

## Doing Away with the Emperor's New Clothes: Dispelling the Myth of the Good Faith Filing Requirement under Chapter 11 & Its International Implications

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1. The increasing prevalence of corporate bankruptcy in the contemporary business milieu in the United States makes for impressive reading: from a mere 3,774 cases filed cumulatively under its three predecessor provisions in 1978,<sup>1</sup> Chapter 11 has gone from strength to strength, tripling over the course of the past thirty years to over 10,000 petitions filed in the year ending June 2008 alone,<sup>2</sup> with most indicators suggestive of even more prolific recourse to the mechanism in the foreseeable future.<sup>3</sup> While the meteoric rise in the number of Chapter 11 filings can be attributed to a wide myriad of factors, conventional wisdom suggests that one of

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<sup>1</sup> See ADMINISTRATIVE OFFICE OF THE U.S. COURTS, 1960 – 2003 BANKRUPTCY FILINGS, 12-MONTH PERIOD ENDING JUNE, BY CHAPTER AND DISTRICT (2004), <http://www.uscourts.gov/bnkrpctystats/1960-0312-MonthJune.pdf>. The bulk of these filings are filed under Chapter XI, with a significantly less number filed under Chapters X and XII. Though not necessarily a fully accurate barometer, one commentator has observed that a comparison of the number of filings in Chapter X with those in Chapter 11 provides an even more impressive contrast, with a sum total of just 3,768 cases being filed under Chapter X (*i.e.* an annual average of an extremely modest 118 filings) in a 32-year period spanning from 1939 to 1970. See DAVID A. SKEEL, JR., *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 126 (2001).

<sup>2</sup> See ADMINISTRATIVE OFFICE OF THE U.S. COURTS, *BANKRUPTCY STATISTICS, 2008 CALENDAR YEAR BY CHAPTER* (2009), [http://www.uscourts.gov/Press\\_Releases/2009/bankrupt\\_f2table\\_dec2008.xls](http://www.uscourts.gov/Press_Releases/2009/bankrupt_f2table_dec2008.xls).

<sup>3</sup> Bankruptcy filings were predicted to rise by more than 40% year-on-year in 2009. See Rachel Feintzeig, *New Year Brings Fresh Crop of Chapter 11 Bankruptcy Filings*, *BANKRUPTCY STATISTICS*, Feb. 7, 2009, [http://www.bankruptcy-statistics.com/index.php?option=com\\_content&view=article&id=248:new-year-brings-fresh-crop-of-chapter-11-bankruptcy-filings&catid=81:national&Itemid=198](http://www.bankruptcy-statistics.com/index.php?option=com_content&view=article&id=248:new-year-brings-fresh-crop-of-chapter-11-bankruptcy-filings&catid=81:national&Itemid=198). It would be useful to note that the recent upswing in economic prospects both internationally and in the United States is unlikely to have a dampening effect on the number of petitions filed – most experts take the view that a positive shift in economic sentiment is unlikely to immediately precipitate a drop in bankruptcy applications – bankruptcy filings are after all, “a lagging economic indicator so it's likely that we'll see bankruptcy filings increase for the next several quarters”. See Eric Morath, *Business Bankruptcy Filings Increased 7% in October*, *WALL ST. JOURNAL*, November 3, 2009. Another commentary published recently buttresses this point, noting that a recovery is, ironically, expected to precipitate a rash of fresh Chapter 11 filings: see Kurt M. Carlson, *The Next Wave: Ironically, A Recovery Could Actually Spur Fresh Business Bankruptcies*, *NAT'L LAW. JOURNAL*, November 30, 2009. The point advanced by these commentaries appear to be fortified by recent statistics that suggests that the number of bankruptcy filings in Financial Year 2009 rising by some 68% from the previous year, including, conspicuously, a spike in third-quarter filings despite a positive upswing in market sentiment. See U.S. COURTS, *BANKRUPTCY FILINGS UP 34 PERCENT OVER LAST FISCAL YEAR* (2009), [http://www.uscourts.gov/Press\\_Releases/2009/BankruptcyFilingsSep2009.cfm](http://www.uscourts.gov/Press_Releases/2009/BankruptcyFilingsSep2009.cfm). These observations are in line with the view that bankruptcy numbers tend to rise for six to eighteen months after an economic recovery. See Chelsea Emery, *Business Bankruptcies Rise Again in February*, *REUTERS*, Mar. 2, 2010, [http://www.reuters.com/article/idUSN0214345320100302?loomia\\_ow=t0:s0:a49:g43:r1:c1.000000:b31231024:z0](http://www.reuters.com/article/idUSN0214345320100302?loomia_ow=t0:s0:a49:g43:r1:c1.000000:b31231024:z0).

the primary reasons for such a discernable increase has been the glacial shift in societal attitudes towards bankruptcy, with the filing of a bankruptcy petition becoming, over time, perceived decreasingly as an indicator of moral dereliction and fraudulent or inefficient management<sup>4</sup> and increasingly as a legitimate financial and risk management tool employed by businesses to fulfil their economic, social or organizational objectives.<sup>5</sup> The continuing ascent of Chapter 11's influence in the American corporate milieu has not gone unnoticed internationally, with an increasing number of jurisdictions desirous of developing "rescue regimes based on, or modelled after, the well-known Chapter 11 provisions of United States bankruptcy law."<sup>6</sup>

2. Unsurprisingly, the unprecedented increase in Chapter 11 filings in the United States has engendered its own set of unique challenges. With an increasing number of businesses seeking access to its safe haven to restructure and to shed or streamline unfavourable obligations in ways that may not be possible, or feasible, outside the formal strictures of bankruptcy, the line between putatively novel and illegitimate motivations for a Chapter 11 filing is, with time, gradually emaciating, with the explicit statutory barriers that Congress has erected before a debtor would be granted relief in bankruptcy appearing, at least in some quarters, increasingly ill-suited to safeguard the Court's jurisdictional integrity against objectionable tactical uses of the regime.<sup>7</sup> Concerned with what it perceives to be an increase in filings where the debtor's motivations appear to be fundamentally at odds with Chapter 11's traditional *raison d'être*, the Bankruptcy Courts have, over time, fashioned an additional implicit good faith filing requirement, a normative barrier to Chapter 11 relief that finds no legislative expression. Though the existence of such implicit requirement was initially viewed with scepticism in certain quarters, the notion that there is, in fact, a good faith filing prerequisite to relief in Chapter 11 has since gained considerable currency in the United States. Indeed, its acceptance amongst legal professionals, to the point of becoming a "universally accepted principle"<sup>8</sup> in the American bankruptcy landscape is best illustrated by the fact that Bankruptcy Courts (in the United States) have in

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<sup>4</sup> See, e.g., VICTOR SAAD & ROBERT T. WILLIAMS, CAUSES OF COMMERCIAL BANKRUPTCY (1932)

<sup>5</sup> The increasingly prevalent use of the Chapter 11 mechanism as a result of such shifting social norms is, it would appear, a relatively recent phenomenon. See KEVIN DELANEY, STRATEGIC BANKRUPTCY: HOW CORPORATIONS AND CREDITORS USE CHAPTER 11 TO THEIR ADVANTAGE 4 – 5 (1992). See also Lawrence Ponoroff & Stephen F. Knippenberg, *The Implied Good Faith Requirement: Sentinel of an Evolving Bankruptcy Policy*, 85 NW. U. L. REV. 919, 919 (1990 – 1991). Another reason for the ascent of recourse to Chapter 11 is the reality that Chapter 11 does, in fact, allow the corporation, or debtor, concerned to retain considerably more value than if liquidated – one in-depth economic study, for example, suggests that a proceeding under Chapter 11 would tend to retain an average of 78% more value in a corporation than a direct liquidation under Chapter 7. See Arturo Bris *et al*, *The Costs of Bankruptcy: Chapter 7 Liquidation versus Chapter 11 Reorganization*, 61 J. FIN. 1253 (2006).

<sup>6</sup> See Pauline Gan, *Insolvency Law in Asia: Recent Developments*, 22 ASIA BUSINESS L.R., 12, 19 (1998).

<sup>7</sup> See Ponoroff & Knippenberg, *supra* note 5, at 921.

<sup>8</sup> RICHARD F. BROUDE, REORGANIZATIONS UNDER CHAPTER 11 OF THE BANKRUPTCY CODE ¶ 7 – 18 (1986).

recent times increasingly invoked the doctrine to dismiss Chapter 11 filings without so much as a hint of methodological self-consciousness, a state of affairs that suggests that the Courts are increasingly subscribing to the view that the existence of the good faith filing requirement under the Bankruptcy Code (“the Code”) is settled and cannot be seriously disputed or doubted.<sup>9</sup> Seen in the context of the present status quo then, it would be unsurprising if many of the nations seeking to replicate the seemingly pre-eminent features of Chapter 11 in their own respective jurisdictions invariably foster the perception that the good faith filing requirement serves as an unassailable and indispensable principle, indeed perhaps even the primary legal lodestar, for the effective marshalling of the boundaries of a reorganization framework such as Chapter 11 and, to that end, genuflect to accommodate its existence in their own respective statutory analogues to Chapter 11 that are enacted as part of such reform efforts.

3. With those realities in mind, this paper espouses a dual-fold objective: first, on the American domestic front, it seeks to challenge the orthodoxy and advance the argument that, notwithstanding its widespread and pervasive acceptance, there is, in fact, a poverty of justification to justify the inference of the existence of an implied good faith filing requirement under Chapter 11; second, by understanding the considerable clout and influence that Chapter 11, and, by extension, the good faith filing requirement as it applies in the United States, possesses on the international front, it will analyze the international implications of the continued subsistence of the doctrine in the United States, with particular focus on the lessons that can be discerned from the American experience with the good faith filing requirement for nations seeking to enact statutory analogues of Chapter 11 in their own domestic insolvency frameworks.

4. In order to comprehensively ventilate the issues that form its subject matter, this paper will be divided into seven parts. Setting the backdrop for the discourse that takes place immediately thereafter, Part I of this paper articulates how, and why, the issue that forms the subject matter of the discussion in this paper transcends the apparent limited jurisdictional confines of the United States and possesses considerable, if not profound, effects on the workings of international commerce and international insolvency law. Reorienting its focus to

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<sup>9</sup> See Diane B. McColl, *Good Faith in Chapter 11 Reorganizations*, 35 S. C. L. REV. 333, 335 (1983 – 1984). See also Eugene J. Di Donato, *Good Faith Reorganization Petitions: The Back Door Lets the Stranger In*, 16 CONN. L. REV 1, 26 (1983 – 1984) (“[The real issue is *not* whether there is a specific requirement of good faith]...the real issue under the Code is *what constitutes* a good faith filing.”). It may be useful to note that some would contend that the lack of methodological self-consciousness is because the Courts act viscerally, as opposed to acting in a legally coherent fashion, in response to certain types of behaviour. See Daniel J. Tyukody, Jr., *Good Faith Inquiries Under the Bankruptcy Code: Treating the Symptom, Not the Cause*, 52 U. CHI. L. REV 795, 807 (1985). This contention would be explored in greater depth later on in this paper.

the US domestic front thereafter, Part II of this paper will provide a brief primer on the good faith filing requirement as it exists in the United States, including providing a brief overview of its articulated justifications, the purported legislative premises for its existence, and distil the typical fact patterns where the doctrine appears to be most frequently invoked by the Courts. Taking cognizance of the fact that the primary argument by a majority of the proponents of the good faith filing requirement is that such requirement stems from long-standing practices that precede the promulgation of the Code, Part III of this paper will traverse the historical journey that the good faith doctrine has chartered over the course of its relatively brief existence, and, in so doing, proffer evidence that the long-standing assumption of the prevalence of such a practice prior to the Code's existence is questionable and that, in any event, its continued existence is inconsistent with Congress' intentional omission of the doctrine from the Code upon its promulgation in 1978. In so doing, Part III will also concurrently consider the concerns that were harboured by the Commission that motivated the good faith filing requirement's (apparent) abolition and highlight how intervening events have served to buttress the legitimacy of such concerns. By drawing together disparate strands of jurisprudence emanating from the US Supreme Court in recent times, Part IV would highlight how the continued existence of the implied good faith filing requirement is plainly inconsistent with the conventional doctrinal approach adopted by the US Supreme Court of according primacy to text. Thereafter, by revisiting the articulated justifications and purported legislative bases for the good faith filing requirement referred to in Part II earlier, Part V would, *inter alia*, attempt to show how the good faith filing requirement derogates from its own intended objectives and proffer two additional arguments in support of the abolition of the doctrine, arguments that resonate as much in the United States as they would in other jurisdictions seeking to replicate a Chapter 11-like mechanism in their own domestic frameworks: first, its otiose nature in light of how that the Code's provisions, when read cumulatively, would already serve as an effective bulwark against egregious debtor-abuse and second, how the continued utilization of good faith as a basis for rejecting a Chapter 11 filing has served to impair the Code's development by inadvertently obscuring from the glare of scrutiny, legitimate, indeed pressing, concerns pertaining to certain features of the Chapter 11 bankruptcy framework. Thereafter, Part VI of the paper will discuss the considerable psychological, legal and practical barriers to reform and highlight the demerits of the approaches to reform advanced by legal scholarship thus far. Finally, before concluding, Part VII of the paper attempts to distil the lessons learnt from the American experience with the good faith filing requirement that other nations intending to utilize Chapter 11 as their lodestar in

the development of a sophisticated and modern rescue regime in their respective jurisdictions should keep in mind.

## I. THE GOOD FAITH FILING REQUIREMENT: AN INTERNATIONAL PROBLEM

5. As this paper proposes to use the discussion on the problems pertaining to the operation of the good faith filing requirement in the United States as a microcosm of sorts in order to better appreciate the *international* implications of the existence of such a doctrine, before embarking upon an in-depth discussion of the good faith filing requirement as it applies in the United States, it would be worthwhile to place the ensuing discourse in its proper context by illustrating how the realities of the contemporary international insolvency milieu and the pervasive influence that Chapter 11 possesses in the international realm elevates what may otherwise constitute a purely domestic (*i.e.* American) concern to that of an international matter entailing significant international repercussions. Though by no means an exhaustive conspectus, three points, in particular, warrant emphasizing.

