UNIT 1

WHAT IS THIS COURSE ABOUT?

This course is about the legal questions that arise when a business or individual does not pay debts owed to creditors. The answers to these legal questions are found primarily in the Bankruptcy Code. And so, we will be looking at the Bankruptcy Code a lot. To make that "easier" for you, there is a lot of the Bankruptcy Code in this book.

A. JUST ENOUGH BANKRUPTCY HISTORY FOR YOU TO BE ABLE TO DEVELOP A NEW BRAVO NETWORK REALITY SERIES, "I WANT TO BE A ROMAN BANKRUPT"

Nothing new about people not paying their debts.¹ And nothing new about bankruptcy being the legal "answer."

Historically, the purposes of bankruptcy were to force debtors into a court proceeding in which their assets were divided up among claimants in some form of collective setting in which all creditors participated, or to criminalize insolvency, or both. Beyond those general purposes, however, outcomes varied.

For example, if a debtor's assets were insufficient to pay all creditors ancient Romans gave themselves the power to dismember and distribute a debtor's body to creditors in proportion to the amount of debts owed each.² Medieval Italians, who gave us the term "bankruptcy,"³ remitted

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¹ I realize that this is a sentence fragment. Miss Lindemann, my eleventh grade "Language Arts" teacher, told me that I could use sentence fragments when I got a book published. DGE

² See 2 WILLIAM BLACKSTONE, COMMENTARIES 472 (1766) ("[Under Roman law], creditors might cut the debtor's body into pieces, and each of them take his proportionate share . . . ."). See also Vern Countryman, Bankruptcy and the Individual Debtor—and a Modest Proposal to Return to the Seventeenth Century, 32 CATH. U.L. REV. 809, 810 (1963).

³ From the concatenation of "hance"—bench or table—and "rota,"—broken or ruptured. Medieval merchants traded from benches or tables in a common area, and the breaking of such a bench signaled the revocation of the merchant's trading privileges or his banishment from the city. ("Concatenation?" This is Markell's footnote.)
criminal penalties for those who could not pay all their debts if they exposed their naked bodies in public, and people then banged the bankrupts’ “backsides” on a public post while the bankrupts loudly proclaimed “I am bankrupt” three times. In France, those who could not pay their debts were made to wear a “Green Cap” at all times so that others would know that they had stiffed their creditors.

B. WHAT YOU SHOULD CARE ABOUT IN THIS COURSE

Even if you really don’t care about this history, in this course, you have to care about the 21st Century questions: (1) what can an individual debtor accomplish in bankruptcy, (2) what can a business debtor accomplish in bankruptcy, (3) what can creditors accomplish in bankruptcy, and (4) what are the roles of lawyers in bankruptcy. These questions, like others that judges or law professors ask, lead to other, more specific questions. The two specific questions that we will be considering most often in this course are (1) what are the possible decisions and (2) who decides.

C. THE NATIONAL BANKRUPTCY REVIEW COMMISSION’S OVERVIEW OF BANKRUPTCY

In 1994, Congress enacted legislation establishing a commission to review business and consumer bankruptcy. In 1997, the Commission submitted a report (that looks a lot like the Greater Las Vegas Smart Yellow Pages) with 170 individual recommendations.

Congress has ignored this big yellow book. You shouldn’t. As law students, you get it free and “un-yellow” on Westlaw: “NBRCR” database. Hundreds of pages of helpful explanations of bankruptcy concepts and discussions of bankruptcy problems. Look at it!

For now, please look at the Commission’s Report’s overview of business bankruptcy and consumer bankruptcy:

1. Business Bankruptcy

“Business bankruptcies are only a small fraction of all filings—about 4% overall—but the bankruptcy system is a critical part of the cycle of business life and death in the American economy. Principally through Chapter 11, business bankruptcy creates the opportunity to restructure failing businesses, to preserve jobs, to prevent the spread of economic failure to smaller suppliers and other dependent busi-

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4. Nickles vetted our use of the more descriptive term “butts” but was oblivious to today’s use of the term “bang.”


6. Id. at 1874.
nesses, and to permit communities to retain their tax base. Liquidation is also an important part of the business bankruptcy system, providing an efficient and orderly way to dissolve a business and to distribute its assets equitably among parties who might otherwise see no recovery at all.”


2. Consumer Bankruptcy

“Consumer bankruptcy has become part of America’s economic landscape. Once regarded as an unlikely legal alternative chosen by only a few desperate families, bankruptcy had become a refuge for one in every 96 American families by the time the National Bankruptcy Review Commission filed its report.

