCING THE EQUITIES: *NLRB V. BILDISCO & BILDISCO*

NLRB v. Bildisco & Bildisco[66] contains the Supreme Court's most extensive discussion of what it means for a bankruptcy court to be a “court of equity.” *Bildisco* dealt with the question of under what conditions a bankruptcy court could permit a debtor in possession to reject a collective bargaining agreement. The Court held that collective-bargaining agreements subject to the National Labor Relations Act[67] were covered by the assumption/rejection provisions for executory contracts contained in § 365 of the Bankruptcy Code.[68]

The Court did not debate the existence, extent, or role of bankruptcy equity in *Bildisco*. The Court assumed equity to be a defining characteristic of bankruptcy courts' operations and explained the nature of bankruptcy equity in Chapter 11: to balance the interests and potential hardships of all the parties involved as they would affect the success of a reorganization. The balancing is left to the business judgment of the bankruptcy court.

The language of the Court's decision is illuminating and worth quoting at length:

> Since the policy of Chapter 11 is to permit successful rehabilitation of debtors, rejection [of an executory contract] should not be permitted without a finding that that policy would be served by such action .... Determining what would constitute a successful rehabilitation involves balancing the interest of the affected parties--the debtor, creditors, and employees. The Bankruptcy Court must consider ***13** the likelihood and consequences of liquidation for the debtor absent rejection, the reduced value of the creditors' claims that would follow from affirmance and the hardship that would impose on them, and the impact of rejection on the employees. In striking the balance, the Bankruptcy Court must consider not only the degree of hardship faced by each party, but also any qualitative differences between the types of hardship each may face.
>
> The Bankruptcy Court is a court of equity, and in making this determination it is in a very real sense balancing the equities, as the Court of Appeals suggested. Nevertheless, the Bankruptcy Court must focus on the ultimate goal of Chapter 11 when considering these equities. The Bankruptcy Code does not authorize freewheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization. The

> Bankruptcy Court's inquiry is of necessity speculative, and it must have great latitude to consider any type of evidence relevant to this issue. [69]

Bildisco leaves no doubt that a balancing of equities in light of bankruptcy policy goals, rather than a statutory checklist, is central to bankruptcy adjudication. Of course, one might ask how this is different from any assignation of a matter to a court's discretion, such as in sentencing or determining whether the probative value of evidence outweighs its prejudicial tendency. One might further ask how this differs from the discretion exercised by administrative law judges, whose powers, like those of bankruptcy judges, do not stem from Article III of the Constitution.

The *Bildisco* Court was emphasizing that the Bankruptcy Code cannot presumptively be read on its face like any other statute. The application of the statutory language of the Code, then, cannot be a robotic exercise, and literal meaning is not enough, for the Code's provisions must be evaluated in light of the policies embodied in the Code. The need to evaluate statutes in light of the policies they embody is hardly a novel concept in statutory interpretation. [70] Nonetheless, *Bildisco*'s purposivist emphasis on the policy goals of bankruptcy over a purely textualist approach is in marked contrast to much of the Rehnquist Court's bankruptcy jurisprudence. [71] In *Bildisco*, ***14** though, the Court was emphasizing that the Code must be read as containing terms of art, written in light of equitable interpretation and application. As Justice Douglas wrote in *Bank of Marin v. England*, "[We] do not read these statutory words with the ease of a computer. There is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction." [72]

What the Court indicated in *Bildisco* is that in Chapter 11 the goal of debtor rehabilitation is to guide the balancing of the equities and that a tie goes to the debtor. In balancing the equities, weighting should not be done by the dollar value of claims. While all prayers for relief, be they for monetary or injunctive remedies, are reduced to monetary claims in bankruptcy by § 502(c)(2), [73] the Court's emphasis on the qualitative nature of parties' hardships means that bankruptcy courts should look to the original nature of the claim. Thus, economic harms should not necessarily be weighed the same as non-economic harms. Tort victims, employees, trade creditors, and financial creditors need not be treated the same on a per-dollar basis in balancing equities. The non-pecuniary harms that would result from a determination should be weighed in the equation. [74]

Bildisco's emphasis on doing substantial justice through balancing competing equities has often been forgotten by courts that either believe they lack the discretion to weigh equities or are less comfortable with the exercise of such discretion. [75] These courts have turned instead to the talismans of statutory authorization and the pre-Code practices doctrine to guide their decisions by limiting equitable discretion and the ability to do substantial justice. The next section considers why courts are so uncomfortable with equitable discretion.

II. JUDICIAL DISCOMFORT WITH EQUITABLE DISCRETION

A. SEPARATION OF POWERS CONCERNS

The exercise of discretion is a concern throughout the American judicial system because it is in some sense a lawmaking activity. In our Constitutional system, the legislative power is the power to set rules of decision, ***15** which is vested in Congress at the federal level. The separation of powers principle holds that the legislature, which is accountable via elections, makes the laws and the judiciary merely interprets them. Broad judicial discretion is problematic because it changes the rule of decision from one set by the elected legislature to one set by the unelected adjudicator. [76]

The actual separation of powers is often blurrier than standard civics classes present it. The legislature can delegate its powers, for example. [77] The existence and scope of such a delegation is a major concern in the realm of administrative law, where a central question is the scope of the rule-making authority of administrative agencies. If there is a proper delegation of lawmaking power to the judiciary, either by the Constitution or by Congress, then judicial discretion does not present such serious separation of powers concerns; rather the powers of each branch of government are simply redefined.

Moreover, it is hard to draw a bright line between judicial interpretation and lawmaking; these activities exist along a spectrum. [78] At one end of the spectrum is the interpretation of statutory terms; at the other is the creation of new rules of decision or causes of action. Somewhere in between stands what might be termed "interstitial lawmaking"--filling in statutory gaps, rather than creating law out of whole cloth.

Interpretation of the law is part of the unquestioned role of the judiciary, [79] and to the extent that administrative agencies assume this judicial role, of agency action. [80] Judicial lawmaking in the sense of creating new rules of decision, however, is often viewed with great suspicion as "judicial activism," violating the separation of powers principle. [81] Interstitial lawmaking by expert ***16** bodies, be they agencies or specialized courts, is also generally tolerated because it is necessary in the modern state.

Agency rulemaking can span the entire spectrum from interpretation to creation of new rules of decision. The courts police such rulemaking by examining the statutory authorization for the rule-making power and determining whether the rulemaking was within the scope of the authorization. [82] Many courts also have adopted this approach when attempting to determine the authorization of bankruptcy courts to depart from the strictures of the Bankruptcy Code. Accordingly, the struggle over non-Code practices has largely become a debate about the scope of the statutory authorization of bankruptcy courts' equitable powers.

As the following section shows, the existence of any such statutory authority at present is doubtful, and the debate over non-Code practices has been misframed in terms of equity for historical reasons. Instead, this article argues, non-Code practices should be viewed in terms of federal common law. The use of the term "equity" in the bankruptcy context is really "fortuitous coinage" for what is better described as federal common lawmaking. [83]

The misframing of the authorization of non-Code practices in terms of equity has been particularly problematic because of the peculiar difficulties that equitable discretion and powers present for any statutory regime. The nature of equity is to be flexible and individualized, while the purpose of a code is to provide clear *ex-ante* rules that will result in uniform decisions. Allowing courts that implement a code-based regime to go farther afield than the statutory language undercuts the point of codification. To the extent that equitable powers authorize unlimited deviations from the Code, they present the danger of the exceptions swallowing the rule.

B. "DOING LAW" VERSUS "DOING JUSTICE"

The misidentification of the authorization of non-Code practices as stemming from the equity powers of bankruptcy courts has led courts to apply inappropriate statutory and historical limitations on non-Code practices because of discomfort with unguided equitable discretion. Judicial discomfort with equity complicates any attempt to reconcile equity powers with a code-based legal regime. The term "equity" itself seems to set off judicial alarm-bells. A general judicial nervousness about "doing justice" instead of "doing law" has been imbedded in our legal system at least since *Marbury v. Madison*. [84] This judicial unease has become distinctly more pronounced on the Rehnquist Court with its comparatively textualist emphasis.

***17** *Marbury*, which lies at the bedrock of the American statutory-Constitutional state, looks to positive rights created by statute or the Constitution. *Marbury* emphasized "where there is a legal right, there is also a legal remedy." [85] At the center of equity jurisprudence, however, lies the maxim that "Equity will not suffer a wrong to be without a remedy." [86] Equity thus looks to the existence of a wrong, which assumes something approaching a divine or natural law set of rights, as opposed to a statutory right. [87] For example, the notoriously vague notion of fiduciary duties are rarely put into a statutory form; they exist, but not by virtue of legislative decree. These sorts of rights might have historical origins, but they are affirmatively non-statutory. [88] Statute and equity are adjudicative systems based on drastically divergent principles of the derivation of rights.

American judges are trained to protect statutory rights and to do law, not justice. [89] In part, though, it stems from the lack of a generally accepted meaning of what substantial justice is. While society might have a common sense of what is just in some situations, there are many technical scenarios for which no societal consensus exists. "Doing justice" is too much of a generality to provide meaningful guidance to courts. In America judges do law, not justice, so the idea of the law instructing them to do substantial justice--"a roving commission to do equity" [90] --is quite unnerving.

The jurisprudential concern about "doing equity" is not just one of a lack of uniform results between courts, but one of judges themselves not knowing how to proceed. It is far easier to follow the techniques of application of law to fact taught in law school than to create justice out of whole cloth; judges are not Solomons. Nor are they generally technical experts in any particular field. Without some channeling or direction of their discretion, many judges ***18** would simply be lost, particularly in cases where one's personal moral (or economic efficiency) compass can give no bearing.

This concern was evident in the Supreme Court's decision in *Butner v. United States*, in which the Court ruled that state law, rather than a "federal rule of equity," [91] should govern the right to rents collected during the period between a mortgagor's bankruptcy and the foreclosure sale of the mortgaged property: [92]

> The equity powers of the bankruptcy court play an important part in the administration of bankrupt estates in countless situations in which the judge is required to deal with particular, individualized problems. But undefined considerations of equity provide no basis for adoption of a uniform federal rule affording mortgagees an automatic interest in the rents as soon as the mortgagor is declared bankrupt. [93]

The problem for the Supreme Court was that considerations of equity were "undefined," and the Court did not feel that it should provide such a definition itself. The circuits that had adopted a "federal rule of equity" to govern the situation had reasoned that "since the bankruptcy court has the power to deprive the mortgagee of his state-law remedy, equity requires that the right to rents not be dependent on state-court action that may be precluded by federal law." [94] This rule, however, sometimes "affords the mortgagee rights that are not his as a matter of state law." [95] The Supreme Court reasoned that state law should govern because treating a party's property rights different in bankruptcy than under state law could allow bankruptcy to become a windfall to certain parties, [96] an "inequity" that using state law as the rule of decision would avoid. [97] The Supreme Court was concerned that entering into a consideration of equity would itself create inequity because these considerations were "undefined."

The Supreme Court's concern about "undefined considerations of equity" was in part because of the issue at hand. The question of automatic security interests in rents is a technical, financial question. It does not implicate social values and mores in the same way as non-statutory substantive due process rights, such as abortion or First Amendment issues, or statutory rights, such as sentencing schemes. Without the strong tug of a moral compass, it is far ***19** easier for federal courts to disregard equitable considerations and defer to the terms of a statutory scheme, state law, and established precedent.

The Bankruptcy Code does not make courts' task any easier. The Code provides no guidance for what it means to be a "court of equity," and the origins of this status are murky.

III. THE LIMITATION OF BANKRUPTCY EQUITY BY STATUTORY LANGUAGE

A. SPECIFIC AUTHORIZATIONS OF EQUITY IN THE BANKRUPTCY CODE

The current Bankruptcy Code authorizes equitable decision-making in a limited number of circumstances. The Code refers twenty-five times to decisions that are to be made "according to the equities of the case" or "in the interests of justice." [98] Several of these provisions are essentially parallel to ***20** each other or interlinked as parts of a single Code section. [99] Accounting for parallel or interlinked provisions, there are only fifteen truly distinct provisions that call for doing equity, and in only one of these provisions, 11 U.S.C. § 1129(b), does the Code spell out what equity requires. [100] Section 1129(b)(1) requires that a "cramdown" reorganization plan that is adopted over the objections of a class of creditors must be "fair and equitable." [101] Section 1129(b)(2) then lists a set of non-exclusive conditions [102] defining what it means to be "fair and equitable." [103] The conditions listed are not broadly applicable principles of adjudication, but specific requirements for cramdown plans, so § 1129(b)(2) does little to inform the exercise of equity in other areas where the Code calls for it.

1. *The Bark and the Bite of* **Norwest Bank Worthington v. Ahlers:** *How Confining Is the Code?*

Section 1129(b) was the statutory provision at issue in *Norwest Bank Worthington v. Ahlers*, the Supreme Court's most rhetorically striking decision on the scope of courts' equitable powers in bankruptcy. [104] The issue before the Court in *Ahlers* was whether the absolute priority rule has a "new value" exception for contributions by equity holders of "labor, experience, and expertise" to a debtor's operations. The absolute priority rule, codified at 11 U.S.C. § 1129(b)(2)(B), requires that equity holders in a debtor enterprise receive nothing in a reorganization unless all the dissenting classes of creditors above them receive property of value equal to the allowed amount of their claims. The Supreme Court declined to rule on the proposed "infusion-of-money-or-money's-worth" exception to the absolute priority rule. Instead, it held that even if there were such an exception after the codification of the absolute priority rule in § 1129(b), the contribution proposed by the debtor's ***21** plan was insufficient. [105]

The debtors in *Ahlers* argued that § 1129(b)'s provision that a reorganization be "fair and equitable" required the objecting creditor to vote "in the best interests of all creditors and debtors," not merely its own self-interest. [106] The debtors also emphasized their sympathetic status as hard-pressed family farmers. [107] The Court sharply rejected their equity argument, declaring, "whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code." [108] In this case, the confine that limited equity was § 1129(b)(2)(B), which laid out what constituted a "fair and equitable" plan.

What exactly does it mean that bankruptcy equity "can only be exercised within the confines" of the Code? This phrase has become the standard retort to "the bankruptcy court is a court of equity." First, it could mean that equity is only a power to implement the Code. If so, though, it is odd to call it equity, as this power exists for all federal courts under the All Writs Act. [109] In any case, this reading is probably precluded by the Court's later decision in *United States v. Energy Resources Co., Inc.*, where it observed that § 105(a) powers "are consistent with the traditional understanding that bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships." [110] Modifying creditor-debtor relationships goes far beyond enforcement of court orders.

Ahlers could also mean that bankruptcy equity is synonymous with the terms of the Code, that is to say that the terms of the Code are equity codified. [111] This reading can be squared with *Energy Resources*, as "broad authority to modify creditor-debtor relationships" can be read as a description of bankruptcy courts' statutory powers. Nonetheless, this reading too fails, for the Code would not require actions to be "fair and equitable" if that is exactly what the Code's provisions were. The Code's fifteen provisions referring to equity would be superfluous if the Code itself defined equity.

A third reading of *Ahlers*, adopted by many courts, is that equity powers must be consistent with the Code's specific provisions. [112] Such a reading ***22** mirrors § 1123(b)(5) of the Code, which authorizes bankruptcy courts to approve reorganization plans containing "any ... appropriate provision not inconsistent with the applicable provisions of this title." [113] This reading too is consistent with *Energy Resources*, as well as with the Supreme Court's admonition that "courts should be loath to announce equitable exceptions to legislative requirements or prohibitions that are unqualified by the statutory text." [114] It is also consistent with the Court's jurisprudence under the Bankruptcy Act of 1898. [115]

This third reading also comports with the Supreme Court's later decision in *Young v. United States*. [116] In *Young*, the Court unanimously held that the three-year lookback period of § 507(a)(8)(A)(i), [117] which mirrors the three-year statute of limitations of the Internal Revenue Code [118] and grants the Internal Revenue Service a priority position for its tax liens, is tolled during the pendency of a prior bankruptcy under the principle of equitable tolling. The Court noted, "Since nothing in the Bankruptcy Code precludes equitable tolling of the lookback period, we believe the courts below properly excluded from the three-year limitation the period [at issue]." [119] In *Young*, the Court had no difficultly allowing an equitable practice not specifically authorized by the Code because it was not precluded by the Code.

Under the third reading, so long as there is not a specific Code provision directly on point, the court has a free hand in deciding whether and how to use its equity powers, limited only by the extent of those powers and proper exercise of its discretion. [120] Such a reading is consistent with the nature of equity discussed in *Pepper v. Litton*--that equity ensures that substantial justice will not be bound by technical considerations. Thus, when it is a close call whether the exercise of equity powers would be inconsistent with or contradict the Code, the third reading's presumption should be in favor of allowing the exercise of the equity powers. [121]

The problem with reading *Ahlers* in any of these ways is that it ignores the case's unusual statutory context. When one reads *Ahlers*' statement that “whatever equitable powers remain in the bankruptcy courts must and can ***23** only be exercised within the confines of the Bankruptcy Code,” [122] not as a free-floating statement of a generic truth, but as it was made, *within the context of the case*, its narrow scope becomes apparent: *Ahlers*' statement that equity exists solely within the confines of the Code can apply only to objections that a plan does not meet the requirements of § 1129(b).

This is *not* because § 1129(b) was the actual issue litigated in the case; it would be reckless to read the Supreme Court's decision so narrowly. Rather, it is because § 1129(b) is the *only* section of the Code that refers to “fair and equitable” *and* then defines some of the requirements of fairness and equity for the purposes of the section. There is no other section of the Bankruptcy Code that explicitly defines what “equity” requires in a specific condition. The rest of the Code lacks any such “confines” of directly applicable statutory language. Therefore, the “confines of the Bankruptcy Code” are much less confining for other equity-based determinations. Instead of the tight fence of the statutory specifications in § 1129(b)(2), there is only the porous boundary of general inferences of *indirectly* conflicting statutory provisions. *Ahlers'* bark is far worse than its bite.

Nonetheless, the fifteen discrete situations in which the Code calls for the exercise of equitable principles in decision-making are hardly enough for a bankruptcy court to be called “a “court of equity.” Some of the specific Code provisions requiring decisions to be made “in the interests of justice” deal with such obscure topics as “the period for the final disposition of grain or proceeds of grain.” [123] The status of “court of equity” implies a larger scope to bankruptcy courts' equity powers than the fifteen specific directives of the Code. As the Supreme Court noted in *Energy Resources*, its most recent decision touching on the equity powers of bankruptcy courts, “bankruptcy courts, as courts of equity, have broad authority to modify creditor-debtor relationships.” [124] The scope of such “broad authority” must be understood to apply to more areas of bankruptcy proceedings than determinations on the proceeds of grain. The following section considers what statutory authorization, if any, there is for bankruptcy courts' *general*, rather than specific, equity powers.

B. IS THERE A GENERAL STATUTORY AUTHORIZATION FOR BANKRUPTCY EQUITY POWERS?

In Anglo-American legal tradition, bankruptcy relief has only existed as a matter of statute; it has never been a Constitutional or common law right [125] ***24** or existed as part of general Chancery powers in equity. [126] If bankruptcy cases themselves are a creature of statute, it would follow *a fortiori* that the powers of bankruptcy courts are also statutorily limited. This principle was recognized by the Supreme Court in an early bankruptcy case, decided under the second bankruptcy act, *In re Christy*, [127] which held that the equity powers of district courts sitting in bankruptcy derive only from the Bankruptcy Act of 1841. [128]

Historically, bankruptcy courts had equity powers as a matter of statute. Today, this article demonstrates, there is no longer direct statutory authorization, and the Code provision that courts generally cite as the source of bankruptcy equity powers, 11 U.S.C. § 105(a), is affirmatively *not* a statutory authorization of equity. Currently there is no statutory authorization for bankruptcy equity powers; to the extent that they now exist it is only as a matter of federal common law. Thus, to understand the problems of statutory authorization of equity power under the current Bankruptcy Code of 1978, [129] it is necessary to foray into the preceding Bankruptcy Act of 1898, [130] which built on the history, and at times the language, of the 1841 Act, albeit through the intervening 1867 Act. [131] In 2005, the Supreme Court noted, “[o]n occasion, a would-be doctrinal rule or test finds its way into our case law through simple repetition of a phrase -- however fortuitously coined.” [132] Although the precise origin of the “court of equity” maxim remains uncertain, the history of American bankruptcy law shows that bankruptcy courts' status as a “court[s] of equity” is less an official statutory status of particular significance than “fortuitous coinage” that has taken on a life of its own and outlived its statutory origins.

1. *Section 2(a)(1) of Bankruptcy Act of 1898*

In *Pepper v. Litton*, the status of bankruptcy courts as “courts of equity” hinged on a specific statutory authorization, § 2 of the Bankruptcy Act of ***25** 1898: [133]

> Courts of bankruptcy are constituted by §§ 1 and 2 of the Bankruptcy Act [of 1898] and by the latter section are invested "with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings." Consequently this Court has held that for many purposes "courts of bankruptcy are essentially courts of equity, and their proceedings inherently proceedings in equity." By virtue of §2[,] a bankruptcy court is a court of equity at least in the sense that in the exercise of the jurisdiction conferred upon it by the Act, it applies the principles and rules of equity jurisprudence. [134]

Section 2(a)(1) of the 1898 Act laid out the jurisdiction of bankruptcy courts: "That the courts of bankruptcy ... are hereby invested, within their respective territorial limits ... with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings ...." [135]

Section 2 of the 1898 Act then enumerated a non-exclusive [136] list of eighteen specific powers of the court. [137] The fourteenth enumerated power, § 2(a)(15), was to "make such orders, issue such process, and enter such judgments in addition to those specifically provided for as may be necessary for the enforcement of the provisions of this Act." [138] Although *Pepper v. Litton* did not specify which subsection of § 2 of the 1898 Act it referenced, it seems clear that it was referring to § 2(a)(1), given that *Local Loan Co. v. Hunt*, [139] the authority cited in *Pepper*, [140] relied upon that section. [141]

Local Loan Co.'s discussion of § 2(a)(1) clarified that the jurisdictional grant in the 1898 Act was of jurisdiction both at law and in equity. Jurisdiction at law was granted for the purpose of punishing bankruptcy crimes; otherwise, bankruptcy was an equitable proceeding:

> The words "at law" were probably inserted to meet clause (4) of §2[(a) of the Bankruptcy Act of 1898], which empowers ***26** such [bankruptcy] courts to arraign, try and punish certain designated persons for violations of the act. But otherwise courts of bankruptcy are essentially courts of equity and their proceedings inherently proceedings in equity. [142]

Thus, statutory authorization for bankruptcy equity in *Pepper v. Litton* was § 2(a)(1) of the Bankruptcy Act of 1898.

The assumption underlying *Pepper v. Litton* was that bankruptcy courts have equitable powers by virtue of *statute*, not by virtue of some *ex nihilo* status as bankruptcy courts. The statutory derivation of equity powers means that these powers must be limited to the extent of the statutory authorization. The statutory authorization of equity powers, and by implication equitable adjudication, is odd for a detailed statutory regime; to the extent that one sees the 1898 Act (or the 1978 Act) as authorizing equity powers, it raises the question why Congress would do so. Arguably, the answer lies in the fact-intensive nature of bankruptcy [143] and Congress's inability to legislate sufficiently precise rules to govern all situations. Congress wanted a flexible statutory regime. It also speaks to the collective nature of bankruptcy--to divide a limited fund among multiple claimants requires creativity and the balancing of equities.

There is no legislative history to support such a view, however. Congress never articulated such a desire independent of the Code's own provisions. As we shall see, bankruptcy equity in the sense of authorizing broad non-Code powers and equitable decision-making is as much a judicial creation as a legislative one. In any event, repeated revisions of the bankruptcy laws have provided bankruptcy courts with the powers of a court of equity without Congressional comment, perhaps ratifying the exercise of equity powers. [144] The 1898 Act provided Justice Douglas with a reasonably explicit statutory authorization of equity powers. The current statutory authorization for bankruptcy equity powers under the Bankruptcy Code of 1978, if any, is less clear.

*27 2. *12 Days of Equity? The Questionable Repeal of 28 U.S.C. § 1481*

As the Bankruptcy Code of 1978 was originally adopted, it contained a provision analogous to § 2 of the Bankruptcy Act of 1898. [145] 28 U.S.C. § 1481, entitled "Powers of bankruptcy court," provided: "A bankruptcy court shall have the powers of a court of equity, law, and admiralty, but may not enjoin another court or punish criminal contempt not committed in the presence of the judge of the court or warranting a punishment of imprisonment." [146]

28 U.S.C. § 1481 would seem to continue the pre-Code equity powers for bankruptcy courts, for, as the Third Circuit has noted, "The enactment of the Code in 1978 increased the degree of regulation Congress imposed upon bankruptcy proceedings, but it did not alter bankruptcy courts' fundamental nature." [147]

28 U.S.C. § 1481 was supposed to go into effect on April 1, 1984. [148] Before this occurred, however, the Supreme Court ruled in *Northern Pipeline Construction. Co. v. Marathon Pipe Line Co*. that the 1978 Code's system of Article I bankruptcy judges was unconstitutional. [149] The Supreme Court stayed the judgment in *Northern Pipeline* to allow Congress an opportunity to amend the bankruptcy court system. [150] *Northern Pipeline* was decided, in part, on an assumption that 28 U.S.C. § 1481 would become effective. [151] Accordingly, the implementation of 28 U.S.C. § 1481 was postponed several times. [152] The provision finally went into effect on June 28, 1984. [153]

***28** On July 10, 1984, twelve days after 28 U.S.C. § 1481 became effective, the Bankruptcy Amendments and Federal Judgeship Act (BAFJA) of 1984 [154] went into effect. Section 113 of BAFJA noted that 28 U.S.C. § 1481 "shall not be effective." [155] Section 121(a) of BAFJA, however, stated that 28 U.S.C. § 1481, already effective as of June 28, 1984, would not be effective until BAFJA's enactment. [156] Until BAFJA was enacted, however, neither provision affected 28 U.S.C. § 1481, so for at least twelve days 28 U.S.C. § 1481 remained in effect. One court called this bizarre sequence of enactments "one of Congress' clumsiest performances," [157] while Professor Vern Countryman observed that "the 1984 legislation dealing with the bankruptcy courts must establish a record for inept performance by Congress." [158]

Most courts and commentators that have addressed the issue have regarded 28 U.S.C. § 1481 as repealed. [159] The last official printing of the ***29** United States Code in 2000 does not include 28 U.S.C. § 1481, and Lexis and Westlaw services do not list 28 U.S.C. § 1481 as part of the current United States Code. Courts have reasoned that § 121(a) of BAFJA was "intended again to postpone the effective date of § 1481 so as to take care of the hiatus which then existed between June 28th and July 10th." [160] The provisions cannot be read as canceling each other out, as there was no other purpose for § 121(a) than to postpone the effective date until 28 U.S.C. § 1481 became ineffective by virtue of § 113.

On the other hand, there is no legislative history that specifically addressed the repeal of 28 U.S.C. § 1481. The meaning of the conflicting BAFJA provisions is ambiguous to say the least, and since divining Congressional intent in these circumstances is well nigh impossible, basic principles of statutory interpretation should govern. The plain reading of §§ 113 and 121(a) results in the sections canceling each other out. Section 113 stated that 28 U.S.C. § 1481 was ineffective as of July 10, 1984, while § 121(a) stated that 28 U.S.C. § 1481 was effective as of July 10, 1984, rather than as of June 28, 1984. This then means that the pre-July 10, 1984 status quo remains, so 28 U.S.C. § 1481 is effective as it had already gone into effect on June 28, 1984. [161] Indeed, as recently as 1996, a bankruptcy court referred to 28 U.S.C. § 1481 in one of its decisions as if it were still in effect. [162] One can only surmise that if Congress intended to repeal it, that it was because Congress believed that 28 U.S.C. § 1481's jurisdictional grant was inconsistent with the holding in *Northern Pipeline*. Yet, if this were the case, why did Congress continue postponing the implementation date of 28 U.S.C. § 1481, rather than repealing it?

The most likely answer is that Congress simply did not notice the equity jurisdiction issue when it passed BAFJA. The crisis that Congress was addressing with BAFJA was *Northern Pipeline*'s invalidation of the bankruptcy courts as created by the 1978 Bankruptcy Act. The issue that concerned Congress in BAFJA was whether it should set up the bankruptcy courts as true Article III tribunals or take another approach as it ultimately did. [163]

***30** The issue of 28 U.S.C. § 1481's repeal is far from clear, and its resolution is far from an academic problem. If bankruptcy courts' equitable powers derive from a textual authorization and that authorization no longer exists, do the powers continue to exist or are the courts acting *ultra vires*? If the powers do exist even without any statutory authorization, that might affect the application of certain Supreme Court decision to bankruptcy courts. Moreover, if the powers continue to exist because of an alternative source of authorization, is the scope of that authorization the same as 28 U.S.C. § 1481? Would 28 U.S.C. § 1481 authorize greater powers for bankruptcy courts than an alternative source of equitable powers? Or might 28 U.S.C. §

1481 place limits on bankruptcy courts' equitable powers that would not otherwise exist, such as its limitation on the criminal contempt powers?