6. First, and perhaps most significantly for the purposes of this paper, whatever the vices or virtues of such a development,<sup>10</sup> fuelled by the overwhelming international sentiment that “reorganization *is* modern bankruptcy law”<sup>11</sup>, Chapter 11 has, in recent times,<sup>12</sup> entrenched itself

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<sup>10</sup> It should be stressed at this juncture that while conventional wisdom suggests that there are significant merits to the adoption of a Chapter 11-type regime as part of a comprehensive bankruptcy framework, such a viewpoint is predicated upon the (not unanimously accepted) view that there is economic merit in preserving the going concern value of an enterprise. For a representative discussion on the merits of the underlying assumptions of the Chapter 11 model, *see* generally Michelle J White, *Does Chapter 11 Save Economically Inefficient Firms*, 72 WASH. UNIV L.Q. 1319 (1994) and Robert K Rasmussen, *The Efficiency of Chapter 11*, 8 BANKRUPTCY DEVELOPMENTS J 319 (1991). For a more empirical investigation and examination of the perceived detriments of Chapter 11, *see* Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate? The Results of a Study and Analysis of the Law*, 97 COM. L.J. 297 (1992) and Stephen J. Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509 (2000). While a comprehensive analysis of such a complex question cannot possibly be fleshed out in extenso in this paper, the author is of the view that the concerns of critics, while understandable, are overstated, and often predicated upon unverifiable suppositions and anecdotal evidence. For an in-depth statistical study as to why the conventional wisdom that Chapter 11 is plagued by inordinate delays and fails more often than it succeeds may not necessarily be warranted, *i.e.* a position in support of the author’s view of the considerable virtues of Chapter 11, *see* Elizabeth Warren & Jay L Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 640 (2009) (“[Our data]...show that prospects [under Chapter 11] are far better than much of the world has been led to believe.”).

<sup>11</sup> Jay L Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2309 (2000).

<sup>12</sup> The move towards US-style reorganization is a relatively recent phenomenon. As one commentator noted, even as recent as in 2001, “Leaving the debtor in possession of the assets, as is typical in a Chapter 11 case in the United States, is uncommon (but not unknown) outside the United States.” *See* the Honourable Samuel L. Bufford *et al*, FEDERAL JUDICIAL CENTER, INTERNATIONAL INSOLVENCY 21 (2001). Indeed, there is much evidence to suggest that even till the 1990s, there was still a considerable tussle between UK-style administration and US-style reorganization as the *de facto* rescue regime of choice around the world. *See* Jay Westbrook, *Chapter 11 Reorganization in the United States*, in RAJAK ED., INSOLVENCY LAW: THEORY & PRACTICE 347, 367 (1993)

as the *de facto* model for others in the international community to replicate,<sup>13</sup> becoming the singular pre-eminent model of bankruptcy law. The pervasive influence of Chapter 11 in the reform of national bankruptcy frameworks worldwide is incontrovertible,<sup>14</sup> with recent reform initiatives inspired, in various ways, by Chapter 11 that were undertaken in numerous leading developed and developing countries, including the United Kingdom,<sup>15</sup> France,<sup>16</sup> Germany,<sup>17</sup> the Netherlands,<sup>18</sup> Australia,<sup>19</sup> Japan,<sup>20</sup> Korea,<sup>21</sup> and China,<sup>22</sup> all serving as emblematic examples of

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(“[While most] developed countries in recent years have recognized the importance of creating rescue regimes...[it] is far from clear whether the pattern for rescue should be administration, aiming generally for a quick going-concern sale, or reorganization, aiming for a negotiated restructuring of a firm’s finances, or some third approach.”)

<sup>13</sup> As two commentators relatively recently observed, “[so] powerful is the idea of reorganization that Chapter 11 has heavily influenced commercial law reform throughout the world.” See Warren & Westbrook, *supra* note 10, at 604.

<sup>14</sup> As will be illustrated below, recent reform initiatives in numerous other developed countries also appear to have been modelled after the Chapter 11 regime in the United States. Quite apart from these countries, numerous other developed countries, including Singapore, are in the midst of, or have been, studying the feasibility of implementing a Chapter-11 like regime in their jurisdictions. See, for example, Wee Meng Seng, 5 SING. J. LEGAL. STUDIES. 228, 229 (2006) (“Serious consideration has also been given to the possibility of adapting the US Chapter 11 as an additional form of insolvency proceedings to further develop the rescue culture in Singapore. If that were to happen, Singapore’s corporate insolvency law would be a hybrid of the English and American models...”). Such a move by developed and developing countries to adopt principles that appear to converge towards a singular bankruptcy model is unsurprising, and is, to a large extent, a function of the reality that globalization results in “enormous pressures for legal convergence, and those pressures are most likely to prevail as to laws that require market-symmetry to be successful.” See Westbrook, *supra* note 11, at 2277.

<sup>15</sup> See, for example, Eilis Ferran, *Company Law Reform in the UK*, 5 SING. J. OF INTL. & COMP. LAW 516, 534 (2001). Indeed, such is the pristine reputation of Chapter 11 amongst English legal practitioners generally that at least one commentator has observed that American jurisprudence (on Chapter 11) is increasingly informing legal arguments for proceedings pertaining to schemes of arrangement, despite the fact that the two regimes are quite distinct creatures. See Nick Segal, *Insolvency: A Closing Chapter*, LEGAL WEEK, September 28, 2006 (“...there has been a major shift in thinking and practice and a desire in some quarters to replicate the style and methods of the Chapter 11 process. We have even seen US Supreme Court opinions being cited in skeleton arguments in recent litigation concerning contested schemes of arrangement”).

<sup>16</sup> See *France to Launch US-Style Bankruptcy Law*, LEGAL WEEK (GLOBAL), December 9, 2003 (“The [French] legislation, which has been modelled on the US Chapter 11 procedure, would allow struggling companies more scope to apply to the courts for creditor protection.”), and Eric Cafritz & James Gillespie, *French Bankruptcy Law Assessed*, INT’L FIN L. REV. (December 2005) (“[T]he centrepiece of the [French bankruptcy legislation] is an entirely new procedure...inspired by the US bankruptcy system’s Chapter 11 process”).

<sup>17</sup> See Eva M. Huntemann, “Germany Insolvency Code shows Chapter 11 Influence” online: <<http://www.turnaround.org/Publications/Articles.aspx?objectID=2846>> and Manfred Balz, *Market Conformity of Insolvency Proceedings: Policy Issues of the German Insolvency Law* 23 BROOK. J. INTL. L. 167, 170 (1997). See also Warren & Westbrook, *supra* note 10, at 626 (“The new German structure was explicitly based on Chapter 11 but with important differences”).

<sup>18</sup> See, for example, Theo Raaijmakers, *Towards a Further Revision of Dutch Insolvency Law*, in REINOUT D. VRIESEENDROP ED., COMPARATIVE AND INTERNATIONAL PERSPECTIVES ON BANKRUPTCY LAW REFORM IN THE NETHERLANDS 3, 3 (2001).

<sup>19</sup> See G Dal Pont & L. Griggs, *The Resuscitation of the Corporate Cadaver: An Autopsy of Business Rescue Laws* 4 AUSTL. J. CORP. L. 309, 310 (1994) (“[The Australian Government has recently] introduced a voluntary administration procedure loosely modelled on the American Chapter 11 reorganisation procedure under the Bankruptcy Reform Act 1978”).

<sup>20</sup> See Jun’ichi Matsushita, *Current Japanese Insolvency Law and the Comprehensive Reform Project*, in TIMOTHY LINDSEY, ED., INDONESIA: BANKRUPTCY, LAW REFORM & THE COMMERCIAL COURT 125, 129 (2000) (In which the author stated that the Japanese Civil Rehabilitation Law was “derived from the...system in Chapter 11”).

<sup>21</sup> See Steven J. Arsenault, *The Westernization of Chinese Bankruptcy: An Examination of China’s New Bankruptcy Law Through the Lens of the UNCITRAL Legislative Guide to Insolvency Law*, 27 PENN. ST. INTL. L. REV. 45, at footnote 5 (2008) (“Chapter 11 of the US Bankruptcy Code served as the basis for amendments to the bankruptcy laws of [other countries] and Korea in recent years.”).

the increasingly pronounced international affinity with the reorganizational framework that found its genesis in the United States.<sup>23</sup> The recent economic crisis has done little to dampen international enthusiasm for Chapter 11: indeed, if nothing else, given that the pressure to “reform” bankruptcy frameworks and adopt Chapter 11-like regimes is particularly pronounced during turbulent times,<sup>24</sup> especially when seen in the context of the continued enthusiasm of the international aid agencies for the incorporation of some form of variation of the US reorganization framework as a precondition to aid,<sup>25</sup> appetites for the development of a Chapter 11-like regime are likely to be further whetted moving forward.<sup>26</sup> These realities, coupled with the clamor in certain influential quarters for the Chapter 11 framework to serve as the architectural framework for the *international sovereign debt* bankruptcy regime<sup>27</sup> necessitates the

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<sup>22</sup> See James Sprayregen *et al*, *The Middle Kingdom's Chapter 11: China's New Bankruptcy Law Comes into Sight*, 23 AM. BANKR. INST. J. 34, 60 (2005) (“[I]n contrast to the current law, under which liquidation is the primary bankruptcy mechanism, the [new legislation] shifts the focus to corporate reorganization and introduces relevant concepts primarily borrowed from the U.S. chapter 11”). See also Arsenault, *supra* note 21, at 45 – 46. It should be noted that China is a particularly conspicuous example, in light of its increasing economic clout in the global financial world, and the rise of numerous China-based corporations internationally.

<sup>23</sup> See Gan, *supra* note 6, at 19. Quite apart from having influenced or inspired reform in the previously stated jurisdictions, some commentators suggest that Chapter 11's sphere of influence is likely to permeate into parts of Europe and the Middle-East next. See also Julius Melnitzer, *French Officials Give Green Light to Bankruptcy Reform*, CORPORATE LEGAL TIMES, March 2004 (“Ultimately, the renewal of French bankruptcy laws and the recent revision of Italian insolvency laws in the wake of the Parmalat scandal may also have a domino effect in the European Union. Commentators say that the changes in two of the EU's major members will make it difficult for Europe-wide rules to avoid incorporating some of the main principles of Chapter 11”) and Schumpeter, *Making a Success of Failure*, THE ECONOMIST (U.S. EDITION), January 9, 2010 (“[The] idea has also spread to eastern Europe and Asia and may even be reaching the bankruptcy-averse Muslim world (last year ten Middle Eastern and north African countries signed a joint declaration on planned reforms).”).

<sup>24</sup> See Gan, *supra* note 6, at 19.

<sup>25</sup> Though this is a point often ignored by academic scholarship, it should not be forgotten a contributing factor towards the adoption of a reorganization model such as Chapter 11 is the not-inconsiderable pressure imposed by international agencies such as the International Monetary Fund of the erection of such frameworks as a precondition to aid for cash-strapped countries. See Sandor E. Schick, *Globalization, Bankruptcy and the Myth of the Broken Bench* 80 AM. BANKR. L. J. 219, 220, at footnote 7 (2006) (“Although adoption of the American model has usually been a result of voluntary processes, in at least several cases external pressure - from the International Monetary Fund - has been the primary impetus”) and Hannah L. Buxbaum, *Conflict of Economic Laws: From Sovereignty to Substance*, 42 VA. J. INTL. L. 931, 946 (2002) (in which the author notes that international agencies have “played an important role in the convergence of bankruptcy law by requiring bankruptcy reform in developing countries as a condition of loan support”).

<sup>26</sup> Indeed, notwithstanding the conventional wisdom that the recent economic crisis had its genesis in the United States, Chapter 11, a US-based regime of course, continues to gain considerable traction internationally, a point underscored by the swift move by numerous countries to reform their bankruptcy regimes post-2008/2009 economic crisis to incorporate Chapter 11 like structures. As one commentator notes, “the [recent] credit crunch has *speeded up the pace of reform*,” including bankruptcy reforms in Eastern Europe, Asia and the Muslim world. See Schumpeter, *supra* note 23.

<sup>27</sup> Some commentators, including the International Monetary Fund, have canvassed the argument that Chapter 11 could be suitably customised to govern insolvency proceedings pertaining to the restructuring of cash-strapped sovereign nations. See, for example, Anne Krueger, “International Financial Architecture for 2002: A New Approach to Sovereign Debt Restructuring” online: <<http://www.imf.org/external/np/speeches/2001/112601.htm>>. While there is an urgent need to come up with a viable *supranational* bankruptcy framework in light of the increasing prevalence of such default by sovereign states and countries (recent events surrounding defaults involving Dubai and Greece, for example, serve to prove the point), a fuller discussion of the merits (and demerits) of such a proposal is beyond the scope of this paper. Suffice it to say, however, that the view that Chapter 11 can serve to be

conclusion that Chapter 11's already considerable influence in the international bankruptcy reform milieu is not only unlikely to be diminished, but is expected to be further accentuated in the foreseeable future.<sup>28</sup> The increasingly central role of Chapter 11 in informing the precise contours of reform initiatives worldwide possesses certain implications that are particularly salient for the purposes of this paper: for one, as many countries are still considerably more parsimonious in their criticism of the more problem-fraught aspects of Chapter 11 model than they perhaps should be,<sup>29</sup> it raises the question of whether such jurisdictions may, whether because not fully *au fait* with the intricacies of the manner in which the good faith filing requirement had been introduced in the United States, or perhaps more likely, because of the uncritical belief that the United States experience has proven that the good faith filing requirement serves as a necessary prerequisite for a thriving Chapter 11-like framework, import the doctrine over to their own jurisdictions. In this regard, it should be stressed that the contention that countries may *inadvertently* import the good faith filing requirement into their own respective jurisdictions is hardly improbable: while many of these jurisdictions would undoubtedly be sensitive to the propriety of tailoring the *substantive* aspects of the Chapter 11 regime to fit their invariably vastly-distinct socio-economic milieu,<sup>30</sup> it is foreseeable that reform in many of these jurisdictions would entail the transplanting of much of the architectural (*procedural*) framework that is presently employed *vis-à-vis* Chapter 11,<sup>31</sup> an act that, as will be

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the void that exists in the absence of an agreed supranational framework is a highly controversial idea and is not an idea that has been met with universal approval. For a *representative* list of arguments that can be advanced against such a proposal, see Daniel Altman, *A Country in Chapter 11? Yes, But...*, N.Y. TIMES, January 6, 2002. Some commentators have also pointed out that the desire to rely on Chapter 11 as a guide to resolve insolvency claims involving sovereign states is misguided, for Chapter 9 of the US Bankruptcy Code, which deals with the reorganization of insolvent municipalities, appears more tailored to the unique demands and needs that invariably stem from the bankruptcy of sovereign nations. See Ross P. Buckley, *The Bankruptcy of Nations: An Idea Whose Time Has Come*, 43 INTL. LAW. 1189 (2009) and IMF wants "Chapter 11", THE PRESS (CHRISTCHURCH), September 19, 1998.

<sup>28</sup> See Schumpeter, *supra* note 23.

<sup>29</sup> Even taking into account the clear virtues of the reorganization model, the dearth of international scepticism and circumspection of some of the vices of Chapter 11 is remarkable in light of the considerable criticism of Chapter 11 by a not-insignificant number of detractors in the United States. As one academic described the rather stark contrast, "Chapter 11, like the prophet, is dishonored by its local academics, but the rest of the world is interested and impressed." See Westbrook, *supra* note 11, at footnote 146.

