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

*By Todd J. Zywicki**

As this review was being written, after failures in the past two Congresses, Congress was once again on the verge of passing a comprehensive bankruptcy reform bill. At the same time, WorldCom, Enron, Global Crossing, and their ignominious peers continue to set records for the size, expense, and public attention drawn to business bankruptcy. Consumer bankruptcies soar toward the 1.5 million per year mark, continuing an irresistible upward trend. Meanwhile, as law firms announce layoffs and salary freezes in most departments, bankruptcy professionals prosper amidst the despair, billing $20 million per month on the Enron case alone—even as creditors and shareholders sit by awaiting payment. Clearly we are witnessing a profound and unprecedented change in the political, social, and economic framework of bankruptcy.

How did we get here and where are we headed in the future? These are the questions brilliantly addressed by David A. Skeel, Jr., in his book, *Debt's Dominion: A History of Bankruptcy Law in America*. Told with a sound understanding of theory, law, and an eye for detail, Skeel's book is an instant classic—a comprehensive and intriguing history of bankruptcy law in America. But to characterize it as "history" is to slight the book's reach and importance. In a concise and readable 250 pages, Skeel brings to life not only the political and economic history of bankruptcy law, but also the fascinating history of the bankruptcy bar itself, including such memorably-drawn figures as "Rough Rider" Jay Torrey who stormed San Juan Hill at the side of Teddy Roosevelt, before going on to spearhead the drive for the first permanent bankruptcy law in American history at the end of the nineteenth century. Modern gurus such as Harvey Miller, the inventor of modern Chapter 11 practice, and consumer practitioner Henry Sommer, are also artfully drawn. Finally, Skeel deftly leads the reader through the fundamental theoretical debates that have shaped bankruptcy law during the past century, including the contentious intellectual debates between "Progressive" academic theorists and their rivals from the "Law and Economics School." Skeel has at once written a book that will serve as the definitive work on the history of bankruptcy law for bankruptcy experts while also crafting a book accessible to the interested generalist in law or business who seeks a comprehensive guide to how the modern American bankruptcy system developed.

Skeel divides the history of bankruptcy law in America into three historical stages: the Nineteenth Century, the era of the 1898 Bankruptcy Act and the Great Depression, and the modern era of the 1978 Bankruptcy Code. As Skeel notes, the shape of bankruptcy law and practice throughout American history is at least as much a factor of political considerations and influence as economic considerations. To develop his point, Skeel draws on the fields of public choice and social choice, both of which use economics to explain politics. The use of these economic tools to shape his narrative provides Skeel's argument with an analytical edge that prior historical studies of American bankruptcy law have lacked. In particular, American bankruptcy law can be understood as resulting from the clash of three sets of interests: pro-debtor ideological interests (often spearheaded by law professors), creditors, and bankruptcy professionals (including bankruptcy judges). Although the outcome of this three-way political wrestling match is unclear at any given moment, the dominant course of evolution of American bankruptcy law has been towards increasingly generous bankruptcy laws that provide strong incentives for both individual and corporate debtors to file bankruptcy.

The first era of American bankruptcy legislation was rooted in the Constitution's enumeration of Congress's power to "establish uniform laws on the subject of Bankruptcies throughout the United States." Like the other economic provisions of the Constitution, the primary purpose of the Bankruptcies Clause of the Constitution was to reign in the pro-debtor excesses of state legislatures under the Articles of Confederation.[1] Under the Articles of Confederation, creditors confronted numerous obstacles to their attempts to collect judgments, including judgment-jumping from one state to another and efforts by some states to discharge obligations owed by debtors, primarily at the expense of out-of-state creditors.[2] According to James Madison, regulation of bankruptcy was "intimately connected with the regulation of commerce, and [would] prevent so many frauds where the parties or their property may lie or be removed into different states that the expediency of it seems not likely to be drawn into question."[3] Subject to these powers designed to augment the power of creditors to recover judgments, most debtor-creditor relations were to remain governed by state law, an allocation of power which remains the case today.