If 28 U.S.C. § 1481 was never repealed, then it continues to provide statutory authorization for the equity powers of bankruptcy courts. Accordingly, the emphasis that many courts have put on other sections of the Bankruptcy Code, especially § 105(a), is unnecessary and misplaced, and has misdirected the debate about the scope of bankruptcy equity based on inapplicable statutory language, as discussed at length below. If 28 U.S.C. § 1481 is still valid, then the limits of bankruptcy courts' equity powers are whatever 28 U.S.C. § 1481 authorizes, limited only by Constitutional concerns.

If, on the other hand, 28 U.S.C. § 1481 was repealed, as seems to be the case, it no longer provides a statutory authorization for the equity powers of bankruptcy courts. No replacement section was ever enacted. The awkward repeal of 28 U.S.C. § 1481 raises several questions: Is there currently any textual authorization for bankruptcy courts' equitable powers? If so, what limits does *that* textual authorization place on the exercise of equitable powers? If there is no valid textual authorization of bankruptcy courts' equitable powers, do these powers continue to exist? And in either case, might there be other non-textual limits on these powers? In other words, one way of determining the meaning of equitable powers is to probe their limitations, be they textual, Constitutional, prudential, or otherwise.

3. *Old Wine in New Vessels? 11 U.S.C. § 105(a)*

The House Committee Report on the 1978 Code noted that 28 U.S.C. § 1481 was "in addition to any power granted under 28 U.S.C. § 1651 (The All Writs Statute) or under § 105 of the Bankruptcy Code." [164] Similarly, the Supreme Court indicated in *Continental Illinois Bank* [165] that § 2(a)(15) ***31** of the 1898 Act and the All Writs Act (then codified at 28 U.S.C. § 262) [166] were separate heads of judicial power distinct from a bankruptcy court's status as a court of equity as derived from § 2(a)(1) of the 1898 Act. [167] In upholding a bankruptcy court's injunction against the enforcement of a lien on a debtor's bonds, the Court held that "[t]he bankruptcy court, in granting the injunction, was well within its power, either as a virtual court of equity, or under the broad provisions of § 2[(a)](15) of the Bankruptcy Act or of § 262 of the Judicial Code." [168] Conceivably, there could be statutory authorization of the equity powers of the bankruptcy courts in these statutory sections. Section 105 of the 1978 Code, 11 U.S.C. § 105, is a provision analogous to § 2(a)(15) of the 1898 Act. It currently [169] provides:

> (a) The court may issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title. No provision of this title providing for the raising of an issue by a party in interest shall be construed to preclude the court from, sua sponte, taking any action or making any determination necessary or appropriate to enforce or implement court orders or rules, or to prevent an abuse of process.

Notwithstanding subsection (a) of this section, a court may not appoint a receiver in a case under this title.

The ability of any district judge or other officer or employee of a district court to exercise any of the authority or responsibilities conferred upon the court under this title shall be determined by reference to the provisions relating to such judge, officer, or employee set forth in title 28. This subsection shall not be interpreted to exclude bankruptcy judges and other officers or employees appointed pursuant to chapter 6 of title 28 from its operation. [170]

Section 105(a), in particular, has become the provision usually cited as authorizing the equitable powers of the bankruptcy court. As one bankruptcy judge has noted, "Parties in interest in bankruptcy often call upon § 105 of Title 11 as a means of enlisting the aid of judicial authority whenever the Bankruptcy Code does not expressly address a particular situation." [171]

As a matter of statutory interpretation, the support for § 105(a) as authorizing bankruptcy equity powers is weak. The word "equity" does not ***32** appear in § 105. This is not an accidental omission. Congress used the word "equity" (in the sense of justice and not ownership) and "equitable" in fifteen distinct Code provisions. [172] A general grant of equity powers in § 105(a) would render the Code's direction for the court to act in accordance with principles of equity in specific circumstances redundant.

By its terms, the first sentence of § 105(a) only authorizes the court to do whatever it finds "necessary or appropriate to *carry out the provisions*" of the Code. A plain language reading of § 105(a) [173] would mean that § 105(a) grants only the power to implement specific statutory sections and does not confer any substantive powers itself.

On the other hand, § 105(b) expressly prohibits a bankruptcy judge from appointing a receiver. [174] Receivership is a traditional type of equitable relief, so perhaps the exclusion of one type of equitable relief implies an authorization of others. Indeed, § 105 contains a much broader authorization than its predecessor section, § 2(a)(15) of the 1898 Act. As one bankruptcy court has observed, "Unlike the restriction under prior law that an order of a Bankruptcy Court must be 'necessary for the enforcement of the provisions of this act,"' § 105 authorizes the Bankruptcy Court to also issue orders "appropriate to carry out the provisions of this title." [175]

Thus, the phrase "provisions of this title" could be read to include the more general goals of specific provisions or even the general policy goals of bankruptcy. More expansive readings of § 105(a) are problematic, though, because the Code never speaks directly about its own purpose; the policy goals of the Code are only addressed in the legislative history, not in "the provisions of this title."

The second sentence of § 105(a), added in 1986, may provide an interpretive key to the first sentence. The second sentence was added as part of the 1986 amendments to the Code in order to provide clear authorization of *sua sponte* action by bankruptcy courts. [176] If the second of § 105(a) is read as a gloss on, or clarification of, the first sentence, then the entire section looks like an authorization of judicial management and enforcement powers, not a grant of general equitable powers.

Indeed, the language of § 105(a) would be a strange way for Congress to have authorized something as important as general equitable powers. Reading ***33** § 105(a) as statutory authorization of any equitable powers of a bankruptcy court stretches the statutory language. Many courts and commentators, however, have taken § 105(a) as an explicit grant of equity power, [177] which has then led to a misplaced debate on the breadth of this statutory grant of equity.

The legislative history makes the ascription of equity authorization to § 105(a) even more questionable. The House Committee Report insists that a bankruptcy court is a court of equity, but it does so in reference to 28 U.S.C. § 1481, not 11 U.S.C. § 105. [178] The legislative history of 28 U.S.C. § 1481 itself refers to § 105. The inference, however, is that 28 U.S.C. § 1481 is the authorization of equity powers, whereas that 11 U.S.C. § 105 is merely an enforcement provision like the All Writs Statute, [179] much like §§ 2(a)(1) and 2(a)(15) of the 1898 Act.

The House Committee Report's comments on § 105 indicate that subsection (a) was meant to clarify the extension of the All Writs Statute to bankruptcy courts. The House Committee Report noted:

> Section 105 is similar in effect to the All Writs Statute, 28 U.S.C. § 1651, under which the new bankruptcy courts are brought by an amendment to 28 U.S.C. § 451, H.R. 8200 § 213[, 95th Cong. (1977)]. The section is repeated here for the sake of continuity from current law and ease of reference, and to cover any powers traditionally exercised by a bankruptcy court that are not encompassed by the All Writs Statute. [180]

***34** Thus, if § 105 is just a duplicative enactment of the All Writs Statute for bankruptcy courts, it is hardly an authorization of broad equity powers; at most it might authorize some equitable remedies such as injunctions for contempt and the issuance of the § 362 automatic stay. [181]

To read the All Writs Statute as authorizing the sort of equity powers that Justice Douglas wrote of in *Pepper v. Litton* taxes the statutory language. In the context of a statutory scheme, the All Writs Statute is an enforcement provision, as the Supreme Court has noted:

> Where a statute specifically addresses the particular issue at hand, it is that authority, and not the All Writs Act, that is controlling. Although that Act empowers federal courts to fashion extraordinary remedies when the need

> arises, it does not authorize them to issue ad hoc writs whenever compliance with statutory procedures appears inconvenient or less appropriate. [182]

The All Writs Statute does not authorize courts to operate according to "the principles and rules of equity jurisprudence," nor does it authorize courts to look to substance over form so that "technical considerations will not prevent substantial justice from being done." [183]

Moreover, if § 105(a) is merely a duplicative version of the All Writs Statute, it is hard to see what if anything makes bankruptcy a "court of equity" in a sense unique enough from other federal courts that it bears comment. If § 105(a) and the All Writs Statute are the source of equity powers, then all federal courts are "courts of equity." The repeated and insistent use of this phrase by courts in reference to bankruptcy courts indicates that there is something that makes bankruptcy courts different from other federal courts by virtue of being courts of equity. Article III courts are authorized to hear cases "in Law and Equity." [184] Indeed, other federal courts, such as the Tax Courts, regularly look to the substance of transactions instead of their form, [185] as a matter of federal common law, even if the form complies with the technical requirements of the statutory scheme of the Internal Revenue Code. Yet, no one would ever think to refer to the Tax Courts as "courts of equity." Thus, being a court of equity must mean something more than just looking to substance over form. Arguably, as we shall see, it means something ***35** more akin to pursuing "substantial justice" or fairness, which may involve deviations from a well-defined statutory system.

Neither the All Writs Statute nor the statutory language of § 105(a) authorizes equity powers for bankruptcy courts. The current statutory authorization of general bankruptcy equity powers is highly questionable. Nonetheless, many courts cling to § 105(a) as an authorization of bankruptcy court's general equity powers, which has led to questionable rulings both for and against various non-Code practices.

C. SQUARE PEGS IN ROUND HOLES: THE PROBLEMS CREATED BY LOCATING BANKRUPTCY EQUITY POWERS IN § 105(a)

Even though an examination of the history of the 1978 Bankruptcy Code indicates that § 105(a) was not intended to authorize or limit bankruptcy courts' equitable powers, and does not even refer to them one way or the other, it has filled courts' need for a statutory touchstone for the authorization of equitable powers in bankruptcy. Courts like to have statutory authorization for their actions. Clear statutory directives allow judges to avoid having to make hard decisions or value judgments and allow for easy appellate review. Statutory directives allow courts to resolve the tension that exists in bankruptcy between the adjudicative methods of equity and statute.

Unfortunately, the language of § 105(a), drafted as an enforcement provision and possibly intended to ratify bankruptcy courts' pre-Code powers, now bears the weight of significantly more expansive powers. Section 105(a) has become the frame of judicial reference for, and, inevitably, a limitation on, equitable powers whose source was never in its statutory language. Using an inappropriate statutory provision as a stand-in talisman for an actual provision dealing with bankruptcy equity has led to a variety of bad or questionable decisions and misplaced debates about the scope of bankruptcy courts' equity powers, about the way those powers are to be applied, and about the propriety of a variety of non-Code practices.

The language of § 105(a) has led several courts to reject non-Code practices normally authorized under the equitable powers of a bankruptcy court. These courts have held that § 105(a) only gives the power to implement other sections of the Bankruptcy Code, and is not authorization of substantive powers.

1. *First Day Orders:* Capital Factors, Inc. v. Kmart Corp.

In *Capital Factors, Inc. v. Kmart Corp.*, the Northern District of Illinois reversed the bankruptcy court's "first day order" that authorized pre-plan payments to "critical" vendors for pre-petition obligations, a non-Code practice. ***36** [186] The district court rejected arguments that the payments were statutorily authorized under § 105(a) powers or were otherwise equitably permitted under the equitable doctrine of necessity. [187]

The District Court held that the doctrine of necessity could be applied only through § 105(a), [188] but "the grant of equitable power in § 105 is limited in that it 'allows [bankruptcy] courts to use their equitable powers only as necessary to enforce the provisions of the Code, not to add on to the Code as they see fit.'" [189] The district court also cited a Seventh Circuit case, *In the Matter of Chicago, Milwaukee, St. Paul, and Pacific Railroad Corp.*, [190] decided under the 1898 Act, in which Judge Posner wrote, "the fact that a proceedings is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be." [191]

The *Kmart* district court noted that the effect of allowing pre-plan payments to certain creditors would be "to elevate the claims of the 'critical' vendors over those of other unsecured creditors and to subordinate the claims of non-'critical' unsecured creditors." [192] The problem, as the district court saw it, was that "[t]he bankruptcy court altered the priority scheme set forth in the Bankruptcy Code." [193]

The difficulty with "critical vendor motions" and "first day orders" is that ***37** even if they deviate from the Bankruptcy Code's priority scheme, they can be necessary to preserve the value of the estate for the benefit of the creditors as a group. The Code's priority scheme [194] deals with the priority of distributions at the time of a plan. Critical vendor motions, however, deal with pre-plan payments. In some cases, a pre-plan payment to select creditors at time A allows other creditors to receive a larger recovery at time B, under a plan, than if there had been no pre-plan payment.

Of course, if creditors do not think that the plan will work, this logic does not apply, as creditors do not want good money chasing bad. The irony is that creditor actions to prevent critical vendor motions because of a lack of confidence in a reorganization's success often become self-fulfilling prophecies because the debtor is unable to continue operations while in bankruptcy and must liquidate.

Insisting on the Code's priority scheme in some circumstances fails to recognize the practical limitations of courts' power under the automatic stay and can actually harm the net estate. Consider a situation in which the debtor has significant property outside of the United States, say an $80 million oil rig in the North Sea. [195] Among the debts that the debtor owes is a $2 million repair bill for work done by a British oil service company without any assets in the United States. As a practical matter, the automatic stay of § 362 [196] cannot be enforced against the oil rig service company if it seizes the oil rig under English law.

Thus, unless the oil rig service company is paid in full, up front, it will seize the rig. In these circumstances, following a narrow interpretation of the Code will deprive the bankruptcy estate of an $80 million, revenue-producing asset on account of a $2 million debt. Creditors value principles much less than principal. Insisting on the letter of the Code defeats its purposes. A first day order permitting the pre-plan payment of a pre-petition debt to the oil service company will actually *protect* value for other creditors and assist in the rehabilitation of the debtor. A deviation from the priority scheme of § 507 [197] at the beginning of the bankruptcy is necessary to effectuate § 362's protection of estate property, and increase the asset pool available for distribution under a plan.

The difficulty that bankruptcy courts face, however, is distinguishing between sensible first day order requests, like with the oil rig, and preferential treatment of favored creditors that does not benefit the estate. Often, all the ***38** court has to go on in ruling on first day order motions is the argument of the debtor's attorney and an affidavit of a debtor's officer. This creates a great potential for abuse of critical vendor motions. Cronies of a debtor's CEO who are also creditors and vendors that are not "critical" can both get favored treatment and circumvent the Code's priority system.

For example, in *Kmart* there were no less than 2,330 "critical" vendors, [198] including some 1,070 newspapers, [199] for whom Kmart requested a "$300 million slush fund." [200] The number of critical vendors seems excessive, although the business model for "mart" stores like Kmart is to carry a huge variety of products and offer one-stop shopping. Even if only ten percent of the critical vendors actually withheld future shipments unless paid pre-plan for pre-petition obligations, the withholding would devastate a "mart" debtor's operations. The reputational hit of bankruptcy to a store like Kmart is significant, but poorly stocked shelves during the pendency of the bankruptcy would hurt the prospects for a successful reorganization even more. Kmart could probably do without most individual vendors, but this is beside the point. For a "mart," the issue is not which individual vendor is critical, but a critical mass of suppliers.

This raises the question, then, of how to separate out the "critical" vendors who will ultimately continue to supply the debtor without pre-plan payment of pre-petition obligations from those who will not. Requiring testimony is simply impractical, as there is no time for a serious evidentiary hearing lasting weeks in the case of a large "mart" debtor. Yet merely taking the debtor's word seems insufficient. A court could require the vendors to produce affidavits that unless paid pre-plan for pre-petition debts, they will cease further supply, but what does this really accomplish? Such affidavits could only be procured in time for a bankruptcy filing by informing all the vendors of the impending filing, which can hurt the debtor, as the vendors will likely cease supply immediately. The bankruptcy estate would bear costs of obtaining such affidavits, so they would ultimately be at the expense of the general unsecured creditors. Moreover, it would be too easy of a system to game and would result in *pro forma* affidavits from most vendors. Once the gate of critical vendor motions is opened, it cannot be shut. The bankruptcy court cannot practically serve as gatekeeper. Allowing the debtor to serve as gatekeeper, though, invites abuse of the bankruptcy process.

In *Kmart*, the district court did not consider the practical business and administrability concerns that complicate critical vendor motions, even ***39** though two of the four motions challenged in *Kmart* dealt with foreign vendors, who present the strongest case for the necessity of authorizing pre-plan payments of pre-petition obligations to protect value for the estate because of their ability to levy on foreign assets of the debtor with relative impunity.[201] Instead, the district court in *Kmart* turned the issue into a matter of statutory interpretation of § 105(a). The district court viewed § 105(a) as the locus of the equitable powers of the bankruptcy court. Accordingly, the powers were limited by the language of § 105(a) as well as by the systemic jurisprudential concerns about judicial lawmaking in the face of Congress' express priority scheme in the Code.

For the district court in *Kmart*, the Code did not just place specific limitations on general equitable powers, but defined the outer limit of those powers. Exactly what room is left for equity is not spelled out; *Kmart* raises the question of what it means for bankruptcy to be a proceeding in equity when there is no room for a court to exercise the discretion of equity beyond what is allowed in any other proceeding. Does bankruptcy equity have any meaning?

The Seventh Circuit did little to answer this question when it took up *Kmart* on appeal. The Seventh Circuit affirmed the District Court's reversal of the Bankruptcy Court's critical vendor order. The Seventh Circuit noted that critical vendor orders might be possible under 11 U.S.C. § 363(b)(1),[202] which authorizes the trustee or debtor in possession upon notice and a hearing to "use, sell, or lease, other than in the ordinary course of business, property of the estate."[203] Nonetheless, the particular order in question could not be approved because it was not supported by a record showing of "the prospect of benefit to other creditors."[204]

The Seventh Circuit sharply rejected § 105(a) as a possible authorization for critical vendor motions. Writing for the court, Judge Easterbrook declared that § 105(a) "does not create discretion to set aside the Code's rules about priority and distribution; the power conferred by section 105(a) is one to implement rather than override."[205] Judge Easterbrook declaimed, "A 'doctrine of necessity' is just a fancy name for a power to depart from the Code .... Older doctrines may survive as glosses on ambiguous language enacted in 1978 or later, but not as freestanding entitlements to trump the text."[206]

As Judge Easterbrook would have it, the only possible role for equitable ***40** practices is to decide ambiguous statutory language. This is hardly something unique to bankruptcy; courts regularly weigh equities in any situation involving ambiguous statutory language. What, if anything, then does it mean for bankruptcy to be a "proceeding in equity"? Is it merely a tip of the hat to bankruptcy's historical origins? Or might it have more substantial meaning, such as a mandate to *do* equity?

2. *Pre-Plan Payments of Pre-Petition Debts:* Official Committee of Equity Security Holders v. Mabey

The Fourth Circuit's decision in *Mabey*[207] vividly posed that very question. *Mabey* was an appeal from a district court's confirmation of a bankruptcy court order under § 105(a) directing the pre-plan establishment of an emergency fund for women injured by Dalkon Shield intrauterine devices (IUDs). The Fourth Circuit held the order violated the Code's pro-rata distribution scheme by effecting a pre-confirmation distribution, even though the disbursement would be deducted from what the claimants would otherwise receive and would go directly to doctors for treatment to prevent irreparable damage to the women's reproductive ability.[208] The doctrine of necessity played no role in the Fourth Circuit's decision. There were no critical vendors and no potential tangible benefit to the estate from the payments. The situation was critical for the tort victims, not for the debtor. There was a risk that by paying the tort victims earlier they might get a windfall if at the time of distribution under the plan there would not be enough assets in the estate to satisfy other creditors claims. But there was also the possibility that the estate's value at distribution would be greater than anticipated. The Fourth Circuit did not consider any of this or weigh the competing equities. Under the *Bildisco* balancing principle, though, the weight of the equities was clear-cut.

The Fourth Circuit took a facially more generous approach to equitable powers than the district court in *Kmart*. Rather than saying that the equitable powers of a bankruptcy court are solely to enforce the Code, the Fourth Circuit, anticipating *Ahlers*, held that equity power could be wielded, but only when it did not contradict the Code:

> While the equitable powers emanating from § 105(a) are quite important in the general bankruptcy scheme, and while such powers may encourage courts to be innovative, and even original, these equitable powers are not a license for a ***41** court to disregard the clear language and meaning of the bankruptcy statutes and rules .... [209]

As the Fourth Circuit applied its standard, "the creation of the Emergency Treatment Fund at this stage of the Chapter 11 bankruptcy proceedings violates the clear language and intent of the Bankruptcy Code, and such action may not be justified as an exercise of the court's equitable powers under 105(a)." [210]

The Fourth Circuit did not try particularly hard to avoid a conflict between the bankruptcy court's exercise of its equitable powers and the Code. The *Mabey* opinion did not point to the "clear language" of the Code that the bankruptcy court disregarded. There is nothing in the Code that states that there may not be any payment before a plan; instead the Fourth Circuit inferred this from the provisions of §§ 1121-29 providing for the filing and confirmation of a plan and from Bankruptcy Rule 3021, entitled "Distribution under Plan." [211] By its terms, however, Rule 3021 says nothing about pre-plan distribution and need not be read to exclude it. [212] There is no reason that the Fourth Circuit had to infer a ban on pre-plan distributions from a Bankruptcy Rule that speaks of distributions under a plan. The statutory scheme itself gave ample wiggle room, had the Fourth Circuit desired to take it. Instead, the Fourth Circuit looked for specific statutory authorization, because it did not have confidence that its equity powers could themselves be the authorization. What bears emphasis is that while *Mabey* would be the correct outcome in a strict statutory regime, bankruptcy is different because it is supposed to apply the statutory scheme with equitable considerations in mind.

One might compare the result in *Mabey* with that in *CoServ*, [213] where the Bankruptcy Court for the Northern District of Texas used the notoriously ill-defined concept of fiduciary duties to rule that a critical vendor order was *required* by the Code. [214] The court held that "Claims May be Paid if ***42** Necessary to Performance of the Debtor in Possession's Fiduciary Duty," which includes the duty to "protect and preserve the estate, including an operating business's going-concern value." [215] As the court explained,

> There are occasions when this duty can only be fulfilled by the preplan satisfaction of a prepetition claim .... In such instances it is only logical that the bankruptcy court be able to use Section 105(a) of the Code to authorize satisfaction of the prepetition claim in aid of the preservation or enhancement of the estate. [216]

If there is a will, judicial creativity knows few limits.

Given the lack of an explicit conflict with a statutory prohibition, the bankruptcy court's order in *Mabey* hardly seems an abuse of its equitable powers under the Fourth Circuit's standard. If the plight of women whose reproductive ability [217] would be irreparably damaged without immediate medical care does not cry out for the use of equitable powers when there is not a necessary conflict with the Code, it is hard to imagine what would. Certainly, the Fourth Circuit did not suggest any scenario. Functionally, *Mabey*, like the *Kmart* decisions, leaves virtually no room for equity in bankruptcy beyond a court's normal powers to enforce and implement statutory provisions. *Mabey* is entirely inconsistent with Justice Douglas's explanation in *Pepper v. Litton* that, as a court of equity, a bankruptcy court was to ensure that "technical considerations" did not stand in the way of "substantial justice." By reading § 105(a) to be the authorization of bankruptcy court's equitable powers, the Fourth Circuit in *Mabey* avoided doing equity on account of an arguably inapplicable statutory limitation.

3. *Division of a Limited Pot:* In the Matter of Chicago, Milwaukee, St. Paul, and Pacific Railroad Corp.

Kmart and *Mabey* were both concerned about upsetting the Code's priority scheme. But the Code's priority scheme is affected not just by the timing of payments, but also by any change in the size of the pot available for distribution or the number of claims. The priority scheme of § 507 is in many ways the heart of the Code, but if it is inviolate, it is hard to see what room is left for equity *within* the Code other than its fifteen specific directives. [218] On the other hand, as Judge Posner observed in *Chicago, Milwaukee*, creating a fair and equitable distribution of a limited pot is exactly what ***43** bankruptcy courts are supposed to do: “[t]he function of equitable considerations in a bankruptcy proceeding is to guide the division of a pie that is too small to allow each creditor to get the slice for which he originally contracted.” [219]

Chicago, Milwaukee was decided in the aftermath of a successful reorganization of a *solvent* railroad under Section 77 the Bankruptcy Act of 1898; it did not involve a pre-plan payment to critical vendors or the doctrine of necessity. The Seventh Circuit upheld the district court's refusal to exercise its discretionary equitable powers under § 2(a)(15) of the Act to decelerate the principal on a defaulted 100-year debenture with an acceleration clause because in a solvent bankruptcy a creditor should get the full benefit of his bargain. In this case, the debenture indenture's acceleration clause was part of the bargain made in the shadow of bankruptcy, so there was no inequitable windfall to the debenture holders, as all other creditors received 100 cents on the dollar. [220]

The Fourth Circuit in *Mabey* [221] as well as the district court [222] and the Seventh Circuit [223] in *Kmart* cited a the sentence from *Chicago, Milwaukee* as authority for their limitation of § 105(a) powers: “The fact that a proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be.” [224]

***44** When this sentence is read in context, however, it is apparent that Judge Posner was saying something quite different.

Rather than saying that equitable considerations *cannot* affect the distribution scheme, Judge Posner was saying that *there is room for equitable discretion* when the debtor is insolvent and creditors cannot be paid 100 cents on the dollar, the situation in most bankruptcies:

> The fact that a proceeding is equitable does not give the judge a free-floating discretion to redistribute rights in accordance with his personal views of justice and fairness, however enlightened those views may be. The function of equitable considerations in a bankruptcy proceeding is to guide the division of a pie that is too small to allow each creditor to get the slice for which he originally contracted. Hence if the bankrupt is solvent[,] the task for the bankruptcy court is simply to enforce creditors' rights according to the tenor of the contracts that created those rights; and one of those rights in this case was the right to accelerate the repayment of principal. [225]

Just as the statutory authorization of bankruptcy courts' equitable powers is questionable, so too is the case law authority upon which *Mabey* and *Kmart* relied for *limiting* bankruptcy equity. [226] Unfortunately, those decisions themselves are part of the body of case law now cited in support of limiting non-Code practices in bankruptcy.

Indeed, Judge Posner's own authority for *Chicago, Milwaukee* is questionable--he cites a concurrence he authored, *Piper Aircraft Corp. v. Wag-Aero, Inc.*, [227] and an opinion that he authored, *Shondel v. McDerMott*, [228] which in turn cites his *Piper Aircraft* concurrence as authority. In both the opinion and concurrence, Judge Posner held forth on the nature of equity and its scope in the merged courts of law and equity, but only regarding non-bankruptcy contexts. The case law support for the limitation of non-Code practices in bankruptcy has less than solid foundations.

45 4. *Unraveling Authority: The Questionable Case Law Basis for a Limited Reading of Section 105(a) Powers

Curiously absent from the opinions of most courts that have declared that § 105(a) is only an enforcement power is an articulated textual or policy reason for such a reading. Instead, most decisions merely cite the sweeping declarations of earlier opinions, which themselves, cite declarations from still earlier opinions. When one traces back these chains of authority, however, the thread unravels, as is the case with *Chicago, Milwaukee* line of citation. Frequently, the original opinions from which declarations about the scope of bankruptcy equity derive deal with very different contexts and issues and were written in the context of different statutory authorization. Even then, the opinions rarely discuss the textual, policy, and prudential concerns that favor limiting the scope of bankruptcy courts' equitable powers through the language of § 105(a).

Perhaps courts consider the issue so self-evident that discussion of textual or policy considerations in not merited, but given the frequency with which § 105(a) arises, this is surprising. More likely, what lies behind courts' unwillingness to grapple with what § 105(a) and equity might actually mean is a sense of unease about judicial discretion, particularly in the context of Code-based systems. Although judicial lawmaking is certainly commonplace, some judges, conscious of their position as unelected, politically unaccountable figures, do not believe that they are authorized to engage in lawmaking. Moreover, even judges who do not have such qualms might be uncomfortable with writing on a blank slate and would prefer to exercise discretion within guidelines. Bankruptcy frequently presents an even greater challenge because exercises of discretion are particularly hard in cases that present purely monetary rather than moral issues.

A chain of Fifth Circuit decisions illustrates the process through which the slogans that now serve as authority for limiting the equity powers of bankruptcy courts under § 105(a) have become divorced from their unusual original (and arguably limiting) contexts. When one examines the context of the origins of these slogans, their wide-applicability is questionable, especially as they often serve as a proxy for consideration of the statutory and policy limitations on bankruptcy equity.

The most recent case in this chain of questionable Fifth Circuit cases is *Mirant*.[229] In *Mirant*, the bankruptcy court enjoined the Federal Energy Regulatory Commission (FERC) from taking any action to force the debtor power company to comply with its unprofitable governmentally-regulated ***46** contracts. The district court overruled the injunctions[230] and on appeal, the Fifth Circuit held that the injunctions were impermissible because they were overbroad.[231] Notably, the Fifth Circuit affirmed that a bankruptcy court's § 105(a) powers permit it to enjoin a federal regulatory agency.[232]

Before reaching this conclusion, the Fifth Circuit emphasized that:

> A court's powers under § 105(a) are not unlimited as that section only "authorizes bankruptcy courts to fashion such orders as are necessary to further the substantive provisions of the Code," and does not permit those courts to "act as roving commissions to do equity."[233]

Yet, the Fifth Circuit acknowledged that a more narrowly tailored injunction in furtherance of the Code's § 365 provisions for rejection of an executory contract would have been permissible under § 105(a).[234] The problem was not with using § 105(a) authority *per se*, but rather with the *scope* of its exercise.