<sup>30</sup> Another motivation for not adopting the Chapter 11 regime *in toto* is the desire on the part of the countries adopting such framework to reap the benefits of its virtues, while attempting to limit the detriment of its vices. See, for example, the observations in Warren & Westbrook, *supra* note 10, at 605 ("[Some of the other] countries that had been attracted by the promise of Chapter 11 significantly modified their new systems by inserting features to correct for the high failure rates and delays claimed to exist in the US system").

<sup>31</sup> Such "transplantation" is, needless to say, not without its own problems. The transplantation of one country's legislative framework into another jurisdiction, even without the importation of the substantive provisions themselves, may often cause significant problems since such transplantation has the tendency of producing unexpected results in a setting distinct from the jurisdiction such laws had initially been crafted for. For a conspectus of the problems that transplantation of one's country's laws into another without due consideration to the rather distinct set of circumstances that exists in the secondary jurisdiction may inadvertently cause, see Gunther Teubner,



evident from the ensuing discussion of the animating sources of the good faith filing requirement within Chapter 11, possesses the potential of percolating the good faith filing requirement conundrum into their respective jurisdictions.<sup>32</sup>

7. Indeed, even if countries adopting features of US bankruptcy laws were, in fact, sensitive to the possible non-consonance of the good faith filing requirement with the reorganizational thrust of Chapter 11, in light of the undeniable truism that “[all] around the world, other nations are beginning to adopt some of the features of U.S. bankruptcy law”,<sup>33</sup> a comprehensive ventilation of the arguments that can be canvassed for and against recognition of the existence of a good faith filing requirement (as will be attempted hereinafter) would serve to further inform the international reform movement towards reorganization of the merits of the US framework as a model to replicate in their own domestic legislative structures and of the virtues of *explicitly* legislating for, or against, a good faith filing requirement in their own respective jurisdictions depending on its philosophical coherence with the reorganization-based framework. Inextricably linked to this is the fact that, for reasons that would be plainly apparent at a later juncture in this paper,<sup>34</sup> by lifting the veneer that protects other provisions within the Code from the glare of critical scrutiny hitherto, the clarification of the lack of a good faith filing requirement in Chapter 11 affords the opportunity for reformist jurisdictions to carefully analyze the viability of the various provisions in Chapter 11 and decide, what features, if any, of the US framework are worthy of replication in their own respective jurisdictions.<sup>35</sup> The Code, after all, is a complex, multi-faceted and highly-integrated gestalt, and the prominence of the good faith filing requirement in the day-to-day operation of the Code invariably renders it a significant player in the dynamics of the workings of the entire Code as well as the efficacy of individual provisions

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*Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergences* 61 M.L.R. 11 (1998).

<sup>32</sup> It should be noted that this is not to say that these jurisdictions are likely to transplant *in toto* the US Chapter 11 regime – the US bankruptcy regime, after all, is clearly a compromise that is, in many respects, unique to the US milieu, and it is unlikely that substantive provisions that are unique to the American situation (for example, the provisions under Chapter 11, *e.g.* §1125(e), that pertain to disclosure requirements to the Securities & Exchange Commission), are likely to be replicated, at least not without substantial modification, elsewhere. Nonetheless, it is not illogical to imagine that other regimes incorporating Chapter 11-like regimes are likely to adopt the key *procedural* provisions that presently operate *vis-à-vis* Chapter 11 proceedings, provisions which, as will be evident later, are treated by both judicial and academic commentators to be the emanating powers for the good faith filing requirement. Seen from that perspective, it is clear that these countries are plainly unlikely to be immune or insulated from having to grapple with the debate undertaken in this paper.

<sup>33</sup> DAVID A. SKEEL, JR., *DEBT’S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 126 (2001).

<sup>34</sup> See Paras 47 and 48 below.

<sup>35</sup> See Mark Andrews, *Chapter and Terse*, *LEGAL WEEK*, November 26, 2009 (Concluding that it would be desirable to use Chapter 11 as the framework for reform in the United Kingdom, but that it would be similarly important to minimize the pitfalls experienced in the United States, the author noted that “[the] undesirability of adopting Chapter 11 lock, stock and barrel should not, however, prevent improvement of our own procedures by replicating its best features”).

within the Code to fulfil their individual *raison d'être*. Put another way, the clarification of the precise contours of the role of the good faith filing requirement under Chapter 11 serves to illuminate the debate about the pros and cons of the replication of the multitude of provisions found within the Chapter in the international and supranational realms, and informs the reform process in jurisdictions using Chapter 11 as a guide to the development of a responsive and sensitive reorganizational framework. Seen from this perspective, it should be plainly evident that the increasing “Americanisation” of bankruptcy law internationally<sup>36</sup> underscores the point that clarification of the precise premises of the good faith filing requirement in Chapter 11, and its consonance with a reorganizational framework, possesses considerable repercussions internationally.

8. Though this paper seeks to primarily focus on the rectitude of the good faith filing requirement in the United States in order to distil and draw lessons from the US experience that can serve to inform reform efforts elsewhere, it is germane to note, in the interest of completeness, that there are at least two other reasons that an in-depth discussion of the good faith filing requirement under Chapter 11 may possess profound implications internationally. The first lies in the increasing international recourse to Chapter 11 by foreign (*i.e.* non-US based) corporations. As recent Chapter 11 applications involving large foreign entities such as Yukos Oil Company and Aerovias Nacionales de Colombia S.A. Avianca have served to illustrate, conglomerates that have their primary operations outside the United States and that often possess little more than a remote connection with the United States have taken cognizance of the broad jurisdiction conferred by the Code to the Bankruptcy Courts of the United States to administer international proceedings largely extrinsic to interests within the United States,<sup>37</sup> and, to that end, have become increasingly willing and desirous of applying for Chapter 11 bankruptcy relief.<sup>38</sup> In part a function of intense competition between various Bankruptcy Courts within the United

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<sup>36</sup> See Gan, *supra* note 6, at 19. Indeed, notwithstanding its faults, having regard to the widely-held perception, particularly outside the United States, of its ability to harness and develop the remaining value of an ailing company, some commentators feel that any harmonization of reorganization mechanisms worldwide must necessarily bear considerable congruency with the Chapter 11 model in the United States. See, in this regard, Ann Cairns, *A Bankrupt Insolvency System*, WALL ST. J (EUROPE), May 14, 2009.

<sup>37</sup> The jurisdictional requirements can be found in 11 U.S.C. §109(a). See also Mark Hoogland, *Comment: Recent Trends in International Chapter 11 Cases: Pragmatic Reorganizations*, 41 TEX. INT'L L. J. 145, 149 (2006) (“With such minimal filing requirements [in the US Bankruptcy Code], nothing stops foreign corporations from quickly establishing a local bank account, making a minimal deposit, hiring local counsel with the necessary retainers, and filing a petition”).

<sup>38</sup> For a deeper discussion on the fate of the bankruptcy applications filed by Yukos Oil Company and Aerovias Nacionales de Colombia S.A. Avianca in the US Bankruptcy Courts, and the vices and virtues of the American bankruptcy regime *vis-à-vis* such applications, see generally Francisco Vazquez, *Cross-Border Bankruptcy Developments: The Movement Towards Universality in the United States*, ANN. SURV. OF BANKR. LAW. Part II § 4 (2005) and Hoogland, *ibid.*

States for the privilege of presiding over cutting-edge, highly lucrative and “prestigious” bankruptcies,<sup>39</sup> Bankruptcy Courts have, from time to time, reciprocated such advances by agreeing to exercise its jurisdiction to administer international bankruptcies, with one commentator at least observing that some bankruptcy courts have been more than willing to construe their jurisdiction to hear such cases “extremely broadly, with pragmatism [serving] as the only restraint”.<sup>40</sup> The willingness on the part of the Bankruptcy Courts in the United States to exercise jurisdiction to administer cases for which the United States may not necessarily be the *forum non conveniens*, and for which bankruptcy proceedings would engage far-reaching external, rather than domestic, interests, further accentuates the point that the matter of whether there exists a good faith filing requirement under Chapter 11 should be a cause for international concern and consideration, for the necessary corollary of the willingness on the part of the Bankruptcy Courts to administer such bankruptcies for which the nexus to the United States is tenuous at best, is that it squarely places such Courts, and by extension the Code, in a position that allows it to vary considerable property and economic rights outside of the United States.<sup>41</sup> The secondary manner in which the good faith filing requirement can directly influence international developments pertains to the continued gravitas of the United States in the economic realm: if the recent economic crisis has served to prove nothing else, it has reaffirmed the time-worn truism that when the United States sneezes, the rest of the world catches a cold. The failure of Lehman Bros in 2008 serves as plain evidence of the fact that the line between domestic and international matters is porous, if not non-existent, at least *vis-à-vis* the matter of feeling the effects and ramifications of a Chapter 11 application: the bankruptcy of the global financial conglomerate with its headquarters and main site of operations in the United States precipitated the attendant bankruptcy of more than 80 related entities in more than a dozen

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<sup>39</sup> The charge that the Courts compete for cutting-edge bankruptcy work both domestically and internationally is neither novel, nor new. Prof. LoPucki, for example, has previously warned of intense competition amongst US Bankruptcy Courts, competition which, if left unchecked, can lead to Courts finding themselves increasingly taking the view that they have jurisdiction in situations where a more objective assessment of the propriety of the filing in that particular jurisdiction would have yielded the opposite result. *See generally* LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* (2005). Applying the argument to Chapter 11 applications such as those by foreign corporations with little more than technical presence in the United States, the observation had been made that there is a possibility that the Courts would accept jurisdiction purely as a means of obtaining high-profile cases which it otherwise should not hear. *See* Hoogland, *supra* note 37, at 167 (“If LoPucki’s charges have merit on the international level, corporations with tenuous ties to the United States may be granted U.S. reorganizations in the near future.”) *See also* David E. Rovella, *Bankruptcy Beauty Contest*, *DAILY DEAL*, September 5, 2001.

<sup>40</sup> Hoogland, *supra* note 37, at 159.

<sup>41</sup> Though it would be impossible to ventilate the issue in full given that it falls outside the four walls of the discussion that forms the main thrust of this paper, this implicates the bigger question of whether “territorialism” or “universalism” should serve as the operative principle *vis-à-vis* bankruptcy laws internationally. For an in-depth discussion on the distinctions between the two, *see* Jay L Westbrook, *Universalism and Choice of Law*, 23 *PENN. ST. INTL. L. REV.* 625, 625-6 (2005).

countries worldwide,<sup>42</sup> and bore indirect negative economic repercussions that affected many other corporations in various parts of the world. Given the United States' position as the largest economy in the world, and the reality that Chapter 11 is primarily utilized to assist in the reorganizations of larger, multi-national corporations, corporations that invariably possess considerable international geographical presence and influence,<sup>43</sup> the jurisprudential approach adopted by the US Bankruptcy Courts as to whether there is a discretion to reject bankruptcy petitions on grounds that they had been filed in bad faith will, in many, if not all such filings, entail significant international repercussions.<sup>44</sup>

9. At bottom therefore, once one has regard to the above-stated realities, a comprehensive ventilation of the merits and demerits of the good faith filing requirement in the United States, and its consonance with the wider Chapter 11 framework, questions that may superficially, at first glance, appear to be a uniquely American matter – *i.e.* one bereft of international dimensions or repercussions – reveals itself, on closer inspection, to be an *international* conundrum, one that bears considerable significance and importance to the international economic and financial communities and that is essential to the continued stability of global economic markets. It is with an understanding of the potential global reach and influence of US bankruptcy laws that the matter of whether a good faith filing requirement exists under Chapter 11 takes on a marked importance in the international realm and warrants examination. It is with those considerations in mind that this paper will, at this juncture, re-orientate its focus and consider the matter of the good faith filing requirement under Chapter 11.

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<sup>42</sup> See Mike Spector & Jeffrey McCracken, *Lehman Units Argue Bankruptcy*, WALL ST. J, May 26, 2009.

<sup>43</sup> See Elizabeth Warren, *Remembering Chapter 7*, 69 AM. BANKR. INST. J (2004), as reproduced in Ali M.M. Mojdehi & Janet D. Gertz, *The Implicit "Good Faith" Requirement in Chapter 11 Liquidations: A Rule in Search of a Rationale*, 14 ABI L. REV. 143, 152 (2006) ("...it may now be rare for a business of any size to liquidate in Chapter 7...there are two corporate chapters [now]: chapter 7 for liquidating small businesses no one wants to fool around with any more, and chapter 11 for the rest"). Such a development should surprise no one who is au fait with Congress' motivations for promulgating Chapter 11: although the Chapter had been intended to replace predecessor provisions that catered for a separate regime for public (*i.e.* typically larger) and private (*i.e.* typically smaller) companies, the design of Chapter 11 were primarily focused on creating a viable and efficient platform for dealing with big-scale bankruptcies. See Dal Pont & Griggs, *supra* note 19, at 58 ("The architects of Chapter 11 were primarily experienced with large case insolvency, and consequently designed a procedure more attuned with the rehabilitation of large rather than small companies"). For a compelling statistical analysis that buttresses the reality of the patent unsuitability of Chapter 11 for small businesses, see Stephen J. Lubben, *Chapter 11 "Failure"* (Seton Hall Pub. Law Research, Paper No. 1375163, 2009), available at <http://ssrn.com/abstract=1375163>. See also James B Haines & Philip J Hendel, *No Easy Answers: Small Business Bankruptcies after BAPCPA*, 47 BOSTON. COLL. L.R. 71, 73 (2005). Profs Warren & Westbrook make an equally compelling argument for the non-viability of small-entity Chapter 11 bankruptcy. See Warren & Westbrook, *supra* note 10, at 636.

<sup>44</sup> To take an obvious example, the bankruptcy of the world's largest automobile maker, General Motors, would have direct repercussions in the over 140 jurisdictions in which subsidiaries and associated companies are located. See Spector & McCracken, *supra* note 42.

## II. AN INTRODUCTION TO THE GOOD FAITH FILING REQUIREMENT

10. As with any body of law, the key to understanding the good faith filing requirement and its place in the wider realm of bankruptcy law is through an appreciation of its *raison d'être*: put simply, if, as intimated earlier, Congress had enumerated numerous statutory grounds<sup>45</sup> that polices the jurisdictional boundaries of Chapter 11 by sieving out cases deserving of such relief from those that do not, why have all nine (out of eleven) Circuits Courts that have had the opportunity to consider the matter hitherto<sup>46</sup> deemed it necessary to infer the existence of good faith as a prerequisite to filing? Proponents contend that as Chapter 11 was intended to be utilized by debtors who possess “a valid reorganization purpose,”<sup>47</sup> or “at least [have] an honesty of purpose – that is, an actual intent to use the statutory process to effect a plan of reorganization,”<sup>48</sup> the good faith filing requirement ensures that the Courts are equipped with the necessary tools to obstruct any filing that does not, strictly speaking, engage the restrictions stipulated under Section 1112(b), but that nonetheless warrants dismissal or conversion in light of its attempt to derogate from those objectives and, in the process, commit fraud on the court.<sup>49</sup> Such an argument is, when invoked, invariably followed by the oft-cited but little-analyzed contention that bankruptcy courts are Courts of Equity,<sup>50</sup> and that accordingly, debtors who seek their assistance must come before them with clean hands and should not be allowed to take improper advantage of the bankruptcy regime or utilize the protection accorded under the regime

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<sup>45</sup> See 11 U.S.C. §1112(b).