As bankruptcy filings increase, creditors justifiably worry whether a promise to repay has any meaning, while consumer advocates express concern that the financial distress of more than a million American families each year foreshadows a larger economic problem. The inherent conflict between the twin goals of bankruptcy—appropriate relief for those in trouble and equitable treatment for their creditors—ensures that it always will be an area of contention. To deal with financial loss, the bankruptcy system necessarily embraces competing interests. Recommendations fully endorsed by either debtors or by creditors would not maintain the balance essential to any consumer bankruptcy system. Bankruptcy is a system born of conflict and competing values. To function well, it must remain unpopular and controversial. No area of bankruptcy law is more complex than consumer bankruptcy.”


D. A CLOSER VIEW OF AN ACTUAL BUSINESS BANKRUPTCY CASE AND AN ACTUAL CONSUMER CASE

1. CIRCUIT CITY BANKRUPTCY

On November 10, 2008, Circuit City Stores, Inc. and affiliates (hereafter “Circuit City”) filed for Chapter 11 relief in the bankruptcy court for the Eastern District of Virginia in Richmond, Virginia. Circuit City was founded in 1949 and headquartered in Richmond. Prior to its bankruptcy filing, Circuit City was a specialty retailer of consumer electronics, operating 712 superstores and 9 outlet stores, with a workforce of approximately 39,600 full and part-time employees, with an additional 11,000 part-time employees anticipated for the Christmas season.

The schedules Circuit City filed with the bankruptcy court showed $3.4 billion in assets and $2.3 billion in liabilities. Hewlett-Packard was
listed as Circuit City’s largest creditor—$118.8 million. Samsung was a close second at $116 million.

Circuit City’s last pre-bankruptcy quarterly report, issued in late September, 2008, reported a quarterly loss of nearly $240 million. Circuit City had lost more than $5 billion in stock market value in the two years before bankruptcy.

There was news of Circuit City’s bankruptcy filing in newspapers such as the Wall Street Journal, International Herald Tribune, and, of course, the Richmond Times Dispatch. In covering the first hearing in the Circuit City bankruptcy, the Richmond paper reported, “The chain’s attorneys, company executives, and lawyers packed the courtroom in the new federal courthouse in downtown Richmond ... Gregg Galardi, a partner in the Delaware [office of the] law firm of Skadden, Arps, Slate, Meagher & Flom LLP that is representing the chain, said repeatedly that Circuit City’s goal is to come out of the bankruptcy reshaped and ready to do business by the end of April.”

Well, Circuit City did not realize this goal. Faced with weak Christmas sales, no lender willing to provide enough new funding to enable it to continue operating, and no buyer for the company, Circuit City decided on January 16, 2009, with court approval, to close its stores and liquidate its assets. Circuit City hired four independent liquidation companies to handle the liquidation of store assets and sent 60-day pink slips to more than 34,000 employees.

On March 11, 2009, the Subcommittee on Commercial and Administrative Law of the House Judiciary Committee held hearings on “Circuit City Unplugged: Why Did Chapter 11 Fail to Save 34,000 Jobs?”

The Circuit City bankruptcy did create jobs for lawyers, some of whom billed Circuit City at $995 an hour. Current estimates are that, before the bankruptcy case is over, Circuit City will pay lawyers and other professionals more than $37,000,000 and will pay its unsecured creditors 10 to 14% on pre-bankruptcy debts. People who bought Circuit City stock will get nothing.

2. MR. 64 AND MRS. 64 BANKRUPTCY

The Circuit City bankruptcy petition was not the only bankruptcy petition filed on November 10, 2008. That day, like every other day, hundreds of bankruptcy petitions were filed in Richmond, Virginia, and around the country by business entities and individuals.

One such petition was Case Number 08-64496, a Chapter 13 petition, filed by a husband and wife in Oregon. There was no news of this bankruptcy in the Wall Street Journal, International Herald Tribune, or even the local Portland newspaper. We will also respect the privacy of the debtors in this case and simply refer to them at “Mr. 64 and Mrs. 64.”

7. Louis Llovio and Michael Martz, Circuit City Files for Bankruptcy, 11/11/08 Richmond Times Dispatch, 2008 WLNK 21819682.
Mr. 64 and Mrs. 64 are no more the typical individuals unable to pay their debts than Circuit City is the typical business unable to pay its debts. Their schedules filed with the bankruptcy court show (1) total assets of $522,185 with two houses, a 2004 Ford F250 truck and a 2006 Ford Fusion, $20 in cash, and $115 in various savings and checking accounts; (2) total debts of $504,813, and (3) monthly income of $8,486.

At the time of their bankruptcy filing, Mr. 64 worked as an electrician for a construction company. Mrs. 64 worked as an apprentice electrician for a different employer. For the first nine months of 2008, Mr. 64 and Mrs. 64 had owned a tanning salon.