The Bankruptcy Code assumes, as the Fifth Circuit noted, that "a debtor is subject to ongoing agency regulation while in bankruptcy."[235] Moreover, under § 362(b)(4), the FERC is usually exempt from the Bankruptcy Code's automatic stay provision.[236] Even if an injunction of the FERC would further some other provision of the Code, it might contradict § 362(b)(4), and certainly be contrary to the general policies expressed in the Code. Thus, there is a serious, if unmentioned, tension in the Fifth Circuit's *Mirant* decision. Even if § 105(a) were to be used in furtherance of the rejection provisions of § 365, it is not clear why this would give the bankruptcy court license to ignore or contradict other explicit provisions of the Code, unless § 105(a) were something closer to "a roving commission[ ] to do equity."

There is a reasonable textual solution to this tension, namely that § 362(b)(4) only exempts government regulatory agencies from the *automatic* stay, but still leaves open the possibility of an injunction on motion after the filing of a bankruptcy petition. In other words, the automatic stay does not prevent normal injunctions, even by a bankruptcy court. The Fifth Circuit, ***47** however, did not consider that possibility in the *Mirant* opinion. Instead, the Fifth Circuit adopted a common law-type solution. The Fifth Circuit declared that it would allow the use of § 105(a) powers to enjoin actors exempt under § 362(b)(4) from the automatic stay, but only under "exceptional circumstances." [237] In other words, there is license to depart from the Code and even contradict explicit provisions, but this authority will be tested under the judge-made standard of "exceptional circumstances."

The cases that the Fifth Circuit relied on for authority in *Mirant* were of an entirely different ilk. The Fifth Circuit in *Mirant* cited *Southmark*. [238] for the proposition that § 105(a) does not constitute a "roving commission[ ] to do equity." [239] *Southmark* in turn cites *Oxford Management* [240] for this proposition, for which *Oxford Management* quotes *Sutton* [241] as authority. These cases have also been relied on by courts outside the Fifth Circuit, [242] including the Seventh Circuit in *Kmart*. [243]

Oxford Management and *Sutton* were clear cut cases of equity as pity, not equity to further reorganization or mitigate a harm. In *Sutton*, the Fifth Circuit affirmed the district court's reversal of bankruptcy court's § 105(a) authorization of monthly support payments from the estate to the wife and children of the formerly wealthy debtor in order to maintain them in a plantation-style house. [244] At one point, these payments had been as high as $10,000 a month. The bankruptcy court entered the support order on the theory that "the debtor had a continuing duty to support his spouse and children." [245] In doing so, the bankruptcy court confused the duty of the debtor as an individual with that of bankruptcy estate. Moreover, it went against the well-established practice under the 1898 Act of not permitting such payments. [246] While the wife and children of the debtor might be somewhat sympathetic figures, especially as they did not appear to have a hand in the debtor's undoing--criminal fraud in his oil business--they were not creditors (even though a ridiculous administrative expense claim was raised) and were arguably beyond the purview of the bankruptcy court's jurisdiction.

***48** Curiously, *Sutton* is one of the few cases that refer to the legislative history of § 105(a). While *Sutton* notes that the House Report describes § 105(a) as akin to the All Writs Statute, [247] the opinion omits the following sentence in the House Report, which stated that § 105(a) existed also "to cover any powers traditionally exercised by a bankruptcy court that are not encompassed by the All Writs Statute." [248] If *Sutton* had considered this, it would have been in a quandary of determining what those "traditional powers" were, and as *Sutton* notes, under the 1898 Act the treatment of support claims from spouses and children changed over time. [249]

Most notable about *Sutton*, however, is that the appeal presented a clear case of inequitable use of equitable powers to provide excessive and lavish support for non-debtors. Although *Sutton* was not decided based on the level of support provided to the wife and children of the debtor, the excessive level of support undoubtedly swayed the court. With a different set of facts that would rebalance the equities, such as support payments to cover the medical bills of a terminally ill child or spouse, one wonders whether the Fifth Circuit would have reached the same conclusion. As such, *Sutton* is an exceptional case, and questionable authority for the limitation of bankruptcy courts' equitable powers.

Oxford, [250] a case frequently cited by the Fifth Circuit for the limitations on equity, also presents an exceptional scenario. In *Oxford*, the bankruptcy court ordered, under its § 105(a) powers, that the bankruptcy estate pay a pre-petition claim for a real estate commission outside of the plan. There was no critical vendor motion or claim that the payment was necessary for a reorganization. Rather, the bankruptcy judge (and the affirming district court judge) simply thought that the payment was necessary for unspecified equitable reasons.

While there may be an unreported factual pattern behind *Oxford* that explains the actions of the bankruptcy court, this is the sort of application of equity that smacks of the Chancellor's proverbial foot, [251] a "what the judge ate for breakfast" jurisprudence. If equity is ever to be applied, it should be for specific ends beyond feeling kindly towards a particular party. The application of equity to facilitate a reorganization for the general aggregate benefit ***49** of the parties involved or to mitigate what could become an irreparable injury, as in *Mabey*, should be evaluated differently than "gee, I liked that creditor" cases. To that end, a clearer articulation of federal common law tests than "exceptional circumstances" is crucial. As courts feel their way through the problems of discretion, they often stumble into the creation of federal common law, but the results are clunky, in part because there is little awareness of the endeavor.

The pattern in the Fifth Circuit is typical: when dealing with easy cases of clear abuse of discretion, the circuit court waxed eloquent with overbroad dicta about the scope of bankruptcy equity, without pointing to any particular authority. Then, when tougher cases later arose, in which non-Code practices were urged for a more meritorious use, the dicta from the earlier cases serves as a bar. Too often, it is dicta and not actual holdings, limited by their facts, that are remembered. Thus, it is likely that Judge Easterbrook's unfortunate Jovian wit in *Kmart*, that "A 'doctrine of necessity' is just a fancy name for a power to depart from the Code," will be what lasts of the opinion, not his actual moderate holding that permits sufficiently reviewed and documented critical vendor orders.

5. *The Dangers of the Teleological Approach to Bankruptcy:* Just For Feet

The previous sections illustrate the problems that arise when courts apply catch-phrases and slogans from earlier decisions outside of the original unusual factual contexts in order to limit the exercise of bankruptcy equity. Different problems arise, however, when courts take a more generous view of bankruptcy equity.

In *Just For Feet*, for example, the District Court for the District of Delaware authorized the pre-plan payment of foreign and domestic trade vendors under the necessity of payments doctrine and § 105(a) because "paying certain pre-petition claims may be *necessary to realize the goal of chapter 11*--a successful reorganization."[252] Declaring that it was within "its equitable powers to authorize payment to vendors when such payment is critical to the reorganization," the district court interpreted § 105(a) to authorize actions taken to fulfill the policy goal, not just specific statutory provisions, of the Bankruptcy Code, even though the effect of its ruling was to deviate from the Code's distribution scheme.[253] *Just For Feet* would imply that unless there is ***50** a literal and unavoidable contradiction between the action taken under the equitable powers and a controlling precedent or statute, there is no limit on the equitable powers as long as they further reorganization. This is the danger of the teleological approach to bankruptcy that places successful reorganization over everything else. The rights of non-consenting creditors get trampled for the sake of the reorganization.

Courts' desire to cabin off equitable discretion has led to a heavy emphasis on finding some sort of statutory authorization for non-Code practices in bankruptcy equity. This, in turn, has led to an inappropriate reliance on § 105(a) as a framework for analyzing non-Code practices and produced numerous decisions that are decidedly at odds with the general tenor of equity in the sense of substantial justice, as expressed in *Pepper v. Litton*. Even in cases where the equities were clear-cut, such as in *Mabey*, the courts felt that without explicit statutory authorization, they were unable to rule with the equities. On the other hand, as *Just for Feet* shows, some sort of limiting principle on the application of bankruptcy equity is necessary.

IV. HISTORICAL LIMITATIONS ON BANKRUPTCY EQUITY

A. HISTORICAL EQUITY POWERS: *GRUPO MEXICANO DE DESARROLLO, S.A. V. ALLIANCE BOND FUND, INC.*

Historical practice is the other method courts have used to constrain equity. The clearest example of this method of limitation is *Grupo Mexicano* [254] *Grupo Mexicano* was not a bankruptcy case; it was an insolvency case dealing with the ability of federal courts to craft creative remedies using their equity powers. *Grupo Mexicano*, however, amply illustrates both the prudential concerns underlying courts' discomfort with equitable discretion and the problems of using historical practice as a limiting device.

One of Grupo Mexicano's creditors feared that Grupo Mexicano was insolvent and preferring its Mexican creditors in its asset allocation in order to frustrate its American creditors' efforts to enforce any possible judgment for them. The creditor requested a preliminary injunction restraining Grupo Mexicano from transferring its assets. The district court granted the preliminary asset freeze injunction.

On appeal, the Supreme Court held that the district court did not have ***51** the authority to issue such an injunction. The Court noted that "[w]e do not question the proposition that equity is flexible; but in the federal system, at least, that flexibility is confined within the broad boundaries of traditional equitable relief."[255] Accordingly, the Supreme Court ruled that federal courts have the equity jurisdiction that was exercised by the English Court of Chancery at the time the Constitution was adopted and the Judiciary Act of 1789 was enacted. "[T]he equitable powers conferred by the Judiciary Act of 1789 did not include the power to create remedies previously unknown to equity jurisprudence."[256] Without specific statutory authorization the judicial power is limited to its original meaning. The injunction requested by the creditor was a so-called "*Mareva*" injunction, which was first deployed by the English Chancery in 1975,[257] and was a "dramatic departure from prior practice."[258]

Citing Justice Joseph Story's Commentaries on Equity Jurisprudence, the Court rejected the idea that equitable remedies could be any remedy that appealed to "the grand aims of equity," or which was part of "a general power to grant relief wherever legal remedies are not 'practical and efficient,' unless there is a statute to the contrary."[259] Such a power, according to Justice Scalia's opinion, would be inconsistent with a "government of laws, not of men."[260] Unchecked judicial discretion would make equity vary with the length of the Chancellor's proverbial foot.[261] In the bankruptcy context, such arbitrary justice would lead to incongruous decisions that are particularly incompatible with the uniformity sought by any Code-based regime. It would also create tremendous uncertainty for creditors and debtors.

Underlying the Court's concern about unbridled equity powers is a concern about separation of powers. If there were no limits on federal courts' equity powers other than efficiency and practicality, it would be the courts, and not Congress, that would determine not only what remedies exist for the vindication of rights, but also, by extension, what rights exist, for "where there is a legal right, there is also a legal remedy."[262] Thus, in *Grupo Mexicano*, the granting of a *Mareva* injunction would have acknowledged a right to such an injunction. As the Supreme Court recognized, it cannot be the province of the court to create such rights; the Constitutional role of the ***52** courts is not to legislate. Legislation by politically unaccountable actors such as unelected Article III judges with life tenure and salary protection or even of bankruptcy judges, appointed by the Circuit Courts for terms,[263] runs contrary to the entire notion of separation of powers.

Although the Supreme Court used the language of separation of powers, one can also sense a general judicial nervousness about "doing justice" instead of "doing law." The Court simply did not know what to do with "a roving commission to do equity," particularly in a case involving a struggle between various sophisticated creditors, in which one's moral compass provides little guidance. This is apparent from the odd manner in which the Court tried to limit equitable discretion. The Court's originalist reading of Article III equity power evidences surprising judicial modesty for a Court that would surely not limit its power to hear only forms of actions available in 1789. It also ignores the evolving nature of equity up to 1789, not to mention its evolution in British courts since 1789 (such as the development of the *Mareva* injunction). *Grupo Mexicano* is an arbitrary amputation of a living judicial tradition.

However questionable the 1789 English Chancery standard is, it should not be surprising, for it is hard to think of another bright line rule for sorting exercises of equitable discretion that would not be at least as strange. The originalist decision in *Grupo Mexicano* is strong evidence of courts' general discomfort with discretion and their desire to channel and guide the exercise of such discretion. Statutory (or Constitutional) language is the preferred means of limiting discretion, but when these tools are not available, discretion must still be curtailed, even if it involves creating judicial glosses on text or even federal common lawmaking, an act which invokes the very separation of powers problem that *Grupo* was concerned with--judicial lawmaking. Judicial lawmaking, then, is chiefly a concern when it is an exercise of judicial discretion rather than effecting a channeling thereof.

Grupo Mexicano raises several questions from the perspective of bankruptcy jurisdiction. First, does *Grupo Mexicano* apply to bankruptcy courts? If so, how much of a limitation would this put on bankruptcy equity powers? Does *Grupo Mexicano* conflict with the pre-Code practices doctrine?

The Supreme Court's 1935 holding in *Continental Illinois Bank* counsels against an application of *Grupo Mexicano* to bankruptcy. In *Continental Illinois*, the Supreme Court noted that "the power of Congress under the bankruptcy clause is not to be limited by the English or Colonial law in force when the Constitution was adopted."[264] But does this mean that *Grupo* ***53** *Mexicano* only binds equity powers of federal courts when *not* in bankruptcy? It would be an unusual situation if federal courts' equity powers in general were far more constricted than their equity powers in bankruptcy; surely Congress did not conceive of such a differentiation when granting bankruptcy courts equity powers--it intended to grant the same equity powers as otherwise existed. The language of 28 U.S.C. § 1481, for example, states that "a bankruptcy court shall have the powers of a court of equity, law, and admiralty, but may not enjoin another court or punish criminal contempt not committed in the presence of the judge of the court or warranting a punishment of imprisonment."[265] Thus, the grant of equity powers to bankruptcy courts was of the general equity powers of federal courts. Congress could not grant more than exists; indeed, 28 U.S.C. § 1481 grants more limited equity powers than federal courts generally have, as it excludes criminal contempt powers and the injunction of other courts' actions.

Assuming that *Continental Illinois* is not a bar to the application of *Grupo Mexicano* to bankruptcy, *Grupo Mexicano* appears, then, initially, to bind bankruptcy courts. *Grupo Mexicano* refers to "federal courts,"[266] not just district courts. Are bankruptcy courts "federal courts" in the sense of the *Grupo Mexicano* opinion? That is, does *Grupo Mexicano* apply only to Article III courts, or to all federal courts?

There is little in *Grupo Mexicano* that indicates a limitation to Article III courts. Perhaps such an limitation is implied by the Court's reliance on the Judiciary Act of 1789. In any case, the scope of *Grupo Mexicano* was not directly addressed in the opinion. By its very nature, however, the issue that arose in *Grupo Mexicano* could not have arisen in bankruptcy. As the Court itself noted, "The law of fraudulent conveyances and bankruptcy was developed to prevent such conduct [as Grupo Mexicano's]; an equitable power to restrict a debtor's use of his unencumbered property before judgment was not."[267]

Upon filing for bankruptcy, the assets of the debtor become part of a court-supervised estate; no assets can flow out of the estate without the court's approval. Moreover, the estate can recover assets transferred by the ***54** debtor before bankruptcy.[268] The result, as Judith Resnik has noted, is that "in light of *Grupo Mexicano*, bankruptcy judges may have more power to freeze assets than do life-tenured judges,"[269] since asset transfers in bankruptcy require court approval, whereas district judges cannot freeze assets pending monetary relief.[270]

The greater power of bankruptcy courts to freeze assets than an Article III court does not say that the *equity* powers of a bankruptcy court are greater than that of an Article III court. The bankruptcy asset freeze is statutory,[271] so it does not derive from bankruptcy courts' equitable powers, even if it can only be enforced via injunction. Indeed, because bankruptcy courts hear their cases on reference from the district court,[272] a district court that did not refer a bankruptcy case would administer the same statutory asset freeze. The equity powers (as opposed to statutory powers) of a bankruptcy court cannot be greater than those of the district court, as the bankruptcy court is a unit of the district court. Thus, *Grupo Mexicano* would define at least an outer boundary to the equity powers of bankruptcy courts.

On the other hand, bankruptcy courts exist as units of the district courts by virtue of statute, not the Constitution. *Grupo Mexicano* is a Constitutional holding addressing the powers inherent in Article III, clause 2. Since the authority of bankruptcy courts derives Constitutionally from Congress's Bankruptcy Power under Article I, Clause 8,[273] *Grupo Mexicano* may not affect bankruptcy courts. Indeed, the powers of bankruptcy courts might, in some areas, be *greater* than that of Article III courts, as they are Constitutionally limited only by Bankruptcy Power and generally applicable provisions such as the requirement of Due Process.[274]

Conceivably, then, bankruptcy courts' equity powers could exceed those of the district courts. Yet, the Supreme Court has, in the context of the Appointments clause, noted that Article I courts exercise the "judicial power" referred to in Article III, clause 1.[275] This presents a strong indication that Article III-based holdings will apply to non-Article III courts when ***55** they exercise the "judicial power," of which equity powers are unquestionably a part.

1. Grupo Mexicano *in Bankruptcy*

Assuming *Grupo Mexicano* limits the equity powers of bankruptcy courts, how has this affected actual bankruptcy practices? Lower courts have generally managed to make *Grupo Mexicano* inapplicable in two ways. Some lower courts have claimed a statutory, non-equitable authorization for the practice in question.[276] Others claim that *Grupo Mexicano* does not apply to bankruptcy proceedings.[277] Still other lower courts have claimed that the non-Code practice has been ratified as a matter of federal common law before *Grupo Mexicano* was decided; that is, that the relief in question is "traditional equitable relief" even if its pedigree does not extend to the English Chancery in 1789.

Both methods were at work in *Stone & Webster*, where a reorganization plan provided for the substantive consolidation of the debtor and some seventy-two debtor subsidiaries into one estate.[278] This would obviously affect the payout that various creditors could receive. Under the unconsolidated plan, the creditors of the parent debtor would receive a 100% recovery and its shareholders $3/share, while the creditors of a subsidiary would get only 7¢ on the dollar at most.[279] "With substantive consolidation, creditors of all debtors [would] receive significant recovery from aggregated estates," but the parent's creditors would not get 100 cents on the dollar. [280]

The parent debtor's equity holders' committee argued against the substantive consolidation and claimed that it was beyond the scope of the court's equity powers in light of *Grupo Mexicano*. [281] The bankruptcy court reviewed the long history of substantive consolidation and noted with particular relish a 1941 case, *Sampsell*, [282] in which the Supreme Court itself upheld substantive consolidation. [283] The bankruptcy court ultimately granted the substantive consolidation based on statutory authorization under § 1123 of the Code, [284] instead of § 105(a) powers. Nonetheless, the bankruptcy court strongly implied that it believed that substantive consolidation would survive *Grupo Mexicano*, absent § 1123, based on its historic status. [285] Likewise, ***56** in *Owens-Corning*, the Third Circuit determined that *Grupo Mexicano* was not a bar to substantive consolidation, even though it ultimately decided against a deemed substantive consolidation in regard only to some creditors. [286]

The argument that *Grupo Mexicano* does not apply to non-Code practices of sufficient historical pedigree was made explicit by the Bankruptcy Court for the Middle District of Tennessee in granting a substantive consolidation motion in *In re American Homepatient, Inc*. Although the *American Homepatient* court was aware of the *Stone & Webster* decision, [287] which avoided ruling on the issue, the *American Homepatient* court ruled that *Grupo Mexicano* did not bar substantive consolidation under equity powers and granted the consolidation motion. [288] The court noted the long pedigree of substantive consolidation and that the practice had been repeatedly ratified by the Supreme Court under the Act. [289] In the eyes of the *American Homepatient* court, this made substantive consolidation acceptable under *Grupo Mexicano*, even though it never addressed whether such a remedy was possible in 1789 or if *Grupo Mexicano* impliedly repudiated earlier Supreme Court decisions. [290] It was good enough for the *American Homepatient* court that the practice had existed, with the Supreme Court's blessing, under the 1898 Act and had not been repudiated by the Code.

Dow Corning [291] presents the most amazing twist on *Grupo Mexicano*' s application in bankruptcy. In *Dow Corning*, the bankruptcy court held that non-debtor releases were authorized by § 1123(b)(6), [292] but refused to approve the releases because it believed that they were precluded by *Grupo Mexicano*. [293] The district court reversed on the basis that the statutory authorization trumped the Constitutional limitation on *equitable*, but not statutory powers. [294]

The Sixth Circuit upheld the district court on similar reasoning, but cited § 105(a) as the grant of statutory power to carry out non-debtor releases through injunctions. [295] The Sixth Circuit concluded that "due to this statutory ***57** grant of power [in § 105(a)], the bankruptcy court is not confined to traditional equity jurisprudence and therefore, the bankruptcy court's *Grupo Mexicano* analysis was misplaced." [296] The underlying assumption of the Sixth Circuit's opinion was that *Grupo Mexicano* applies to the equity powers of the bankruptcy courts. [297] The only reason that *Grupo Mexicano* did not bar the non-debtor releases is that they were not an exercise of equitable powers, but rather an exercise of § 105(a) powers, which the Sixth Circuit correctly read as a grant of statutory powers and not a statutory grant of equitable powers.

Grupo Mexicano may limit some non-Code practices. To the extent that a court finds statutory authorization for those practices under § 105(a), however, it can claim that *Grupo Mexicano* is inapplicable because it governs only the exercise of equity powers that exist under Article III, not statutory grants of equity powers. Even if *Grupo Mexicano*'s technical limitations can be avoided in the bankruptcy context, though, it does not follow that *Grupo Mexicano*'s underlying separation of powers concern is assuaged, a problem considered in greater detail below.

B. THE PRE-CODE PRACTICES DOCTRINE

1. *Section 105(a) as a Source for the Pre-Code Practices Doctrine?*

Even though *Grupo Mexicano* may not apply to bankruptcy courts, historical practice serves as a limitation on (or justification for) equitable powers in bankruptcy through the pre-Code practices doctrine. The pre-Code practices doctrine is the statutory interpretation principle, repeatedly enunciated by the Supreme Court, [298] that pre-Code practices continue to be valid, unless

Congress evinced clear intent to depart from them under the Code. Although the pre-Code practices doctrine has come to us in Supreme Court decisions, the earliest hint at such a doctrine is in the legislative history of § 105(a).

Arguably, although the plain language of § 105(a) does not authorize equity powers, it is a device that incorporates bankruptcy courts' historical equity powers into the Code. Such a reading is not apparent from the text of § 105(a), but the House Committee Report noted that § 105(a) was meant to "cover any powers traditionally exercised by a bankruptcy court that are not encompassed by the All Writs Statute."[299] Thus, according to the House Report, § 105(a) goes beyond the All Writs Statute and incorporates historical bankruptcy court powers into the Code.

***58** If the legislative history is given credence, § 105(a) merely confirms the pre-Code powers of a bankruptcy court. These pre-Code powers cannot include general equity powers, however. Equity powers were authorized as a matter of *statute* under the 1898 Act. Whatever powers § 105(a) incorporates, it cannot include those that were statutorily authorized under the 1898 Act, or else § 105(a) would reincorporate the entire 1898 Act, as all of those powers were traditionally exercised. Given that the 1978 Code *replaced* the 1898 Act, such a broad reading of the legislative history of § 105(a) is not tenable. What, then, was the legislative history referring to? Clearly to some unenumerated powers of bankruptcy courts.

Unfortunately, only a handful of the published opinions that consider the scope of § 105(a) reference the legislative history. None has seriously considered what "powers traditionally exercised by a bankruptcy court" means. Incorporation of historical practice is extremely problematic because bankruptcy practice has not been static in the United States for the last two centuries nor has it been uniform. Variation between districts and referees were major complaints under the 1898 Act.[300] At the very least, one would like to know how widespread and well-established "traditional powers" must be, whether these powers can be expanded by analogy, whether they include powers from proceedings similar to bankruptcy, such as equity receiverships,[301] and, most importantly, whether a bankruptcy court's traditional powers included *general* equitable powers or only specific, limited equitable powers.

Although it is unclear precisely what powers the House Committee was referring to, the legislative history seems to state that § 105(a) incorporates the pre-1978 federal common law of bankruptcy as developed under the 1898 Act. Obviously, this is tempered by any provision in the 1978 Code explicitly disavowing such pre-1978 federal common law. In other words, this is essentially a statement of the pre-Code practices doctrine.

2. *Development of the Pre-Code Practices Doctrine*

The Supreme Court first addressed the relation between equity and pre-Code practices in a series of cases from 1986 to 1998: *Midlantic*,[302] *Kelly v. Robinson*,[303] *Timbers*,[304] *Ahlers*,[305] *Ron Pair*,[306] *Davenport*,[307] and *Cohen v.* ***59** *de la Cruz*.[308] The majorities in these cases shifted, and the Court usually addressed the role of pre-Code practices in dicta, but, taken as a whole, these cases form a clear jurisprudence on the role of pre-Code practices in bankruptcy. These cases also point to the existence of a federal common law of bankruptcy before the 1978 Code.

The Court first addressed the role of pre-Code practices in a pair of 1986 opinions, *Midlantic* and *Kelly v. Robinson*. In these decisions, the Court emphasized that the Code was written against the background of bankruptcy practice as developed under the 1898 Act, which must inform any reading of the Code. In *Midlantic*, the Court refused to hold that the Bankruptcy Code abrogated exceptions created by the courts in construing the Bankruptcy Act. In other words, while specific Code sections supplant pre-Code practices, there is no general presumption that pre-Code practices have been displaced by the Code. The Court also acknowledged the special place of pre-1978 federal common law in bankruptcy: "The normal rule of statutory construction is that if Congress intends for legislation to change the interpretation of *a judicially created concept*, it makes that intent specific. The Court has followed this rule with particular care in construing the scope of bankruptcy codifications."[309]

Thus, the Code does not abrogate what we might characterize as the pre-1978 federal common law of bankruptcy as a whole.

On these lines, the Court in *Kelly v. Robinson*[310] specifically looked to the practice of courts under the Act, even though the practice was itself a departure from the text of the Act. The debtor in *Kelly* had been convicted of welfare fraud but given a suspended sentence conditioned on meeting the terms of her probation, which included making restitution payments.[311] The debtor then filed for bankruptcy, listed her restitution obligations as a debt, and received a discharge. [312] When the debtor ceased making her restitution payments, the state probation authority informed her that it considered the restitution obligation non-dischargeable. [313] The debtor then filed for a declaratory judgment from the bankruptcy court, which held the debt to be non-dischargeable under § 523(a)(7) of the Code, 11 U.S.C. § 523(a)(7), which prohibits the discharge of any debt "to the extent such debt is for a fine, penalty, or forfeiture payable to and for the benefit of a governmental unit, and is not compensation for actual pecuniary loss." [314] The debtor argued ***60** that the restitution payments were for actual pecuniary loss and thus dischargeable and appealed.

The Supreme Court held that the restitution obligation was non-dischargeable because the statute under which the restitution order was made did not require restitution to correlate with the actual loss suffered. [315] The legislative history of the Bankruptcy Code also swayed the Court in its interpretation that § 523(a)(7) was not meant to allow the discharge of criminal restitution orders. The language of the Bankruptcy Act of 1898 had allowed for (but did not require) the discharge of criminal penalties. [316] Most courts, however, had refused to discharge criminal penalties. [317] Thus:

Congress enacted the Code in 1978 against the background of an *established judicial exception* to discharge for criminal sentences, including restitution orders, an exception created in the face of a statute drafted with considerable care and specificity. [318]

Kelly, like *Midlantic*, teaches that a reading of the provisions of the Bankruptcy Code must be informed by the pre-1978 federal common law of bankruptcy--non-statutory pre-Code practices.

In *Ron Pair*, [319] the Court took a very narrow reading of its decisions three years earlier in *Midlantic* and *Kelly*. The government had secured a tax lien on debtor and objected to a reorganization plan that did not grant it post-petition interest on its lien, up to the value of the collateral. [320] The debtor urged that judgment and statutory liens be treated differently than consensual security interests. [321] The debtor claimed that pre-Code practice distinguished between consensual and non-consensual liens and, citing *Midlantic* and *Kelly*, argued that absent explicit repudiation in the Bankruptcy Code, such practices should be assumed to continue. [322]

The Court rejected the debtor's argument and distinguished *Midlantic* and *Kelly* in ruling for the Government. The Court noted that its *Midlantic* decision was not dependent upon pre-Code practice, which merely provided "interpretive assistance." [323] Similarly, pre-Code practice was but an interpretive aid in *Kelly*, as it "reflected policy considerations of great longevity and importance." [324] The Court emphasized that "in determining that Congress had not intended to depart from pre-Code practice ... we did not rely on a ***61** pale presumption to that effect." [325] Thus, "in an appropriate case, a court must determine whether Congress has expressed an intent to change the interpretation of a judicially created concept in enacting the Code." [326]

Such appropriate cases, however, do not include those where the statutory language of the Bankruptcy Code is clear, and its natural interpretation does not conflict with any significant state or federal interest, such as criminal justice or environmental protection, or with other parts of the Code. [327] In short, when interpreting unambiguous statutory language that does not conflict with other law, there is no reason to turn to pre-Code practices. Moreover, the Court noted, pre-Code practice must be widespread and consistent to be considered. [328] If a practice only existed in a few cases, Congress cannot be assumed to be cognizant of it. [329]

Four Justices dissented in *Ron Pair,* arguing that the statutory language in question was far from unambiguous [330] and that the Court took too narrow a view of *Midlantic* and *Kelly*. [331] Instead, the dissent claimed that, "The rule of *Midlantic* is that bankruptcy statutes will not be deemed to have changed pre-Code law unless there is some indication that Congress thought it was effecting such a change." [332] The dissent also noted that in the previous term, the Court had declared, "[I]t is most improbable that [a change in the existing bankruptcy rules] would have been made without even any mention in the legislative history." [333] In *Ron Pair* the Court backed away from the broad statement about the role of pre-Code practices in interpreting the Code that it had articulated in *Midlantic* and *Kelly*.