<sup>46</sup> Out of the 11 Circuits in the United States, only the 3<sup>rd</sup> and 10<sup>th</sup> Circuits, both of which appear not to have had the opportunity to consider the matter at Circuit level, have yet to explicitly adopt the good faith doctrine in any reported decision. All of the other circuit courts that have had the opportunity to consider the matter have come out in favour of the doctrine. The following constitutes a representative list of cases decided by these circuits: *Connell v. Coastal Cable, T.V., Inc.* (*In re Coastal Cable T.V., Inc.*), 709 F.2d 762 (1st Cir. 1983); *Sonnax Industries, Inc. v. Tri Component Prods. Corp.* (*In re Sonnax Indus., Inc.*), 907 F.2d 1280 (2d Cir. 1990); *Carolin Corp. v. Miller*, 886 F.2d 693 (4th Cir. 1989); *Little Creek Development. Co. v. Commonwealth Mortgage Corp.* (*In re Little Creek Dev. Co.*), 779 F.2d 1068 (5th Cir. 1986); *Trident Assocs. Ltd. Partnership v. Metropolitan Life Ins. Co.* (*In re Trident Assocs. Ltd. Partnership*), 52 F. 3d 127 (6th Cir. 1995); *In re Madison Hotel Assocs.*, 749 F.2d 410 (7th Cir. 1984); *Prod. Credit Ass'n v. Wieseler* (*In re Wiesler*), 934 F.2d 965 (8th Cir. 1991); *Idaho Dept. of Lands v. Arnold* (*In re Arnold*), 806 F.2d 937 (9th Cir. 1986); and *Phoenix Piccadilly, Ltd. Partnership v. Life Insurance. Co of Va.* (*In re Phoenix Piccadilly, Ltd.*), 849 F.2d 1393 (11th Cir. 1988).

<sup>47</sup> *In re SGL Carbon Corp.*, 200 F.3d 154, 166 (3rd Cir. 1999)

<sup>48</sup> Miles H. Cohn, *Good Faith and the Single-Asset Debtor*, 62 AM. BANKR. L.J. 131, 134 (1988), quoting 6 *Collier on Bankruptcy*, ¶ 6.07[1] at 1045 – 46 (Chapter X) (14<sup>th</sup> Ed).

<sup>49</sup> See, e.g., *Furness v. Lilienfield* 35 B.R. 1006, 1011 (D. Md. 1983).

<sup>50</sup> This matter will be discussed in greater depth later on. Suffice it to say at this juncture that the impression that the bankruptcy court is a court of equity that is unconstrained by law is, at best, of little significance; at worst, a complete fallacy.

as an instrument of oppressive or inequitable conduct or to wrongly deprive or delay the creditors' enforcement of their (otherwise squarely-applicable) state law remedies.<sup>51</sup>

11. As to the question of statutory authority, although some commentators have suggested that there are at least five plausible discrete provisions within the Code (and its regulations) above and beyond the Court's own inherent powers to govern proceedings before it that could be relied upon as the animating source for the doctrine,<sup>52</sup> the most commonly cited statutory provisions that are, in fact, relied upon as providing the Courts the authority to implicitly invite inquiry into the debtor's good faith are those found in Sections 1112(b)<sup>53</sup> and 362(d)(1)<sup>54</sup> respectively, on the premise that bad faith in filing a petition constitutes "sufficient cause", as "cause" is typically understood under the auspices of either provision, for the Courts to dismiss a petition, or to lift the automatic stay.<sup>55</sup>

12. The preceding discussion, of course, begs the question: what amounts to "sufficient cause" under either provision? Put another way, what do, or should, the Courts take into account in deciding which side of the "borderline between fulfilment and perversion"<sup>56</sup> each individual petition falls on? Given the inherently amorphous nature of an abstract appellation such as "good faith",<sup>57</sup> it is perhaps unsurprising that the law has, at least in this respect, remained considerably fluid and that the Courts have so far been slow to articulate any comprehensive rule or definition, preferring instead to adjudicate on the *bona fides* of petitions on an incremental case-by-case basis. Indeed, as will be apparent from the discussion below, the Courts have, over time, devised

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<sup>51</sup> This is, in large part, linked to the fact that recourse to bankruptcy in the United States is generally granted as of right and is not predicated upon any requirement of *factual* insolvency. See ELIZABETH WARREN & JAY L. WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 422 (6<sup>th</sup> Edition, 2009).

<sup>52</sup> For other possible animating sources within the boundaries of the Code and its regulations, as well as the virtues and vices of using each of them as the animating source, see Di Donato, *supra* note 9, at 4 – 8. Curiously, bankruptcy judges have, from time to time, suggested that all or any of these animating sources, on their own, are sufficient to justify the existence of the good faith filing requirement. See, e.g., the views of various bankruptcy judges as encompassed in Karen Gross *et al.*, *Good Faith: A Roundtable Discussion*, 1 AM. BANKR. INST. L. REV 11, 20 – 21 (1993).

<sup>53</sup> See, e.g., *In re Northwest Recreational Activities Inc.*, 4 Bankr. 36 (N.D. Ga. 1980) and *In re Spenard Ventures, Inc.*, 18 Bankr. 164 (D. Alaska 1982).

<sup>54</sup> See, e.g., *In re Beach Club*, 22 Bankr. 597 (N.D. Cal. 1982) and *Polkin, Inc. v. Lotus Inv., Inc.*, 16 Bankr. 592 (S.D. Fla. 1981).

<sup>55</sup> The ramifications of the capricious reliance on both §1112(b) and §362 on a case-by-case basis notwithstanding their distinct conceptual underpinnings will be explored further later in the paper. *Infra* note 155.

<sup>56</sup> *Infra* note 69.

<sup>57</sup> It should be highlighted that this is not a problem unique to the bankruptcy context. See, e.g., Judith Greenstone Miller, *Amendment to Provide Good Faith Filing Requirement for Chapter 11 Debtors*, 102 COMMERCIAL L. J. 181, 187 – 188 (1997) and Janet A. Flaccus, *Have Eight Circuits Shorted? Good Faith and Chapter 11 Bankruptcy Petitions*, 67 AM. BANKR. L.J. 401, 435 – 441 (1993).

an ever-expanding though non-exhaustive<sup>58</sup> list of factors or indicia that purport to be indicative of bad faith,<sup>59</sup> with the weight placed on each individual factor in large part dependent on the facts of each case. Illustrative factors encompassed within such a list include instances where the debtor runs no ongoing business, is in possession or owns a single asset and/or has engaged in improper pre-petition conduct. Though the good faith filing requirement has been invoked in a wide myriad of circumstances,<sup>60</sup> its impact is perhaps most perceptible in two particular situations that have cumulatively accounted for four out of every five reported cases that invoke consideration of the *bona fides* of the bankruptcy petition:<sup>61</sup> filings where the debtor is a single asset estate, invariably real estate, and “strategic” bankruptcy filings, or filings that had been made with the intention of “inappropriately” taking advantage of one or more particular provisions of the Code.<sup>62</sup>

### III. UNDERSTANDING THE PAST TO APPRECIATE THE PRESENT: A HISTORICAL ANALYSIS OF THE CODE & THE ROLE OF THE GOOD FAITH DOCTRINE

13. In order to obtain an in-depth understanding of the contours of the implied good faith filing requirement under the Code, it is important to first have an appreciation of its genesis in the context of bankruptcy law and its influence in the various incarnations of bankruptcy laws in the United States. The good faith filing requirement first entered into bankruptcy lexicon with the enactment of the Bankruptcy Act in 1898,<sup>63</sup> with Congress imposing it as a requirement for confirmation of composition agreements between the bankrupt and his creditors in consideration for freeing the former of all of the latter’s claims. In 1933, Congress extended<sup>64</sup> the application of the doctrine to petitions filed under Chapter X, the chapter that was, at the time, dedicated to the reorganizations of publicly-listed companies. Significantly, in light of the fact that most companies, public or otherwise, were considerably more desirous of filing their reorganizations

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<sup>58</sup> See, e.g., *In re SGL Carbon Corp*, 200 F3d 154, 166 n. 10 (3rd Cir 1999) (“...no list [can ever be] exhaustive of all the factors which could be relevant when analyzing a particular debtor’s good faith”).

<sup>59</sup> See Cohn, *supra* note 48, at 134.

<sup>60</sup> A fair share of cases (some 11% of all cases) have also revolved around questions in relation to the legitimacy of serial filings. See Flaccus, *supra* note 57, at 408 and 428 – 429. Other, considerably less frequent, categories of cases include cases involving dishonesty *simpliciter* on the part of the debtor, which, in the appropriate circumstances, may lead to automatic dismissal. See, e.g., *In re Hartford Run Apts.*, 102 B.R. 130 (Bank S.D. Ohio 1989).

<sup>61</sup> See Flaccus, *supra* note 57, at 408.

<sup>62</sup> In most circumstances, the provision being utilized is either §362, the automatic stay provision, or §365, the power to reject executory contracts. See McColl, *supra* note 9, at 341.

<sup>63</sup> See §12 Bankruptcy Act of 1898, 55 Cong. Ch. 541, 30 Stat. 544 (repealed).

<sup>64</sup> There is evidence to suggest that Congress was, in so doing, merely codifying what was existing *equity receivership* practice. See, e.g., *First National Bank of Cincinnati v. Flershem* 290 U.S. 504 (1934). As such considerations are beyond the ambit of this paper, for a more in-depth discussion of the reasons for the 1933 amendments, see Eric Brunstad, *The Good Faith Doctrine: When Can a Solvent Entity File and Other Mysteries* in 79 NATIONAL CONFERENCE OF BANKRUPTCY JUDGES at Para 4-8 (2005).

under Chapter XI as opposed to Chapter X given the latter's acutely more cumbersome and intrusive procedures,<sup>65</sup> the good faith filing requirement was *not* explicitly extended to Chapter XI. When Congress erected the Code in 1978, it amalgamated Chapters X, XI and XII into one omnibus chapter, *i.e.* Chapter 11, under which the good faith filing requirement was conspicuous only by its absence.

14. What then is one to make of the lack of an *explicit* good faith filing requirement in the Code? The prevailing view, one that has gained considerable currency in both the judicial and academic circles,<sup>66</sup> is as articulated in the Bankruptcy Court decision (decision of Judge Ordin) of *In re Victory Construction Co Inc.*<sup>67</sup> Given the centrality of Judge Ordin's reasoning to the arguments employed by proponents of the good faith filing doctrine (and, by extension, to the arguments that this paper seeks to debunk), namely that legislative history supports its continued existence post the 1978 promulgation of the Code,<sup>68</sup> notwithstanding its considerable length, the salient part of Judge Ordin's decision pertaining to the existence of the good faith filing requirement *vis-à-vis* Chapter 11 merits setting out in full. It reads as follows:<sup>69</sup>

The provisions of the Code dealing with rehabilitation and reorganization must be viewed as direct lineal descendants of a legal philosophy solidly embedded in American bankruptcy law. Review and analysis of [predecessor provisions] and cases decided under these sections, disclose a common theme and objective: avoidance of the consequences of economic dismemberment and liquidation, and the preservation of ongoing values in a manner which does equity and is fair to rights and interests of the parties affected. But the perimeters of this potential mark the borderline between fulfillment and perversion; between accomplishing the objectives of rehabilitation and reorganization, and the use of these statutory provisions to destroy and undermine the legitimate rights and interests of those intended to benefit by this statutory policy. That borderline is patrolled by courts of equity, armed with the doctrine of "good faith": the requirement that those who invoke the reorganization or rehabilitation provisions of the bankruptcy law must do so in a manner consistent with the aims and objectives of bankruptcy philosophy and policy must, in short, do so in "good faith".

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<sup>65</sup> See WARREN & WESTBROOK, *supra* note 51, at 390 – 91 and DELANEY, *supra* note 5, at 24 ("...Chapter XI gradually became the most popular business chapter because of several advantages that debtor companies found when comparing it with the other chapters").

<sup>66</sup> See, *e.g.*, Miller, *supra* note 57, at 186 ("The Code's failure to address the issue [in the 1978 Amendments] may be viewed as an implicit adoption of the case law developed in this area at the time of enactment").

<sup>67</sup> 9 B.R. 549 (Bankr. CD. Cal. 1981).

<sup>68</sup> Almost every single commentary and case that argues for the continued existence of the good faith filing requirement canvasses this point in support of such a proposition. For a representative list of cases adopting such an analysis, *infra* note 71. For commentaries advancing such an argument, see Miller, *supra* note 57, at 186 and McColl, *supra* note 9, at 338. Note however, that there does exist a line of cases that has rejected the *In re Victory* approach and that continues to apply a distinct standard: *supra* McColl, at 341.

<sup>69</sup> 9 B.R. at 558.



Conduct interdicted in the cases can be summarized as conduct which is inconsistent with the underlying purposes and contemplation of the reorganization and rehabilitation process and constitutes a perversion of legislative intent. The cases analyzing these concepts and principals are as consistent with the purposes and objectives of Chapter 11 of the Code as with the prior legislative enactments from which the Code was derived. *It would be more than anomalous to conclude that in consolidating the provisions of Chapters X, XI, and XII in Chapter 11 of the Code, Congress intended to do away with a safeguard against abuse and misuse of process which had been established and accepted as part of bankruptcy philosophy (either by statute or decisional law) for almost a century. "Good faith" must therefore be viewed as an implicit prerequisite to the filing or continuation of a proceeding under Chapter 11 of the Code.*

[Italics added]

15. Hailed by the Fifth Circuit as a conclusion that was arrived at as a result of undertaking an “excellent historical survey”,<sup>70</sup> Judge Ordin’s observations, and conclusions, have hitherto been employed as the core reasoning in a myriad of cases in numerous circuits for the embracement of an implied good faith filing requirement under the Code.<sup>71</sup> Yet, despite the near unanimous concurrence of both academic commentators and judicial arbiters alike,<sup>72</sup> a critical scrutiny of Judge Ordin’s reasoning suggests that he may have overstated the case for the propriety of inferring the existence of good faith filing doctrine by virtue of the Code’s legislative history and reference to its predecessor statutory analogues. Stripped to its essence, the result that Judge Ordin arrived at, namely that Congress could not have intended to disabuse Chapter 11 of the good faith filing requirement in 1978 when the Code came into effect given that such a requirement had served as an integral part of its predecessor provisions, rests on two core premises: (a) that the good faith filing requirement *was, in fact*, an integral part of the provisions its promulgation had intended to replace; and (b) that, whatever the conclusion one arrives at *vis-à-vis* the matter of how integral the good faith filing requirement was to its predecessor provisions, Congress *did not intend* to limit the Court’s powers (to dismiss a Chapter 11 bankruptcy filing for lack of good faith) with the introduction of the Code in 1978. By

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<sup>70</sup> Little Creek Dev. Co. v. Commonwealth Mortgage Co. (*In re* Little Creek Dev.) 779 F.2d 1068, 1071 (5<sup>th</sup> Cir. 1986).

