

Aggressive Uses of Chapter 11 of the Federal Bankruptcy Code

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Introduction

The filing of a voluntary bankruptcy petition under Chapter 11 of the Bankruptcy Code of 1978 by the LTV Corporation on July 17, 1986 focused renewed attention on the recent evolution of corporate reorganizations under the Bankruptcy Code. This article reviews that evolution and offers alternative explanations for the kinds of uses noted in recent Chapter 11 petitions. To some observers, a Chapter 11 petition is becoming one of the standard financial strategies of large corporations. In a period of disinflation, the filing of a Chapter 11 petition is not a completely unexpected or unnatural response to the need to reduce corporate obligations.

Alternative legal mechanisms do exist for the orderly downsizing of corporate assets and liabilities in the face of a generally falling price level or a significantly reduced demand in specific markets. Those alternatives include assignments for the benefit of creditors, corporate liquidations, and corporate dissolutions and reorganizations under state law, as well as contractual agreements for nonbankruptcy lending ("work-outs"). However, those alternatives often are unsatisfactory because they do not provide a convenient method for debtors to stay all creditors' claims automatically or to reject burdensome contingent liabilities. Thus, corporate reorganization under Chapter 11 typically is the debtor's preferred alternative. Creditors also may prefer the orderly process of negotiation with a debtor through creditors' committees under the supervision of a federal bankruptcy court, instead of attempts to reorganize the debtor without the

court's protection and assistance.

A more restrained, and probably more accurate, view of bankruptcy petitions such as that filed by LTV is that a Chapter 11 filing may be helpful in restructuring large claims of secured creditors and of creditors with the priority claims described in section 507 of the Bankruptcy Code (11 U.S.C. section 507). Nevertheless, the use of Chapter 11 filings as a sword rather than a shield was not traditionally contemplated under the 1978 Bankruptcy Code or the prior United States bankruptcy acts.

I. An Economic Perspective

Basic economics textbooks pay little, if any, attention to bankruptcy proceedings as a mechanism for allocating resources. When an uncompetitive firm becomes insolvent, economics texts generally assume that its assets will be liquidated to satisfy creditors and that the firm no longer will exist. Economists call this process "exit from the market." Shareholders may suffer large losses, including the complete loss of their investments. At times, new investors purchase some of the liquidated assets on favorable terms, putting up fresh capital, and a new firm "enters the market." Some former assets are scrapped, some former employees are not re-employed, and some former creditors are not paid fully. The new firm generally has a better chance of succeeding than the old firm because it has some combination of lower costs, greater productivity, and better management. Economists describe this market-driven process as being efficient because investors purchase

assets or new stock in the firm at market prices. Those investors could have used their capital for other purposes.

In practice, corporate reorganizations under the Bankruptcy Code allocate resources in a manner that may differ significantly from an economist's description of corporate reorganizations. Under Chapter 11, troubled firms essentially bargain with creditors' committees and, occasionally, with their own employees regarding the conditions under which they can remain "going concerns." Negotiations with employees typically would cover the restructuring of executives' compensation contracts and unions' collective bargaining agreements.

The bankruptcy judge acts as a mediator/arbitrator, following the Bankruptcy Rules. However, the real power to affect the day-to-day operations of a debtor is in the hands of the creditors' committees. Usually, management of the bankrupt firm attempts to remain in control of the ongoing operations of the enterprise. In such cases, management is referred to as the "debtor in possession." Often, as was the case with the LTV filing, bank creditors already have a functioning committee that has been negotiating with management before a bankruptcy petition is filed. Thus, it is not at all inaccurate to describe the bankruptcy judge as a detached mediator or referee. Usually, the judge plays only a small role in preparing a reorganization plan. That plan ordinarily is drafted by the debtor and must be ratified by the creditors' committees. The committees may serve as active, involved co-managers of the bankrupt firm, and it is not unusual for counsel for the creditors' committees to meet at least weekly with management.

If no agreement between the bankrupt firm and its creditors can be reached voluntarily, the court, usually acting through a trustee, can impose a solution. One possible solution is a complete liquidation of the firm, but such a solution is used in Chapter 11 cases only after a judge determines that no viable alternative exists. It would be mere coincidence if a firm reorganized in a Chapter 11 proceeding had the same assets, liabilities, capitalization, labor force, wage rates, and productivity as a market-organized firm. Indeed, a Chapter 11 proceeding may support, at least temporarily, the continued existence of a firm that otherwise would have been liquidated.