During the nineteenth century, the federal government enacted three bankruptcy laws prior to the 1898 Act: the Bankruptcy Acts of 1800, 1841, and 1867 (p. 25). Each Act was spawned in the midst of financial crisis and was repealed soon thereafter. The 1800 Act lasted only three years, the 1841 Act lasted only two years, and the 1867 Act was repealed eleven years later. All together, therefore, these three acts lasted a total of sixteen years. In the intervening periods, debtor-creditor relations remained wholly the province of state law. Skeel attributes this legislative transience to "legislative cycling," a phenomenon identified by economists and political scientists that can arise where lawmakers hold three or more positions which cannot be aligned on a simple linear spectrum of choices (p. 28). Where such cycling occurs, legislative outcomes will be highly unstable across time.

This legislative cycling continued until the enactment of the first permanent bankruptcy law in 1898. The impetus for the 1898 Act came from creditors who were increasingly frustrated with the difficulties of using state court systems to collect interstate debts. The increasing nationalization of the American economy following the Civil War made it necessary to develop a coherent national debt-collection system. Skeel observes that, although the impetus came from creditors, the legislative process was almost immediately captured by pro-debtor interests, who produced a more pro-debtor bill than originally anticipated. Moreover, the law rejected the English model of treating bankruptcy as an administrative proceeding, instead implementing a litigation-oriented, court-driven process that primarily benefited bankruptcy lawyers rather than creditors. As Skeel observes of the final product, "These characteristics—the generally debtor-friendly approach to bankruptcy, and the primacy of lawyers rather than an administrator—distinguish U.S. bankruptcy law from every other insolvency law in the world." (p. 43).

The 1898 Act remained in place until supplanted by the 1978 Code. During this period, however, bankruptcy law and practice were certainly not static. Skeel deftly works his way through the fascinating economic and political history of the period. The intervention of the Great Depression, the reorganization of the railroads through equity receiverships, and William O. Douglas's high-profile hearings while Chairman of the Securities and Exchange Commission are among the pivotal events. From this economic and political process emerged the Chandler Act amendments to the Act, which increased governmental oversight of the bankruptcy process. The end result of these developments was to drive prestigious Wall Street law firms and practitioners from bankruptcy practice, including most notably, Paul Cravath, whose firm essentially invented reorganization practice through railroad equity receiverships. At the same time, ordinary bankruptcy lawyers remained unscathed, and in many ways richer and more influential than ever before.

The process replicated itself in the enactment of the 1978 Bankruptcy Code. Again the reform effort was initiated by creditors, in this case seeking to restrain the growing consumer bankruptcy filing rates of the 1970s and to streamline business reorganization procedures. Instead, reform efforts were once again captured by bankruptcy lawyers and pro-debtor ideological advocates. By making bankruptcy more attractive to individuals, personal bankruptcies have risen from less than 200,000 in 1978 to almost 1.5 million annually. By making bankruptcy more attractive for corporations as well, it has routinized corporate bankruptcy, turning it into a business and strategic decision rather than a last resort. Perhaps the biggest beneficiaries of the 1978 Code, however, were bankruptcy lawyers, who dramatically increased their wealth and prestige during that time. Once considered an unsavory ghetto, today the largest and most prestigious law firms in America have thriving bankruptcy practices, as do leading investment banks, accounting firms, and consultants. Today, bankruptcy is big business.