<sup>71</sup> Indeed, one commentary highlights that as of 2006, Judge Ordin’s comments appear to have been cited on at least 146 separate occasions to justify the finding that there had been an implied good faith filing requirement. *See* Mojdehi & Gertz, *supra* note 43, at 149. While it would be imprudent, in the interests of brevity, to list all of the said cases here, a sample of cases relying on Judge Ordin’s reasoning includes the following: *Little Creek*, 779 F.2d at 1071, *In re* Southern Cal. Sound Systems Inc., 69 B.R. 893, 899 (Bank. S.D. Cal. 1987) and *In re* First Dade Corp., 17 B.R. 887, 890 (Bankr. M.D. Fla. 1982).

<sup>72</sup> *See, e.g.*, Ponoroff & Knippenberg, *supra* note 5, at 943 (“...the Courts and commentators who have had occasion to address the subject *almost unanimously* have recognized the bankruptcy’s court authority to impose a good faith filing requirement, and, by nearly the same margin, have endorsed its application of such a requirement.”)

critically analyzing both suppositions seriatim, it will be seen that neither of the two conclusions arrived at by Judge Ordin is unassailable, and both, in fact, rest on rather suspect foundations.

A. *Was there an implied good faith filing requirement pre-1978?*

16. We turn first to his finding that the good faith filing requirement had been an integral part of predecessor provisions. After analyzing a wide variety of cases that had been decided before a number of courts at various levels, including a decision of the US Supreme Court, and arriving at the conclusion that all of them, save a singular exception,<sup>73</sup> supported the proposition that a good faith filing requirement existed, Judge Ordin concluded that “the *trend of the current cases* under Chapter XI and Chapter XII is to supply a “good faith” filing requirement by implication when confronted with...statutes which do not contain an express provision to that effect.”<sup>74</sup> While, at first blush, one perusing Judge Ordin’s reasoning process might, much like the Fifth Circuit did, conclude that his analysis possesses the credibility conveyed by detail (having, after all, analyzed a number of cases before arriving at such conclusion), such credibility dissipates upon a closer reading of the cases that Judge Ordin relied upon in support of such a proposition, for rigorous scrutiny of the jurisprudence in question detracts from any such suggested *trend*: indeed it would appear that only two of the decisions cited by the learned judge even so much as *considered* the question of an implied good faith requirement outside the auspices of Chapter X.<sup>75</sup> Significantly, a critical reading of both decisions would highlight that neither is at all persuasive for the proposition that they had been relied upon for. The first, the First Circuit decision of *Charleston Savings v. Martin (In re Colonial Realty Inv. Co.)*<sup>76</sup> had itself arrived at the conclusion that an implied good faith filing requirement could be inferred into Chapter XI by placing (undue) reliance on two cases that had been filings that were made under Chapter X,<sup>77</sup> the obvious logical fallacy of which is patently obvious.<sup>78</sup>

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<sup>73</sup> *Sumida v. Yumen*, 409 F.2d 654 (9<sup>th</sup> Cir. 1969), *cert. denied*, 405 U.S. 964, *reh’g denied*, 405 U.S. 1048 (1971). A discussion of this case, and its relevance to the present discussion, is found later in this paper.

<sup>74</sup> *In re Victory Construction*, 9 B.R. at 557. Although it should be obvious, Judge Ordin’s observation *vis-à-vis* Chapter X is unimpeachable in light of Chapter X’s explicitly mandating of an early adjudication of the issue.

<sup>75</sup> *Id.* It would be reminded that the question of whether Chapter X has a good faith requirement is irrelevant in the debate given the explicit requirement of good faith as found in the said Chapter.

<sup>76</sup> 516 F.2d 154 (1<sup>st</sup> Cir. 1975)

<sup>77</sup> The two cases in question were *Chrystal v. Green Point Sav. Bank (In re Franklin Garden Apartments)*, 124 F. 2d 451 (2d Cir. 1941) and *Ruskin v. Griffins* 250 F.2d 875 (2d Cir. 1958).

<sup>78</sup> The fallacy here, of course, is that relying on Chapter X to establish the proposition, without more, is fallacious for Chapter X is unique in that, unlike the other Chapters, it contained an explicit good faith requirement. Put another way, at least *vis-à-vis* the matter of the question of the rectitude of the good faith filing requirement, Chapters X and XI are plainly *not* statutory analogues. In the premises, the existence of such good faith requirement in one Chapter but not the other is a principled difference warranting arriving at a wholly different conclusion as to

17. The second case relied upon, the US Supreme Court decision of *SEC v. US Realty & Improvement Co* (“*US Realty*”),<sup>79</sup> warrants closer analysis. In *US Realty*, an insolvent public company had filed for bankruptcy under Chapter XI. The SEC intervened, taking the position that the petition should have been filed under Chapter X. The Supreme Court found in favour of the SEC and dismissed the petition in favour of relief on the premise that a Chapter X filing would be more appropriate as the said Chapter had been devised for the reorganization of large public corporations such as the one in question in that case, whilst Chapter XI had been peculiarly adapted for the speedy reorganization of smaller businesses and individuals. Surprisingly, *US Realty* continues to be relied upon, even in contemporary times, by some scholars as evidence for the proposition that there had been an *implied* good faith filing requirement for filings under Chapter XI before its replacement by its’ successor, *i.e.* Chapter 11.<sup>80</sup> To be sure, there is *some* evidence appears to buttress such a proposition: the fact that Congress in 1940 shelved “emergency” plans to introduce such a good-faith filing requirement for Chapter XI on the premise that *US Realty* rendered such amendments less urgent, for example, does, at first glance, appear to lend itself to the argument that the Supreme Court purported to decide the matter of the existence of an implicit good-faith filing requirement under Chapter XI.<sup>81</sup> However, on a more critical reading of legislative history, it becomes apparent that *US Realty* had never been intended to establish such a broad proposition. Indeed, that this is so is perhaps rendered most obvious from the fact that even Congress viewed *US Realty* as standing for nothing more than the self-evident proposition that proceedings that are more suitably filed under Chapter X should not be filed in Chapter XI: this would explain why, when Congress eventually decided to “[codify] the law of the [*US Realty*]”<sup>82</sup> some twelve years after it first posited drafting the “emergency” legislation alluded to above, it did so not by introducing an explicit good faith filing requirement as a prerequisite to filing under Chapter XI, but *via* promulgating a provision that conferred on judicial arbiters the power to order proceedings that had been filed under Chapter XI to comply with the requirements under Chapter X.<sup>83</sup> When seen

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the existence of the good faith filing doctrine. For a comprehensive conspectus on the flaws of such analogical reasoning that fails to account for the “relevant” differences between Chapter X and Chapter XI, and, indeed, on analogical reasoning in general, see Cass R. Sunstein, *Commentary: On Analogical Reasoning*, 106 HARV. L. REV. 741, 744 (2006) (“For analogical reasoning to operate properly, we have to know that A and B are “relevantly” similar, and that there are not “relevant” differences between them”). In this case, using the analytical framework adopted by Sunstein, the existence of a good faith filing requirement in Chapter X makes it a *relevantly* different from Chapter XI.

<sup>79</sup> 310 U.S. 434 (1940).

<sup>80</sup> See, e.g., Brunstad, *supra* note 64 at Para 4-10 – 4-11.

<sup>81</sup> See 8 *Collier on Bankruptcy*, ¶ 4.11 at 413 n. 7 (Chapter XI) (14<sup>th</sup> Ed, 1988).

<sup>82</sup> House Report No. 2320, 82d Cong., 2d Sess. 19 (1952), as reproduced in 8 *Collier on Bankruptcy*, ¶ 4.22 at 462 n. 2 (Transfer of Proceedings, Chapter XI to X) (14<sup>th</sup> Ed, 1988).

<sup>83</sup> See 11 U.S.C. §328 (1952) (repealed 1979).

in the context of the numerous dogged attempts by public companies to file under Chapter X in order to avoid the glare of governmental scrutiny at the time despite the existence of a dedicated Chapter for public companies (i.e. Chapter XI),<sup>84</sup> *US Realty* serves as nothing more than a strong caution by the Supreme Court that proceedings that are more suitably brought under Chapter XI would be dismissed if they had been brought under Chapter X instead. The concern on the part of the Supreme Court, seen in the context of bankruptcy trends at the time, was hardly surprising, given that it was Legislature's intention when it enacted two distinct chapters, i.e. Chapters X and XI, to facilitate the existence of two *mutually exclusive and parallel* reorganization regimes, one for public companies and one for private companies, rather than allowing for a singular, porous framework that granted corporations unencumbered autonomy in deciding which Chapter it would file under. As noted elsewhere, at the time:<sup>85</sup>

Business reorganizations [were] governed principally by chapters X and XI, both of which are adopted by the Congress as part of the bankruptcy reforms in 1938. *These chapters were not intended to be alternate paths of reorganization; they were to be mutually exclusive.* Chapter X was meant for the reorganization of public companies and chapter XI for the rehabilitation of small and privately owned businesses.

[Italics added]

18. Given that both Chapters X and XI have since been subsumed under the omnibus Chapter 11, the relevance of *US Realty* in contemporary times would, one logically assume, be considerably diminished – in fact, if nothing else, an enlightened reading of *US Realty* that is cognizant of the above-stated matters necessitates a singular conclusion, namely that the good faith filing requirement under Chapter X was intended to do nothing more than limit debtors to filing under the *proper* reorganization chapter under the Code's predecessor. In light of the fact that there is *only a single reorganization chapter* (i.e. Chapter 11) under the contemporary Code,<sup>86</sup> *US Realty*, much like the good faith filing requirement itself, has been rendered otiose.<sup>87</sup>

19. Coming back to *In re Victory Construction*, once one carefully scrutinizes and obtains a clearer understanding of the persuasiveness of the authorities that Judge Ordin relies upon, it

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<sup>84</sup> *Supra* note 65.

<sup>85</sup> S. Rep. No. 95-989, at 9-10 (1978)

<sup>86</sup> It should be added for completeness that there are, strictly speaking, other Chapters in the Code that allows for reorganization of particular entities (e.g. Chapter 9) but these are sufficiently small in number and sufficiently narrow in scope and specialized to be disregarded for the purposes of this paper.

<sup>87</sup> This argument will be considered in greater depth in due course. *See* Paras 23 – 25.

would be difficult not to take issue with his conclusion that “the *trend* of the current cases under Chapter XI and Chapter XII is to supply a “good faith” filing requirement by implication when confronted with...statutes which do not contain an express provision to that effect”. Indeed, one could go further and legitimately query as to whether the conclusion that should be arrived at should have been the converse, since the only decision that appeared to be squarely on point, *Sumida v. Yumen*,<sup>88</sup> arrived at the diametrically opposed conclusion, *i.e.* that Chapter XI and XII afforded no such implicit requirement. In *Sumida v. Yumen*, the Second Circuit had to decide on an appeal by the debtor from a District Court decision in which the Court had dismissed the debtor’s application to file for bankruptcy under Chapter XII for lack of good faith. As Chapter XII, much like Chapter 11, did not contain an explicit good faith filing requirement, this finding had been made by the District Court in spite of the absence of an explicit provision that required debtors to file in good faith. On appeal, the Second Circuit noted that although it appreciated the motivations of the District Court in arriving at the conclusion that it did and candidly conceded that, in its’ view, the debtor’s attempts at reorganization were plainly futile, it nonetheless reversed the District Court’s decision, observing that, notwithstanding its own reservations as to the *bona fides* of the debtor that:

...[t]here is *no such provision in Chapter XII requiring the court to pass on the merits of the petition as soon as it is filed.* “Good faith” is considered by a court in a Chapter XII proceeding *only after the plan has been approved by creditors and confirmation is requested by the debtor.*<sup>89</sup>

20. To the extent it is relevant, it would be useful to note that the legislative schema of Chapter XII and XI are similar, namely that there is the absence of an explicit good faith filing requirement. Nonetheless, the Court concluded that *Sumida v. Yumen* served as nothing more than an aberration, a decision that departed from the “norm”. In this connection, it warrants reiteration that the “norm” in this case was the problem-fraught reasoning employed by the Court as discussed at Paras 16 – 18 above. Accordingly, when one appreciates the underlying jurisprudence that *In re Victory Construction* had been predicated upon, there was clearly no basis to warrant Judge Ordin arriving at the conclusion that there had been a trend towards inferring a good faith requirement into Chapters XI and XII: at best, the position under Chapter XI and XII in 1978 was one of considerable non-clarity and uncertainty; at worst, the law appeared to be completely at odds with Judge Ordin’s summation of the state of jurisprudence at

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<sup>88</sup> *Sumida v. Yumen*, 409 F.2d 654 (9<sup>th</sup> Cir. 1969), *cert. denied*, 405 U.S. 964, *reh’g denied*, 405 U.S. 1048 (1971).

<sup>89</sup> *Id.* at 659.

the time. In either event, it would be difficult not to respectfully disagree with Judge Ordin's characterisation of the longevity of the good faith filing requirement when he noted that it "*had been established and [is] accepted as part of bankruptcy philosophy* (either by statute or decisional law) for almost a century", an argument that has, unfortunately, been adopted uncritically by numerous commentators<sup>90</sup> who continue to gloss over the fact that (as the preceding discussion makes patently clear) such a conclusion is not borne out by the weight of the jurisprudence underlying Chapter XI and XII.

*B. Did Congress not intend to limit the Court's powers with the 1978 Amendments?*

21. Although useful in illuminating the lack of clarity that constituted the state of jurisprudence pre-Code, the above discourse, of course, does not engage the second half of Judge Ordin's contention, namely that Congress had never intended to exclude the operation of the good faith filing requirement when it enacted the Code in 1978. In this regard, it should be noted that overwhelmingly, a large majority of the advocates for the contention that Congress intended to repose in the Courts' the power to reject "bad faith" petitions argue that such powers are implicit under Section 1112(b), pointing out that Congress never intended to set out an exhaustive list of criteria in the said provision.<sup>91</sup>

22. Viewed *in vacuo*, the argument is a seductive one: if Congress never intended to demarcate the boundaries of judicial power to the specific limbs enumerated in Section 1112(b), there would invariably be considerable force underlying any argument that Congress must have intended for the Courts to be able to act where such filings have been made in *bad faith*, whatever the standard one decides to ascribe to the term "bad faith". Nonetheless, on deeper analysis, one informed by the entire legislative journey that the Bill that culminated in the Code had traversed, it becomes plain that such a contention ignores Congress' motivations as can be inferred rather unequivocally and unambiguously from the circumstances surrounding the conspicuous omission of the good faith filing requirement from the Code.