Corporate reorganization arguably is always a smoother process for all concerned rather than a straight liquidation under Chapter 7 of the Bankruptcy Code. That is why the threat of filing a Chapter 7 petition serves management as a strong bargaining tactic in dealing with creditors' committees. Regardless of the outcome of a Chapter 11 proceeding, all parties theoretically have a sense of participation and partial control

in a corporate reorganization. If reorganization produces a new firm that proves to be uncompetitive, and if further restructuring is required, at least the affected parties will have time to adjust to the changed circumstances.

Yet, to the extent that a Chapter 11 petition thwarts the discipline of the marketplace, the ultimate costs of corporate reorganization to society may be greater than those of corporate liquidation. This can occur because the court's judgment as to the viability of the reorganized firm and any arrangement reflecting the vested interests of the creditors may be wrong. On the other hand, lawyers seem to believe that creditors' lawyers, bankruptcy judges, and trustees usually assess the possibilities of corporate reorganizations accurately because of their repeated experiences with working out the consequences of Chapter 11 petitions. Also, the continued presence of corporate management in debtor-in-possession arrangements under most Chapter 11 plans guarantees that the role of business judgment will be significant. Thus, in the end, the normal result of a corporate reorganization traditionally has not been completely at odds with the overall lessons of human experience.

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II. Priorities Among Creditors

Section 507 of the Bankruptcy Code prescribes a schedule of the priorities of distribution for claims of classes of creditors in a bankruptcy proceeding. A simplified listing of the priorities under Section 507 is as follows:

- Administrative expenses of the bankrupt's estate.
- Postpetition unsecured claims arising prior to the appointment of a bankruptcy trustee.
- Up to \$2,000 per claimant for unsecured claims for accrued but unpaid wages, salaries, commissions, vacation, and sick leave pay.
- After deducting the \$2,000 per employee above, unsecured claims for up to \$2,000 per claimant for contributions to employee benefits.
- Unsecured claims of farmers against grain elevators or of fishermen against fish processing plants.
- Up to \$900 per unsecured claimant for security deposits and down payments for services not rendered or goods not provided.
- Unsecured claims of governmental units for taxes, customs duties, and penalties accrued but unpaid.

Claims for employees' wages and benefits have third and fourth priority in the schedule. General, unsecured, unsubordinated

claims, including the balance of claims for wages and benefits, are given no priority and, thus, effectively have eighth priority — behind all other classes of prior claims.

Secured claims are *not* subject to the schedule of priorities, but bankruptcy trustees may restrain secured creditors from realizing upon their liens in return for providing "adequate protection" to the secured creditors while their claims are stayed. Unfortunately, one man's "adequate protection" may be another man's outrageous infringement of rights. In practice, secured creditors often are forced to renew their extensions of credit to bankrupt enterprises in order to allow those enterprises to continue operating for the benefit of all creditors, both secured and unsecured.

Holders of investment securities have no priority of claim and generally are paid, if at all, only after all prior classes of creditors are paid in full. A normal ranking of security holders is as follows:

- Subordinated debt holders, including bond and note holders.
- Preferred shareholders.
- Common equity shareholders.

Holders of investment securities are referred to the terms of the relevant legal documents to determine the relative priority of different types of investment securities within the classes of investment security holders.

III. Evolution of the Bankruptcy Code

The power to establish uniform laws on bankruptcies was given to Congress under Article I, section 8, clause 4, of the United States Constitution. Bankruptcy was bound up with controversies regarding debtors' prison under the common law and, for the first century of its existence, the United States had no permanent bankruptcy law.¹ Congress managed to keep bankruptcy laws on the books only briefly, during the years 1800-1803, 1841-1843, and 1867-1878. Disputes regarding the availability and liberality of discharges from debts in bankruptcy proceedings created the political pressures that caused the repeal of those early bankruptcy acts. Generally, Jeffersonians, Jacksonians, and Southern and Western Democrats favored liberal bankruptcy laws as a means of discharging prior debts and granting debtors fresh starts in life. Naturally, Tories, High Federalists, Whigs, and Republicans (that is, the creditor class) opposed the liberal discharges available to nonmerchant debtors under bankruptcy laws.² In