Skeel highlights three groups as being especially influential in the shaping of bankruptcy law from 1898 to the present: (1) creditor interests, (2) pro-debtor ideological interests, and (3) the interests of bankruptcy professionals. Although it is often thought that creditors will be the most powerful of these groups, in practice Skeel concludes that "bankruptcy professionals are the ones who have most strongly influenced the shape of U.S. bankruptcy law in the century since its enactment in 1898." (p. 81). Moreover, bankruptcy professionals and pro-debtor ideological interests will often share similar positions on bankruptcy legislation issues. Pro-debtor ideological interests favor expansion of debt relief on ideological grounds. It is, of course, a misnomer to characterize them as "consumer advocates," in that increasing the leniency of bankruptcy increases the risk of lending. In turn, this increased risk is passed on to all borrowers in the form of higher interest rates, higher downpayments, greater reliance on secured debt, and fewer customer benefits. Bankruptcy professionals favor increased bankruptcies because they get paid only if there are bankruptcies. More bankruptcies increases the wealth and prestige of bankruptcy professionals. The combination of pro-debtor ideological interests and bankruptcy professionals has proven to be a formidable political alliance.

Skeel's analysis thus helps to unravel the politics surrounding the Bankruptcy Reform Act of 2002 (the "BRA"), which was finally ready to be passed in August 2002 after an arduous legislative process that consumed almost a full decade. There are some dramatic differences in the new political environment, however, which help to explain why reform will likely succeed this time, whereas it has failed in the past. First, the traditional dominance of pro-debtor ideology in Congress appears to have been counterbalanced by the rise of a new "personal responsibility" ideology. The takeover of Congress by the Republicans in 1994 ushered in a new conservative majority that has tended to view consumer bankruptcy as a moral and social issue of personal responsibility. This has led to an ideological movement for less tolerance of bankruptcy fraud and abuse. Second, creditors have succeeded in overcoming the collective action problems that have frustrated them in the past. Unsecured and secured creditors have worked together to craft a compromise that is acceptable to both groups. Finally, the clout of bankruptcy professionals on Capitol Hill has weakened substantially as a result of the Republican control of Congress. Moreover, the irresponsible and inflammatory rhetoric that bankruptcy professionals have deployed to try to thwart reform has dramatically backfired on them. Their reckless accusations have squandered the one trump card they held to influence Congress—their image as neutral and technical purveyors of advice to Congress. The result has been to substantially weaken their image and influence in Congress.

In the final chapters of the book Skeel turns to the future of bankruptcy, reviewing many of the current "hot topics" in bankruptcy law and policy, as well as offering predictions about the future of bankruptcy law, both domestically and internationally. Of particular interest is the impact of globalization on the future evolution of American bankruptcy law. Somewhat surprisingly, Skeel concludes that globalization will have little impact on the structure of American bankruptcy law. "Although the new, world economy will have important effects," he writes, "the basic parameters of American bankruptcy law are unlikely to change. We will continue to see the same three forces—creditors, pro-debtor ideology, and bankruptcy professionals—and the shape of the bankruptcy process will remain roughly the same." (p. 241). In particular, Skeel observes, despite the many criticisms of American bankruptcy law, under the pressures of globalization, bankruptcy law in much of the world is evolving to look *more* like the American bankruptcy system, rather than less. On both business bankruptcy and consumer bankruptcy, Skeel observes, the rest of the world is loosening its bankruptcy laws. Thus, even though foreign bankruptcy laws generally remain stricter than in the United States, the direction is clear—they are moving toward more generous bankruptcy laws. He writes, "The important point, however, is that all of the pressure unleashed by globalization is pushing in this direction. All around the world, other nations are beginning to adopt some of the features of U.S. bankruptcy law. There is little evidence of a trend in any other direction, in the United States or elsewhere." (p. 243).

Skeel is correct that the rest of the world is adopting more generous bankruptcy laws, but in the United States there is in fact clear evidence of a counter-trend as exemplified by the BRA. Not only does the BRA temper the pro-debtor character of consumer bankruptcy, it also streamlines business bankruptcies to reduce the cost and delay of the Chapter 11 process. There is no viable constituency for the adoption of new pro-debtor laws. In addition, creditors are becoming increasingly ingenious in devising contractual and other "self-help" mechanisms for effectively opting-out of bankruptcy completely, or for devising mechanisms to minimize the expense, risk, and delay of being entangled in America's notorious bankruptcy morass. These legislative and practical attempts to reign in the excesses of the American bankruptcy system manifest a clear trend toward more restrictive bankruptcy access in the United States in the future.