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<sup>90</sup> See, e.g., McColl, *supra* note 9, at 338 and Miller, *supra* note 57, at 185 – 186.

<sup>91</sup> There is, admittedly, some, albeit limited, support for such an interpretation. See S. REP. NO. 989, 95<sup>th</sup> Cong., 2d Sess., as reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5787, 5903. ("The court will be able to consider other factors as they arise and to use its equitable powers to reach an appropriate result in individual cases"). Nonetheless, seen in the context of the foregoing discussion, this paper takes the view that Congress *must have plainly intended* to rid Chapter 11 of the Code of the good faith filing requirement.

23. In order to understand why this is so, a brief conspectus of how the 1978 Code ended up coming into being would be of utility. The Code's journey starts some eight years prior to its eventual enactment: given the problems that had plagued previous incarnations of the Code, Congress decided in 1970 to set up the Commission on the Bankruptcy Laws of the United States ("the Commission"), a Commission tasked with critically analyzing the bankruptcy framework that was in existence at the time with a view to proposing and reporting on desirable changes that should be effected to it. As a result, in 1973, the Commission presented its findings together with a draft bill that eventually resulted in the creation of the Code in 1978. Conspicuously, in its report, the Commission *explicitly* moved for the elimination of the good faith filing requirement under Chapter X,<sup>92</sup> observing that the proposed replacement would instead serve to allow a "party in interest to move the court for an order of dismissal or conversion to liquidation *if it is unreasonable to expect that a plan can be effectuated, rather than requiring the Court to determine whether good faith exists at an often premature stage and without adequate evidence.*"<sup>93</sup> Put differently, it was the Commission's view that the assessment of good faith should be made at the point of time when a plan is presented for confirmation, not at the *premature* stage of the petition's filing. Though the Bill was thereafter made to undergo several more amendments and revisions,<sup>94</sup> the good faith filing requirement was never reintroduced into any successive version of the draft Code and, consequently, was not incorporated in the Code when it was finally passed into law in 1978.<sup>95</sup> Once one takes cognizance of how the good faith filing requirement under Chapter X came to be omitted initially from the proposed revised legislation, it becomes difficult, if not impossible, to accept the argument that Congress intended for the rubric of good faith to be used as a prerequisite to seeking relief under Chapter 11 of the Code since it is clear beyond peradventure that the good faith filing requirement had been *deliberately* eliminated.

24. Further evidence that Congress intended to disabuse the Code of the good faith filing requirement can be found in the fact that the doctrine does not gel coherently and, to that extent, makes for strange bedfellows, with the carefully crafted provisions of the Code. For example, given that some of the requirements that had been listed under Section 1112(b) also concurrently

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<sup>92</sup> H.R. DOC NO. 137, PART I, 93d Cong., 1<sup>st</sup> Sess. 183 (1973).

<sup>93</sup> *Id.* at 222, n. 7.

<sup>94</sup> For a more complete historical analysis, see Flaccus, *supra* note 57, at 412–416.

<sup>95</sup> This is significant for while the views of such Commissions do not strictly speaking, have the effect of law and, are accordingly, non-binding, they are nonetheless conventionally given considerable weight, particularly where the recommendations in question have been adopted without substantial change. For an understanding of the influence of the comments of Commissions for the purposes of statutory interpretation, see NORMAN J. SINGER & J.D. SHAMBIE SINGER., STATUTES AND STATUTORY CONSTRUCTION 592 (7<sup>th</sup> Edition, 2007).

serve as indicia of bad faith that could, on their own, result in the dismissal of a petition on grounds of bad faith, this leads to the anomalous situation where two different standards, one under the Code, and one under the implied good faith filing doctrine, can be concurrently and simultaneously applied to the exact same factual matrix and, quite alarmingly, engender two diametrically opposed conclusions. An example would serve to underscore the point: while the Court is not authorized to dismiss a case solely for the absence of a reasonable likelihood of rehabilitation if the Court places strict reliance on the wording of the provisions found in the Code,<sup>96</sup> it may nonetheless do so solely on that ground if it decides to turn a blind eye to the provisions of the Code and dismiss the petition under the implied good faith doctrine (*albeit* on precisely the same reasoning).<sup>97</sup> Such a substantial overlap can only be explained by the fact that the requirements listed in Section 1112(b) had been intended to *replace* rather than *supplement* the good faith filing requirement. The Commission's minutes of meeting that led to the earlier-mentioned recommendation to eliminate the good faith filing requirement fortifies this analysis, observing that the enumeration of specific categories (under Section 1112(b)) had been motivated by the Commission's belief that "that the good-faith test *should be replaced* with *specific grounds* for dismissing or adjudicating a Chapter case, either on a creditor's application or on the court's own initiative [and that the] grounds *shall apply in all* Chapter cases."<sup>98</sup> Such an understanding is, in fact, further reinforced by the fact that the good faith doctrine features prominently in numerous other parts of the Code, including, in other circumstances, as a prerequisite to filing:<sup>99</sup> to that end, if Congress saw it fit to articulate the good faith requirement *explicitly* for the purposes of confirmation, a fact that plainly illustrates that "Congress obviously knew how to impose a good faith requirement when it wished to do so,"<sup>100</sup> why was it deemed

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<sup>96</sup> This is because the conjunctive nature of 11 U.S.C. §1112(b)(1) necessarily requires a concurrent finding that there be "continuing loss to or diminution in the estate" before the petition can be dismissed. *See In re Victoria Ltd. Partnership*, 187 B.R. 54, 59 (Bankr. Mass. 1995).

<sup>97</sup> This is by no means an unusual phenomenon – indeed, as will be seen later, the Courts have, from time to time, ridden roughshod over the provisions of the Code and used the good faith filing requirement as the basis for dismissing a petition, even though they were well equipped to do so on the basis of existing statutory bases.

<sup>98</sup> Commission on the Bankruptcy Laws of the United States, Minutes of Meeting of February 22 – 24, 1973, at 38 – 41, as reproduced in Gerald K. Smith & Randolph J. Haines, *Chapter 11 – Reorganization*, ANN. SURV. BANKR. L. 495, 504 (1988).

<sup>99</sup> A further argument in support of this is that the absence of a good faith provision in §§ 109(d) and 301 particularly glaring in light of the fact that it is expressly provided for when it comes to determining damages for involuntary bankruptcy filings under §303(i)(2). *See* Smith & Haines, *ibid*, at 495. This is a point that has been observed in several commentaries, though most fail to thereafter explore or develop the implications of such an apparent dichotomy. *See*, for example, Michael W. McConnell & Randal C. Parker, *When Cities Go Broke: A Conceptual Introduction to Municipal Bankruptcy*, 60 U. CHI. L. REV. 425, 461 (1993) (In which the authors, in discussing the explicit existence of a good faith filing requirement under Chapter 9 of the Bankruptcy Code, observed that "[good] faith...appears with some frequency in the Bankruptcy Code, but only in §921(c) [is it] an explicit good faith requirement *included as a threshold to filing*").

<sup>100</sup> *In re Victoria Ltd. Partnership*, 187 B.R. 54, 60 (Bankr. Mass. 1995).



not to be of sufficient importance to be included in Section 1112,<sup>101</sup> especially if it had been intended to play the central role that it has since plainly occupied?

25. Once one takes cognizance of the legislative history of the Code therefore, there is considerable force underlying the argument that Congress was, in enacting the Code without reintroducing the good faith filing requirement in succeeding versions of the Bill, giving voice to the Commission's concerns about the utility of such a requirement in light of the belief that any such assessment at such an early juncture would invariably constitute a premature assessment of the merits of reorganization, an assessment that has to often be made by the Court without the benefit of comprehensive information as to the prospects of the debtor to be able to successfully restructure. When seen from that perspective, it is difficult not to arrive at the conclusion that in intentionally removing the express requirement for good faith as a prerequisite to filing that was in existence in Chapter X,<sup>102</sup> and not reintroducing the requirement into the Bill, Congress was plainly endorsing the Commission's view of the impropriety of introducing any good faith filing requirement into Chapter 11.<sup>103</sup>

26. What is particularly germane for other nations seeking to introduce their own analogue to Chapter-11 in their own respective jurisdictions are the underlying motivations for the Commission's (and by extension Congress') reluctance to introduce a good faith filing requirement: indeed, with the benefit of hindsight, the Commission's dual-fold fears that it would be impossible for a judicial arbiter, however enlightened, to come to a fully-informed decision as to the *bona fides* of a Chapter 11 filing at its infancy given the complete dearth of information available,<sup>104</sup> and of the incessant pursuit of unmeritorious claims by creditors who are more than willing to advance allegations of bad faith at every conceivable juncture of a Chapter 11 proceeding,<sup>105</sup> have proven not to be misplaced. Contrary to the belief of some in the

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<sup>101</sup> This provision provides the grounds for which a petition can be dismissed.

<sup>102</sup> See Flaccus, *supra* note 57, at 403.

<sup>103</sup> By analogy, this appears to be in line with developments in other jurisdictions that suggest that all deletions made to laws should be presumed to be substantive, "unless there is internal or admissible evidence to show that only language polishing was intended." See RANDAL L. GRAHAM, STATUTORY INTERPRETATION: THEORY AND PRACTICE 167 (2001). Nonetheless, in light of the fact that the omnibus Chapter 11 is not a direct lineal descendant of Chapter X (it is, in fact, the descendant of Chapters X, XI and XII), coupled with the fact that, strictly speaking, the 1978 amendments, seen in its totality, amount to the deletion of a provision, as opposed to the deletion of mere words of a provision, it is conceded that such an analogy is only of extremely limited persuasive force.

<sup>104</sup> The absence of information available, is to a large extent, a function of the plain reality that debtors often file for Chapter 11 not because they have given in-depth consideration of the company's long-term prospects, but because it appeared to be the only way to continue business in the short-term given the dogged pursuit of their creditors.

<sup>105</sup> It should be noted that this concern appears *not* to be shared by some members of the judiciary in the Bankruptcy Court. See generally the comments made in Gross, *supra* note 52, at 11.

judiciary that it would be possible to tell, with a sufficient degree of precision, “two weeks into the case that [a particular business] is a sick puppy that’s not going to make it,”<sup>106</sup> the difficulty in arriving at such a conclusive determination of a filing at such an early stage is evidenced by the plethora of cases in which appellate courts have had to reverse a bankruptcy court’s overzealous dismissal of a petition on the premise of bad faith.<sup>107</sup> Such confidence on the part of the Bankruptcy Courts also stems from the ignorance of the reality that in many, if not most Chapter 11 bankruptcies, the debtor is forced to file without having been afforded the time or opportunity to scrupulously analyze and reflect on the viability of long-term operations, and, therefore, without being in a position at the point of time of filing to comment on the prospects for a successful reorganization. It is imperative, in this regard, not to ignore the realities of the likely dearth of information that management itself is in possession of *vis-à-vis* the long term prospects of a company at the time of filing – as one commentator concluded upon surveying a not-inconsiderable number of bankruptcies:<sup>108</sup>

[A] large majority of [debtors] entered Chapter 11 with one or more of their creditors in hot pursuit, and filing was probably the only way they could remain in business, or avoid liquidation. Their focus, quite naturally, was on short term survival, and only later, if at all, would a substantial number of them turn their attention to the long-range prospects for their businesses.

27. If the twin bedrocks underlying Chapter 11 are the belief that there are significant virtues in the continued reposing of decision-making in financially-troubled entities on those who know the company best, *i.e.* management,<sup>109</sup> and the desire to ensure that unnecessary corporate carnage is minimized through expeditious filing by “providing inducements to initiate formal reorganization cases before its assets had been dissipated and the possibility of reorganization minimized,”<sup>110</sup> bedrocks that undoubtedly appear to be the primary reasons for the numerous converts internationally to Chapter 11, allowing a judicial arbiter to second-guess decisions to file for Chapter 11 at a juncture where even management has not had an opportunity to reflect and critically analyze the prospects for the continuation of the business (one that is realistically only available *after* filing), appears inimical to the fundamental tenets of Chapter 11 itself and serves to detract, rather than enhance, the efficacy of the Chapter 11 regime. To be sure, this is

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<sup>106</sup> Gross, *supra* note 52, at 31 (Comments of Judge William Hillman of the Massachusetts Bankruptcy Court).

<sup>107</sup> See Miller, *supra* note 57, at 190.

<sup>108</sup> See Lynn M LoPucki, *The Debtor in Full Control – Systems Failure Under Chapter 11 of the Bankruptcy Code?* 57 AM. BANKR. L.J. 99, 114 (1983)

<sup>109</sup> See Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336 (1993).

<sup>110</sup> See Harvey R. Miller, *Chapter 11 in Transition – From Boom to Bust and Into the Future* 81 AM. BANKR. L. J. 375 (2007).

not to suggest that there is no merit whatsoever in establishing safeguards to check opportunistic behaviour or unbridled optimism (on the part of debtors),<sup>111</sup> but to merely highlight that there is no gain in the development of a safeguard (in this case, the good faith filing requirement) that fails to give voice to the commercial realities underlying bankruptcy filings and that detracts from the overarching motivations of the legislation that it seeks to uphold. With that in mind, it becomes apparent that the conspicuous absence of an explicit good faith filing requirement in Chapter 11 serves as nothing more than the manifestation of the recognition on the part of the Commission, and Congress, that there are no principled policy justifications for the introduction of a good faith filing requirement if one is to avoid giving leaden feet to the entire *raison d'être* of the re-organizational thrust of the regime.