Two years later, however, in *Davenport*, [334] the Court appeared to reaffirm the broad reading of *Midlantic* and *Kelly. Davenport* presented the same issue as *Kelly*, the dischargability of criminal restitution orders, but in a Chapter 13 context. In *Kelly*, a Chapter 7 case, the Court held the restitution order to be non-dischargeable. [335] In *Davenport*, however, the Court ruled, based on different statutory language, that restitution orders are dischargeable ***62** in Chapter 13. The 7-2 majority emphasized, though, in a point that the dissent echoed for its own argument: [336]

Our refusal to carve out a broad judicial exception to discharge for restitution orders does not signal a retreat from the principles applied in *Kelly*. We will not read the Bankruptcy Code to erode past bankruptcy practice absent a clear indication that Congress intended such a departure. [337]

The crucial factor for the Court was the unambiguous statutory language: "Where, as here, congressional intent is clear, our sole function is to enforce the statute according to its terms." [338]

3. *The Current State of the Pre-Code Practices Doctrine*

The most recent Supreme Court statement on the pre-Code practices comes from *Cohen v. de la Cruz*, [339] a civil parallel to *Kelly*. In *Cohen*, the Court held that § 523(a)(2)(A) barred the discharge of liability arising from the debtor's fraud, including punitive damages. The statutory language in question excepted from discharge "any debt ... for money, property, services, or ... credit, to the extent obtained by ... false pretenses, false representation, or actual fraud." [340] Thus, it could be read not to cover punitive damages, depending on whether the emphasis was on "any debt" or "debt ... for." The unanimous Court noted that under the Bankruptcy Act of 1898, all liabilities arising from fraud were non-dischargeable, not just the portion of liability that was restitutive. [341] The Court quoted *Davenport* [342] that the Bankruptcy Code cannot be read "to erode past bankruptcy practice absent a clear indication that Congress intended such a departure." [343] This factor, along with the statutory language, the meaning of parallel statutory provisions, and the general policy against allowing bankruptcy to be used to shed liability for fraudulent behavior all supported the decision. [344] While the decision in *Cohen v. de la Cruz* did not rest solely on pre-Code practices, it shows the continuing importance of pre-Code practice in elucidating the statutory language of the Code.

Indeed, without the pre-Code practices doctrine, the Code would be impossible to implement. Some of the most basic principles of bankruptcy practice are nowhere to be found in the Code. For example, it is axiomatic that all equity interests are junior in priority to all creditors. How do we know ***63** this? For Chapter 7 cases, § 726 provides the order of distribution. [345] There is no analogous provision in Chapters 9, 11, 12, or 13. While the cramdown provision of Chapter 11 refers to "the holder of any claim or interest that is junior to the claims of such class [of unsecured claims or interests]," [346] the Code does not tell us which claims are junior and which are senior. The answer derives from state law, but what bankruptcy generally adopts state law as to the validity of claims, such is not necessarily the case to the priority of claims. [347] The rule that creditors are senior to equity holders is a pre-Code practice that lacks any statutory pedigree. The Bankruptcy Code cannot be the alpha and the omega of bankruptcy law.

The Court's well-established methodology for bankruptcy cases is this: first consider the applicable statutory language. If it is clear, then apply that language. If the language is ambiguous, however, then there can be recourse to pre-Code practices as an interpretive aid similar to legislative history. This methodology puts tremendous pressure on the Court's determination of the clarity of the statutory language, much like the Court's parallel *Chevron* methodology [348] in Administrative Procedure Act cases. [349] Under *Chevron* doctrine, when an administrative agency's interpretation of a statute is challenged, the agency's interpretation is given deference, but only if the statutory language is ambiguous. This means that the crucial point to determine in a *Chevron* analysis is whether the statute is in fact ambiguous. There is an unfortunate circularity to this methodology; the clarity of statutory language is sometimes only apparent in light of an examination of non-textual sources, such as pre-Code practices and legislative history.

4. *Problems with the Pre-Code Practices Doctrine*

The pre-Code practices doctrine is problematic. First, it places an arbitrary limit on the development of the federal common law of bankruptcy. By authorizing pre-Code non-Code practices, there is an implicit exclusion of post-Code non-Code practices. This distinction makes little sense. Bankruptcy law existed as a matter of statute both before and after 1978. The Court has recognized the existence of federal common law of bankruptcy from before 1978. Why should there not be post-1978 federal common law? While the 1978 Code might affect pre-Code federal common law, there is no reason to think that it precludes a continuing development of federal common law of bankruptcy

Indeed, federal common law is arguably more important than ever for the ***64** successful operation of the bankruptcy system. Reorganization techniques have only become more complex under the Code. Shouldn't bankruptcy courts have the flexibility to adapt to these techniques? Most other areas of federal law have agencies with rule-making authority that give those areas of law the flexibility to adapt to new developments via interstitial lawmaking. Bankruptcy is unique among major areas of federal law in lacking an administrative agency with rule-making power. The Office of the United States Trustee does not have rule-making power for the bankruptcy system. The Judicial Conference makes the Bankruptcy Rules, but these operate quite differently than, say, regulations promulgated by the EPA; Bankruptcy Rules, like the Federal Rules of Civil Procedure, are essentially procedural. Why shouldn't bankruptcy judges, who, like agencies, are Article I entities with particular technical expertise, have similar interstitial lawmaking powers?

The second problem with the pre-Code practices doctrine is defining pre-Code practices. Simply put, the historical literature on pre-1978 bankruptcy practice is inadequate for this task. Even if it were adequate, there is still the question of how a pre-Code practice is defined. Are these practices to be interpreted narrowly or can they be broadened to analogous situations? For example, the Code contains no mention of substantive consolidation.[350] Instead, it is "a caselaw doctrine[,] which has been developed over the years."[351] Substantive consolidation started as a practice almost identical to veil piercing:

> In the early years, when the doctrine of substantive consolidation was first evolving, the courts applied a test almost identical to the test for alter ego and/or piercing the corporate veil .... In the older [pre-Code] cases, the application of substantive consolidation was limited to extreme cases involving fraud or neglect of corporate formalities and accounting procedures.[352]

The limited pre-Code application of substantive consolidation has been expanded under § 105(a) equitable powers to include consolidation of corporations that have observed the necessary corporate formalities and not engaged ***65** in fraud, when the creditors relied on corporate interconnectedness. Thus, in order to give tort victims greater compensation, the District of Delaware even extended substantive consolidation in *Owens Corning* to a situation in which there was reliance on formal *separateness* and neither fraud nor abuse of corporate formalities.[353]

While bankruptcy courts' statutory equity powers cannot be grandfathered in under the pre-Code practices doctrine, the practices formerly authorized under the equity powers of the bankruptcy courts might present a different situation if they were widespread and are not repudiated by an affirmative provision in the Code. For example, the Ninth Circuit has noted that "[e]ven though [the practice of] substantive consolidation was not codified in the statutory overhaul of bankruptcy law in 1978, the equitable power [of substantive consolidation] undoubtedly survived enactment of the Bankruptcy Code. No case has held to the contrary."[354] Such is the case with virtually all pre-Code *bankruptcy* practices authorized under the color of equity. Difficulties have arisen only with attempts to apply the pre-Code practices doctrine to pre-Code equity receivership, *i.e.*, non-bankruptcy, practices.[355]

66 5. *Does the Pre-Code Practices Doctrine Imply a Living Federal Common Law of Bankruptcy?

In the middle of the Court's string of decisions discussing the pre-Code practices doctrine was *Ahlers*. *Ahlers* touched on pre-Code practices only briefly, but its language is significant: "We think that the statutory language and the legislative history of § 1129(b) clearly bar any expansion of any exception to the absolute priority rule beyond that recognized in our cases at the time Congress enacted the 1978 Bankruptcy Code."[356]

Not only does *Ahlers* comport with the general thrust of the Court's jurisprudence, that the pre-1978 federal common law of bankruptcy continues to be valid, but there is also an important negative implication to *Ahlers*. *Ahlers* refused to allow a judicial expansion of the pre-1978 exceptions to the absolute priority rule, but this was based on the existence of a codification of the absolute priority rule in the 1978 Code and a legislative history that supported the exclusive nature of the codification. This implies that pre-Code practices that are not codified can be expanded--that is, there is a *living* federal common law of bankruptcy in addition to the pre-Code practices doctrine.

V. THE FEDERAL COMMON LAW OF BANKRUPTCY

A. CAN THERE BE A FEDERAL COMMON LAW OF BANKRUPTCY?

1. *Defining Federal Common Law*

Definitions of federal common law vary,[357] but as the Supreme Court uses the term, "in the strictest sense, [it is] a rule of decision that amounts, not simply to an interpretation of a federal statute, but rather to the judicial 'creation' of a special federal rule of decision."[358] The Supreme Court's definition focuses on one end of the spectrum between judicial interpretation and judicial lawmaking,[359] as opposed to the broader definition suggested by Martha Field: "any rule of federal law created by a court ... when the substance of that rule is not clearly suggested by federal enactments--constitutional or congressional."[360] Field's definition "includes much we think of as interpretation; it leaves no clear-cut line between federal common law and federal interpretational law."[361]

The Supreme Court's definition encompasses both interstitial lawmaking and more traditional common lawmaking, such as creation of new rights of ***67** action or rules of decision. Non-Code practices tend to fall within the narrower ambit of the Court's definition. They range from interstitial lawmaking, that is filling in the gaps where Congress has not spoken but working with the statutory structure--*e.g.*, pre-plan payments for pre-petition debts or cross-collateralization--to creating rules of decision and rights of action-- substantive consolidation, non-debtor releases, and channeling injunctions other than those issued under 11 U.S.C. § 524(g).

2. *The Status of Federal Common Law Post-Erie*

It is hornbook law going back to Justice Brandeis' proclamation in *Erie v. Tompkins* that there is "no federal general common law."[362] But it is also well established that there is federal common law in a "few and restricted"[363] specific areas.[364] As the Supreme Court explained in *Texas Industries, Inc. v. Radcliff Materials, Inc.*, these areas:

> fall into essentially two categories: those in which a federal rule of decision is "necessary to protect uniquely federal interests" and those in which Congress has given the courts the power to develop substantive law.
>
> The vesting of jurisdiction in the federal courts does not in and of itself give rise to authority to formulate federal common law, nor does the existence of congressional authority under Art. I mean that federal courts are free to develop a common law to govern those areas until Congress acts. Rather, absent some congressional authorization to formulate substantive rules of decision, federal common law exists only in such narrow areas as those concerned with the rights and obligations of the United States, interstate and international disputes implicating the conflicting rights of States or our relations with foreign nations and admiralty cases.[365]

Thus, there are two areas in which federal common lawmaking power can exist: when necessary to protect a uniquely federal interest and when Congress has authorized it.[366]

***68** 3. *Where Does Bankruptcy Fall in the Texas Industries Analysis?*

Can there be a federal common law of bankruptcy under *Texas Industries*? [367] This article argues yes on the basis of the language of the Bankruptcy Clause, the legislative history of the Bankruptcy Code, the pre-Code practices doctrine, and the nature of bankruptcy practice.

Generally, federal common law is considered in the context of whether courts should apply federal common law instead of state law as the rule of decision. This question in the bankruptcy context is beyond the scope of this article. [368] Rather, the question this article aims to address is when there is no state law to provide a rule of decision, can federal courts in bankruptcy create a federal common law that goes beyond the letter of the Code? [369] To put this into some perspective, state law and federal non-bankruptcy law generally determine the existence and size of claims, [370] but bankruptcy law provides the priority of claims, which is crucial when there is a limited pot. For example, property rights such as security interests are created by state law, but federal law (including *Erie*) determines their relative status in bankruptcy. [371]

The possibility of a federal common law of bankruptcy is an open question. The Supreme Court has never directly addressed the issue, and the courts of appeals are split. The Second [372] and Third [373] Circuits have acknowledged ***69** a federal common law of bankruptcy in their dicta to illustrate parallel non-bankruptcy common law practices. The Eighth Circuit has rejected the existence of a specific delegation of power to create a federal common law right to extend state redemption periods in Chapter 12 farm bankruptcies under 11 U.S.C. § 1222(b)(3) and (5). Such a provision by provision approach implies an acceptance in principle that there *could* be federal common lawmaking power in bankruptcy, at least under *Texas Industries*' second path, even if it did not exist in this instance. [374] In contrast, the Sixth Circuit created the very right that the Eighth Circuit denied, albeit without any discussion of its authorization to make federal common law. [375] Other courts have certainly engaged in what can only be described as federal common lawmaking without ever addressing the issue. [376]

The Fifth Circuit is the only circuit court of appeals to take up the question of whether there is a general delegation of federal common lawmaking power in bankruptcy. [377] In *Walker v. The Cadle Co. (In re Walker)*, the issue before the Fifth Circuit was whether there was a right of action for contribution between joint violators of the automatic stay. [378] The Fifth Circuit was ***70** facing the same question as the Supreme Court in *Texas Industries* -- whether a right to contribution existed under federal common law--but in a bankruptcy, rather than an anti-trust, context. This might have constrained the Fifth Circuit more than if *Walker* had dealt with the creation of a right without a parallel, non-bankruptcy situation previously addressed by the Supreme Court.

Nonetheless, based on the absence of legislative history indicating that Congress intended to create such a right and the obvious purpose of the automatic stay to protect debtors, not violators, of the stay, the Fifth Circuit held that there was no such right. [379] The Fifth Circuit observed that because there was no statutory right, it could only exist under federal common law, but that under *Texas Industries*, courts have a restricted ability to make federal common law: [380]

> We do not wantonly use our power to fashion common-law remedies, for the Supreme Court has cautioned us to invoke the power of the "federal common law" only when either "a federal rule of decision is necessary to protect uniquely federal interests, [or] ... Congress has given the courts the power to develop substantive law." This grant of power is very narrow, and although bankruptcy might seem to be a "uniquely federal interest," the Court has stated that, the existence of congressional authority under Art. I [does not] mean that federal courts are free to develop a common law to govern those areas until Congress acts .... Simply put, bankruptcy is not an area where the courts have wide discretion to fashion new causes of action. [381]

The Fifth Circuit then noted that "in enacting the Bankruptcy Code[,] Congress created a comprehensive legislative program ...." [382] For the Fifth Circuit, codification foreclosed the possibility of federal common law in bankruptcy. [383] It is not clear, though, why this would not have been the case with the 1898 Act too, as bankruptcy exists only as a matter of statute. While federal common law may add on to that statutory structure, it does not create bankruptcy relief where none existed before.

Whatever the merits of the Fifth Circuit's decision regarding the right to ***71** contribution, there are serious analytical problems in *Walker*'s treatment of federal common lawmaking power. *Texas Industries* laid out two separate ways in which federal common lawmaking was authorized. First, there are cases "in which a federal rule of decision is necessary to protect uniquely federal interests." [384] Second, there are cases "in which Congress has given the courts the power to develop substantive law." [385] The Fifth Circuit's analysis of both paths was cursory, and, more to the point, erroneous. Federal common lawmaking in bankruptcy is proper under both of *Texas Industries*' paths, as detailed below.

4. ***Path 1: Constitutional Sources for a Federal Common Law of Bankruptcy***

The Fifth Circuit noted that bankruptcy is not explicitly included in *Texas Industries*' list of areas in which courts are free to develop federal common law under the first path. Bankruptcy is not necessarily "concerned with the rights and obligations of the United States, interstate and international disputes implicating the conflicting rights of States or [ ] relations with foreign nations and admiralty cases." [386] The Fifth Circuit, however, treated the *Texas Industries*' list as exclusive, not illustrative. [387] But the language of the Supreme Court's list that "absent some congressional authorization ... federal common law exists only *in such narrow areas as*" makes clear that it was only providing examples, not defining the boundaries of federal interests engendering common lawmaking power. [388]

Assuming *Texas Industries*' list is illustrative, it does not answer the question of whether bankruptcy is an area of "uniquely federal interests" such that common lawmaking power should be presumed. This article argues that the reason this power should be presumed is because bankruptcy has been relegated to an exclusively federal role once Congress acted under the Bankruptcy Power.

Article I, § 8, clause 4 of the Constitution vests Congress with the power "To establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States." [389] The key element in the Bankruptcy Clause is that it empowers Congress to pass *uniform* bankruptcy laws. [390] The uniformity provision leaves little room for non-federal bankruptcy law, and thereby makes bankruptcy a "uniquely federal interest." ***72** Although the precise dimensions of the uniformity remain uncharted, [391] the Supreme Court's decision in *Central Virginia Community College v. Katz* noted that the history of the Bankruptcy Clause demonstrated that bankruptcy was an important enough federal interest that the states yielded their sovereign immunity in bankruptcy. [392] Indeed, it was an important enough interest to receive particular mention in the Constitution.

As the Court noted in *Katz*, the uniformity interest in bankruptcy is particularly strong because of the pre-Constitution history of bankruptcy and insolvency law. Whereas England had one sovereign and was subject to one uniform bankruptcy law, [393] each of the states enacted its own bankruptcy or insolvency law. [394] This led to the 18th century equivalent of forum shopping--debtors would abscond to more favorable jurisdictions, and the fear of debtors' flight was a major factor supporting debtors' prisons. [395] Rather than allow the Full Faith and Credit Clause to govern such disputes, which would have continued the problem of debtors' forum shopping, the Constitution instead opted to give Congress the power to create a uniform federal rule that would govern all bankruptcies. [396] Indeed, the extent of the unique federal interest in bankruptcy is demonstrated by the authorization under the first bankruptcy act for federal courts to issue writs of habeas corpus to release debtors from state prisons, thereby overriding state criminal law, to facilitate their attendance at bankruptcy proceedings. [397]

The uniformity element, in conjunction with the provisions of the Code, operates to make bankruptcy exclusively, and therefore uniquely, federal. Bankruptcy is essentially an *in rem* proceeding. [398] Unlike equity receiverships at state law, bankruptcy courts have jurisdiction not over just specific items of property, but over the debtor and all the debtor's property interests. [399] Once an order for bankruptcy relief is granted, any sort of state insolvency proceeding must give way to the bankruptcy case because all assets of the bankruptcy estate are subject to exclusive federal jurisdiction. [400] The automatic ***73** stay enjoins any state insolvency proceeding [401] while a bankruptcy is pending, and the discharge injunction [402] prevents any state insolvency proceeding based on pre-petition debts. [403]

Thus, the only way that a state insolvency proceeding can go forward once an order for bankruptcy relief is granted is for the bankruptcy court to lift the stay, which it is unlikely to do without consent of all creditors and the debtor; doing so eviscerates any meaningful bankruptcy jurisdiction and the Code's priority scheme [404] because it allows certain creditors to jump to the head of the line. Thus, there can only be parallel state and federal insolvency proceedings when a federal court chooses to relinquish its jurisdiction. This contrasts with areas of law like antitrust, in which there are both federal and state causes of action and potentially parallel federal and state proceedings for the same conduct. Bankruptcy's nature of exclusive jurisdiction over the debtor's assets makes it a uniquely federal concern because it allows no room for state action.

In some sense, the case for bankruptcy being a uniquely federal interest is a preemption argument. States are not *per se* preempted from passing and enforcing their own insolvency and bankruptcy laws;[405] they are only barred from applying those laws once federal bankruptcy jurisdiction is triggered.[406] That is to say, there is not traditional explicit, field, or conflict preemption, but an amalgam best described as a functional preemption; the explicit provisions of the Code create a conflict preemption when there is federal bankruptcy jurisdiction. The Code's functional preemption means that Congress essentially occupies the field.[407] The uniformity element that is required in any Constitutional bankruptcy law combined with the *in rem* nature of bankruptcy and the Code's expansive definition of the bankruptcy estate, automatic ***74** stay, and discharge injunction make bankruptcy a "uniquely federal interest."

This reading conforms with the rest of the Article I, § 8, Clause 4, which deals with establishing a "uniform Rule of Naturalization."[408] The inclusion of these two topics, naturalization and bankruptcy, in the same clause and the parallel construction suggests a parity between the issues. No one would doubt that naturalization is a "uniquely federal interest." It follows then that bankruptcy too is a "uniquely federal interest."

5. *Path 2: Statutory Sources for a Federal Common Law of Bankruptcy*

If bankruptcy is a "uniquely federal interest," then it does not matter if Congress authorized federal common lawmaking. If bankruptcy is not a "uniquely federal interest" engendering common lawmaking powers, though, it may still be authorized by Congress's action. There is no question that Congress has the power under the Bankruptcy Clause to authorize federal common lawmaking in bankruptcy; the question under *Texas Industries*' second path is whether it did.

It is not clear how explicit an authorization is required by *Texas Industries*. Field has noted that "[i]f [*Texas Industries*] is a directive standard, it clearly requires only an implicit rather than explicit legislative directive."[409] If so, there arguably is such an authorization in the case of bankruptcy. While the case for such an authorization involves some significant assumptions, it does accord with the legislative history, the pre-Code practices doctrine, and the practical realities of bankruptcy.

The pre-Code practices doctrine indicates that *Walker*'s general "presumption that a remedy was deliberately omitted from a statute is strongest when Congress has enacted a comprehensive legislative scheme"[410] does not apply to bankruptcy. Congress has repeatedly amended the Bankruptcy Code since the string of cases that have enunciated the pre-Code practices doctrine. Congress is aware of the pre-Code practices doctrine and has done nothing to curtail it.[411] Could this interpretive move also apply to finding a grant of common lawmaking powers absent an express directive? Congress could have been clearer on this point, but there is arguably a delegation of lawmaking power to the bankruptcy courts via equity powers.

As noted above, the House Report on the Bankruptcy Act of 1978 cited 28 U.S.C. § 1481 as authority for its statement that "[t]he bankruptcy court ***75** will remain a court of equity."[412] If one gives the legislative history credence, this comment, when read literally, does not speak to common lawmaking power or show that federal courts sitting in bankruptcy jurisdiction are in any way different from regular federal courts with equity jurisdiction. As this article has argued, however, the use of the term "equity" in the bankruptcy context is really "fortuitous coinage" for what is better described as federal common lawmaking. Generally, it is reckless to read Congress's use of term χ to mean Y. But in this case, the term "equity" in the context of bankruptcy jurisdiction and powers is a term of art that means "federal common law." Thus, a "court of equity" is better understood as a "court with federal common lawmaking power."

For example, in *Prudence Realization Corp. v. Geist*, the Supreme Court held that federal law, rather than state law, determined the priority of mortgage participation claims held by the guarantor of the mortgage.[413] While the guarantor's claims would have been subordinated to the claims of other participants in the mortgage under state law,[414] the Supreme Court rejected the state rule and instead crafted a new rule of federal common law.[415] The Court noted that "it is for that court ... to define and apply federal law in determining the extent to which the inequitable conduct of a claimant in acquiring or asserting his claim in bankruptcy requires its subordination ....”[416]

Yet, in *Butner*, the issue before the Supreme Court was whether state or federal law should govern the rights to the rents collected between a mortgagor's bankruptcy and the foreclosure sale of the mortgaged property.[417] A circuit split existed on the issue. Five circuits had determined the issue by looking to state law, whereas “[t]he Third and Seventh Circuits ha [d] adopted a *federal rule of equity* that affords the mortgagee a secured interest in the rents even if state law would not recognize any such interest until after foreclosure.”[418] This “federal rule of equity” is more aptly described as “federal common law”; what the Third and Seventh Circuits did was create a rule of decision. Although the Supreme Court rejected this “federal rule of equity” ***76** in *Butner* because of *Erie* concerns about its interplay with state law, the point remains that bankruptcy powers authorized as equity are better thought of as authorized by federal common law. *Butner* only rejected federal common law in bankruptcy to the extent it conflicted with state law in that case; the implication in its ruling is that federal common law may exist in bankruptcy when it does not conflict with state law. *Pepper v. Litton* places even that limitation into question, as *Pepper* authorized federal common lawmaking of equitable subordination that *was* inconsistent with a state court judgment. Although a state court in *Pepper* had granted the sole shareholder of the debtor a default judgment for wages against the debtor, the Supreme Court held that this judgment could be subordinated or disallowed.[419]

Reading “court of equity” as a term of art meaning “court with federal common lawmaking power” also comports with a significant comment in the legislative history of § 510(c). Section 510(c) provides that courts may

> Under principles of equitable subordination, subordinate for purposes of distribution all or party of an allowed claim to all or part of another allowed claim or all or part of an allowed interest to all or part of another allowed interest ....[420]

Besides stating “the bankruptcy court shall remain a court of equity,”[421] the legislative history of § 510(c) includes a statement by the legislative leaders that it “is intended that the term ‘principles of equitable subordination’ follow existing case law and *leave to the courts development of this principle*.”[422] A fair reading of the legislative history is that the power to develop principles of equitable subordination--that is to create a federal common law of bankruptcy--is what it means for bankruptcy courts to remain “courts of equity.”[423]

Thus, reading “equity” as a term of art in the bankruptcy jurisdiction and powers context, the legislative history was stating that “the bankruptcy court will remain a court with federal common lawmaking powers.” This reading comports with the pre-Code practices doctrine, which has in effect been ratified by Congress' repeated amendments to the Bankruptcy Code that have left the doctrine unchanged or even codified non-Code practices.[424] ***77** Moreover, because this reading is anchored in the legislative history, it can survive the possible repeal of 28 U.S.C. § 1481.

When 28 U.S.C. § 1481 is considered with the history of the Bankruptcy Code and Congressional ratification by inaction in subsequent revisions to the Bankruptcy Code, there is a case to be made that Congress intended federal courts to have some sort of lawmaking authority in bankruptcy, even if this intention was only vaguely articulated. Admittedly, no single one of these elements, analyzed by itself, is sufficient for finding an implicit directive. The combined total, though, is greater than the sum of its parts, and when viewed in conjunction with the special bankruptcy concerns arguing for delegating such powers, it is plausible to find a delegation of lawmaking power to federal courts in bankruptcy cases.

Arguably, by placing bankruptcy proceedings in courts, rather than an agency, Congress intended the existence of the common law power inherent in the judicial power, for as the Supreme Court has noted, even Article I courts possess the judicial power.[425] Bankruptcy referees under the 1898 Act exercised wide-ranging discretion.[426] As Alan Schwartz has noted:

> Congress in 1978 wanted to elevate the stature of the bankruptcy courts rather than reduce it. This goal produced the replacement of the bankruptcy referee system with “real judges” who are appointed for substantial terms and

> paid high salaries. To grant these new judges less authority to make policy than the referees they replaced would have been irrational. [427]

In short, it is hard to think that Congress would *not* have wanted federal judges to have common lawmaking power in bankruptcy. Of course, such common lawmaking power is tempered by the strictures of the Code [428] and by the scope of the bankruptcy power itself. [429]

6. *Explaining the Pre-Code Practices Doctrine Without Federal Common Law*

Federal courts have common lawmaking powers in bankruptcy under the "uniquely federal interests" path of *Texas Industries* and perhaps too under the "Congressional authorization" path. Indeed, they must, for if they did not and the Fifth Circuit were correct in *Walker*, how does one explain the pre-Code practices doctrine, which recognizes pre-Code federal bankruptcy common ***78** law even after codification? The only viable explanation is a sort of "water-over-the-dam" approach like the Supreme Court took in *Northwest Airlines, Inc. v. Transport Workers Union of America, AFL-CIO*. In that case, the Supreme Court noted that:

> it is much too late to deny that there is a significant body of federal law that has been fashioned by the federal judiciary in the common-law tradition, [but] it remains true that federal courts, unlike their state counterparts, are courts of limited jurisdiction that have not been vested with open-ended lawmaking powers .... [T]he federal lawmaking power is vested in the legislative, not the judicial branch of government; therefore, federal common law is 'subject to the paramount authority of Congress.' [430]

Of course, the *Northwest Airlines* approach says nothing about how to treat past judge-made law. Is it still valid? Is it grandfathered in under principles of *stare decisis*? If deference were given to *stare decisis*, it does not explain the pre-Code practices doctrine, as codification presented an opportunity to approach bankruptcy practice with a clean slate without the accretions of precedents formed under the 1898 Act.

In that case, can past judge-made bankruptcy law be challenged as applied to new parties on the basis of being judicially created? It is hard to strike down the entirety of the "significant body of federal law that has been fashioned by the federal judiciary in the common-law tradition." [431] Not only have parties relied on the law as it has developed, but Congress has ratified much of this law both by subsequent codifications that incorporate it and by inaction. It seems unlikely that past federal common lawmaking is to be invalidated. The "water-over-the-dam" approach lacks any intellectual consistency. Like the pre-Code practices doctrine and *Grupo Mexicano*, it allows development up to an arbitrary line. Such an approach of Constitutional convenience is anathema to a purist view of the Constitution and is an untenable method of Constitutional adjudication; our law must be based on better principles.