the aftermath of the depression following the Panic of 1893, the first permanent bankruptcy law was passed in 1898. That legislation provided principally for straight liquidations. Then, in fits and starts between 1932 and 1938, in the throes of resolving the problems of a time when "so many were debtors, and so few were solvent," the forerunners of the reorganization provisions of the present Bankruptcy Code were enacted in 1938. Provisions for corporate reorganizations (Chapter 10) and corporate arrangements (Chapter 11) appeared for the first time as part of the Chandler Amendments of 1938. Still, bankruptcy was a defensive measure for corporate debtors, and the requirement of corporate good faith in filing bankruptcy petitions, not difficult to establish during the Great Depression, routinely was enforced by the courts.

The present Bankruptcy Code was enacted in 1978. Chapters 10 and 11 of the 1938 bankruptcy act were combined in the new Chapter 11. Under the new Chapter 11, the stay of creditors' claims became automatic upon the filing of the petition. The automatic stay was seen as a procedural improvement from the debtors' perspective because, previously, the stay had to be requested separately, and creditors could resist the application for a stay, even after the Chapter 11 petition was filed. Also, the requirement of actual insolvency at the time of filing under the 1938 act was eliminated in the new Chapter 11.

The Bankruptcy Code was amended in 1984, following a June 1982 United States Supreme Court decision striking down crucial parts of the 1978 Code.³ The 1984 amendments primarily were procedural, covering the jurisdiction and tenure of bankruptcy judges. However, the 1984 amendments also restricted the extent of discharges in consumer bankruptcies, established standards for judging the reasonableness of employers' rejections of collective bargaining agreements, reordered the priority of distributions of stored grain to farmers, and exempted certain repurchase agreements covering financial instruments from the automatic stay provisions of the Code.

1 A good overview of the comparative histories of the evolution of bankruptcy acts in the United States and the United Kingdom is Vern Countryman. A History of American Bankruptcy Law, 81 Commercial Law Journal 226 (1976), from which much of the historical information in this commentary is taken.

2 See Countryman (id.) at 229-230. Of course Jeffersonians objected when the first bankruptcy act (1800) made discharges available only to merchants. On the other hand, Hamiltonians found the act useful. Robert Morris, once the financier of the American Revolution, and by then "the most daring real estate plunger in the United States," financed speculative housing development in the District of Columbia, beginning in 1796. Unfortunately, in 1797, a financial panic arose from the outbreak of the wars between England and revolutionary France. Morris was ruined and spent more than three years in the Philadelphia debtors' prison. His discharge in 1801 under the 1800 bankruptcy act probably was the most famous bankruptcy discharge in the nineteenth century. See John C. Miller, *The Federalist Era: 1780-1801*, 252 (1960).

3 *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982).

Throughout the evolution of the present Bankruptcy Code, the statutes enacted have been reasonably clear expressions of the Congressional view that bankruptcy should be a defensive, nonroutine measure and should not be used to advance the financial interests of corporate debtors beyond the point that would have been achieved by competition in a free market among solvent corporations.

IV. Aggressive Uses of Bankruptcy

A potentially disturbing trend of filings under the Bankruptcy Code began with the classic "surprise filing" by the *Johns-Manville Corporation* in 1982. Johns-Manville, facing an unpredictable amount of claims for damage thought to be caused by asbestos, proposed a Chapter 11 reorganization under which all present and future asbestos claimants would be reimbursed from a separate fund created by Johns-Manville. Meanwhile, the normal business operations of the corporation continued, comparatively unimpeded by the claims of asbestos victims. The victims' fund is to receive up to \$2.5 billion over 25 years, including the contribution of at least 50 percent of the common voting equity shares of the corporation. The *Johns-Manville* case has been questioned in some of the bankruptcy literature as lacking the elements of a good-faith filing, but at this writing it appears that the settlement will stand?