28. Perhaps ironically, *In re Victory Construction*, the case that, as the foregoing discussion has noted, is widely regarded as the genesis of the implied good faith filing requirement under the Code, serves as an apt illustration of the Herculean task that the Courts face in assessing the *bona fides* of a filing at such a preliminary juncture. In order to appreciate why this is so, it is necessary to briefly state the facts of the case. In that case, two real estate developers had utilised a dormant corporation to acquire a commercial property that was estimated to be worth somewhere between \$2.76m and \$3.2m, and that was encumbered by debts amounting to almost \$2.9m consisting of low-interest rate loans, out of a bankruptcy estate for a relatively small sum of money with the hope of eventually converting it to a hotel. After the developers attempted unsuccessfully to negotiate a favourable restructuring of the debt, the developers filed for Chapter 11. The creditors had opposed the filing on the premise that they had not been adequately protected, and, *in the alternative*, that the filing had been made in circumstances suggesting bad faith. At first instance, the Bankruptcy Court found that the filing should be dismissed, on the premise that it was made in bad faith. The debtor appealed the decision and proceeded to seek a stay of the order in the interim, a stay that was granted. Eventually, the

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<sup>111</sup> The author accepts that debtors may sometimes file for Chapter 11 with the blinkered view that their plainly structurally unsound and failing company can somehow rise from the ashes. As Lavien J. once eloquently observed, “Bankruptcy is perceived as a haven for wistfulness and the optimist’s valhalla where the atmosphere is conducive to fantasy and miraculous dreams of the phoenix arising from the ruins. Unfortunately, this Court is not held during the full moon, and while the rays of sunshine sometimes bring the warming rays of the sun, they more often bring the bright light that makes transparent and evaporates the elaborate financial fantasies constructed of nothing more than the gossamer wings and of sophisticated tax legerdemain”. See *In re Maxim Industries Inc* 22 Bankr 611, 613 (1982). Nonetheless, the concern remains of the propriety of the good faith filing requirement, for it is near impossible for the Bankruptcy Courts to make an informed determination at such an early stage in the bankruptcy; and indeed, this runs the risk of throwing out filing of both companies that are bound to eventually liquidate and those with a fighting chance but for which management have not had a chance to reflect upon the long-term prospects.

debtor was able to propose a plan that the Bankruptcy Court found had not been proposed in bad faith, an act that served to have the effect of “cleansing” away the ostensible *initial* bad faith, thus rendering any appeal on the decision to lift the automatic stay moot. The Court would eventually go on to approve the proposed plan. The manner in which the litigation surrounding *In re Victory Construction* unfolded serves as an apt illustration of how premature any such assessment of bad faith can be, especially in circumstances where, as is the case with most such filings,<sup>112</sup> the debtor has not had sufficient opportunity to contemplate fully, let alone, propose a detailed and well-thought-out plan. In a related vein, if bad faith at the point of filing, can, as *In re Victory Construction* suggests, be “cleansed” retrospectively by a good faith proposal at confirmation, how could any plan, however *mala fides* it may, at first glance, appear to be, ever be dismissed at the outset of the case?

29. Anecdotal evidence suggests that the Commission’s secondary fear, namely that overly-litigious creditors would resort to alleging bad faith at every possible turn leading to unnecessary litigation, is also similarly borne out, with one bankruptcy judge observing extra-judicially that under the present bankruptcy framework, “creditors always [have] good faith on their minds because it [is] their first punch besides a motion to lift,”<sup>113</sup> a first punch that another judge concedes is invariably utilized in *virtually every single filing* for certain categories of cases.<sup>114</sup> In short, the continued existence of the good faith filing requirement despite Congress’ best efforts has exacerbated the very problem its intended elimination had been intended to address and stem, namely the spawning of unnecessary litigation *vis-à-vis* the advancement of premature allegations by creditors of bankruptcy petitions being filed in bad faith.

30. That Congress intended to eliminate any good faith limitation to a debtor’s right to elect Chapter 11 relief with the promulgation of the Code in 1978 appears to be further buttressed by intervening developments.<sup>115</sup> For example, despite the considerable jurisprudence that had accumulated over time on the principles that should be applied to sieve out the “abusive” single-asset real estate cases, Congress decided in 1994 to amend the Code to provide creditors relief from the automatic stay in such cases unless the debtor files “a viable plan of reorganization” or

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<sup>112</sup> See LoPucki, *supra* note 108.

<sup>113</sup> Gross, *supra* note 52, at 15 (Comments of Mr William Greendyke, former Bankruptcy Judge in Houston).

<sup>114</sup> *Id.* at 14 (Comments of Judge Robert Mark, Bankruptcy Judge of the South District of Florida).

<sup>115</sup> One intervening development that had not been explored in this paper but that has been canvassed in other forums is the fact that the lack of any move by Congress to include an explicit good faith filing requirement in the Code even when it overhauled other aspects of the Code is, in and of itself, indicative of the absence of any *implied* requirement. See Mojdehi & Gertz, *supra* note 43, at 149.

has commenced making payments to the secured creditor within 90 days.<sup>116</sup> The only logical explanation to the 1994 Amendments is that it is the product of Congressional recognition that unlike in more conventional situations, where the plan confirmation stage would constitute the appropriate juncture to assess the *bona fides* of a debtor, the unique circumstances of single asset real estate cases renders it necessary to expedite the timeframe to assess such *bona fides* to that of 90 days. If, however, as proponents would suggest, the good faith filing requirement is able to sieve meritorious cases from unmeritorious ones *via* a principled “evaluation of the debtor’s financial condition, motives and the local financial realities”<sup>117</sup>, an evaluation that encompasses an assessment of the realistic likelihood of a successful organization that could be undertaken as early as *at the time of filing*, what additional purpose would such amendments serve? Viewed through that prism, it is difficult to ascribe any other intention to the amendments except to suggest that it is the manifestation of Congressional recognition that no implied good faith filing requirement exists, a recognition that is no doubt predicated on the belief that any assessment of *bona fides* made so prematurely is necessarily speculative and constitutes an unscientific and idiosyncratic manner of assessment of the likelihood of a successful organization.

31. Two conclusions thus appear to be warranted from the preceding discussion: first, there is considerable force underlying the contention that the good faith filing requirement under Chapter X had, in fact, been intentionally omitted from its successor, *i.e.* Chapter 11, and that by extension, Congress, in passing the eventual Bill, had applied its mind in endorsing such an elimination, and second, that the motivations underlying the Commission’s recommendation for such elimination appears to be borne out both as evidenced by case law, and by anecdotal evidence of unmeritorious creditor challenges. In the circumstances, just as Judge Ordin’s statement on prior jurisprudence supporting his view that an implied good faith filing requirement exists is not borne out once one takes cognizance of the jurisprudence that his views are predicated upon in their proper context, his attendant observation that “it would be more than anomalous to conclude that in consolidating the provisions of Chapters X, XI, and XII in Chapter 11 of the Code, Congress intended to do away with a safeguard against abuse and misuse of process which had been established and accepted as part of bankruptcy philosophy (either by

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<sup>116</sup> 11 U.S.C. §362(d)(3).

<sup>117</sup> *See Little Creek Dev. Co. v. Commonwealth Mortgage Co. (In re Little Creek Dev. Co.)*, 779 F. 2d 693 (4<sup>th</sup> Cir. 1989). With those considerations in mind, *Little Creek* developed a set of indicia of bad faith factors that Courts should take note of in deciding whether an application was being made in good faith or otherwise. While there was considerable caution at the time not to apply them in a mechanistic manner, the indicia in *Little Creek* has nonetheless served as “persuasive authority” as the *de facto* starting point of any such analysis. *See, e.g., In re Landings Assocs. Ltd. Partnership*, 145 B.R. 101 (Bankr. M.D. Fla. 1992).

statute or decisional law) for almost a century” also appears to directly contradict the considerable evidence that alludes, in fact, to the diametrically opposite conclusion.

32. Where then does the preceding analysis leave the status of the good faith filing requirement? As the good faith filing requirement owes its provenance largely to the conclusions arrived at by Judge Ordin in *In re Victory Construction* (and, indeed, wholly to the reasoning employed in that case), and in light of the fact that the two pillars supporting his conclusion that there is a good faith filing requirement appears inconsistent with the evidence, namely that the continued existence of the good faith doctrine is inconsistent with the ancestry of the Code and with Congressional intent, the invariable conclusion that one must arrive at is that the implied good faith filing requirement should have no place in the contemporary Chapter 11 bankruptcy framework.

#### IV. THE TREND TOWARDS “NEW TEXTUALISM” & WHAT IT MEANS FOR THE GOOD FAITH DOCTRINE

33. The discourse hitherto has revolved around the matter of how the Code’s unique historical context militates against the embracement of an implied good faith filing requirement under Chapter 11. As the ensuing discussion would plainly highlight, such an interpretation fully comports with contemporary jurisprudence emanating from the US Supreme Court, jurisprudence that provides us an insight into the approach that is utilized in understanding the latitude with which the Courts would recognize implicit barriers (in this case, the good faith requirement) that are not set out in the Code. Two cases, in particular, are instructive. In the first, *Taylor v. Freeland & Kronz*,<sup>118</sup> the debtor had, upon filing for a Chapter 7 bankruptcy, filed as an exemption any potential returns from an outstanding lawsuit. The trustee, acting under the belief that the lawsuit would be of *de minimis* value, failed to make any objection to such an exemption within the time allocated under law. When the lawsuit was eventually settled for a considerable sum, the trustee commenced an action to recover the amount on the premise that the exemption had been filed by the debtor in bad faith. Accordingly, the issue before the Court was whether good faith serves as a prerequisite to the claiming of an exemption under Section 522(1) of the Code.<sup>119</sup> It is pertinent to note that at the time the case was heard in the Supreme Court, much like the present situation surrounding the matter of whether good faith serves as a

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<sup>118</sup> 503 U.S. 638 (1992). For a more in-depth analysis of the decision, see Kenneth Decourcy Ferguson, *Repose or Not? Informal Objections to Claims of Exemptions after Taylor v. Freeland*, 50 OKLA. L. REV 45 (1997).

<sup>119</sup> 11 U.S.C. §522 enumerates the exempted assets that can be retained by a debtor even in a bankruptcy.

prerequisite to the filing of a case under Chapter 11, numerous circuits were, for much of the same reasons underlying the argument that a good faith filing requirement exists under Chapter 11, engrafting an implied good faith requirement for such exemption claims. Notwithstanding that, in a majority opinion,<sup>120</sup> the Supreme Court ruled that to the extent that the various provisions that were intended to penalize debtors for improper conduct failed to limit bad faith exemption claims, Congress, rather than the Courts, represents the proper body to rewrite Section 522(l) in a manner that incorporates a good faith requirement. As the Supreme Court observed:

These [statutory] provisions may limit bad-faith claims of exemptions by debtors. *To the extent that they do not, Congress may enact comparable provisions to address the difficulties that Taylor predicts will follow our decision. We have no authority to limit the application of §522(l) to exemptions claimed in good faith.*<sup>121</sup>

[Italics added]

34. To be sure, it could be argued that on the narrowest of readings, *Taylor v. Freeland & Kronz* serves as precedent for nothing more than the proposition that the Court would not engraft an implied good faith prerequisite to exemptions claims filed under Section 522(l), and to that end, is of no relevance to the resolution of the rather separate question of whether a good faith requirement exists under Chapter 11. Nonetheless, given that any distinction between the filing of bad faith claims and the filing of a petition in bad faith is one without a difference insofar as both, in essence, relate to the debtor's "attempt to commit fraud upon the court,"<sup>122</sup> there is considerable force underlying the argument that the reasoning of the Court is illuminating not only in relation to the limits on barring exemption claims made in bad faith but concurrently on the proper approach to be adopted on the imposition of *implicit good faith* barriers under the Code. Indeed, as one commentator perceptively observed, if the Courts are not vested with the authority to imply such a requirement into Section 522(l), the same line of reasoning would resonate with even more force in the determination of the separate, though related, question of whether a good faith filing requirement exists under Chapter 11, particularly since the latter would, in all likelihood, implicate acts that are conventionally accepted to bear less moral culpability than the former.<sup>123</sup>

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<sup>120</sup> Thomas, J., delivered the opinion of the Court, in which Rehnquist, C. J., and White, Blackmun, O'Connor, Scalia, Kennedy, and Souter, JJ., joined. Stevens, J., filed a dissenting opinion.

<sup>121</sup> 503 U.S. 638 at 642.

<sup>122</sup> *Furness v. Lilienfield*, 35 B.R. 1006, 1011 (D. Md. 1983).

<sup>123</sup> *See Flaccus, supra* note 57, at 422.

35. Another Supreme Court decision that buttresses the conclusion arrived at above, and that lends further support to the proposition that the reading of implied exceptions to the right of a party to file would be frowned upon and would be in contravention of the prevailing jurisprudential philosophy, is that of *Toibb v. Radloff*.<sup>124</sup> In *Toibb v. Radloff*, the debtor, an individual whose sole asset were shares that, at the time, had been valued at some \$150,000, converted a Chapter 7 bankruptcy filing to one under Chapter 11. The Bankruptcy Court at first instance, acting *sua sponte*, ordered the debtor to show cause as to why it should not re-convert the Chapter 11 petition back to one under Chapter 7 on the premise that the petitioner was not “engaged in business”. Significantly, for the purposes of the discussion at hand, the requirement that a party should be engaged in business is not statutory, having been implied into the Code as a result of a previous decision of the Eighth Circuit, in which, much like the present state of affairs *vis-à-vis* the good faith filing requirement, the said Court concluded by reference to legislative history that Congress must have intended to limit access to Chapter 11 to individuals with businesses.<sup>125</sup> Both the appeals to the District Court and the Eighth Circuit were unsuccessful, but the debtor successfully petitioned for a writ of certiorari to canvass the matter in the Supreme Court.<sup>126</sup> In a majority opinion,<sup>127</sup> the US Supreme Court overturned the decision of the lower courts and found that the debtor did, in fact, have standing to apply for Chapter 11 relief. The Court’s reasoning in this regard warrants close analysis.

36. The Supreme Court observed that when interpreting a statute (in this instance, the Code), a Court should “look first to the statutory language and then to the legislative history if the statutory language is unclear”.<sup>128</sup> Turning first to Section 109 of the Code [the provision of law that lists the classes of entities and individuals who may file for relief in bankruptcy], the Supreme Court highlighted that in light of the fact that Congress had taken pains to enumerate, under the said provision, those who could (and could not) receive protection under the various chapters, it would be slow to “infer the exclusion of certain classes of debtors from the protections of Chapter 11.”<sup>129</sup> Turning next to the Code’s legislative history, the Court highlighted that even if it ignored the fact that Section 109 had been clear on its face and the

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<sup>124</sup> 501 U.S. 157 (1991)

<sup>125</sup> See *Wamsganz v. Boatman’s Bank*, 804 F. 2d 503 (8<sup>th</sup> Cir. 1986).

<sup>126</sup> The writ of certiorari was granted on the premise of the conflict between a decision of the 8<sup>th</sup> Circuit (that contends that there is an *implied* requirement for an individual applying for Chapter 11 relief to be running a business) and that of a decision of the 11<sup>th</sup> Circuit (that no such *implied* requirement exists).

<sup>127</sup> Blackmun, J., delivered the opinion of the Court, in which Rehnquist, C. J., and White, Marshall, O’Connor, Scalia, Kennedy, and Souter, JJ., joined. As was the case in *Taylor v. Freeland & Kronz*, Stevens, J. filed a dissenting opinion.

<sup>128</sup> 501 U.S. at 160.