B. FEDERAL COMMON LAW OF BANKRUPTCY IN ACTION

What does federal common lawmaking look like in action? One example ***79** we have seen is the Seventh Circuit's opinion in *Kmart v. Capital Factors*. In *Kmart*, Judge Easterbrook created a common law evidentiary requirement for critical vendor motions, [432] even if the tenor of the opinion's rhetoric came out strongly against such motions. *Kmart* thus created a rule of decision for critical vendor motions: without an adequate showing of necessity supported by some sort of evidence, a critical vendor motion cannot be granted in the Seventh Circuit. Implied in this rule of decision is a non-Code right to make pre-plan payments for pre-petition debts upon a showing of necessity to the debtor's reorganization. In this sense, the Seventh Circuit actually authorized a significant deviation from the Code's priority scheme.

Likewise, the Delaware Bankruptcy Court's treatment of non-debtor releases in *Genesis Health Ventures* is an example of the creation of federal common law. The Bankruptcy Code does not provide for releases of non-debtors. It does provide a discharge injunction for that prevents actions against debtors to recover on pre-filing debts. [433] The Code also allows for channeling injunctions that requires all claimants to look to a settlement trust, but only in asbestos related bankruptcies.[434] Otherwise, the Code specifically provides that the "discharge of a debt of the debtor does not affect the liability of any other entity on ... such debt."[435] These provisions do not address the question of liability of non-debtors for debts not incurred by the debtor.[436] Nor should they; one would think that bankruptcy courts would only have jurisdiction over the bankruptcy estate, not disputes between third parties unrelated to claims on the estate. Accordingly, several circuits do not permit releases of non-debtors.[437]

On the other hand, such disputes are often related to claims on the estate because the outcomes can affect the business operations of the estate. Corporate debtors exist as a matter of law, but their actual operations are a function of people. Sometimes, in order for a debtor's reorganization to succeed, it needs specific personnel. If these personnel are distracted by lawsuits, they may not be able to render effective services to the debtor.

Having determined that § 105(a) powers were inapplicable to the situation, ***80** [438] the *Genesis Health Ventures* court navigated these competing concerns by carefully laying out the factors that courts have considered when reviewing such releases and attempting to divine a multi-factor test--a rule of decision for when to permit such releases.[439]

A final example is the Third Circuit's *Owens Corning* decision, reversing the District Court's grant of the debtor's substantive consolidation motion. In *Owens Corning*, the debtor and most of its creditors moved for the substantive consolidation of the debtor and all its myriad subsidiaries, which had jointly filed for bankruptcy.[440] Doing so would have created a larger combined pool of assets from which all general unsecured creditors could have drawn, regardless of the assets of the entity with whom they had transacted. The motion was opposed by some of Owens Corning's bank creditors.[441] The bank creditors had made loans to Owens Corning and only five of its subsidiaries, all of which cross-guaranteed the others' loans.[442] Without substantive consolidation, there would be fewer claimants on assets held by Owens Corning and the five subsidiaries, and the banks would have a larger recovery than if they had to share with all the other creditors in the assets of all consolidated debtors. The District Court granted the substantive consolidation motion in a situation in which there was reliance on formal *separateness* and neither fraud nor abuse of corporate formalities.[443]

In a carefully considered opinion, the Third Circuit reversed. The Third Circuit noted that "[s]ubstantive consolidation, a construct of federal common law, emanates from equity."[444] This is the only occasion in which a federal court ruling on a non-Code practice has described the non-Code practice in terms of federal common law. Notably, even in this case, there is an intertwining of federal common law and equity in the description of the non-Code practice. Substantive consolidation is historically an equity-derived practice,[445] but it has become part of bankruptcy via federal common law. The Third Circuit noted that a multi-factor checklist was unsatisfactory for analyzing substantive consolidation cases because they are intensely fact-intensive.[446] Instead, the Third Circuit articulated five principles to guide analysis of substantive consolidation motions and laid down the conditions required for granting such a motion.[447] In doing so, the Third Circuit created ***81** a non-Code right and a corresponding rule of decision.

C. RECONCILING EQUITY WITH A GOVERNMENT OF CODES: FEDERAL COMMON LAW

"The most important question regarding judicial discretion is universal: will judges utilize their discretion to make public policy rather than defer to other institutions?"[448] However one chooses to answer this question as a general matter, bankruptcy presents a unique situation in which the structure of the bankruptcy system and the nature of bankruptcy cases weigh in strongly for urging judges to take the lead in lawmaking, albeit with proper deference to the policies that Congress has embodied in the Code.

While common lawmaking power in bankruptcy is a matter of Constitutional and statutory interpretation, the realities of bankruptcy practice also call for the existence and use of such power. Long ago, the Supreme Court noted the importance of the flexibility of the Bankruptcy Clause to encompass new developments in business. The 1978 Bankruptcy Code was meant to preserve

> the capacity of the bankruptcy clause to meet new conditions as they have been disclosed as a result of the tremendous growth of business and development of human activities from 1800 to the present day. And [prior

> bankruptcy acts], far-reaching though they be, have not gone beyond the limit of congressional power; but rather have constituted extensions into a field whose boundaries may not yet be fully revealed.[449]

Bankruptcy is extremely fact-specific.[450] The nature of bankruptcy requires flexibility and discretion. Bankruptcy is about how to divide efficiently and fairly a fund that is too small to satisfy all claimants.[451] Satisfying multiple claimants from a limited fund always involves balancing the interests of the claimants, as well as the debtor in Chapter 11 and Chapter 13 cases. Such balancing cannot always be done robotically according to the Code's formulas.

***82** The Code itself calls for judicial discretion in numerous instances.[452] In addition to the various provisions calling on the court to act if it determines that the act in question is "fair and equitable" or the like,[453] trustees can "use, sell, or lease" the bankruptcy estate's property only "after notice and a hearing."[454] Relief from the automatic stay may be granted "after notice and a hearing" "for cause, including lack of adequate protection of an interest," or a finding that the "property is not necessary for an effective reorganization."[455] "The court, after notice and a hearing, may authorize the trustee to obtain" prioritized secured credit.[456] The trustee "subject to the court's approval may assume or reject any executory contract or unexpired lease," and if the debtor has defaulted on the contract or lease, the trustee provides "adequate assurance of future performance under such contract or lease."[457] The court must value collateral in order to determine the extent to which a debt is secured.[458] The court must decide whether the claims of creditors are "substantially similar" to other claims of creditors in a putative class for a reorganization plan.[459] The court must determine whether a disclosure statement for a plan consent contains "adequate information."[460] A plan may only be confirmed if the court finds that "confirmation of the plan is not likely to be followed by liquidation, or the need for further reorganization, of the debtor"--that is that the debtor is a viable entity going forward.[461] These are hardly the only instances in which a court must exercise discretion in bankruptcy.

All of these instances call for an application of judgment by the court; there is already wide discretion invested in bankruptcy courts by the express provisions of the Code. These provisions should not be read as excluding other discretion, as in Chapter 11, a "party in interest, including the debtor, the trustee ... [a] creditor ... an equity security holder, or any indenture trustee, may raise and may appear and be heard on any issue in a case under this chapter."[462] Even for Chapters 7, 9, 12, and 13, these explicit Code provisions should be viewed as nothing more than the areas of necessary discretion that Congress could think of at the time of codification. Judging always involves some measure of discretion; the question is how it is to be ***83** channeled. Contrary to the usual cannons of statutory interpretation, the history and nature of bankruptcy law, including the presumption that "[t]he bankruptcy court will remain a court of equity,"[463] urge for a reading of the Code as confirming specific discretionary powers, but not denying more general ones without explicit repudiation.

The "court of equity" tradition recognizes this. Equity could satisfy the practical demands of bankruptcy practice, but as noted above, it triggers a wariness or even hostility on the part of American courts[464] and currently has questionable authorization if any.[465] Federal common law involves less free-ranging discretion than equity and does not carry so much of the baggage of "judicial activism" because it is so firmly entrenched in our legal traditions--federal common law is channeled by precedent and judicially devised tests, not the span of the Chancellor's proverbial foot.[466] Federal common law is a better way to channel judicial discretion than the statutory language of § 105(a) or the pre-Code practices doctrine. Federal common law is flexible yet principled, unlike equity which is merely flexible. Moreover, there is solid authority for federal common lawmaking in bankruptcy-- the unique federal interest because of the uniformity requirement of bankruptcy laws, Congressional authorization implicit in the Code, and the pre-Code practices doctrine.

Even courts that have limited bankruptcy equity through statutory language or judge-made tests recognize that there is something unique about bankruptcy that requires more discretion than other proceedings. The Fourth Circuit recognized this in a decision in the A.H. Robbins bankruptcy, when it allowed an injunction barring suits against non-debtor third-parties under the bankruptcy court's § 105(a) powers. There was no explicit statutory authorization for such an injunction but it was upheld because, among other factors, "it was 'essential' to the plan" and "'the entire reorganization hing[ed] on [it]."[467] Likewise, in *Dow Corning*, the Sixth Circuit acknowledged that "the bankruptcy court, as a forum for resolving large and complex mass litigations, has substantial power to reorder-creditor debtor relations needed to achieve a successful reorganization."[468] In essence, the Sixth

Circuit articulated a different doctrine of necessity--that without broad discretion bankruptcy courts are incapable of untangling the Gordian knot of ***84** creditor-debtor relations and shepherding complex corporate reorganizations to successful conclusions for the general benefit. A rigid adherence to the Code is simply impractical in bankruptcy law.

Given the fact intensive nature of bankruptcy, Congress cannot possibly envision all of the unusual situations that might arise under the Code. Courts have institutional advantages in lawmaking.[469] This is especially true for specialized courts like bankruptcy courts that have expertise in a technical topic like corporate reorganization. Thus, federal common law now tempers the rigidity of the Code, just as equity once tempered the rigidity of English common law.[470] Federal common lawmaking, within the confines of the Code, ensures that Congress's policy intent is served and is not shackled by Congress' choice of language.

To the extent that courts go too far in making federal common law in bankruptcy, Congress can override their rulings by amending the Code. As Judge Henry Friendly argued, federal common law:

> permits overworked federal legislators, who must vote with one eye on the clock and the other on the next election, so easily to transfer a part of their load to federal judges, who have time for reflection and freedom from fear as to tenure and are ready, even eager, to resume their historic law-making function--with Congress always able to set matters right if they go too far off the desired beam.[471]

Indeed, as a positive matter, federal common lawmaking is what federal courts have been doing in bankruptcy for over a century. Congress has yet to raise objections. It certainly had the opportunity to do so when adopting the Bankruptcy Code, but instead chose to invest bankruptcy courts with wide discretion.

The exercise of lawmaking power by bankruptcy courts is consistent with the post-New Deal system of administrative agencies exercising lawmaking power through rule-making and adjudications. Bankruptcy is the only major statutory system in the United States without a federal agency responsible for its implementation. Instead, in bankruptcy, the courts play the role that agencies fill in other areas of law. Although bankruptcy proceedings are ***85** not governed by the Administrative Procedure Act,[472] bankruptcy judges bring technical expertise to bear like agencies in rule-making. Viewing bankruptcy judges as an analog to agencies takes into account the technical, specialized, fact-specific nature of bankruptcy and also makes sense of the non-Article III status of bankruptcy judges. While bankruptcy judges are appointed and subject to removal by the Courts of Appeals for the circuits in which they serve,[473] their non-Article III status lessens separation of powers concerns, because they do not aggrandize the judiciary's powers at the expense of Congress's. Certainly, if Congress directly appointed bankruptcy judges, there would be no separation of powers concern.

Courts already regularly create non-Code rights in bankruptcy and create rules of decision to guide the granting of these rights.[474] As a positive matter, federal common lawmaking is an important part of bankruptcy practice, but it masquerades under the guise of equity. As Scott Rosenberg has noted, “federal courts simply do not speak the language of federal common law in bankruptcy cases.”[475]

As a normative matter, judicial lawmaking in bankruptcy should be called and analyzed in terms of federal common law, not equity. Federal common lawmaking is already occurring, but no one recognizes it as such. Courts seem to have some sense that equity is not the proper framework for their activities; instead, they produce a clunking common law without acknowledging it. It is time to call the process what it is and let courts do what they are good at--developing common law. The vocabulary and the analytical framework need to be adjusted to match the actual judicial processes. At the very least, the term “equity,” when used in the jurisdictional and court powers sense, as opposed to the specific provisions of the Code, should be understood as a term of art meaning “federal common lawmaking.” Doing so will remove non-Code practices from the realm of rhetoric and let them be considered within the well-defined tradition of federal common law that adheres to precedent when applicable and provides certainty and rule of law along with flexibility to match new circumstances.

The mislabeling of federal common lawmaking as equity in bankruptcy ***86** has greatly colored courts' approach to all actions authorized under the banner of equity, particularly non-Code practices. Federal common law provides the mechanism for balancing the serious and legitimate concerns posed by *Grupo Mexicano* about the exercise of equity powers with the arguments in favor of bankruptcy equity in *Pepper v. Litton* and *Bildisco*. Federal common law reconciles the concerns about unbridled judicial discretion with the arguments that bankruptcy equity is authorized, legally required, consistent with the nature of bankruptcy, necessary for practical reasons, and harmonious with the post-New Deal state's acceptance of agency rule-making power as consistent with the separation of powers doctrine.

Federal common lawmaking does so by channeling discretion into the multi-factored rules of decision that are so frequently the hallmark of common lawmaking. Even the most equitable of all bankruptcy practices, equitable subordination, has been shoehorned into a multi-factor test.[476] Common law tests limit judicial discretion while retaining the ability to adapt to new situations. Common law judging is familiar to judges and adds to legal certainty by treating likes alike while remaining sensitive to factual distinctions between cases. It also acknowledges the importance of judicial expertise, particularly in a technical area like bankruptcy, and is part of the Article III judicial power in areas like bankruptcy that are "uniquely federal interests." Common law presents a moderate, middle-ground between unrestrained equity and unbending and outdated, opaque, or absent statutory terms.

A common law understanding of bankruptcy practices also indicates that there is a broad middle-ground between the proceduralist or law-and-economics approach to bankruptcy and the practicalist or traditional approach.[477] A common law interpretation is much closer to the traditional practicalist emphasis on the uniqueness of every bankruptcy case and the fact-intensive nature of bankruptcy proceedings. Yet, a common law approach also presents more predictable application of judicial discretion making it possible for parties to factor in legal regimes into their behavior *ex-ante*, as the proceduralists would like.

Courts are equipped with the necessary tools for reconciling bankruptcy courts' status as "courts of equity" with the statutory terms of the Bankruptcy Code. They already use federal common law to do so; it is only the conceptualization and the vocabulary that is absent. It is well time to reconsider ***87** these absences and to view non-Code practices in terms of federal common lawmaking rather than equity. Doing so will allow courts to avoid choosing between the poles of rigid, robotic application of the Code and unpredictable, unprincipled discretion and should result in more sensible rulings on pre-Code practices.

Footnotes

a1 Law clerk to the Hon. Jane R. Roth, U.S. Court of Appeals for the Third Circuit. J.D., *cum laude*, Harvard Law School, 2005; M. Phil., *summa cum laude*, Columbia University, 2001; A.M., *cum laude*, Columbia University, 2000; A.B., *magna cum laude*, Harvard College, 1998. The author would like to thank Thomas Ambro, Martin Bienenstock, Samuel Bufford, Michael Gadarian, Richard Lieb, Richard Levin, John F. Manning, Elizabeth Warren, and Jared Wessel for their comments and encouragement, Lesley Lawrence for her research assistance, and Sarah Levitin for her patient and understanding editing. The views expressed in this article are solely those of the author.

1 *E.g.*, Young v. United States, 535 U.S. 43, 50 (2002); United States v. Energy Res. Co., Inc., 495 U.S. 545, 549-50 (1990); Norwest Bank Worthington, v. Ahlers, 485 U.S. 197, 206 (1988); Young v. Higbee Co., 324 U.S. 204, 214 (1945); Prudence Realization Corp. v. Geist, 316 U.S. 89, 95 (1942); SEC v. U.S. Realty Co., 310 U.S. 434, 455 (1940); Pepper v. Litton, 308 U.S. 295, 304 (1939); Taylor v. Standard Gas & Elec. Co., 306 U.S. 307, 323 (1939); Wayne United Gas Co. v. Owens-Ill. Glass Co., 300 U.S. 131, 136 (1937); Cont'l Ill. Nat'l Bank & Trust Co. v. Chi., Rock Island Pac. Ry. & P. R. Co., 294 U.S. 648, 675 (1935); Local Loan Co. v. Hunt, 292 U.S. 234, 240-41 (1934); Bardes v. Hawarden Bank, 178 U.S. 524, 535 (1900); *Ex parte*, the City Bank of New Orleans (*In re* William Christy), 44 U.S. 292.311-313 (1845).

According to one bankruptcy judge, "the bankruptcy court is a court of equity" is the most frequently uttered substantive phrase by attorneys in her courtroom. *See* Marcia Krieger, "*The Bankruptcy Court is a Court of Equity": What Does that Mean?* 50 S.C. L. REV. 275, 297 (1999).

2 Krieger, *supra* note 1, at 297.

3 *E.g.*, *In re* Just For Feet, Inc., 242 B.R. 825-26 (D. Del. 1999); *In re* Ionosophere Clubs, Inc., 98 B.R. 174, 179 (Bankr. S.D.N.Y. 1989); *In re* Gulf Air, 112 B.R. 152, 154 (Bankr. W.D. La. 1989).

4 *E.g.*, *In re* Owens Corning, 419 F.3d 195 (3d Cir. 2005); *In re* Owens Corning, 316 B.R. 168 (Bankr. D. Del. 2004); *In re* Huntco, Inc., 302 B.R. 35 (Bankr. E.D. Mo. 2003); Alexander v. Compton (*In re* Bonham), 229 F.3d 750 (9th Cir. 2000); *In re* Circle Land & Cattle Corp., 213 B.R. 870 (Bankr. D. Kan. 1997); *In re* Standard Brands Paint Co., 154 B.R. 563, 570 (Bankr. C.D. Cal. 1993); Eastgroup Props. v. S. Motel Assoc., Ltd., 935 F.2d 245 (11th Cir. 1991); First Nat'l Bank of El Dorado v. Giller (*In re* Giller), 962 F.2d 796 (8th Cir. 1992); Union Sav. Bank v. Augie/Restivo Baking Co., Ltd. (*In re* Augie/Restivo Baking Co., Ltd.), 860 F.3d 515 (2d Cir. 1988); Drabkin v. Midland-Ross Corp. (*In re* Auto-Train Corp.), 810 F.2d 270 (D.C. Cir. 1987). *See also* FED. R. BANKR. P. 1015, Advisory Committee's Note ("consolidation, as distinguished from joint administration, is neither authorized nor prohibited by this rule since the propriety of consolidation depends on substantive considerations and affects the substantive rights of the creditors of different estates."). Some courts have cited 11 U.S.C.§ 1123(a)(5)(C) (2000) as statutory authorization for substantive consolidation. *E.g., In re* Stone & Webster, Inc., 286 B.R. 532 (Bankr. D. Del. 2002); Standard Brands, 154 B.R. at 567.

5 *E.g., In re* Saybrook Mfg. Co., Inc., 963 F.2d 1490, 1491 (11th Cir. 1992); Unsecured Creditors' Comm. v. First Nat'l Bank & Trust (*In re* Ellingsen MacLean Oil Co.), 834 F.2d 599, 603 (6th Cir. 1987); Burchinal v. Cent. Washington Bank (*In re* Adams Apple, Inc.), 829 F.2d 1484, 1490 (9th Cir. 1987); Borne Chem. Co. v. Lincoln First Comm. Corp. (*In re* Borne Chem. Co.), 9 B.R. 263, 269-70 (Bankr. D. N.J. 1984); *In re* Vanguard Diversified, Inc., 31 B.R. 364, 366 (Bankr. E.D.N.Y. 1983); *In re* Gen. Oil Distrib., Inc., 20 B.R. 873, 876 (Bankr. E.D.N.Y. 1982); Otte v. Mfrs. Hanover Comm. Corp. (*In re* Texlon Corp.), 596 F.2d 1092, 1098 (2d Cir. 1979).

6 *See, e.g.*, Class 5 Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648 (6th Cir. 2002); *In re* Genesis Health Ventures, Inc., 266 B.R. 591 (Bankr. D. Del. 2001); *In re* PWS Holding Corp., 228 F.3d 224 (3d Cir. 2000); *In re* Cont'l Airlines, 203 F.3d 203 (3d Cir. 2000); *In re* Specialty Equipment Co., Inc., 3 F.3d 1043 (7th Cir. 1993); *In re* Drexel Burnham Lambert Group, Inc., 960 F.2d 285 (2d Cir. 1992); *In re* A.H. Robins Co., Inc., 880 F.2d 694 (4th Cir. 1989). *But see In re* Lowenschuss, 67 F.3d 1394 (9th Cir. 1995); *In re* Zale Corp., 62 F.3d 746 (5th Cir. 1995); *In re* Western Real Estate Fund, Inc., 922 F.2d 592 (10th Cir. 1990); Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc., 885 F.2d 621 (9th Cir. 1989).

7 Krieger, *supra* note 1, at 275, 277-292.

8 Scarborough v. Chase Manhattan Mortgage Corp. (*In re* Scarborough), No. 03-228, slip op. at 13 (E.D.Pa. Oct. 28, 2004) ("The cases relied on by the parties ... set forth bright line rule tests for applying [11 U.S.C.] § 1322(b)(2)'s anti-modification provision [for mortgages on debtors' principal residences]. The problem with this is that, in an effort to create simplicity and predictability, they fail to adequately safeguard equity.").

9 *See* John F. Manning, *Textualism and the Equity of the Statute*, 101 COLUM. L. REV. 1, 5 (2001).

10 Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 574-580 (1998). *See also* Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987).

11 The question of how bankruptcy equity powers interact with non-Code law, such as state law, is beyond the scope of this article. *See* Thomas E. Plank, *The Erie Doctrine and Bankruptcy*, 79 NOTRE DAME L. REV. 633 (2004); Alfred Hill, *the Erie Doctrine in Bankruptcy*, 66 HARV. L. REV. 1013 (1953). *See also* Butner v. United States, 440 U.S. 48 (1979).

12 *See infra* section III.B.

13 *Compare In re* Owens Corning, 419 F.3d 195 (3d Cir. 2005), Compagnie Noga D'Importation et D'Exportation S.A. v. The Russian Fed'n, 361 F.3d 676, 688 (2d Cir. 2004), ***and*** Nesbit v. Gears Unlimited, Inc., 347 F.3d 72, 87 (3d Cir. 2003), which take the existence of federal common law of bankruptcy as a given, *with* Justice v. Valley Nat'l Bank, 849 F.2d 1078, 1087-88 (8th Cir. 1988), which found that federal common lawmaking was inappropriate in the given instance, *and with* Walker v. The Cadle Co. (*In re* Walker), 51 F.3d 562, 566 (5th Cir. 1995), which determined that bankruptcy is not an appropriate area for federal common lawmaking. *Compare also In re* Cont'l Airlines, 91 F.3d 553, 570-71 (3d Cir. 1996) (en banc) (Alito, J., dissenting) (questioning federal common lawmaking authority in bankruptcy).

14 U.S. CONST. art. I, § 8, cl. 4.

15 546 U.S. 356, 126 S. Ct. 990 (2006).

16 Baird, *supra* note 10, at 574-580; Warren, *supra* note 10. Such a binary divide obviously oversimplifies the complexity and nuance of bankruptcy scholarship, as Professor Baird acknowledges, *supra* note 10, at 576, but it is also a useful characterization of the field.

17 Baird, *supra* note 10, at 576.

18 *Id*. at 577.

19 *Id*. at 579.

20 *Id*.

21 *Id*. at 579-80.

22 *Id*. at 578.

23 *Id*. at 580.

24 *Id*. at 579-80.

25 Alan M. Ahart, *The Limited Scope of Implied Powers of a Bankruptcy Judge: A Statutory Court of Bankruptcy, Not a Court of Equity*, 79 AM. BANKR. L.J. 1, 37-39 (2005).

26 Krieger, *supra* note 1; Ahart, *supra* note 25.

27 Krieger, *supra* note 1, at 301; Ahart, *supra* note 25, at 18.

28 *In re* Moller, 1876 U.S. Dist. LEXIS 191, at *4 (S.D.N.Y. 1876) ("A court of bankruptcy is a court of equity.").

29 *Ex Parte* Foster, 9 F. Cas. 508; 1842 U.S. App. LEXIS 600 (C.C.D. Mass. 1842) (Story, J.) ("I lay it down as a general principle that the district court is possessed of the full jurisdiction of a court of equity over the whole subject matters which may arise in bankruptcy, and is authorized by summary proceedings *to administer all that relief which a court of equity could administer*, under the like circumstances, upon a regular bin and regular proceedings, instituted by

competent parties.") (emphasis added); Ayer v. Brastow, 2 F. Cas. 263, 265, 1842 U.S. Dist. LEXIS 27, at *7-*8 (D. Maine 1842) ("The proceedings in bankruptcy are according to the course of equity, and to enable the court *to do full justice to all partners in interest*, the district court, sitting as a court of bankruptcy, is *clothed with all the powers of a court of general equity jurisdiction*.") (emphasis added).

30 27 Cong. Sess. 1, Ch. 9, 5 Stat. 440, 445, §6 (1841) (emphasis added), repealed Mar. 3, 1843, Ch. 82, 5 Stat. 614.

31 Krieger, *supra* note 1, at 298-301. *See also* N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 53 (1982) (explaining difference between summary and plenary jurisdiction in bankruptcy).

32 Krieger, *supra* note 1, at 298.

33 *Id*. at 298-301; Ahart, *supra* note 25, at 18.

34 *See, e.g., In re* Ohio Copper Mining Co., 241 F. 711, 713 (S.D.N.Y. 1917) ("The bankruptcy court is a court of equity, armed with equity powers in aid of its jurisdiction and the enforcement of its orders."); *In re* Swofford Bros. Dry Goods Co., 180 F. 549, 553 (W.D. Mo. 1910) ("A proceeding in bankruptcy is a proceeding in equity, and, for the purposes of enforcing and protecting its jurisdiction, a court of bankruptcy has all the inherent powers of a court of equity"); United States v. Liberman, 176 F. 161, 162 (C.C. E.D.N.Y, 1910) ("under the powers of a court of bankruptcy as a court of equity"); *In re* Hicks, 133 F. 739, 746 (N.D.N.Y. 1905) ("The power to enjoin is inherent in the court of bankruptcy, as a court of equity."); *In re* Siegel-Hillman Dry Goods Co., 111 Fed. 980, 983 (E.D. Mo. 1901) ("This court, sitting in bankruptcy, can exercise the full powers of a court in equity for the ascertainment and enforcement of the rights and equities of the various parties interested in the estate of the bankrupt company."); *Ex Parte* Norwood, 18 F.Cas. 452, 455 (D. Ill. 1873) ("The bankruptcy law clothes the district courts, sitting as courts of bankruptcy, with all the powers of courts of equity."); *In re* Mallory, 1871 U.S. Dist. LEXIS 223, at *6 (D. Nev. 1871) ("Now, when congress delegated to the district courts, this equitable jurisdiction in bankruptcy, it must follow, by necessary implication, that it also delegated at the same time the power to administer such remedies known to the law as were absolutely indispensable to the complete exercise of the jurisdiction expressly conferred."); Ayer v. Brastow, 1842 U.S. Dist. LEXIS 27, at *7-*8 (D. Maine 1842) ("The proceedings in bankruptcy are according to the course of equity, and to enable the court to do full justice to all partners in interest, the district court, sitting as a court of bankruptcy, is clothed with all the powers of a court of general equity jurisdiction."); *Ex Parte* Foster, 9 F. Cas. 508; 1842 U.S. App. LEXIS 600 (C.C.D. Mass. 1842) (Story, J. on circuit) ("I lay it down as a general principle that the district court is possessed of the full jurisdiction of a court of equity over the whole subject matters which may arise in bankruptcy, and is authorized by summary proceedings to administer all that relief which a court of equity could administer, under the like circumstances, upon a regular bin and regular proceedings, instituted by competent parties.").

35 Act of Mar. 2, 1867, 39th Cong. Sess 2, Ch. 176, 14, 14 Stat. 517, 518 (repealed 1878); Act of Aug. 19, 1841, 27th Cong. Sess. 1, Ch. 9, 5 Stat. 440, 445 (repealed Mar. 3, 1843) (Bankruptcy courts shall have "full authority and jurisdiction to compel obedience to all orders and decrees passed by them in bankruptcy, by process of contempt and other remedial process, to the same extent the circuit courts may now do in any suit pending therein in equity.").

36 28 U.S.C. § 1651 (2006).

37 *See infra* section III.B for discussion of 11 U.S.C. § 105(a) and 28 U.S.C. § 1481.

38 11 U.S.C. § 362 (2006).

39 11 U.S.C. § 524(a) (2006).

40 11 U.S.C. § 544 (2006).

41 11 U.S.C. § 541 (2006).

42 11 U.S.C. § 502(b)(9) (2006).