Other potentially disturbing bankruptcy decisions soon followed in the wake of the *Johns-Manville* case. In February 1984, the United States Supreme Court decided, 5-4, in *National Labor Relations Board v. Bildisco & Bildkco, Inc.*, that employers undergoing Chapter 11 reorganizations unilaterally may abrogate or modify collective bargaining agreements that are seriously burdensome to the employer when, on balance, the equities of the case favor modification of burdensome terms.⁵

The *Bildisco* case illustrates the way that bankruptcy courts usually resolve fundamental conflicts between provisions of the Bankruptcy Code and other provisions of federal law: Bankruptcy provisions prevail. It is only natural for bankruptcy courts to consider the creation of viably reorganized entities as their paramount duty in Chapter 11 cases. The remedy for those distressed by such tendencies on the part of the bankruptcy courts is to petition Congress for amendments to the Bankruptcy Code that would specifically address such conflicts. However, as is noted below, the bankruptcy courts have modified somewhat their tendency to elevate bankruptcy procedures above other considerations of federal or state law only in environmental pollution cases.

Labor leaders lobbied Congress to overturn the effect of the *Bildisco* decision, and Congress did so in the July 1984 amendments to the Bankruptcy Code (11 U.S.C. section 1113, "Rejection of collective bargaining agreements"). Although they still allow employers to reject collective bargaining agreements, these amendments establish standards for judging the reasonableness of the rejection in light of good-faith efforts to negotiate modification of the agreements. In the first court test of the 1984 amendments, in *re Wheeling-Pittsburgh Steel Corp.* (W.D. Pa. 1985), the district court sustained an employer's rejection of wage provisions of a union contract under section 1113, even though it was arguable that the employer had not bargained in good faith on the wage concessions. The union was holding out for further bank lenders' concessions before agreeing to the wage concessions. Upon appeal (May 1986), the Third Circuit Court of Appeals remanded the case to the district court, finding that the standards for rejection established by section 1113 of the Bankruptcy Code had not been met.⁶

In the *Dalkon Shield* (intrauterine device) litigation, a Chapter 11 filing by the A.H. Robins Company (March 1986) was intended to forestall future product liability claims against the company. At the date of filing, Robins had settled 9,300 claims for \$517 million, with 5,000 more claims still pending. As in the *Johns-Manville* case, the *Robins* filing was intended to cut off future product liability claims and to enable the rest of the company to continue operating without the burden of those claims. However, enough allegations of high-level corporate malfeasance emerged in the *Robins* case that the court appointed a special monitor to review the ongoing operations of senior management. Management remains in control of the company at this writing?

4 See, e.g., Mark J. Roe, *Bankruptcy and Mass Tort*, 84 *Columbia Law Review* 846 (1984); Note, *The Manville Corporation bankruptcy: an abuse of the judicial process?* 11 *Pepperdine Law Review* 51 (1983); Note, *Manville: good faith reorganization or "insulated" bankruptcy?* 12 *Hofstra Law Review* 121 (1983); Note, *Manville corporation and the "good faith" standard for reorganization under the Bankruptcy Code*, 14 *University of Toledo Law Review* 1467 (1983); Note, *Manville bankruptcy: treating mass tort claims in Chapter 11 proceedings*, 96 *Harvard Law Review* 1121 (1983).

5 A thorough account of the *Bildisco* decision, 465 U.S. 513 (1984), and the enactment of the collective bargaining provisions of the Bankruptcy Code Amendments of 1984 is Thomas R. Haggard, *The Continuing Conflict Between Bankruptcy and Labor Law -- The Issues that Bildisco and the 1984 Bankruptcy Amendments Did Not Resolve*, 1986 *Brigham Young University Law Review* 1. See also, Benjamin Weintraub and Alan N. Resnick, *Bankruptcy Law Manual, Problems with labor Unions: Rejecting Collective Bargaining Agreements*, paragraph 8.11 (9) (1986). See *In re Bildisco*, 682 F.2d 72 (3d Cir. 1982).

6 *Wheeling Pittsburgh Steel Corp. v. United Steelworkers of America*, 791 F.2d 1074 (3d Cir. 1986).