Contrary to Skeel's predictions, therefore, globalization probably will not create a uniform trend toward American-style bankruptcy systems. Rather, the likely result will be global *convergence* of bankruptcy regimes. Regimes that are excessively pro-debtor, such as the United States, will tend to become less so; regimes that are insufficiently pro-debtor, such as Europe, will tend to liberalize. The effect of globalization will be to establish a process of competition in economic policy that will tend to reward countries that adopt efficient economic policies and punish those that do not, leading to a convergence on efficient rules. In fact, this has been what has happened with respect to interstate competition in the American system of federalism. Given the free flow of capital around the world today, it is likely that such pressures will increasingly shape corporate governance rules around the world. Excessively pro-debtor regimes such as the United States will be forced to temper their excesses in order to remain competitive in the global environment, whereas Europe and elsewhere will tend to liberalize in order to increase entrepreneurship and capital development in their moribund economies.

To the extent that Chapter 11 raises the costs and risks of investing in America, international investors will direct their capital to more efficient markets. In short, the pressures on the United States to adopt more efficient bankruptcy laws is much greater than in the past. Moreover, as it becomes increasingly expensive to indulge the ideological desires of the bankruptcy progressives, it can be predicted that their influence over the future of bankruptcy law will become increasingly muted. In the consumer bankruptcy arena, the BRA reflects a similar trend in the direction of greater restrictions on access to bankruptcy. American society is gradually reestablishing traditional values in the wake of what Francis Fukuyama has dubbed "the Great Disruption" of the past several decades.[4] Promiscuous consumer bankruptcy laws were just one of the many social experiments of recent decades that have proven unsuccessful in the face of human nature and inconsistent with the needs of successful societies.[5] The movement toward greater accountability in consumer bankruptcy represents a necessary step of social self-correction after a period of chaos and revolution.

David Skeel has written a brilliant and comprehensive book on the history of bankruptcy law in America. The use of cutting-edge analytical tools makes it possible for him not only to persuasively explain the history of American bankruptcy law, but also to offer insightful predictions about the future evolution of bankruptcy law in America. It is certainly the most important book on bankruptcy law that has been published since Thomas Jackson's acclaimed *The Logic and Limits of Bankruptcy*. Given the prominence of bankruptcy in today's business and political headlines, this is a book that should gain a wide audience. Bankruptcy lawyers will feast on its comprehensive history of bankruptcy law and its colorful portrayals of famous bankruptcy figures. General business lawyers will find it a rich introduction to the world of bankruptcy and its interaction with other areas of law. Finally, readers of general business history books will be fascinated to learn of the ways in which the bankruptcy system has shaped American economic history in the past and will continue to do so in the future.

* Todd J. Zywicki: Associate Professor of Law, George Mason University School of Law; Co-Chair, Bankruptcy Subcommittee, Financial Services and E-Commerce Practice Group. This review is adapted from a longer essay, Todd J. Zywicki, *The Past, Present, and Future of Bankruptcy Law in America*, (Forthcoming in the *Michigan Law Review*).

Footnotes

[1] *See* Todd J. Zywicki, *The Bankruptcy Clause*, *in* THE HERITAGE GUIDE TO THE CONSTITUTION (forthcoming 2002).

[2] Thus, although conventional wisdom has it that the Bankruptcy Clause of the Constitution was a protection for debtors, it actually was intended primarily to assist creditors. Indeed, many states maintained imprisonment for debt well into the Nineteenth Century. *Id.*

[3] *See* THE FEDERALIST NO. 42 (James Madison).

[4] FRANCIS FUKUYAMA, THE GREAT DISRUPTION: HUMAN NATURE AND THE RECONSTITUTION OF SOCIAL ORDER (1999).

[5] *See* Todd J. Zywicki, *Bankruptcy Law as Social Legislation*, 5 TEX. REV. L. & POL. 393 (2001).