43 11 U.S.C. § 510(c) (2006).

44 This informality of procedure is still preserved in the equity courts of the few states, like the Delaware Chancery Court, that have not merged law and equity into a unity court.

45 11 U.S.C. § 507 (2006).

46 11 U.S.C. §§ 1123(a)(4), 1222(a)(3), 1322(a)(3) (2006).

47 This maxim is often presented in its Latin form, *æquitas est æqualitas*.

48 20 U.S. (7 Wheat.) v (1822); 42 U.S. (1 How.) xli (1842); Equity Rules of 1912, 226 U.S. 627-673 (1913); 38 Stat. 956 (Law and Equity Act of 1915).

49 *See* Bankruptcy Act of 1898, 55 Cong. 2d Sess., Ch. 541, 30 Stat. 544 (1898) (codified at 11 U.S.C. §§ 18-32 (repealed 1978)).

50 *See* EDWARD D. RE AND JOSEPH R. RE, REMEDIES 30 (5th Ed. 2000) ("Equity Regards Substance Rather than Form."). *Cf.* Richard Francis' *Maxims of Equity* (1726), quoted in PETER CHARLES HOFFER, THE LAW'S CONSCIENCE: EQUITABLE CONSTITUTIONALISM IN AMERICA (1990), 11-12 ("[E]quity regards not the circumstance, but the substance of the act.").

51 *E.g.*, Larson v. First State Bank of Vienna (*In re* Eggen), 21 F.2d 936, 938 (8th Cir. 1927) ("A court of bankruptcy is a court of equity, and its judicial officers, its judge and its referee in bankruptcy, in deciding and adjudging the rights and duties of parties entitled to their decision, are governed by the principles and rules of equity jurisprudence."); *In re* Siegel-Hillman, 111 F. at 983 ("This court, sitting in bankruptcy, can exercise the full powers of a court in equity for the ascertainment and enforcement of the rights and equities of the various parties interested in the estate of the bankrupt company.").

52 *E.g., In re* Kane, 127 F. 552, 553 (7th Cir. 1904) ("A court of bankruptcy is a court of equity, seeking to administer the law according to its spirit, and not merely by its letter."); Swarts v. Siegel, 117 Fed. 13, 16 (8th Cir. 1902) ("In equity, and in bankruptcy, which is a branch of equity, names and forms are unimportant where the truth is evident.").

53 *E.g., In re* Lahongrais, 5 F.2d 899, 901 (D. Nev. 1871) ("Furthermore a court of bankruptcy is a court of equity, and has jurisdiction as such court to set aside an allowance made as an administration expense, when it appears that it was procured through fraud, or that the amount allowed was so grossly excessive as to be tantamount thereto."); Ayer v. Brastow, 1842 U.S. Dist. LEXIS 27, at *7-*8 (D. Maine 1842) ("The proceedings in bankruptcy are according to the course of equity, and to enable the court to do full justice to all partners in interest, the district court, sitting as a court of bankruptcy, is clothed with all the powers of a court of general equity jurisdiction.").

54 Pepper v. Litton, 308 U.S. 295, 304-305 (1939).

55 H.R. Judiciary Comm., Bankruptcy Reform Act of 1978, H.R. REP., NO. 95-595, at 359 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6315 ("This section[, proposed 11 U.S.C. § 510(b), enacted as 11 U.S.C. § 510(c)] is intended to codify case law, such as *Pepper v. Litton*, 308 U.S. 295 (1939) and *Taylor v. Standard Gas and Electric Co.*, 306 U.S. 295 (1939) and is not intended to limit the [bankruptcy] court's power in any way. The bankruptcy court will remain a court of equity, proposed 28 U.S.C. 1481; *Local Loan v. Hunt*, 292 U.S. 234, 240 (1934).").

56 H.R. Judiciary Comm., Bankruptcy Reform Act of 1978, H.R. REP., NO. 95-595, at 359 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6315.

57 *Id. See infra* section III.B.2. for discussion of 28 U.S.C. § 1481.

58 H.R. Judiciary Comm., Bankruptcy Reform Act of 1978, H.R. REP., NO. 95-595, at 359 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6315.

59 11 U.S.C. § 510(c) (2006).

60 308 U.S. at 298.

61 *Id*. at 296-297. 13 Eliz. C. 5 (1571), often called "The Statute of Elizabeth," was the first English fraudulent conveyances statute.

62 308 U.S. at 297-298.

63 *Id*. at 298-302.

64 *Cf.* NMSBPCSLDHB, L.P. v. Integrated Telecom Expr. Inc. (*In re* Integrated Telecom Expr. Inc.), 308 F.3d 108 (3d Cir. 2004) (plan of reorganization failed to meet "good faith" filing requirement of 11 U.S.C. § 1129(a)(3) (2000) because sole purpose of bankruptcy filing was to benefit debtors' shareholders at the expense of one lessor whose claim in bankruptcy was limited to one year's rent under 11 U.S.C. § 502(b)(6)(A) (2000)); *In re* Owens Corning, 419 F.3d 195, 216 (3d Cir. 2005) (deemed substantive consolidation as to certain creditors denied because "it is here a tactic used as a sword and not a shield.").

65 Neal Mitchell Assocs. v. Braunstein (*In re* Lambeth Corp.), 227 B.R. 1, 7 (B.A.P 1st Cir. 1998).

66 NLRB v. Bildisco & Bildisco, 465 U.S. 513 (1984).

67 29 U.S.C. § 150 *et seq*. (1982).

68 465 U.S. at 516. In reaction to *Bildisco*, Congress enacted § 1113 of the Bankruptcy Code to govern the rejection of collective bargaining agreements. 11 U.S.C. § 1113 (2006). While *Bildisco*'s holding on what procedures govern the rejection of collective bargaining agreements is no longer applicable law, the enactment of § 1113 in no way vitiates the general applicability of *Bildisco*'s discussion of the role of equity in Chapter 11 proceedings, which was not confined to the context of § 1113.

69 *Id*. at 527.

70 *E.g.*, United States v. Heirs of Boisdore, 8 How. 113, 122 (1849) ("In expounding a statute, we must not be guided by a single sentence or member of a sentence, but look to the provisions of the whole law, and to its object and policy.").

71 *See, e.g.*, Dewnsup v. Timm, 502 US 410 (1992). *See generally* Alan Schwartz, *Constitutional Law and the Supreme Court: the New Textualism and the Rule of Law Subtext in the Supreme Court's Bankruptcy Jurisprudence*, 45 N.Y.L. SCH. L. REV. 149 (2001).

72 Bank of Marin v. England, 385 U.S. 99, 103 (1966).

73 11 U.S.C. § 502(c)(2) (2006).

74 Unfortunately, *Bildisco* does not indicate anything about how equities should be weighed in Chapter 7 or Chapter 13 cases, or arguably in liquidating Chapter 11s.

75 *See* BENJAMIN CARDOZO, THE NATURE OF THE JUDICIAL PROCESS 166-67 (1921) ("I was much troubled in spirit, in my first years upon the bench, to find how trackless was the ocean on which I had embarked."). *See also* Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 467-68 (1897) (discussing role of non-legal factors on judicial decision-making).

76 In the case of bankruptcy judges, this concern was exacerbated because of the formerly low prestige of bankruptcy referees (and later bankruptcy judges) relative to Article III judges under the 1898 Act. Indeed, the prestige concerns of the Article III judiciary were quite evident during the debates on the Bankruptcy Act of 1978 and subsequent 1982 and 1984 amendments. *See* Vern Countryman, *Scrambling to Define Bankruptcy Jurisdiction: The Chief Justice, the Judicial Conference, and the Legislative Process*, 22 HARV. J. LEGIS. 1, 9 (1985).

77 *E.g.*, Tex. Indus., Inc., v. Radcliff Materials, Inc., 451 U.S. 630, 640 (1981).

78 Martha A. Field, *Sources of Law: The Scope of Federal Common Law*, 99 HARV. L. REV. 883, 893-94 (1986); Peter Westen & Jeffrey Lehman, *Is There Life for Erie After the Death of Diversity?*, 78 MICH. L. REV. 311, 332 (1980); *but cf.* Martin H. Redish, *Federal Common Law, Political Legitimacy, and the Interpretive Process: An "Institutional" Perspective*, 83 NW. U. L. REV. 761, 788 (1989) ("[T]he difference between common law and statutory interpretation are [sic], both conceptually and politically, qualitatively different."). Notably, Redish defines many of the points along the spectrum as interpretation in order to achieve a neater binary divide. *Id*. at 794.

79 Marbury v. Madison, 5 U.S. 137 (1803).

80 *See, e.g.*, Chevron U.S.A. Inc. v. Nat'l Res. Def. Council, 467 U.S. 837 (1984).

81 *E.g.*, Sosa v. Alvarez-Machain, 542 U.S. 692, 750 (2004) (Scalia, J., concurring) ("We Americans have a method for making the laws that are over us. We elect representatives to two Houses of Congress, each of which must enact the new law and present it for the approval of a President, whom we also elect. For over two decades now, unelected federal judges have been usurping this lawmaking power ....").

82 *See, e.g.*, FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 125-26 (2000).

83 *See* Lingle v. Chevron U.S.A. Inc., 125 S.Ct. 2074 (2005).

84 Marbury v. Madison, 5 U.S. 137 (1803).

85 *Id*. at 163.

86 SNELL, PRINCIPLES OF EQUITY 24 (27th Ed. 1973) ("Indeed, it would not be difficult to reduce [all of the equity maxims to two:] 'Equity will not suffer a wrong to be without a remedy', and 'Equity acts on the person."'). This maxim also appears as *ubi jus ibi remedium* (where there is a right, there is a remedy) and *lex semper dabit remedium* (the law always gives a remedy), formulations that are much closer to that of *Marbury v. Madison*.

87 The office of Lord Chancellor was originally held by a prelate. Krieger, *supra* note 1, at 279.

88 *Cf*. Griswold v. Connecticut, 381 U.S. 479, 492 (1965) (Goldberg, J., concurring).

89 Oral Argument, *In re* John Amendt, No. 05-2458 (3d Cir., Jan. 18, 2006) *at* http://ca3phi02/iptvmedia/05-2458InReJohnAmendt.wmv at 13:49. (Becker, J.) (Petitioner urging court to grant mandamus to prevent venue transfer of an ERISA case under an abuse of discretion standard) (Judge Becker: "When you [petitioner's counsel] say how [will we] explain to ourselves [a denial of mandamus, we respond]--We'll follow the law. Your suggestions here that this [transfer of venue] is grotesque and all the rest of this. This is a legal case. This is going to be decided on the law, not on the emotions .... To think that the Third Circuit Court of Appeals is going to decide on the basis of emotional arguments! There are emotional factors on both sides in every case. There are legal issues here. And when you say 'how do you explain to people?' You have to explain that a federal appellate court is confronted with certain precedents, like our precedent on mandamus, and these other things ....").

90 United States v. Sutton, 786 F. 2d 1305, 1308 (5th Cir. 1986).

91 Butner v. United States, 440 U.S. 48, 49, 53 (1978).

92 *Id*. at 49.

93 *Id*. at 55-56.

94 *Id*. at 53.

95 *Id*. at 56.

96 *Id*. at 55.

97 *Id*. at 56-57.

98 *See* 11 U.S.C. § 365(d)(5) (2006) (trustee is to perform all obligations of the debtor on an unexpired lease of personal property unless court decides otherwise "based on the equities of the case."); 11 U.S.C. § 502(j) (2006) (reconsideration of allowed or disallowed claim is to be made "according to the equities of the case"); 11 U.S.C. § 510(c)(1) (2006) (claims may be subordinated "under principles of equitable subordination"); 11 U.S.C. § 524(g)(2)(B)(ii)(III) (2006) (asbestos channeling injunction may only be issued if pursuit of claims outside of plan would likely threaten "plan's

purpose to deal equitably with claims and future demands"); 11 U.S.C. § 524(g)(4)(B)(ii) (2006) (injunction issued in conjunction with chapter 11 plan only if "the court determines ... such injunction ... is fair and equitable"); 11 U.S.C. § 524(h)(1)(A) (2006) (referencing the "fair and equitable" requirements of 11 U.S.C. § 1129(b)); 11 U.S.C. § 552(b)(1) (2006) (after acquired property clauses in security agreements are valid except to the extent that the court orders otherwise after notice and a hearing "based on the equities of the case."); 11 U.S.C. § 552(b)(2) (2006) (limitation on post-petition effect of after-acquired property clauses of security agreements to be "based on the equities of the case"); 11 U.S.C. § 557(d)(2)(D) (2006) (disposition of grain or proceeds of grain may be by "such other method as is equitable in the case"); 11 U.S.C. § 723(d) (2006) (determination of distribution of surplus recovered by a partnership trustee against general partners shall be equitable); 11 U.S.C. § 1112(d)(3) (2006) (conversion of case from chapter 11 to chapter 12 must be equitable); 11 U.S.C. § 1113(b)(1)(A) (2006) (debtor rejecting a collective bargaining agreement shall make a proposal for modifications in employee benefits and protections that assures that "all creditors, the debtor, and all of the affected parties are treated fairly and equitably"); 11 U.S.C. § 1113(c)(3) (2006) (collective bargaining agreements to be rejected only if "the court finds ... the balance of the equities favors rejection"); 11 U.S.C. § 1114(f)(1)(A) (2006) (debtor modifying retiree benefits must assure that "all creditors, the debtor, and all of the affected parties are treated fairly and equitably"); 11 U.S.C. § 1114(g)(3) (2006) (modification of payment of retiree benefits if "all creditors, the debtor, and all of the affected parties are treated fairly and equitably, and [a modification of the order] is clearly favored by the balance of the equities"); 11 U.S.C. § 1114(l) (2006) (court may reinstate retiree benefits that have been modified unless the equities favor modification); 11 U.S.C. § 1129(b)(1) (2006) (cramdown plan must be "fair and equitable" to be confirmed); 11 U.S.C. § 1129(b)(2) (2006) (defining what "fair and equitable" includes for the purposes of § 1129(b)(1)); 11 U.S.C. § 1170(e)(1) (2006) (approval of abandonment of railroad line requires "a fair arrangement at least as protective of the interests of employees as that established under section 11326(a) of title 49"); 11 U.S.C. § 1172(c)(1) (2006) (approval of railroad reorganization plan requires "a fair arrangement at least as protective of the interests of employees as that established under section 11326(a) of title 49"). *See also* 11 U.S.C. § 1228(b)(1) (2006) and 11 U.S.C. § 1328(b)(1) (2006) ("circumstances for which the debtor should not justly be held accountable" for failure to make payments under a plan); 11 U.S.C. § 524(c)(3)(B) (2006) and 11 U.S.C. § 524(c)(6)(A)(i) (2006) (no "undue hardship"); 11 U.S.C. § 557(f)(1) (2006) ("in the interests of justice"). Many historically equitable doctrines, such as good faith, *see* 11 U.S.C. § 1129(a)(3) (2006), fraud, *see* 11 U.S.C. § 548 (2006), and laches, *see* 11 U.S.C. § 524 (2006), are incorporated throughout the Code, but without allowing judicial discretion.

99 *Compare* 11 U.S.C. § 524(g)(2)(B)(ii)(III) (2006) *with* 11 U.S.C. § 524(g)(4)(B)(ii) (2006); *compare* 11 U.S.C. § 552(b)(1) (2006) *with* 11 U.S.C. § 552(b)(2) (2006); *compare* 11 U.S.C. § 1113(b)(1)(A) (2006) *with* 11 U.S.C. § 1113(c)(3) (2006), 11 U.S.C. § 1114(f)(1)(A) (2006), *and* 11 U.S.C. § 1114(g)(3) (2006); *compare* 11 U.S.C. § 1129(b)(1) (2006) *with* 11 U.S.C. § 1129(b)(2) (2006) *and* 11 U.S.C. § 524(h)(1)(A) (2006); *compare* 11 U.S.C. § 1170(e)(1) (2006) *with* 11 U.S.C. § 1172(c)(1) (2006); *compare* 11 U.S.C. §§ 1228(b)(1) (2006) *with* 1328(b)(1) (2006); *compare* 11 U.S.C. §§ 524(c)(3)(B) (2006) *with* 524(c)(6)(A)(i) (2006).

100 Arguably, 11 U.S.C. § 1170(e)(1) and 11 U.S.C. § 1172(c)(1) originally detailed a measure for equity, in that they call for railroad reorganization plans, including the abandonment of a railroad line to contain "a fair arrangement at least as protective of the interests of employees as that established under section 11347 of title 49." 49 U.S.C. 11347 has since been omitted. *See* Pub. L. 104-88, title 1, § 102(a), Dec. 12, 1995, Stat. 804. *See* 49 U.S.C. § 11326(a) (2006).

101 11 U.S.C. § 1129(b)(1) (2006).

102 11 U.S.C. § 102(3) (2006).

103 11 U.S.C. § 1129(b)(2) (2006).

104 Norwest Bank Worthington v. Ahlers, 485 U.S. 197 (1988).

105 *Id.* at 203 n.3.

106 *Id*. at 206.

107 *Id*. at 209.

108 *Id*. at 206.

109 28 U.S.C. § 1651 (2006).

110 United States v. Energy Res. Co., Inc., 495 U.S. 545, 549 (1990).

111 Krieger, *supra* note 1, at 311. ("equity lies not in the court, but in the Bankruptcy Code it applies.").

112 *E.g.*, Jamo v. Katahdin Fed. Credit Union (*In re* Jamo), 283 F.3d 392, 403 (1st Cir. 2002) ("Section 105(a) does not provide bankruptcy courts with a roving writ, much less a free hand. The authority bestowed thereunder may be invoked only if, and to the extent that, the equitable remedy dispensed by the court is necessary to preserve an identifiable right conferred elsewhere in the Bankruptcy Code.") (bankruptcy court lacked power to modify a reaffirmation agreement or compel the parties to enter into a judicially-crafted reaffirmation agreement).

113 11 U.S.C. §1123(b)(5) (2006).

114 Guidry v. Sheet Metal Workers Nat'l Pension Fund, 493 U.S. 365, 376 (1990).

115 *See, e.g.*, SEC v. United States Realty, 310 U.S. 434, 455 (1940).

116 Young v. United States, 535 U.S. 43 (2002).

117 11 U.S.C. § 507 (a)(8)(A)(i) (2006).

118 26 U.S.C. §§ 6501 - 6502 (2006).

119 535 U.S. at 47.

120 *See* United States v. Energy Res. Co., Inc., 495 U.S. 545, 549-50 (1990) ("Even if consistent with the Code, however, a bankruptcy court order might be inappropriate if it conflicted with another law that should have been taken into consideration in the exercise of the court's discretion.").

121 There is also a fourth reading of *Ahlers*, which is really a broader version of the third reading. This fourth reading is that equity must be consistent not just with the Code's specific provisions, but with the general tenor of the Code and the policies underlying it.

122 Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 206 (1988).

123 11 U.S.C. § 557(f) (2006).

124 495 U.S. at 549.

125 United States v. Kras, 409 U.S. 434, 446-47 (1973).

126 Krieger, *supra* note 1, at 275, 277-292. *See also* Plank, *supra* note 11, at 668; Berry v. Root, 148 F. 2d 945, 946 (5th Cir. 1945) ("While a court of bankruptcy often applies equitable principles, and may sometimes entertain a controversy in equity arising out of the bankruptcy in which it will follow the precedents and practice of a court of equity, yet as respects the original bankruptcy proceeding it is not strictly a court of equity, but a statutory court created by the Bankruptcy Act, and governed by it.").

127 *Ex parte*, the City Bank of New Orleans (*In re* William Christy), 44 U.S. 292. 311-313 (1845).

128 27 Cong. Ch. 9; 5 Stat. 440 (1841).

129 11 U.S.C. § 101 *et seq*. (2006).

130 Bankruptcy Act of 1898, 55 Cong. 2nd Sess., Ch. 541, 30 Stat. 544 (1898) (codified as amended at 11 U.S.C. §§ 1-1103 (1976 & Supp. II 1978) (repealed 1978)).

131 *See* Steve H. Nickles & David G. Epstein: *Bankruptcy Symposium: Another Way of Thinking About Section 105(a) and Other Sources of Supplemental Law Under the Bankruptcy Code*, 3 CHAP. L. REV. 7, 13-14 (2000).

132 Lingle v. Chevron U.S.A. Inc., 125 S.Ct. 2074 (2005) (holding that the "substantially advances government interests" test for regulatory takings does not apply).

133 Bankruptcy Act of 1898, 55 Cong. 2nd Sess., Ch. 541, 30 Stat. 544, 544-545 (1898) (codified as amended at 11 U.S.C. § 2 (1976 & Supp. II 1978) (repealed 1978)).

134 Pepper v. Litton, 308 U.S. 295, 304 (1939) (internal citations omitted).

135 Bankruptcy Act of 1898, 55 Cong. 2nd Sess., Ch. 541, 30 Stat. 544, 544-545 (1898) (codified as amended at 11 U.S.C. § 2(a)(1) (1976 & Supp. II 1978) (repealed 1978)).

136 *See id*. § 2

137 *Id*. §§ 2(a)(2) - (19).

138 *Id*. § 2(a)(15).

139 Local Loan Co. v. Hunt, 292 U.S. 234 (1934).

140 308 U.S. at 304.

141 292 U.S. at 240.

142 *Id. See also* Bardes v. Hawarden Bank, 178 U.S. 524, 535 (1900) ("the words 'at law,' in the opening sentence conferring on the courts of bankruptcy 'such jurisdiction, at law and in equity, as will enable them to exercise original jurisdiction in bankruptcy proceedings,' may have been inserted to meet clause 4, authorizing the trial and punishment of offences, the jurisdiction over which must necessarily be at law and not in equity.").

143 *See* Butner v. United States, 440 U.S. 48, 55-56 (1979) ("The equity powers of the bankruptcy court play an important part in the administration of bankrupt estates in countless situations in which the judge is required to deal with particular, individualized problems.").

144 *Cf*. FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 157-58 (2000) (Congressional ratification of prior agency practice may be inferred from absence of comment in later legislation).

145 *See* Bankruptcy Reform Act of 1978, P.L. 95-598, 92 Stat. 2549 (Nov. 6, 1978), § 241.

146 28 U.S.C. § 1481 (1982) (possibly repealed in 1984). The House Report on the Bankruptcy Code noted that § 1481 "gives the bankruptcy court the powers of a court of equity, law, and admiralty. It is the concomitant of the bankruptcy courts increased jurisdiction, and is necessary to enable the bankruptcy court to exercise that jurisdiction and its powers under the bankruptcy code. It is in addition to any power granted under 28 U.S.C. 1651 (the All Writs Statute) or under section 105 of the bankruptcy code." H.R. REP. NO. 595; 95th Cong., 1st Sess; HR 8200 (Sept. 8, 1977).

147 The Official Comm. of Unsecured Creditors of Cybergenics Corp., on behalf of Cybergenics Corp., v. Chinery, 330 F.3d 548, 567 (3d Cir. 2003).

148 Bankruptcy Reform Act of 1978, P.L. 95-598, 92 Stat. 2682 (Nov. 6, 1978), § 402(b). *Also see id*. 92 Stat. 2683, § 404 (providing for transition from Bankruptcy Act of 1898 to Bankruptcy Code of 1978). For effective date of rest of Bankruptcy Reform Act of 1978, October 1, 1979, *see id.*, 92 Stat. 2682 (Nov. 6, 1978), § 401. Thus, 11 U.S.C. § 2a continued to be in effect until March 31, 1984. *Id*. 92 Stat. 2683, § 404(a).

149 N. Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50 (1982).

150 *Id*. at 88. The Supreme Court granted a ninety-day stay in *Northern Pipeline*, which it later extended for a further ninety days. WILLIAM L. NORTON, JR., *et. al.*, 2 NORTON BANKR. L. & PRAC. 2d §§ 4:10 (2005). Congress did not manage to act before the stay lapsed, but a stop-gap measure was found in the universal adoption of an Emergency Local Rule that cured the 1978 Acts' jurisdictional defects. *Id*. §§ 4:10 and 4:25. For a detailed history of this process and the politics involved, *see* Countryman, *supra* note 76.

151 *Id*. at 55.

152 *See* Pub. L. No. 98-249, 98 Stat. 116 (March 31, 1984) (postponing effective date until May 1, 1984); Pub. L. No. 98-271, 98 Stat. 163 (April 30, 1984) (postponing effective date until May 26, 1984); Pub. L. No. 98-299, 98 Stat. 214 (May 25, 1984) (postponing effective date until June 21, 1984); Pub. L. No. 98-325, 98 Stat. 268 (June 20, 1984) (postponing effective date until June 28, 1984).

153 *See* Pub. L. No. 98-325, 98 Stat. 268 (June 20, 1984).

154 98 P.L. 353; 98 Stat. 333 (1984).

155 98 P.L. 353; 98 Stat. 333, § 113 (1984).

156 98 P.L. 353; 98 Stat. 333, § 121 (1984).

157 *In re* Haddad, 68 B.R. 944, 948 (Bankr. D. Mass., 1987).

158 Countryman, *supra* note 76, at 40. Congress's inept legislation resulted in significant litigation as to whether the positions of the entire corps of bankruptcy judges who were sitting in 1984 had been eliminated and recreated thus necessitating reappointment. *Id*. at 38. The Director of the Administrative Office of the United States Courts stated that the positions of bankruptcy judges had been eliminated and that they should not therefore receive their salaries. *Id*. As a result, several bankruptcy judges brought a declaratory judgment action against the Director. *Id*. at 39. Litigants in several bankruptcy cases also unsuccessfully argued that the judgments rendered against them by bankruptcy judges were invalid because the judges were not properly appointed as a result of the 1984 confusion. *See, e.g.*, *In re* Benny, 44 B.R. 581 (N.D. Cal. 1984), *dismissed in part, aff'd in part*, 791 F.2d 712 (9th Cir. 1986), *appeal after remand*, 812 F.2d 1133 (9th Cir. 1987); *In re* Tom Carter Enters., Inc., 44 B.R. 605 (C.D. Cal. 1984); *In re* Production Steel, Inc., 48 B.R. 841 (M.D. Tenn. 1985); *In re* Moens, 800 F.2d 173 (7th Cir. 1986); *In re* Moody, 46 B.R. 231 (M.D.N.C. 1985); *In re* Koerner, 800 F.2d 1358 (5th Cir. 1986). The Department of Justice intervened in these cases to support the unsuccessful attack on the judges' appointment. Lundy v. Meachem, 980 F.2d 1450, 1455 (D.C.Cir. 1992).

159 *See, e.g.,* Indus. Tool Distrib., Inc., 55 B.R. 746, 749 n.6 (Bankr. N.D. Ga. 1985) ("it is highly likely that Congress meant to make §1481 prospectively ineffective, which is what § 113 of the 1984 Act does. Further, since § 1481 was already in effect and there was no reason not to give it an effective date of July 10, 1984, § 121(a) was obviously an oversight."); SEC v. Danning (*In re* Carter), 759 F.2d 763, 766 (9th Cir. 1985); *see* City Nat'l Bank of Miami v. Gen. Coffee Corp. (*In re* Gen. Coffee Corp.), 758 F.2d 1406 (11th Cir. 1985); *In re* Amatex Corp., 755 F.2d 1034, 1037 n.2 (3d Cir. 1985); Thistlethwaite v. First Nat'l Bank of Lafayette (*In re* Exclusive Indus. Corp.), 751 F.2d 806, 807 n.1 (5th Cir. 1985); Omega Equip. Corp. v. John C. Louis Co., Inc., 51 Bankr. 569, 572 (D.D.C. 1985); Robinson v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 52 B.R. 940, 941 n.2 (S.D.N.Y. 1985). *See also* 1A COLLIER ON BANKRUPTCY, ¶ 3.01[8a] (15th ed. 1985) ("Section 1481 was effectively repealed by the Bankruptcy Amendments and Federal Judgeship Act of 1984."); 1987 Advisory Committee Note to Bankruptcy Rule 9020, *reprinted in* 10-9020 COLLIER ON BANKRUPTCY (15th Ed. Rev. 2005) App. 9020, (referring to the "former section 1481); *id*. n.1 ("With the enactment of Pub. L. No. 98-353 (1984), section 1481 was repealed.").

160 *In re* Haddad, 68 B.R. 944, 948 (Bankr. D. Mass., 1987).

161 *See* Better Homes of Va. v. Budget Serv. Co., 52 B.R. 426, 430 (E.D. Va. 1985) ("under the general rule of statutory construction as to mutually exclusive statutes passed on, and effective on, the same date, § 1481 would remain unaffected by either provision"), *aff'd on other grounds*, Budget Serv. Co. v. Better Homes, 804 F.2d 289, 293 n.4 (4th Cir. 1986).

162 *See* Elder-Beerman Stores Corp. v. Thomasville Furniture Indus. (*In re* Elder-Beerman Stores Corp.), 197 B.R. 629, 632 (Bankr. D.Ohio, 1996). *See also, In re* Cont'l Air Lines, Inc., 61 B.R. 758, 775 n.35 (S.D. Tex. 1986).

163 NORTON, JR., *et. al.*, 2 NORTON BANKR. L. & PRAC. 2d §§ 2:11 (2005). After the *Northern Pipeline* decision, the Judicial Conference recommended an emergency local rule, which was universally adopted, that distinguished bankruptcy jurisdiction between core and non-core proceedings. *Id*. §§ 4:10 and 4:25. BAFJA essentially adopted the "Emergency Rule." *Id*.