In other aggressive filing developments under the Bankruptcy Code, a new line of cases is evolving that might limit corporations' capacity to cut off liability for toxic waste pollution of the environment by filing Chapter 11 petitions. In January 1986, the United States Supreme Court decided, 5-4, that bankruptcy trustees may not abandon corporate property under 11 U.S.C. section 554 (a) that is burdensome to the bankruptcy estate if the abandonment causes environmental damage that contravenes state laws or health and safety regulations. The case decided in January 1986 was *Midlantic Bank v. New Jersey Department of Environmental Protection*, which was an appeal of two 1984 Third Circuit cases involving Quanta Resources Corporation.⁸ It is noteworthy that, in the *Midlantic* case, Justice Rehnquist wrote the dissenting opinion which stated, in relevant part:

The Bankruptcy Court may not, in the exercise of its equitable powers, enforce its views of sound public policy at the expense of the interests the Code is designed to protect. In these cases, it is undisputed that the properties in question were burdensome and of inconsequential value to the estate. Forcing the trustee to expend estate assets to clean up the sites would plainly be contrary to the purposes of the Code.

The *Midlantic* case involved a liquidation, but comparable concerns would arise in Chapter 11 cases if abandonment of contaminated property seemed essential to achieving a financially successful corporate reorganization. In the future, it is not inconceivable that corporations would attempt to cut off toxic waste liability by filing Chapter 11 petitions with the intent to abandon contaminated property. At present, the weight of court decisions appears to be against such aggressive use of Chapter 11 petitions.⁹

The original bankruptcy court order in the *Bildisco* case was issued in 1981. Since then, *Bildisco* has had two progeny worthy of note: *Wilson Foods* and *Continental Air Lines*. In

April 1983, Wilson, then the fifth-largest meat packer in the United States, filed a Chapter 11 petition in Oklahoma. Wilson then unilaterally rejected collective bargaining agreements covering two-thirds of its employees and reduced wages by 40 to 50 percent. Wilson's petition showed an estimated positive net worth of more than \$67 million. After reducing wages, Wilson was reported to have obtained a new line of credit for \$80 million from a New York City bank.¹⁰

In September 1983, Continental, then the eighth-largest airline in the United States, filed a Chapter 11 petition in Texas. Continental had been bargaining with its employees for wage concessions as part of a corporate strategy for becoming an efficient, low-cost carrier in a deregulated environment. After the filing, Continental unilaterally rejected contracts with several unions, including the pilots' union. All employees temporarily were laid off. A few days later, one-third of the employees were recalled, but new wages were reduced from former levels by more than half in some instances. Although Continental had a heavy debt burden at the time of filing, net worth still was positive. The reorganized Continental, together with low-cost affiliates such as New York Air, is a strong competitor over major airline routes in the United States and on certain international routes; furthermore, it is usually mentioned as a potential acquirer of other, troubled airlines. During the spring and summer of 1986, Continental's parent company, Texas Air, was involved in negotiations to acquire Eastern Airlines and People Express. At this writing, it appears that those acquisitions will be consummated.

Taking the Chapter 11 baton from Continental is *Frontier Airlines*, a unionized carrier serving the western United States that was acquired in 1985 by the ultimate low-cost air carrier, People Express. Facing a heavy debt burden and expanded price competition over most of its domestic routes, People Express offered Frontier for sale in the late spring of 1986. One potential acquirer, United Airlines, was close to completing the purchase of Frontier but, as of this writing, has not done so.

One of the obstacles to United's acquisition of Frontier was its inability to negotiate

7 See *A.H. Robins Co. v. Piccinin*, 788 F.2d 994 (4th Cir. 1986). The Fourth Circuit upheld a preliminary injunction staying all claims arising from Dalkon Shield litigation against personally named co-defendants (typically, officers and directors of Robins) once the Robins Chapter 11 petition was filed. This decision is viewed as an affirmation of the broad injunctive powers of a bankruptcy court to stay all claims involving a debtor reorganizing under Chapter 11.

8 *Midlantic*, 474 U.S. _____, 88 L.Ed.2d 859 (1986). The Supreme Court made a similar finding in the case of *Ohio v. Kovacs*, 469 U.S. _____, 83 L.Ed.2d 649 (1985). In *Kovacs*, the Supreme Court held that a discharge in bankruptcy was allowed for a debtor whose property was seized by a state receivership which began to clean up a toxic waste site and then ordered the debtor to pay for the clean-up. The Supreme Court left for another ruling (*Midlantic*) the resolution of the issue of allowing bankruptcy trustees to abandon contaminated property.