In February, 2009, the bankruptcy court approved a plan of repayment by Mr. 64 and Mrs. 64 that would, over a five-year period, pay 35% to Mr. 64 and Mrs. 64’s unsecured creditors and pay $4,000 to their bankruptcy attorney “through the plan.” Shortly thereafter, Mrs. 64 lost her job, and the child support payments she was receiving from a former husband were reduced because of his financial problems. In May, 2009, Mr. 64 and Mrs. 64 filed a modified plan that reduced Mr. 64 and Mrs. 64’s monthly payments to creditors by $400 and thus reduced the total payment to unsecured creditors to 8%.

There are a couple of reasons that we wanted you to have this early look at a real business bankruptcy case and a real individual bankruptcy case.

First reason. While, like Emmy Lou Harris, “We Believe in Happy Endings”, there are not always (or even often) “happy endings” in bankruptcy stories. More specifically,

- bankruptcy *cannot* fix all problems—can’t even fix all debt problems;
- in bankruptcy, most creditors do *not* get paid most of what they are owed;

The ending of a bankruptcy case depends in the main on (1) the liquidation and going concern values of the debtor’s assets; (2) the debtor’s ability to generate cash flow i.e., the debtor’s ability to make money that can be used to pay creditors; (3) creditors’ interests and needs; and (4) the “bankruptcy” attorneys’ and bankruptcy judge’s ability to work creatively and effectively with the bankruptcy concepts covered in this book.

Second reason. It is mistake to think that lawyers think of looking to the Bankruptcy Code only when dealing with “bankrupts” like Circuit City or Mr. 64 and Mrs. 64.

It is a mistake because there is no longer any such person as a “bankrupt.” Circuit City is not a “bankrupt.” Nor are Mr. 64 and Mrs. 64. The 1978 Bankruptcy Code eliminated the use of the term “bankrupt.” A person who has filed a bankruptcy petition with the bankruptcy court for bankruptcy relief is supposed to be called a “debtor”, not a “bankrupt.”
More important, it is a mistake to think that bankruptcy law questions only arise when a debtor has filed for bankruptcy relief. Increasingly, lawyers and law students need to consider bankruptcy law questions in connection with transactions. Obviously, when C makes a loan to D, C needs to consider the possible effects of D’s later filing for bankruptcy. And when S sells B goods on credit, S needs to think about the possible effects of B’s filing for bankruptcy, and B needs to think about the possible effects of S’s filing for bankruptcy. And, when L leases a building to T, L needs to consider the possible effects of T’s filing for bankruptcy and T needs to consider the possibility of L’s filing for bankruptcy.

E. THIS COURSE AND CONSTITUTIONAL LAW AND CONTRACTS LAW AND PROPERTY LAW AND MORE CONSTITUTIONAL LAW

While this course is primarily about bankruptcy law, this course also covers constitutional law concepts not “covered”\(^8\) in your constitutional law course, and contract law concepts not covered in your contracts course, and property concepts not covered in your property course.

First, constitutional law. The United States Constitution delegates to Congress the exclusive power to establish “uniform laws on the subject of Bankruptcies” in Article 1, section 8, clause 4.

Now, constitutional law and contracts. Article I, section 10 of the Constitution bars states (not the federal government) from impairing contract obligations. When read together, Article 1, section 8, and Article 1, section 10, mean that Congress may enact “uniform laws on the subject of Bankruptcies” which impair the obligation of contracts. As the Seventh Circuit explained: “All parties to a contract are, of necessity, aware of the existence of, and subject to, the power of Congress to legislate on the subject of bankruptcies. They were and are chargeable with knowledge that their rights and remedies ... are affected by existing bankruptcy laws and all future bankruptcy legislation which might be enacted.” *In re Prima Co.*, 88 F.2d 785, 788 (7th Cir. 1937).

Now property law and con law. A mortgage, security interest or other lien is a property interest. A creditor who has a lien on the debtor’s property has a property interest. The Fifth Amendment prohibits taking private property without just compensation. And, the Article 1 Congressional power to enact bankruptcy laws is “subject to the Fifth Amendment’s prohibition against taking private property without compensation.” United States v. Security Indus. Bank, 459 U.S. 70, 75 (1982). Accordingly, the Bankruptcy Code [and this book] regularly distinguishes between what bankruptcy can do to a creditor’s right to payment (which is in the nature of a contract right) and what bankruptcy can do to a creditor’s lien (which is in the nature of a property right).

\(^8\) “Not covered” is, of course, law students’ way of saying “We don’t remember our professors’ covering.”