164 *See* H.R. Judiciary Comm., Bankruptcy Reform Act of 1978, H.R. REP., NO. 95-595, at 448 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6404.

165 Cont'l Ill. Nat'l Bank & Trust v. Chi., Rock Island & Pac. Ry. Co., 294 U.S. 648 (1935).

166 28 U.S.C. § 262 (1934) (authorizing federal courts "to issue all writs not specifically provided for by statute, which may be necessary for the exercise of their respective jurisdictions").

167 294 U.S. at 675.

168 *Id.* at 676.

169 The second sentence of § 105(a) was added as part of the 1986 Amendments to the Code.

170 11 U.S.C. § 105(a) (2006).

171 Manuel D. Leal, *The Power of the Bankruptcy Court: Section 105*, 29 S. TEX. L. REV. 487, 489 (1988).

172 *See supra* note 98.

173 *In re* Cont'l Airlines, 203 F.3d 203, 211 (3d Cir. 2000) (§ 105(a) does not "create substantive rights that would otherwise be unavailable under the Bankruptcy Code."). *Cf. Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 206 (1988) ("whatever equitable powers remain in the bankruptcy courts must and can only be exercised within the confines of the Bankruptcy Code").

174 11 U.S.C. § 105(b) (2006).

175 *In re* Howell, 4 B.R. 102, 105 (Bankr. M.D. Tenn. 1980).

176 *See* 132 Cong. Rec. S5092 (daily ed. Oct. 3, 1986).

177 *E.g., In re* Stone & Webster, Inc., 286 B.R. at 539; *In re* Wellman, 89 B.R. 880, 883 (Bankr. D. Colo. 1988); *In re Wilnor Drilling, Inc.*, 29 B.R. 727, 729-30 (S.D. Ill. 1982); Fed. Land Bank of St. Paul v. Brown (*In re* James), 20 B.R. 145, 149 (Bankr. E.D. Mich. 1982); Deborah A. Crabbe, *Are Non-debtor Releases/Permanent Injunctions Authorized Under the Bankruptcy Code?* 2003 AM. BANKR. INSTIT. J. LEXIS 94 (May 2003); David B. Stratton, *Equitable Remedies in Bankruptcy Court: Grupo Mexicano, Substantive Consolidation and Beyond*, 2003 AM. BANKR. INSTIT. J. LEXIS 39, at *3 (March 2003); Hon. Stephen A. Stripp, *An Analysis of the Role of the Bankruptcy Judge and the Use of Judicial Time*, 23 SETON HALL L. REV. 1330, 1360-68 (1993); Brian Leepson, Note and Comment, *A Case for the Use of a Broad Court Equity Power to Facilitate Chapter 11 Reorganization*, 12 BANKR. DEV. J. 775, 776, 793, 798 (1996); Jason A. Rosenthal, Note, *Courts of Inequity: The Bankruptcy Laws' Failure to Adequately Protect the Dalkon Shield Victims*, 45 FLA. L. REV. 223, 230-238 (1993); Adam J. Wiensch, Note, *The Supreme Court, Textualism, and the Treatment of Pre-Bankruptcy Code Law*, 79 GEO. L. J. 1831, 1861 (1991).

178 *See* H.R. Judiciary Comm., Bankruptcy Reform Act of 1978, H.R. REP., NO. 95-595, at 359 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6315.

179 28 U.S.C. § 1651 (2006). ("The Supreme Court and all courts established by Act of Congress may issue all writs necessary or appropriate in aid of their respective jurisdictions and agreeable to the usages and principles of law.") 28 U.S.C. § 451 (1982) (possibly repealed in 1984), a definitional section for the All Writs Statute, clarified that bankruptcy courts were included in the application of the All Writs Statute.

180 H.R. REP. NO. 95-595, at 316-317 (1977).

181 11 U.S.C. § 362 (2006).

182 Pa. Bureau of Corr. v. U.S. Marshals Serv., 474 U.S. 34, 43 (1985).

183 *Pepper*, 308 U.S. at 304-305.

184 *See* U.S. CONST. art. III, § 2.

185 *See* Comm'r. v. Court Holding Co., 324 U.S. 331, 334 (1945). Similarly, the economic analysis of law so *en vogue* with some judges over the last couple of decades is precisely an analysis of economic substance instead of legal form, yet no one would think to term this equitable analysis.

186 Capital Factors, Inc. v. Kmart Corp., 291 B.R. 818 (N.D. Ill. 2003), *aff'd*, 359 F.3d 866 (7th Cir. 2004).

187 *Id*. at 821-23. The doctrine of necessity developed in equity receiverships for railroads. *See, e.g.*, B & W Enters., Inc. v. Goodman Oil Co. (In re B & W Enters., Inc., 713 F.2d 534, 536-37 (9th Cir. 1983). It is actually an amalgam of two rules from equity receiverships for railroads, the Six Months Rule and the Necessity of Payments Rule. *See id.*; *see also In re* CoServ, L.L.C., 273 B.R 487, 492 n.7 (Bankr. N.D. Tex. 2002). *See B & W Enters.*, 713 F.2d at 536-37. Only the Six Months Rule has been incorporated in the Bankruptcy Code at 11 U.S.C. 1171(b) (2006) and only for railroad reorganizations. *See id.*; *see also* CoServ, 273 B.R at 492 n.7. *But see* Kmart, 291 B.R. at 822 ("The doctrine [of necessity] is not codified *anywhere* in the Bankruptcy Code ....") (emphasis added).

188 291 B.R. at 822.

189 *Id*.

190 *In re* Chi., Milwaukee, St. Paul, & P. R.R. Co., 791 F.2d 524 (7th Cir. 1986). *See infra* text accompanying notes 220-226 for a discussion of this case. Curiously the district court failed to cite another equally binding case decided under the 1898 Act, *In re* Kane, 127 F. 552 (7th Cir. 1904), in which the Seventh Circuit affirmed a district court bankruptcy decision that had allowed a debtor to use his state law exemption but not according to the procedures required at state law. The *Kane* court declared in no uncertain terms that "A court of bankruptcy is a court of equity, seeking to administer the law according to its spirit, and not merely by its letter." *Id*. at 553.

191 291 B.R. at 823 (internal citation omitted).

192 *Id*. at 822. The concern over pre-plan payments is potentially two-fold. First, it elevates the claims of "critical" vendors over those of other unsecured creditors, functionally subordinating the "non-critical" unsecureds to the "critical" unsecureds. Second, paying off pre-petition claims pre-plan often incurs "more senior debt at the expense of unpaid unsecured creditors, since [the] secured, super-priority, post-petition loan will increase concomitantly with the amounts

paid [to the critical vendors]" subordinating "non-critical" unsecureds to the DIP lender for a greater amount. *See* CoServ, 273 B.R. at 496.

193 291 B.R. at 823. The passage of a year between Kmart's bankruptcy filing and the district court's decision cast also question on the "critical" nature of any vendor and hence the necessity of confirming the order.

194 11 U.S.C. § 507 (2006).

195 Many thanks to Martin Bienenstock of Weil, Gotshal & Manges, LLP for this scenario.

196 11 U.S.C. § 362 (2006).

197 11 U.S.C. § 507 (2006).

198 *In re* Kmart Corp., 359 F.3d 866, 869 (7th Cir. 2004).

199 Hope Yen, *Supreme Court Won't Hear Kmart's Bankruptcy Case*, MIAMI HERALD, Nov. 16 2004, at C3. Kmart's proposed payments to newspapers were for goodwill. *Id*.

200 LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS 134 (Ann Arbor: Univ. of Michigan Press, 2005).

201 *See supra* discussion accompanying notes 195-197.

202 *In re* Kmart Corp., 359 F. 3d 866, 872 (2004).

203 11 U.S.C. § 363(b)(1) (2006).

204 359 F. 3d at 874.

205 *Id*. at 871.

206 *Id*.

207 Official Comm. of Equity Sec. Holders v. Mabey, 832 F.2d 299 (4th Cir. 1987).

208 *Id*. at 300.

209 *Id*. at 302. The Ninth Circuit adopted a similar position in *American Hardwoods*. It noted that "[w]hile endowing the court with general equitable powers, section 105 does not authorize relief inconsistent with more specific law," and then proceeded, as in *Mabey*, to find the equitable relief granted inconsistent with the Code. Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc., 885 F.2d 621, 625 (9th Cir. 1989).

210 Mabey, 832 F.2d at 302.

211 *Id*.

212 FED. R. BANKR. PROC. 3021 (1987) ("After confirmation of a plan, distribution shall be made to creditors whose claims have been allowed, to holders of stock, bonds, debentures, notes, and other securities of record at the time of commencement of distribution whose claims or security interests have not been allowed and to indenture trustees who have filed claims pursuant to Rule 3003(C)(5) and which have been allowed.").

213 *In re* CoServ, L.L.C., 273 B.R 487 (Bankr. N.D. Tex. 2002).

214 *Id*. at 496-97.

215 *Id*. (citing 11 U.S.C. §§ 704, 1106 (2000)).

216 273 B.R. at 497.

217 It is worthwhile noting that reproductive ability has special constitutional significance. *See* Skinner v. Okla., 316 U.S. 535 (1942) (heightened equal protection and due process scrutiny when reproductive ability is at stake).

218 *See supra* note 98.

219 *In re* Chi., Milwaukee, St. Paul, & P. R.R. Co., 791 F.2d 524, 528 (7th Cir. 1986).

220 In *Chicago, Milwaukee* the railroad-debtor had issued 100-year debentures, which would pay 5% per annum, if there were available net income, with the principal to be repaid at the end of the term. *Id*. at 525-26. After the railroad filed for bankruptcy, the indenture trustee declared the debentures in default. *Id*. at 526. (It is not clear from the opinion if the default was simply the filing for bankruptcy--an *ipso facto* clause, permitted under the Act, unlike under the Code--or if there was a monetary default.) By the terms of the indenture, this accelerated the debentures to becoming immediately payable in full. The acceleration raised issues of how to value the debenture holders' claims, particularly in regard to what interest rate to use to calculate present value and what to do for years for which there was no way of predicting if there was available net income on which the 5% interest payment was contingent.

The debtor had appealed, arguing that the district judge should have decelerated the debentures. While the debenture holders did not challenge the district judge's power to decelerate, *id.*, the Seventh Circuit upheld the district judge's decision, *because the debtor was solvent*, not because deceleration would have been an abuse of equitable power. *Id*. at 527. Indeed, Judge Posner noted that "The only good reason for refusing to give a creditor in reorganization all that he bargained for when he extended credit is to help other creditors, the debtor's assets being insufficient to pay all creditors in full." *Id*.

Creditors, of course, bargain in light of bankruptcy, which includes both the Code's priority scheme *and* the court's § 105(a) powers, including the possibility of a deviation from the priority scheme. In any case, unsecured creditors can hardly claim a reliance interest on their priority, as they usually have no way of knowing what sort of haircut to expect because they do not know the debtor's assets and liabilities.

221 Mabey, 832 F.2d at 302. There is a certain irony to this miscitation, as in *Mabey*, the Fourth Circuit called the district court to task for citing an authority that did not speak to the issue. *Id*.

222 Kmart, 291 B.R. at 832.

223 Kmart, 359 F.3d at 871.

224 791 F.2d at 528.

225 *Id*.

226 Judge Posner's own authority for *Chicago, Milwaukee is* questionable--he cites a concurrence he authored, Piper Aircraft Corp. v. Wag-Aero, Inc., 741 F.2d 925 (7th Cir. 1984) (Posner, J., concurring) and an opinion that he authored, Shondel v. McDerMott, 775 F.2d 859 (7th Cir. 1985) (Posner, J.) and that cites the *Piper Aircraft* concurrence as authority. In both the opinion and concurrence, Judge Posner held forth on the nature of equity and its scope in the merged courts of law and equity, but only regarding non-bankruptcy contexts.

227 741 F.2d 925 (7th Cir. 1984) (Posner, J., concurring).

228 775 F.2d 859 (7th Cir. 1985) (Posner, J.).

229 Official Comm. of Unsecured Creditors of Mirant Corp. v. Potomac Elec. Power Co. (*In re* Mirant Corp.), 378 F.3d 511, 524 (5th Cir. 2004), *aff'g In re* Mirant Corp., 303 B.R. 304 (N.D. Tex. 2003), *rev'g In re* Mirant Corp., 303 B.R. 319 (Bankr. N.D. Tex. 2003).

230 *In re* Mirant Corp., 303 B.R. 304 (N.D. Tex. 2003).

231 378 F.3d at 524.

232 *Id*. at 523.

233 *Id*. at 523 (citing *In re* Southmark Corp., 49 F.3d 1111, 1116 (5th Cir. 1995) (citing in turn *In re* Oxford Mgmt., Inc., 4 F. 3d 1329, 1334 (5th Cir. 1993) (quoting United States v. Sutton, 786 F. 2d 1305, 1308 (5th Cir. 1986)))).

234 Mirant, 378 F.3d at 524.

235 *Id*. at 524.

236 *See* 11 U.S.C. § 362(b)(4) (2006) (exempting from the automatic stay the "commencement or continuation of an action or proceeding by a governmental unit ... to enforce such governmental unit's ... police and regulatory power").

237 La. PSC v. Mabey (*In re* Cajun Elec. Power Coop., Inc.), 185 F.3d 446, 457 n.18 (5th Cir. 1999) (citing Corporacion de Servicios Medicos Hospitalarios de Fajardo v. Mora, 805 F.2d 440, 449 n.14 (1st Cir. 1986)).

238 *In re* Southmark Corp, 49 F.3d 1111, 1116 (5th Cir. 1995).

239 Mirant, 378 F.3d at 523.

240 Chiasson v. J. Louis Matherne & Assocs. (*In re* Oxford Mgmt., Inc.), 4 F.3d 1329, 1334 (5th Cir. 1993).

241 United States v. Sutton, 786 F.2d 1305, 1308 (5th Cir. 1986).

242 *See, e.g.*, *In re* SPM Mfg. Corp., 984 F.2d 1305, 1311 (1st Cir. 1993); *In re* Chi., Milwaukee, 891 F.2d at 162.

243 Kmart, 359 F.3d at 871.

244 786 F.2d 1305. *See also* Leal, *supra* note 171, at 491 n.6 (plantation-style house).

245 *Id*. at 1306.

246 *Id*. at 1306-07.

247 *Id*. at 1307.

248 H.R. REP. NO. 95-595, at 316-317 (1977).

249 786 F.2d at 1306-07.

250 Chiasson v. J. Louis Matherne & Assocs. (*In re* Oxford Mgmt., Inc.), 4 F.3d 1329 (5th Cir. 1993).

251 *See* JOHN SELDEN, TABLE TALK 43 (Pollock ed., 1927) ("Equity is A Roguish thing, for Law wee have a measure known what to trust too. Equity is according to the conscience of him that is Chancellor, and as that is larger or narrower, soe is equity. Tis all one as if they should make the Standard for the measure wee call A foot, to be the Chancellors Foot; what an uncertain measure would this be; One Chancellor ha's a long foot another A short foot a third an indifferent foot; this the same thing in the Chancellors Conscience.").

252 *In re* Just for Feet, Inc., 242 B.R. 825-26 (D. Del. 1999) (emphasis added).

253 *Id*. Allowing pre-plan payments in full to certain critical vendors functionally subordinates other unsecured creditors. *See supra* note 192. Section 510(c) of the Code authorizes subordination of claims, 11 U.S.C. § 510(c) (2006), but instructs that this is to be done in accordance with principles of equity, and equitable subordination usually requires that the subordinated party have unclean hands. *See, e.g.*, B & W Enters., Inc. v. Goodman Oil Co. (*In re* B & W Enters., Inc., 713 F.2d 534, 537-38 (9th Cir. 1983) ("the subordination of a creditor's claim normally requires a showing that the creditor 'has acted inequitably in the course of his relationship with the debtor and that those actions have harmed the debtor or his other creditors in some way.'").

The *Just For Feet* court's lack of hesitation in allowing pre-plan payments to critical vendors may have been because the debtor appeared to be balance-sheet solvent and merely suffering from liquidity problems, 242 B.R. at 823, a situation not unlike that in *Chicago, Milwaukee*. If this were the case, then a pre-plan payment would not change the distribution scheme because all creditors could be paid in full, although they would have incurred a risk in the interim.

254 Grupo Mexicano de Desarrollo, S. A. v. Alliance Bond Fund, Inc., 527 U.S. 308 (1999).

255 527 U.S. at 322.

256 *Id*.

257 *Id*. at 328 n.9.

258 *Id*. at 328.

259 *Id*. at 321. We should be chary of taking Story's treatise as a normative statement--treatises are as frequently normative as positive--but a full analysis of Story's approach to equity jurisprudence is beyond the scope of this article.

260 *Id*. (quoting Marbury v. Madison, 5 U.S. (1 Cranch.) 137, 163 (1803)).

261 *See supra* note 251.

262 Marbury, 5 U.S. at 163.

263 28 U.S.C. §§ 152(a), (e) (2006).

264 Cont'l Ill. Nat'l Bank & Trust Co. v. Chi., Rock Island, and Pac. Ry. Co., 294 U.S. 648, 669-70 (1935) (internal citations omitted).

265 28 U.S.C. § 1481 (1982) (possibly repealed in 1984). The House Report on the Bankruptcy Code noted that § 1481 "gives the bankruptcy court the powers of a court of equity, law, and admiralty. It is the concomitant of the bankruptcy courts increased jurisdiction, and is necessary to enable the bankruptcy court to exercise that jurisdiction and its powers under the bankruptcy code. It is in addition to any power granted under 28 U.S.C. § 1651 (the All Writs Statute) or under section 105 of the bankruptcy code." H.R. REP. NO. 595; 95th Cong., 1st Sess; HR 8200 (Sept. 8, 1977).

266 527 U.S. at 319 ("'the equity jurisdiction of the federal courts is the jurisdiction in equity exercised by the High Court of Chancery in England at the time of the adoption of the Constitution and the enactment of the original Judiciary Act, 1789 (1 Stat. 73.)'") (quoting A. DOBIE, HANDBOOK OF FEDERAL JURISDICTION AND PROCEDURE 660 (1928)).

267 527 U.S. at 319.

268 *See* 11 U.S.C. § 547 (2006) (voidable preferences); § 548 (2006) (fraudulent transfers); Uniform Fraudulent Transfer Act, §§ 4-5.

269 Judith Resnik, *Constricting Remedies: The Rehnquist Judiciary, Congress, and Federal Power*, 78 IND. L.J. 223, 266 (2003).

270 *See* Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 657-58 (6th Cir. 2002).

271 11 U.S.C. § 363 (2006) (use of estate property); § 541 (2006) (property of the estate defined).

272 28 U.S.C. § 157 (2006).

273 U.S. CONST. art. I, § 8, cl. 4.

274 *See* John T. Cross, *Congressional Power to Extend Federal Jurisdiction to Disputes Outside Article III: A Critical Analysis from the Perspective of Bankruptcy*, 87 NW. U. L. REV. 1188, 1199 (1993).

275 Freytag v. Comm'r of Internal Revenue, 501 U.S. 868, 889 (1991).

276 *E.g.*, *In re* Stone & Webster, Inc., 286 B.R. 532 (Bankr. D. Del. 2002).

277 *In re* Owens Corning, 419 F.3d 195, 209 n.14 (3d Cir. 2005).

278 Stone & Webster, 286 B.R. 532.

279 *Id*. at 536.

280 *Id*.

281 *Id*.

282 Sampsell v. Imperial Paper & Color Corp., 313 U.S. 215, 219 (1941).

283 286 B.R at 538-39.

284 11 U.S.C. § 1123 (2006).

285 286 B.R. at 537.

286 *In re* Owens Corning, 419 F.3d 195, 209 n.14 (3d Cir. 2005).

287 *In re* Am. Homepatient, Inc., 298 B.R. 152, 165 (Bankr. M.D. Tenn. 2003).

288 *Id*. at 166.

289 *Id*. at 165.

290 Similar reasoning, albeit less explicit appears in Official Comm. of Asbestos Claimants v. G-I Holdings, Inc. (*In re* G-I Holdings Inc.), 2001 Bankr. LEXIS 2029, at *19-*20 (Bankr. D.N.J. 2001) (finding authority to consolidate debtors, but declining to do so).

291 Class Five Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648 (6th Cir. 2002).

292 11 U.S.C. § 1123(b)(6) (2006) ("Subject to subsection (a) of this section, a plan may ... (6) include any other appropriate provision not inconsistent with the applicable provisions of this title.").

293 *In re* Dow Corning Corp., 244 B.R. 721, 744 (Bankr. E.D. Mich. 1999).

294 *In re* Dow Corning Corp., 255 B.R. 445, 480 (E.D. Mich. 2000).

295 280 F.3d at 657-658.

296 *Id*.

297 *Cf. In re* Owens Corning, 419 F.3d 195, 209 n.14 (3d Cir. 2005).

298 *See* discussion accompanying notes 302-344 *infra*.

299 H.R. REP. NO. 95-595, at 316-317 (1977).

300 Wiensch, *supra* note 177, at 1831.

301 *See supra* note 217.

302 Midlantic Nat'l Bank v. N.J. Dep't of Envtl. Prot., 474 U.S. 494 (1986).

303 Kelly v. Robinson, 479 U.S. 36 (1986).

304 United Sav. Ass'n. of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365 (1988).

305 *In re* Ahlers, 485 U.S. 197 (1988).

306 United States v. Ron Pair Enters., Inc., 489 U.S. 235 (1989).

307 Pa. Dept. of Pub. Welfare v. Davenport, 495 U.S. 552 (1990).

308 Cohen v. de la Cruz, 523 U.S. 213 (1998).

309 Midlantic Nat'l Bank v. N.J. Dept. of Envtl. Prot., 474 U.S. 494, 501 (1986) (emphasis added).

310 Kelly v. Robinson, 479 U.S. 36 (1986).

311 *Id*. at 38-39.

312 *Id*.

313 *Id*. at 39-40.

314 *Id*. at 40-41.

315 *Id*. at 52-53.

316 *See* The Bankruptcy Act of 1898, Ch. 541, §§ 17, 57, 63, 30 Stat. 544.

317 479 U.S. at 44-46.

318 *Id*. at 46 (emphasis added).

319 United States v. Ron Pair Enters., Inc., 489 U.S. 235 (1989).

320 *Id*. at 237.

321 *Id*. at 243.

322 *Id*.

323 *Id*. at 243-244.

324 *Id*. at 245.

325 *Id*. at 244-245.

326 *Id*. at 245.

327 *Id*.

328 *Id*. at 246.

329 *Id*. *Cf*. NLRB v. Bildisco & Bildisco, 465 U.S. 513, 525 (1984) (noting that there cannot be a presumption that Congress adopted any particular pre-Code practice if that practice was not consistent and widespread).

330 489 U.S. at 249.

331 *Id*.

332 *Id*. at 252.

333 *Id*. at 254 (quoting United Sav. Ass'n. of Tex. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 380 (unanimously affirming that "adequate protection" under 11 U.S.C. § 362(d)(1) (1982) does not entitle an undersecured creditor to interest on its collateral during the automatic stay)).

334 Pa. Dept. of Pub. Welfare v. Davenport, 495 U.S. 552 (1990).

335 *See supra* note 315.

336 495 U.S. at 565.

337 *Id*. at 563.

338 *Id*. at 564.

339 Cohen v. de la Cruz, 523 U.S. 213 (1998).

340 11 U.S.C. § 523(a)(2)(A) (2006).

341 *See* 523 U.S. at 221.

342 Pa. Dept. of Pub. Welfare v. Davenport, 495 U.S. 552, 563 (1990).

343 523 U.S. at 221 (internal quotation marks and citation omitted).

344 *Id*. at 222.

345 11 U.S.C. § 726 (2006).

346 11 U.S.C. §§ 1129(b)(2)(B)(ii), 1129(b)(2)(C)(ii) (2006).

347 *See* Prudence Realization Corp. v. Geist, 316 U.S. 89 (1942) (rejecting state law priorities in favor of federal common law rule).

348 Chevron U.S.A. Inc. v. Nat'l Res. Def. Council, 467 U.S. 837 (1984).

349 Schwartz, *supra* note 71, at 187.

350 *See In re* Raejean Bonham, 229 F.3d 750, 765 (9th Cir. 2000) ("even though substantive consolidation was not codified in the statutory overhaul of bankruptcy law in 1978, the equitable power undoubtedly survived enactment of the Bankruptcy

Code."). *But see* 11 U.S.C. § 1123(a)(5)(C) (2006) ("Notwithstanding any otherwise applicable nonbankruptcy law, a plan shall-- ... provide adequate means for the plan's implementation, such as-- ... merger or *consolidation* of the debtor with one or more persons") (emphasis added).

351 *In re* Standard Brands Paint Co., 154 B.R. at 567 (Bankr. C.D. Cal. 1993).

352 *Id*. at 568. Veil-piercing type substantive consolidation cases still occur. *E.g.*, Bonham, 229 F.3d at 750. *See In re* Owens Corning, 419 F.3d 195, 205-09 (3d Cir. 2005), for the history of substantive consolidation.

353 *In re* Owens Corning, 316 B.R. 168 (Bankr. D. Del. 2004) (granting substantive consolidation), *rev'd, Owens Corning*, 419 F.3d 195.

Even non-bankruptcy practices, such as the "doctrine of necessity," have been transformed into "pre-Code" practices and then expanded by analogy to areas that they did not historically cover. The doctrine of necessity was adopted from the related field of equity receiverships for railroads. *See supra* note 187. Two of the factors arguing for the importance of keeping a bankrupt railroad in operation, especially in the earlier half of the twentieth century, were the importance of the rails to the national economy and the difficulty for consumers in finding an immediate replacement. *See*, *e.g.*, *In re* Boston & Me. Corp., 634 F.2d 1359, 1374-78 (1st Cir. 1980) (citing Gregg v. Metro. Trust Co., 197 U.S. 183, 196 (1905) (McKenna, J., dissenting) for the position that it declined to adopt, "[The] principle has its foundation in the public interests. A railroad, from its nature and public responsibilities, must be kept a going concern. This is the supreme necessity, and affords the test of the equity invoked for the claims for supplies.").

These factors underlay Judge Lynn's decision authorizing pre-plan payments to critical vendors in the bankruptcy of Mirant Corporation: "Debtors are among the most important providers of [electric] power in the United States and a disruption of the services provided by them could have a meaningful, adverse effect on segments of the national economy." *In re* Mirant Corp., 296 B.R. 427, 428 (Bankr. N.D. Tex. 2003). The concern about the national economy hearkens back to the railroad origins of the doctrine of necessity; electric power is even more vital to the national economy today than railroads were a century ago. While Judge Lynn cited as authority his own critical vendors decision in *In re* CoServ, L.L.C., 273 B.R 487 (Bankr. N.D. Tex. 2002), which held that the doctrine of necessity was only applicable for railroad reorganizations, 273 B.R. at 492, n7, he seems to have quietly reversed himself on this point in *Mirant*. In the wake of *Mirant*, is the doctrine of necessity is limited just to railroads, or may it and other pre-Code practices not explicitly rejected by the Code be expanded by analogy to new areas? If one can expand the doctrine of necessity to electric power, it seems reasonable to expand it to other instrumentalities of national commerce, such as air traffic, shipping, or trucking. *But see* B & W Enters., Inc. v. Goodman Oil Co. (*In re* B & W Enters., Inc., 713 F.2d 534 (9th Cir. 1983) (allowing for rescission of pre-plan critical vendor payments in a trucking case without ruling on authority to allow such payments).

354 Bonham, 229 F.3d at 765.

355 *See supra* note 187.

356 *In re* Ahlers, 485 U.S. 197, 206 (1988).

357 Field, *supra* note 78, at 889.

358 Burlington Indus., Inc. v. Ellerth, 524 U.S. 742 (1998).

359 *See supra* text accompanying notes 77-80.

360 Field, *supra* note 78, at 890. *Cf.* Redish, *supra* note 78.

361 Field, *supra* note 78, 893-94.

362 Erie R.R. Co. v. Tompkins, 304 U.S. 64, 78 (1938). While *Erie* revolved around the federalism concerns of federal general common law applying to diversity jurisdiction cases, it also has separation of powers implications. This article focuses solely on the separation of powers implications and does not address the relationship of federal and state law. *See supra* note 11.

363 Wheeldin v. Wheeler, 373 U.S. 647, 651 (1963).

364 United States v. Standard Oil Co., 332 US 301, 308 (1947).

365 Tex. Indus., Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 641 (1981).

366 In spite of the Supreme Court's acceptance of federal common lawmaking in limited enclaves, the very possibility of federal common law is still questioned. Martin Redish, *supra* note 78, at 766-67, has argued that any federal common lawmaking is a violation of the Rules of Decision Act (RDA), which provides that "[t]he laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States where they apply." 28 U.S.C. § 1652 (2006).