9 In *United States v. Maryland Bank & Trust Co.*, _____ F.Supp. _____ (D. Md.), slip op. Apr. 9, 1986), the environmental protection laws were extended to enable the Environmental Protection Agency to maintain lawsuits against innocent parties foreclosing on contaminated property and to require them to pay for the costs of cleaning up the property. It is believed that such precedents will complicate Chapter 11 proceedings in the future by raising the spectre of unsecured liabilities in amounts that, if not stayed or discharged, would disrupt the orderly reorganization of companies operating under Chapter 11 in cases involving infringement of environmental protection laws.

10 Graeme Browning, *Using Bankruptcy to Reject Labor Contracts*, 70 *American Bar Association Journal* 60 (Feb. 1984)

a mutually satisfactory transitional salary scale for Frontier's pilots, who generally earned less than United's pilots. Other potential acquirers of Frontier apparently were willing to purchase it only if the collective bargaining agreements with the principal Frontier unions were rejected. People Express apparently threatened to file a Chapter 11 petition for Frontier in order to induce Frontier's unions to be more forthcoming. Thus, the Frontier case illustrates another variation of the aggressive use of Chapter 11 filings: The threat to file becomes a bargaining chip in labor negotiations. United's negotiations regarding Frontier were interrupted by the filing of a Chapter 11 petition for Frontier on August 28, 1986.¹¹

One debtor that has shown real initiative following a bankruptcy reorganization is *Wickes corporation*, a California-based building supply company that filed its Chapter 11 petition in April 1982, shortly before the upturn from the 1981-82 recession began. Reorganized under strong management, Wickes reduced operating expenses, closed unprofitable stores, and renegotiated or rejected a number of building leases for its stores. Wickes emerged from Chapter 11 in early 1985. A year later, in April 1986, Wickes attempted to acquire the National Gypsum Corporation for approximately \$1.2 billion. After that takeover attempt failed, during August 1986, Wickes mounted a new hostile tender offer for Owens-Corning Fiberglas Corporation, Toledo, Ohio. Wickes apparently intended to finance the tender offer with an issue of so-called "junk bonds" and with the planned post-acquisition sale of Owens-Corning operations not closely related to the core operations of Wickes. The tender offer was valued at \$2.1 billion. On August 29, 1986, Wickes terminated the offer, but analysts estimated that Wickes had a net gain of at least \$30 million from the increased value of Owens-Corning shares acquired during the takeover attempt. It is significant that a company that not long ago filed a Chapter 11 petition, apparently in good faith, has been able to mount hostile tender offers for multi-billion-dollar corporations within little more than a year after ceasing to operate under the supervision of a bankruptcy court.

V. Implications for the Bankruptcy System

The sequence of all the cases cited above is a signal that something might be wrong in the bankruptcy system. For bankruptcy specialists, and for economists generally, those cases are like,

in the words of Thomas Jefferson, a "fire-bell in the night....[W]e have the wolf by the ears, and we can neither hold him, nor safely let him go. Justice is in one scale, and self-preservation in the other."¹² Jefferson was writing about the pernicious effects of slavery on the preservation of the Union and about the controversies raised by the Missouri Compromise. The message of those words, however, for defenders of the notions of a free market and of market discipline in American enterprise, is that actions currently taken under Chapter 11, while perfectly legal under the present Bankruptcy Code, may be moving inexorably in the direction of a race to the courthouse to enable solvent, albeit troubled, corporations to gain positive advantages over competitors. Such a race for competitive advantage through the legal process eventually undermines the free-market system, as well as the other laws overridden by the Bankruptcy Code, such as environmental protection or labor laws.

Yet, competitors in any line of business "have the wolf by the ears" in that they cannot safely renounce the use of Chapter 11 filings as a means of reducing operating costs unless *all* significant competitors in that line of business refrain from filing as long as they are solvent. Thus, justice (fair play) demands that all solvent competitors refrain from filing, but self-preservation demands that all competitors retain the capacity to file as long as any significant competitor has that capacity.

If efficiency in the market is achieved most easily by becoming a low-cost producer under the protective umbrella of a Chapter 11 filing, why should any corporation exert itself to achieve efficiency by bargaining and by open competition in a free market? Before 1978, a showing of insolvency was a prerequisite of a Chapter 11 filing, but that requirement was dropped in the present Bankruptcy Code.¹³ The question now presented is whether the benefits that were supposed to flow from the removal of the requirement of insolvency have been outweighed by the deficiencies — if they are, in [fact, deficiencies — of the present statute. After all, in the words of one bankruptcy expert,

Chapter 11 is supposed to be rehabilitative,.. a device "which can be used to cure a company that's ill or hemorrhaging." It is better to apply the cure while a company "has strength and vitality left — before letting it die."¹⁴

11 Press reports in early September 1986 indicated that Armco, a major producer of steel, also allegedly was using the threat of a Chapter 11 filing to induce its employees' union to make wage concessions. In fact, the union agreed to the concessions and no Chapter 11 petition was filed.

12 Letter from Thomas Jefferson to John Holmes, April 22, 1820, in *The Portable Thomas Jefferson* 567, Merrill D. Peterson ed. (1975, reprinted 1980).

13 Browning, *supra* note 10

Thus, it is important to remember that not all observers believe that the present uses of Chapter 11 are all bad. The issue of good faith in filing could be addressed satisfactorily by scrutinizing Chapter 11 filings in light of the question: "Is this company financially troubled enough to justify the filing?" By that standard, some of the recent Chapter 11 filings (for example, *Wickes*, *LTV*, and *Frontier*) might not be particularly troublesome.

VI. summary

The law of bankruptcy has been intended since 1898 to grant debtors relief from claims of unsecured trade creditors, bank lenders, and the like, but not to affect substantially the claims of employees for accrued, but unpaid, wages and benefits, or the claims of governmental units for taxes. Such claims were, and still are, given priority in the distribution of assets of bankruptcy estates. Since 1982, a new trend has emerged in which aggressive bankruptcy filings are used to achieve the greater financial objectives of the corporations filing Chapter 11 petitions. The 1984 amendments to the Bankruptcy Code were intended to rein in perceived abuses of the corporate capacity to disavow employment contracts. Some may argue that the July 17, 1986 filing by LTV Corporation was yet another corporate effort in the direction that was opposed by the 1984 amendments. It is possible to contend that the filing was designed to enable LTV to modify its collective bargaining agreements substantially or to reject future liability for employee benefits, including pension or insurance liabilities. On the other hand, LTV clearly was having financial troubles, and issues regarding the good faith of its failing still have to be resolved by the bankruptcy court.

The cases described above fall into three broad categories:

1. Contingent products liability or environmental protection

Johns-Manville (1982)

A.H. Robins (1986)

Midlantic (1986) (Chapter 7)

2. Executory collective bargaining agreements

Bildisco (1981-1984).

Wilson Foods (1983)

Continental Air Lines (1983)

Frontier Airlines (1986)

3. Restructuring and downsizing corporate liabilities

Wickes (1982)

LTV (1986).

The Supreme Court thus far seems to be sustaining the primacy of bankruptcy considerations in the second and third categories of cases, while continuing to sustain the primacy of environmental protection laws in cases that do not involve mass tort litigation.

In any case, it is clear that companies with the benefit of the protection afforded by Chapter 11 filings have advantages in corporate financial structure that are not available to similarly situated, but presumably solvent, competitors who do not file. Thus, it is reasonable to predict that, in a disinflationary environment, an increased number of aggressive Chapter 11 filings will occur in any industry in which a significant competitor alters its costs of production by filing a Chapter 11 petition. In the absence of a more orderly, formal procedure for downsizing corporate assets and liabilities in the United States, such a use of Chapter 11 is neither illogical nor completely unforeseeable. The remedy for aggressive uses of Chapter 11, if a remedy becomes desirable as a matter of public policy, is to be found by following the traditional path of Congressional enactment of corrective amendments of the Bankruptcy Code.

At the same time, the purpose of the 1978 revisions of Chapter 11 should be kept in mind: The rehabilitation of ailing companies should be effected before they become terminally ill. If nothing concentrates the mind like the prospect of being hanged, then the opportunity for a debtor to file a Chapter 11 petition before its case is terminal ought to serve a constructive purpose: It should encourage lenders, employees, and the company's other constituent groups to cooperate in attempting to improve the chances for restoring the company's competitive viability in order to avoid the filing. The same spirit of cooperation should prevail if a filing occurs despite everyone's best efforts.