Although far beyond the scope of this article, the RDA might be unconstitutional to the extent that it is a *per se* bar on federal common lawmaking, which is a core part of the Article III "judicial power" that cannot be removed by act of Congress. In any event, federal common lawmaking *in bankruptcy* would not be barred even by Redish's proposed stricture. The RDA originally referred to "trials at common law" not "civil actions." The change was only made in 1948, 62 Stat. 944 (June 25, 1948). Thus, the RDA did not originally apply to bankruptcy, which was not a "trial at common law." *In re* De Gottardi, 114 F.328 (D.Cal. 1902). *But cf.* Peachtree Lane Assocs. v. Granader (*In re* Peachtree Lane Assocs.) 186 B.R. 663 (Bankr. N.D.Ill.) (rejecting contention that current RDA does not apply in bankruptcy because it only governs Article III courts). Assuming bankruptcy to be a "civil action" in the meaning of the statute, it is doubtful that Congress intended the RDA to extend to bankruptcy even if it wanted to expand the scope of the RDA's application. Moreover, Congress has provided for federal common lawmaking in bankruptcy as it is a matter of practical necessity. *See infra* sections VI.A.4-6 and VI.C.

367 *Erie* itself arguably does not apply to bankruptcy, as bankruptcy jurisdiction is federal question, not diversity. *See In re* Zaepfel & Russell, Inc., 49 F. Supp. 709 (D. Ky. 1941), *aff'd* 136 F.2d 215 (6th Cir. 1943).

368 *See* Cross, *supra* note 274, at 1227 (noting that state-law claims in bankruptcy are not proper areas for the creation of federal common law); *also see supra* note 11.

369 This article does not address other areas of federal common law that interact with bankruptcy, such as federal common law of procedure or patents and copyrights.

370 *See* Butner v. United States, 440 U.S. 48, 54-55 (1979).

371 *See* Andrew DeNatale & Prudence B. Abram, *The Doctrine of Equitable Subordination as Applied to Nonmanagement Creditors*, 40 BUS. LAW. 417, 420 (1985).

372 Compagnie Noga D'Importation et D'Exportation, S.A. v. The Russian Federation, 361 F.3d 676, 688 (2d Cir. 2004) ("we note that an issue similar to the one before us has arisen in the federal common law of bankruptcy and set off.") (noting parallelism between treatment of different federal agencies as constituent parts of the same entity under federal common law of bankruptcy and treatment of the Russian Federation and the Government of Russia as part of same entity for arbitration purposes).

373 Nesbit v. Gears Unlimited, Inc., 347 F.3d 72, 87 (3d Cir. 2003) (noting that substantive consolidation for Title VII purposes, like in bankruptcy, is one of federal common law, although it is an "intentionally open-ended, equitable inquiry"). *But cf. In re* Cont'l Airlines, 91 F.3d at 570-71 (3d Cir. 1996) (en banc) (Alito, J., dissenting) ("... the court seemed to say that the Bankruptcy Code contains an 'interstice'--a gap--regarding the circumstances under which an appeal that might upset a plan of reorganization may be pursued. Further, the court appeared to suggest that the federal courts have the authority to create a rule of federal common law to fill this gap.").

374 Justice v. Valley Nat'l Bank, 849 F.2d 1078, 1087-88 (8th Cir. 1988).

375 *In re* Glenn, 760 F.2d 1428, 1435 (6th Cir. 1985) (balancing the equities regarding curing default in absence of Congressional directive).

376 *E.g.*, *In re* Owens-Corning, 419 F.3d 195, 206-209 (3d Cir. 2005), and the entire line of substantive consolidation cases cited therein.

377 The Ninth Circuit recently addressed the issue in a cursory manner. In *Norfolk Southern Ry. v. Consolidated Freightways Corp*. (*In re Consolidated Freightways Corp*.), 2006 U.S. App. LEXIS 8698, at *5-*6 (9th Cir. 2006), the Ninth Circuit was asked to adopt the "interline trust doctrine" as a federal common law rule. Interlining is the practice of shipping goods via multiple shippers but on one bill of lading. Payment is made to either the initial or final shipper, who then essentially subcontracts the shipment to other shippers. It appears that at state law, these payments are considered to be held in trust for the other shippers. In *Consolidated Freightways*, the shipper who received payment filed for bankruptcy and one of the other shippers sued to recover the interline payment, arguing they the funds were held in trust and should not be part of the bankruptcy estate and thus subject to pro rata distribution among all unsecured creditors. The Ninth Circuit declined to adopt the interline trust doctrine as federal common law holding that under Butner v. United States, 440 U.S. 48, 54-55 (1979), the mere fact that an interested party in involved in a bankruptcy "does not justify the creation of a new federal common law rule" adopting the interline trust doctrine, and that Congress had considered, but not included the interline trust doctrine in the Bankruptcy Code. *Id*. The decision's reliance on *Butner* seems odd given that *Butner* urges courts to defer to state law. If the interline trust doctrine was really part of state law, though, it would seem strange for *Consolidated Freightways* to enter into a discussion of federal common law.

378 Walker v. The Cadle Co. (In re Walker), 51 F.3d 562 (5th Cir. 1995)

379 *Id*. at 566.

380 *Id*. at 566-567.

381 *Id*. at 567 (5th Cir. 1995) (citing Texas Industries, Inc. v. Radcliff Materials, Inc., 451 U.S. 630, 640 (1981)) (bracketed language in original).

382 *Id*. at 567 (quoting Wieboldt Stores, Inc. v. Schottenstein, 111 Bankr. 162, 168 (N.D. Ill. 1990).

383 *Walker* might not have foreclosed all federal common lawmaking in bankruptcy; while courts may not have "wide discretion" to do so, according to *Walker*, they may still have some discretion in the matter, although the opinion gives no indication as to where the line between discretion and wide discretion lies.

384 Tex. Indus., 451 U.S. at 641.

385 *Id*.

386 *Id*.

387 51 F.3d at 567.

388 451 U.S. at 641 (emphasis added).

389 U.S. CONST. art. I, § 8, cl. 4.

390 The existence of Congressional power to legislate on bankruptcies does not alone grant federal courts common lawmaking power in bankruptcy. 451 U.S. at 641 ("... nor does the existence of congressional authority under Art. I mean that federal courts are free to develop a common law to govern those areas until Congress acts.").

391 Cent. Va. Cmty. Coll. v. Katz, 126 S.Ct. 990, 1004 (2006). Butner, 440 U.S. at 54 n.9, 55 (uniformity requirement does not prevent bankruptcy law from incorporating the laws of the states despite variants in state law).

392 Katz, 126 S.Ct. at 1004-05.

393 *Id*. at 997-98.

394 *Id*.

395 *Id*.

396 *Id*. at 999-1000.

397 *Id*. at 996.

398 *Id*. at 996-97; Tenn. Student Assistance Corp. v. Hood, 541 U. S. 440, 448 (2004).

399 Commercial Bank of Manchester v. Buckner, 61 U.S. (20 How.) 108, 122 (1857).

400 11 U.S.C. § 541 (2006).

401 State regulatory proceedings are a different matter under 11 U.S.C. § 362(b)(4) (2006) (exempting from the automatic stay the "commencement or continuation of an action or proceeding by a governmental unit ... to enforce such

governmental unit's ... police and regulatory power"). *See* Pac. Gas & Elec. Co. v. People of the State of Cal. *ex rel*. Cal. Dept. of Toxic Substances Control, 350 F.3d 932 (9th Cir. 2003).

402 11 U.S.C. § 524(a)(2) (2006).

403 The possible exception to this would be a state insolvency proceeding based on pre-petition executory contracts or leases that "rode through" bankruptcy because they were neither assumed nor rejected by the trustee. *See* NLRB v. Bildisco & Bildisco, 465 U.S. 513, 546 n.12 (1984) (Brennan, J., concurring in part and dissenting in part) (noting the possibility of ride-through).

404 11 U.S.C. § 507 (2006).

405 Adams v. Storey, 1 Fed. Cas. 141 (C.C.D.N.Y. 1817); Gill v. Jacobs, 10 Fed. Cas. 373 (C.C.D.S.C. 1816) ("The power, then, of making bankrupt laws no longer remains with the several states; it is vested in the United States government."). *See also* United States v. Kras, 409 U.S. 434, 447 (1973) ("Congressional power over bankruptcy, of course, is plenary and exclusive.") (citing Kalb v. Feuerstein, 308 U.S. 433, 438-439 (1940) (holding that state law is preempted *once a bankruptcy petition is filed*)).

406 *Compare* Butner v. United States, 440 U.S. 48, 54 n.9 (1979) ("state laws are thus suspended only to the extent of the actual conflict with the system provided by the Bankruptcy Act of Congress."). *See also* Kalb, 308 U.S. at 438-39.

407 *See* Cent. Va. Cmty. Coll. v. Katz, 126 S.Ct. 990, 1000 (2006).

408 U.S. CONST. art. I, § 8, cl. 4.

409 Field, *supra* note 78, at 934 n.226.

410 Walker v. The Cadle Co. (*In re* Walker), 51 F.3d 562, 567 (5th Cir. 1995).

411 *See, e.g.,* FDA v. Brown & Williamson Tobacco Corp., 529 U.S. 120, 125-26 (2000).

412 H.R. Judiciary Comm., Bankruptcy Reform Act of 1978, H.R. REP., NO. 95-595, at 359 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6315 ("This section[, proposed 11 U.S.C. § 510(b), enacted as 11 U.S.C. § 510(c)] is intended to codify case law, such as *Pepper v. Litton*, 308 U.S. 295 (1939) and *Taylor v. Standard Gas and Electric Co.*, 306 U.S. 295 (1939) and is not intended to limit the [bankruptcy] court's power in any way. The bankruptcy court will remain a court of equity, proposed 28 U.S.C. 1481; *Local Loan v. Hunt*, 292 U.S. 234, 240 (1934).").

413 Prudence Realization Corp. v. Geist, 316 U.S. 89, 95 (1942).

414 *Id*. at 92.

415 *Id*. at 96-97.

416 *Id*. at 95.

417 Butner v. United States, 440 U.S. 48, 49 (1979).

418 *Id*. at 53 (emphasis added).

419 Pepper v. Litton, 308 U.S. 295, 302-03 (1939).

420 11 U.S.C. § 510(c) (2006).

421 H.R. Judiciary Comm., Bankruptcy Reform Act of 1978, H.R. REP., NO. 95-595, at 359 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6315.

422 124 Cong. Rec. H11089 (daily ed. Sept. 28, 1978) (statement of Rep. Edwards), *reprinted in* 1978 U.S.C.C.A.N. 6436, 6452 (1978) (emphasis added); 124 Cong. Rec. S17406 (daily ed. Oct. 6, 1978) (statement of Sen. DeConcini), *reprinted in* 1978 U.S.C.C.A.N. 6505, 6521 (emphasis added).

423 It should be noted, however, that equitable subordination is arguably a *sui generis* situation in which bankruptcy courts currently have statutory authorization of equity powers.

424 *E.g.*, 11 U.S.C. §§ 524(g), 1129(b)(2) (2006).

425 Freytag v. Comm'r of Internal Revenue, 501 U.S. 868, 889 (1991).

426 *See* Wiensch, *supra* note 177, at 1831.

427 Schwartz, *supra* note 71, at 186.

428 *E.g.*, *In re* Ahlers, 485 U.S. 197, 206 (1988).

429 *See* Plank, *supra* note 11 at 662; Thomas E. Plank, *The Security of Securitization and the Future of Security*, 25 CARDOZO L. REV. 1655, 1724 (2004).

430 Northwest Airlines, Inc. v. Transport Workers Union of America, AFL-CIO, 451 U.S. 77, 95 (1981). *Also* Corr. Serv. Corp. v. Malesko, 534 U.S. 61, 75 (2001) (Scalia, J, concurring) (the federal common law right of action created in *Bivens v. Six Unknown Named Agents of the Federal Bureau of Narcotics*, 403 U.S. 388 (1971), is "a relic of the heady days in which this Court assumed common-law making powers to create causes of action.").

431 451 U.S. at 96.

432 Federal rules of evidence have long been an area in which common lawmaking has been permitted. *See* FED. R. EVID. 501 (evidentiary privileges in federal-question cases).

433 11 U.S.C. § 524(a)(2) (2006).

434 11 U.S.C. § 524(g) (2006).

435 11 U.S.C. § 524(e) (2006).

436 *In re* PWS Holding Corp., 228 F.3d 224, 245 (3d Cir. 2000) (11 U.S.C. § 524(e) "only provides that a discharge of the debtor does not affect the liability of non-debtors on claims by third parties against them for the debt discharged in bankruptcy.").

437 *See, e.g.*, *In re* Lowenschuss, 67 F.3d 1394, 1401 (9th Cir. 1995); *In re* Zale Corp., 62 F.3d 746, 760 (5th Cir. 1995); *In re* Western Real Estate Fund, Inc., 922 F.2d 592, 600 (10th Cir. 1990), *modified by* Abel v. West, 932 F.2d 898 (10th Cir.1991).

438 *In re* Genesis Health Ventures, Inc., 266 B.R. 591, 603 (Bankr. D. Del. 2001).

439 *Id*. at 603-07

440 *In re* Owens Corning, 316 B.R. 168, 169 (Bankr. D. Del. 2004).

441 *Id*.

442 *Id*. at 170.

443 *Id*. at 173.

444 *In re* Owens Corning, 419 F.3d 195, 205 (3d Cir. 2005).

445 *Id*. at 206-09.

446 *Id*. at 210-11.

447 *Id*. at 211.

448 Jared R. Wessel, *Judicial Policy-Making at the International Criminal Court: An Institutional Guide to Analyzing International Adjudication*, 44 COLUM. J. TRANSNAT'L L. 377, 380-81 (2006).

449 Cont'l Ill. Nat'l Bank & Trust v. Chi., Rock Island & Pac. Ry. Co., 294 U.S. 648, 671 (1935) (internal citations omitted).

450 *See* Butner v. United States, 440 U.S. 48, 55-56 (1979) ("The equity powers of the bankruptcy court play an important part in the administration of bankrupt estates in countless situations in which the judge is required to deal with particular, individualized problems."). *Also* Harvey R. Miller, *The Changing Face of Chapter* 11: *A Reemergence of the Bankruptcy Judge as Producer, Director, and Sometimes Star of the Reorganization Passion Play*, 69 AM. BANKR. L.J. 431 (1995).

451 *See In re* Chi., Milwaukee, St. Paul, & P. R.R. Co., 791 F.2d 524, 528 (7th Cir. 1986).

452 Schwartz, *supra* note 71, at 187. The following litany is drawn from Schwartz.

453 *See supra* note 98.

454 11 U.S.C. § 363(b)(1) (2006).

455 11 U.S.C. § 362(d) (2006).

456 11 U.S.C. § 364(c) (2006).

457 11 U.S.C. § 365(a)-(b) (2006).

458 11 U.S.C. § 506(a) (2006).

459 11 U.S.C. § 1122(a) (2006).

460 11 U.S.C. § 1125(b) (2006).

461 11 U.S.C. § 1129(a)(11) (2006).

462 11 U.S.C. § 1109(b) (2006).

463 H.R. Judiciary Comm., Bankruptcy Reform Act of 1978, H.R. REP., NO. 95-595, at 359 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6315.

464 *See supra section* III.

465 *See supra section* IV.B.

466 *See supra* note 251.

467 Am. Hardwoods, Inc. v. Deutsche Credit Corp. (*In re* Am. Hardwoods, Inc., 885 F.2d 621, 626 (9th Cir. 1989) (citing *In re* A.H. Robbins Co. (Menard-Sanford v. Mabey), 880 F.2d 694 (4th Cir. 1989)).

468 Class 5 Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648 (6th Cir. 2002).

469 Field, *supra* note 78, at 934.

470 *Cf.* FDIC v. Colonial Realty Co., 966 F.2d 57 (2d Cir. 1992) ("Equity is 'the correction of the law wherein it is defective by reason of its universality.' *1 Story's Equity Jurisprudence* 3 (W.H. Lyon, Jr., ed., 14th ed. 1918). Because '[e]very system of laws must necessarily be defective [,] cases must occur to which the antecedent rules cannot be applied without injustice, or to which they cannot be applied at all.' *1 Story's Equity Jurisprudence* at 9.").

471 Henry Friendly, *In Praise of Erie-and of the New Federal Common Law*, 39 N.Y.U. L. REV. 383, 419 (1964). *See also* Henry Friendly, *The Gap in Lawmaking-Judges Who Can't and Legislators Who Won't*, 63 COLUM. L. REV. 787 (1963).

472 5 U.S.C.§ 551 *et. seq*.

473 28 U.S.C. §§ 152(a), (e) (2006).

474 *See, e.g.*, *In re* Mirant Corp., 296 B.R. 427, 429-30 (Bankr. N.D. Tex. 2003) (applying *CoServ* critical vendors test); *In re* CoServ, L.L.C., 273 B.R. 487, 498-99 (Bankr. N.D. Tex. 2002) (creating critical vendors test); Class 5 Nev. Claimants v. Dow Corning Corp. (*In re* Dow Corning Corp.), 280 F.3d 648, 658 (6th Cir. 2002) (creating a seven-factor test for a bankruptcy court's injunction of a non-consenting creditor's claims against a non-debtor); *In re* Genesis Health Ventures, Inc., 266 B.R. 591, 606 (Bankr. D. Del. 2001) (adopting a five-factor test for third-party releases from *Zenith Electronics*, 241 B.R. at 110); *In re* Standard Brands Paint Co., 154 B.R. 563, 571 (Bankr. C.D. Cal. 1993) (applying D.C. Circuit *Auto-Train* test and Second Circuit *Augie/Resitvo* test for substantive consolidation).

475 Scott A. Rosenberg, *The Theory of Protective Jurisdiction,* 57 N.Y.U. L. REV. 933, 982 (1982).

476 *See* Brian Leepson, Note and Comment, *A Case for the Use of a Broad Court Equity Power to Facilitate Chapter 11 Reorganization*, 12 BANKR. DEV. J. 775, 802-803 n.186 (1996). *Also* Otero Mills, Inc. v. Sec. Bank & Trust (*In re* Otero Mills, Inc.), 21 B.R. 777 (Bankr. D.N.M. 1982), *aff'd* 25 B.R. 1018 (Bankr. D.N.M. 1982); Drabkin v. Midland-Ross Corp. (*In re* Auto-Train Corp.), 810 F.2d 270 (D.C. Cir. 1987);); Union Sav. Bank v. Augie/Restivo Baking Co., Ltd. (*In re* Augie/Restivo Baking Co., Ltd.), 860 F.3d 515 (2d Cir. 1988).

477 *See supra* text accompanying notes 16-25.

80 AMBKRLJ 1

End of Document

Faculty

Gianfranco Finizio is a Litigation, Bankruptcy & Financial Restructuring partner at Kilpatrick, Townsend & Stockton LLP in New York and focuses his practice on bankruptcy and insolvency matters. He advises and represents a diverse range of clients, including official committees of unsecured creditors, indenture trustees, debtors, bank agents, and major secured and unsecured creditors in complex chapter 11 bankruptcy cases, out-of-court restructurings and other distressed situations. Mr. Finizio was listed in the 2021 and 2022 editions of *Chambers USA: America's Leading Lawyers for Business* in the area of Bankruptcy/Restructuring. He also was recognized as a New York "Rising Star" in 2022 and the seven years immediately preceding for Business Bankruptcy by *Super Lawyers*. Mr. Finizio is a 2022 ABI "40 Under 40" honoree. While attending law school, he served as a judicial intern to Hon. Stephen A. Bucaria in the New York Supreme Court. He also was a staff member of the *ABI Law Review*. Mr. Finizio received his B.B.A. *cum laude* in 2006 from George Washington University and his J.D. from St. John's University School of Law in 2009, where he received a CALI Award.

Hon. Craig T. Goldblatt is a U.S. Bankruptcy Judge for the District of Delaware in Wilmington, where he has served since his appointment in April 2021. Prior to his appointment, he was a bankruptcy litigator in the Washington, D.C. office of WilmerHale, where his practice primarily involved the representation of financial institutions and other commercial creditors in complex bankruptcy litigation and appeals. Earlier in his career, Judge Goldblatt clerked for Hon. Richard D. Cudahy of the U.S. Court of Appeals for the Seventh Circuit and Hon. David H. Souter of the U.S. Supreme Court. He is a Conferee in the National Bankruptcy Conference (for which he serves as Secretary) and is a vice president of the American College of Bankruptcy. He also has been active on the Business Bankruptcy Committee of the American Bar Association's Business Law Section. Judge Goldblatt has served on the Education Committee of the National Conference of Bankruptcy Judges and as an adjunct professor at Georgetown University Law Center and George Washington University Law School, where he teaches classes focused on bankruptcy law. He received his Bachelor's degree *magna cum laude* from Georgetown University in 1990 and his J.D. with honors from the University of Chicago Law School in 1993, where he served as comment editor of the *University of Chicago Law Review*.

Evan C. Hollander is a senior partner in Orrick Herrington & Sutcliffe LLP's New York office and a member of the firm's Restructuring group. He has more than 25 years of experience representing debtors, creditors and directors in a wide range of complex restructuring matters — both in and out of court — with a particular emphasis on complex U.S. and cross-border restructurings. In addition, he assists clients seeking to acquire the assets of, or claims against, troubled companies, and in structuring commercial transactions to reduce or eliminate risk. In addition to his experience in U.S.-based restructuring matters, involving both U.S. domestic corporations and as well as foreign corporations seeking relief in the U.S., Mr. Hollander has advised clients on numerous foreign and multinational restructuring matters. An active member of ABI, he routinely speaks and writes on key topics in financial restructuring and insolvency law. Mr. Hollander received his B.A. from Columbia College and his J.D. from Emory University School of Law, where he was the executive articles editor for the *Bankruptcy Developments Journal*.

Lucy F. Kweskin is a partner in Mayer Brown's New York office and a member of its Global Restructuring practice. She advises clients, with a special focus on lenders, on all stages of corporate restructurings (both in and out of court) and has experience with forbearance agreements, foreclosures, restructuring support agreements, debtor-in-possession financing, §363 sales and chapter 11 plans. Ms. Kweskin frequently litigates bankruptcy-related disputes concerning valuations, makewhole claims, intercreditor issues, fraudulent transfers, recharacterization, veil-piercing and breaches of fiduciary duty. In addition to lenders, she represents stakeholders across the capital structure, including debtors, distressed acquirers, official committees of unsecured creditors, litigation financiers and landlords. Prior to attending law school, Ms. Kweskin worked at Deutsche Bank in its Global CDO group. She is a 2022 ABI "40 Under 40" honoree and a Lecturer of Law at Columbia Law School, where she teaches a course titled Advanced Bankruptcy: Deals and Issues in the Current Environment. Ms. Kweskin received her B.s. in economics from the Wharton School at the University of Pennsylvania and her J.D. from Columbia Law School, where she was a James Kent Scholar. During law school, she interned for Hon. Robert E. Gerber of the U.S. Bankruptcy Court for the Southern District of New York.

Barbra R. Parlin is a partner in Holland & Knight LLP's New York office and a member of the firm's Litigation Section. Her practice focuses on advising parties involved in complex commercial insolvency and restructuring proceedings, as well as related litigation and transactional matters. She represents both U.S.-based and foreign companies, court-appointed liquidators, indenture trustees, secured and unsecured lenders, asset-buyers, landlords, licensors, parties to prepetition contracts and leases, and litigants in adversary proceedings in connection with both domestic and cross-border insolvency cases, as well as out-of-court restructurings and wind-down proceedings. In addition, Ms. Parlin advises clients on the business aspects of bankruptcy and workouts, providing counsel with respect to pre-bankruptcy planning, transaction review, claims, distressed asset sales, and lending and investment strategies. Her experience crosses a broad array of industries, including corporate and structured finance, aviation, securities, manufacturing, transportation, construction, real estate, higher education, energy, technology, telecommunications, retail, health care, resort and hospitality, leasing, professional firms and maritime. She appears on behalf of clients in matters pending in bankruptcy courts around the country, as well as in other state and federal courts. Ms. Parlin also has experience in matters concerning corporate governance and fiduciary duties, director and officer liability, derivative actions, securities and common law fraud litigation and investigations, and other commercial litigation. She has advised boards of directors with respect to their fiduciary obligations and has managed a broad range of litigation matters, including bankruptcy and avoidance litigation, securities fraud, shareholder derivative litigation, SEC investigations, merger and acquisition (M&A) litigation, corporate governance actions, construction litigation, directors' and officers' insurance issues, and other general commercial litigation. Ms. Parlin has served as the Holland & Knight New York office's recruiting partner, chair of the New York office's diversity committee, and partner-coordinator of the New York office's Women's Initiative. She currently is a member of the New York office's operations committee. Ms. Parlin currently is a member of the New York office operations committee and a member of the advisory board for ABI's New York City Bankruptcy Conference. She received her B.A. *magna cum laude* in religious studies from Yale University and her J.D. *cum laude* from New York University School of Law, where she received the George A. Katz Memorial Award for Academic Excellence in Securities Regulation from New York University School of Law, and also served as staff editor and articles editor of the *Environmental Law Journal*.

Rachael L. Ringer is a partner with Kramer Levin Naftalis & Frankel LLP in New York and has played a prominent role in advising on many of the largest bankruptcies and restructurings in recent years across a diverse range of industries, including retail, financial services, oil and gas services, biopharmaceuticals, shipping and health care. She handles high-stakes and complex bankruptcy matters on behalf of creditors' committees, bondholders and companies. Ms. Ringer's recent representations include the Boy Scouts of America official creditors' committee, as well as the ad hoc committee of consenting governmental claimants in the Purdue Pharma bankruptcy cases. She also has recently represented the Aegerion, Hexion and Toys "R" Us creditors' committees, as well as a large lender in the Nine West bankruptcy. Ms. Ringer regularly advises hedge funds in bankruptcy cases, out-of-court restructurings and sale transactions in bankruptcy-related matters and in connection with investments in distressed credits with complex capital structures. She was a member of the bankruptcy team representing the holders of more than $18 billion in Puerto Rico Electric Power Authority bonds in the lawsuit challenging the constitutionality of Puerto Rico's proposed bankruptcy statute. *Chambers USA* recognized Ms. Ringer as up and coming in the Bankruptcy/Restructuring field in 2021 and 2022, and she is a member of the 2021 class of ABI's "40 Under 40." She also was named one of *Turnarounds & Workouts*'s 2020 Outstanding Young Restructuring Lawyers, one of *Law360*'s 2020 Rising Stars and one of The M&A Advisor's 2019 Emerging Leaders. In addition, she was a finalist in Bankruptcy Litigation for the Euromoney Legal Media Group Americas Rising Star Award and has been named a *New York Super Lawyers* Rising Star every year from 2017-22. Ms. Ringer received her B.A. with high distinction from the University of Michigan in 2007 and her J.D. *cum laude* in 2010 from the Maurice A. Deane School of Law at Hofstra University, receiving the ABI Medal of Excellence in Bankruptcy.

Glenn E. Siegel is a partner with Morgan, Lewis & Bockius LLP's Business and Finance Practice in New York and former co-head of the firm's Restructuring and Bankruptcy practice. He has decades of experience handling high-level bankruptcies and counseling major stakeholders and clients on all sides of bankruptcy and restructuring matters. In the chapter 11 bankruptcy of automotive parts maker Delphi Corp., Mr. Siegel counseled the largest debtor-in-possession lender in its acquisition of Delphi. In the chapter 11 bankruptcy of Residential Capital, he counseled the largest residential mortgage-backed securities (RMBS) trustees to achieve a settlement of billions of dollars in claims. Mr. Siegel represents shareholders, bondholders, indenture trustees, creditor committees, secured creditors, debtors and other participants in bankruptcy and workout matters. He frequently lectures on issues pertaining to public-debt-holders, including claims trading, second-lien loans and subordination. He also frequently authors and co-authors articles on bankruptcy-related topics and developments. Prior to joining Morgan Lewis, Mr. Siegel was a partner in the bankruptcy practice of another international law firm. He received his B.A. from Brooklyn College in 1979, his J.D. from Boston University School of Law in 1982 and his LL.M. in corporate law from New York University School of Law in 1984.

Edward H. Tillinghast, III is a partner and Practice Group Leader of Sheppard Mullin's Finance and Bankruptcy Practice Group in New York. He specializes in U.S. and cross-border insolvencies, particularly involving Asia and Latin America, and related creditors' rights and bankruptcy-related litigation. Mr. Tillinghast's broad bankruptcy and creditors' rights litigation and appellate experience, and his understanding of business realities, is helpful in creating and implementing business solutions to complex financially driven problems and resulting opportunities, regardless of whether they involve structuring a business deal or litigating related issues. He has been involved in many real estate-related bankruptcies representing commercial real estate developers, lenders, lessors and lessees. Mr. Tillinghast has represented ad hoc and official committees, debtors, distressed asset-purchasers, equityholders, funds, indenture trustees and institutional lenders. He also has litigated creditors' rights-related cases in many courts, including the U.S. Supreme Court, various U.S. Circuit Courts of Appeals, and various district and bankruptcy courts, and he has led cases in courts in Australia, Bermuda, the British Virgin Islands, the Cayman Islands, China, England, Germany, Hong Kong, Indonesia and Japan. Mr. Tillinghast received his undergraduate degree with honors from Lake Forest College and his J.D. from Chicago-Kent College of Law, where he served on the editorial board of the *Chicago-Kent Law Review*.