<sup>129</sup> 501 U.S. at 161.



attendant fact that the legislative history was not sufficiently clear as to amount to a “clearly expressed legislative intent,”<sup>130</sup> there would have been no basis upon which to infer the inclusion of an implied caveat to Section 109. In its words:

...[t]he plain language of the Bankruptcy Code permits individual debtors not engaged in business to file for relief under Chapter 11. Although the structure and legislative history of Chapter 11 indicate that this Chapter was intended primarily for the use of business debtors, the Code contains no "ongoing business" requirement for Chapter 11 reorganization, and we find no basis for imposing one.<sup>131</sup>

37. There are at least two separate, though no doubt interlinked, implications of the decision arrived at by the Supreme Court in *Toibb v. Radloff* on the question of whether a good faith filing requirement could be implied into the Code. First, the Court’s comments on the exhaustiveness with which Congress set out the requirements under Section 109 apply with equal force in the present context: if Congress had taken the trouble to enumerate the categories of persons / businesses that could file under each of the respective chapters, it would be difficult to give weight to the contention that a further “implied” good faith filing requirement could legitimately find room to operate in spite of its conspicuous absence from Chapter 11 of the Code.<sup>132</sup> Second, *Toibb v. Radloff* also goes a long way to diminishing the contention on the part of proponents of the good faith filing requirement that in stating that the Courts would “be able to consider other factors as they arise and to use its equitable powers to reach an appropriate result in individual cases”<sup>133</sup>, it would allow for the introduction of the implied good faith doctrine, since such language, on its face, would plainly fail to overcome the considerable hurdle of having to amount to a “clearly expressed legislative intent” that the Supreme Court in *Toibb v. Radloff* observed would be required before there would be sufficient evidence to disregard the plain reading of Sections 109 and 1112(b).

38. Lest it be suggested that the two cases discussed above were decided in contradiction of some wider jurisprudential trend *vis-à-vis* bankruptcy proceedings or the proper interpretation to be ascribed to provisions in the Code, it should be stressed that these cases are, in fact, exemplars that are reflective of the Supreme Court’s increasing intellectual affinity with “new textualism”,

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<sup>130</sup> This was the threshold that the Court had set in *Consumer Product Safety Comm'n. v. GTE Sylvania, Inc.*, 447 U.S. 102, 108 (1980) on the question of when the language of a statute would not be deemed to be conclusive.

<sup>131</sup> 501 U.S. at 163.

<sup>132</sup> In other words, why would Congress enumerate the individual limbs of §1112 and come up with §109 if all of that can be conveniently ignored by the Courts *via* recourse to an implicit good faith doctrine?

<sup>133</sup> *Supra* note 91.

a doctrinal approach that accords primacy to the ideals of certainty and predictability.<sup>134</sup> Under this approach, the Court is likely to rely more on the statutory language to infer the intention of Congress than to refer to policy and legislative history, a stance consonant with the argument that Section 109 is exclusive and should not be made subject to unarticulated exceptions (such as the good faith filing requirement), and that does not afford the implying of implied barriers to relief under the Code. Indeed, that the Supreme Court is unlikely to subscribe to the view that a good faith filing requirement can be inferred into the Code based on the prevailing judicial philosophy is further supported by the fact that where the Court has, in the recent past, departed from the “new textualism” approach *vis-à-vis* cases involving the interpretation of the Code, it has invariably taken pains to do so in a manner that serves to maximally *confine*, rather than expand, the discretion of the Courts that administer the Code.<sup>135</sup> Put differently, the “new textualism” approach, which would suggest that no good faith filing requirement can be engrafted into Chapter 11 in the absence of an express legislative provision, appears to be the *most liberal* baseline to the interpretation of the Code, not the *most conservative* one.

39. In this connection, it should be noted that the Supreme Court’s use of the “new textualism” approach to statutory interpretation, and its wariness of conferring broad discretion on bankruptcy courts to determine the proper eligibility standards before a debtor would be granted relief is particularly apt given the separation of powers envisioned by the Constitution *vis-à-vis* matters of bankruptcy law. By fashioning their own implicit eligibility criteria before access to Chapter 11 would be granted, the Courts have essentially conferred upon themselves the power to “moderate the evolution of bankruptcy purposes and policy”<sup>136</sup> and to serve as *de facto* arbiters of policy under the Code.<sup>137</sup> As Article 1, Section 8 of the US Constitution vests the power to enact uniform federal laws on the subject of bankruptcies to Congress, and, to that end, plainly envisions such a role to be played not by bankruptcy courts,<sup>138</sup> but by legislature,<sup>139</sup>

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<sup>134</sup> For a deeper discussion on the “new textualism” doctrine, see William N. Eskridge Jr., *The New Textualism*, 37 UCLA L. REV 621 (1990).

<sup>135</sup> See generally Alan M. Schwartz, *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).

<sup>136</sup> Ponoroff & Knippenberg, *supra* note 5, at 923 and 969 (“Implicit [in the assumption that the Courts are defining access to bankruptcy relief] is the basic jurisprudential assumption that the Courts and the judiciary are the appropriate political agency for making these scope determinations.”)

<sup>137</sup> See Miller, *supra* note 57, at 182 and Ponoroff & Knippenberg, *supra* note 5, at 923 (“[The good faith doctrine is] pressed into service by the courts to bring order and standards to the business of assuring that bankruptcy policy and purposes evolve in a sensible, purposeful way.”)

<sup>138</sup> Furthermore, though the author does not subscribe to such a view, a plausible argument could be made that non-Article III bankruptcy judges, without the protection of tenure, may not necessarily be best placed to give voice to such policy considerations. See generally LOPUCKI, *supra* note 39.

the Courts' actions may, to some, appear to tantamount to "arrogat[ing] to itself the functions of the legislature"<sup>140</sup> and constitute a plain violation of structural principles of separation of powers. Given the constitutional design of bankruptcy law, it is incontrovertible that the remedy for aggressive uses of Chapter 11, on the assumption such actions necessitate a remedy in the first place (which for the reasons discussed at some length below, it would be submitted, it does not), is not in the development of a judicial sieve (such as the good faith filing doctrine) but through the effecting of necessary Congressional amendments.<sup>141</sup>

#### V. FITTING A SQUARE PEG INTO A ROUND HOLE: HOW THE GOOD FAITH DOCTRINE HAS DETRACTED FROM ITS RAISON D'ETRE AND DIMINISHED THE EFFECTIVENESS OF THE CODE

40. The preceding discussion has considered how the implied good faith filing requirement under Chapter 11 is contrary to both legislative intent and the proper canons of interpretation that should be applied to the Code. By considering how such doctrine has been applied in practice in the absence of a coherent theoretical framework to guide its development, the following discussion would canvass a more fundamental normative objection against its continued existence, namely the doctrine's failure to live up to, and uphold, its very *raison d'etre*. As can be seen later on, such arguments apply with equal force internationally, insofar as the dissonance of the good faith filing requirement with the Chapter 11 framework is concerned.

41. As alluded to earlier, it is conventional wisdom that, at its core, the good faith filing requirement was fashioned by the Courts in order to protect its jurisdictional integrity and to sieve out meritorious cases from unmeritorious ones.<sup>142</sup> Whatever the criteria adopted by the

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<sup>139</sup> In the interest of completeness, it should be noted that some commentators argue against such a contention by contending that the said constitutional provision must "be limited to the subject of insolvent debtors because without this limitation, there is no limit at all". See Eric Brunstad, *supra* note 64, at Para 4-6. Such an argument cannot be countenanced since no such limitation exists on the face of the US Constitution, and in any event, it is clear that insolvency is not, and has never been, the defining feature of bankruptcy in the United States. For a rebuttal of Brunstad's points through the employment of such a reasoning process, see Mojdehi & Gertz, *supra* note 43 at 156–158.

<sup>140</sup> *In re The Bible Speaks* 65 Bankr. 415 (Bankr. D. Mass 1986).

<sup>141</sup> Any suggestion that Congress is too slow to reflect changes in bankruptcy policy in the Code *via* effecting timely amendments ignores the changes that have been effected by Congress to the Code whenever it feels that the Code is being abused. For an example of such a timely intervention in the recent past, see Flaccus, *supra* note 57, at 438.

<sup>142</sup> It is important to stress, at this juncture, that the motivations articulated above represent the conventionally-accepted modern-day *raison d'etre*. In truth, though almost all the commentators fail to appreciate this, one of the primary motivations underlying the *explicit* good faith doctrine's initial conception in Chapter X was the need to ensure that debtors file in the proper reorganization chapter as between Chapters X, XI and XII. This, in part, explains why the current incarnation of the good faith doctrine is so problematic – the modern day resurrection of a doctrine fails to acknowledge, and adapt, to the different circumstances or to appreciate the fact that it was initially fashioned for a completely different purpose in a completely different setting. Stated bluntly, the good faith doctrine

Courts to separate the wheat from the chaff, the extent to which such ideals are adhered to is invariably dependent on the consistent application of objective standards by which all such cases can be independently and transparently assessed. In other words, for the doctrine to be of any utility, it must surely do more than merely exist; it must be capable of being moulded into a useful implement by the Courts in a way that is able to bring “order and standards to the business of assuring that bankruptcy policy and purposes evolve in a *sensible, purposeful* way.”<sup>143</sup> Unfortunately, as will be apparent from the ensuing discourse, the Courts have not only failed to develop the doctrine in an intellectually coherent fashion, but have, on occasion, allowed the good faith filing requirement to develop and morph into an unruly horse that has ridden roughshod over the other carefully crafted provisions of the Code.

42. To commence analysis on this front, it is worthy to note that notwithstanding the extensive application of the implied good faith filing requirement in hundreds, if not thousands, of courts, a coherent conceptual framework remains conspicuously absent. As one judicial commentator noted, good faith continues to serve as a lodestar of minimal utility in light of the reality that the term “bad faith” covers:

...too may different kinds of conduct, in too many different situations. Indeed one is tempted to say that it is not a category at all, but merely a pejorative phrase, functioning at such a high level of abstraction that one can scarcely discern what might be underneath it. With all the cases before us, we can see that there is no principle uniting them. There is no showing that the same sorts of facts are not dealt with elsewhere in the law, perhaps in a more coherent fashion. In a search for a principle, one might as well take all cases in which the plaintiff is named 'Smith,' or which were filed on a Tuesday.<sup>144</sup>

43. Though the above-stated criticism had been levelled at the doctrine over a quarter of a century ago, it remains of considerable relevance in contemporary times in light of the fact that the standards that are being used to dictate what sort of debtor conduct or characteristics amount to “bad faith” remain no further advanced than when the above charge was made. Indeed, if nothing else, the doctrine has regressed, moving in the opposite direction<sup>145</sup> with the Courts crafting an increasingly lengthy laundry list of factors that it would take into account when determining as to whether there is “bad faith” while simultaneously adopting the stance that it

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as presently conceived is the square peg that is being forced into the “Chapter 11 abuse” round hole. For a more in-depth discussion of this, see Smith & Haines, *supra* note 98, at 501 – 503.

<sup>143</sup> Ponoroff & Knippenberg, *supra* note 5, at 923.

<sup>144</sup> *In re Victoria Construction*, 42 B.R. 145, 149 (Bankr. C.D.Cal. 1984).

<sup>145</sup> See Smith & Haines, *supra* note 98, at 499.

would be necessary would take into account an amalgam of factors rather than place reliance on a single fact but that the existence of a single factor, if sufficiently egregious, may be sufficient to amount to bad faith.<sup>146</sup> It need hardly be stated that as such a list grows, so too does the ambit of the Court's increasingly unbridled discretion. Unsurprisingly therefore, in most cases, the Courts fail to offer any principled justification or coherent rationale for the inquiry into whether the filing of the petition had been made in good faith; doing "little more than describ[ing] those prominent factors that are present in [each] case."<sup>147</sup> Even in borderline cases, critical analysis of how the debtor's actions warrant a bad faith finding is often eschewed and what invariably "passes for analysis of a debtor's good faith is usually no more than a conclusion."<sup>148</sup> In these circumstances, it is unsurprising that even the most strident of proponents of the good faith filing requirement concede that the implied good faith filing requirement has developed jurisprudence in an arbitrary, haphazard and unprincipled fashion.<sup>149</sup>

44. Indeed, taking the point further, it is particularly disturbing to note that there is considerable divergence amongst the Bankruptcy Courts even on the broader matter of the overarching *standard* that should be applied in assessing bad faith – while some courts insist on the application of an objective/subjective test,<sup>150</sup> others conclude that a debtor's subjective bad faith is, *ipso facto*, sufficient,<sup>151</sup> while yet others decline the invitation to take a determinative position as to whether an objective, subjective or some hybrid standard should be applied, insisting that the "totality of the circumstances" must be considered before deciding whether the filing had been made in bad faith.<sup>152</sup> Stripped to its essence therefore, the question of whether a petition was filed in good faith; indeed, even the evidential standards that should apply and the sort of factual matrixes that would be deemed to amount to bad faith depends, in large part, on

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<sup>146</sup> See *Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (In re Little Creek Dev. Co.)*, 779 F.2d 1068 (5th Cir. 1986)

<sup>147</sup> Cohn, *supra* note 48, at 134.

<sup>148</sup> Tyukody, Jr, *supra* note 9, at 805 – 806.

<sup>149</sup> See Miller, *supra* note 57, at 190 (In advocating for the statutory creation of a "good faith" standard, the author stated "Congress should provide an answer to a question that causes much delay and expense in bankruptcy particularly when recent case law is starting to cause conflicts over the continued viability of this eligibility requirement...A good faith rule will eliminate the excesses of the current bad faith case law. Some cases that actually belong in bankruptcy are dismissed on bad faith grounds merely because they are single asset real estate cases. The large number of reported decisions at the district court and court of appeals level that have reversed a bankruptcy's court dismissal based on bad faith illustrate this problem.") See also Mojdehi & Gertz, *supra* note 43, at 149 (While the authors supported the requirement, they nonetheless admitted that it had developed "notwithstanding Congress' deliberate elimination [of the] express good faith requirement").

<sup>150</sup> See, e.g., *Carolin Corp. v. Miller*, 886 F.2d 693 (4th Cir. 1989).

<sup>151</sup> See, e.g., *Phoenix Piccadilly Ltd. v. Life Ins. Co. of Va. (In re Phoenix Piccadilly Ltd.)*, 849 F.2d 1393 (11th Cir. 1988).

<sup>152</sup> See *Little Creek Dev. Co. v. Commonwealth Mortgage Corp. (In re Little Creek Dev. Co.)*, 779 F.2d 1068 (5th Cir. 1986).

the caprice of the views of the Bankruptcy Court, and Circuit, that a debtor happens to find itself before. As if that does not sufficiently complicate matters, the problems plaguing the development of a uniform standard infects even the application of already disparate standards to particular factual matrixes: to state but a few more prominent examples, while some courts have found that it would not necessarily be bad faith to file for bankruptcy solely for the purpose of utilizing a particular provision to its advantage,<sup>153</sup> others have concluded the converse.<sup>154</sup> Furthermore, while in some instances, the good faith requirement is seen as jurisdictional (with dismissal then necessarily becoming the only avenue that is open as a response to a filing made in bad faith), in others, it is not.<sup>155</sup> As can be seen from the above examples, rather than coming up with bright-line guidelines, standards appear to evolve not on principles, but on the application of personal predilections,<sup>156</sup> with what might be perceived to be a clear abuse of process by one bankruptcy judge being found to be nothing more than a legitimate litigation strategy to another.<sup>157</sup> Indeed, the divergences in practices and standards between circuits, and even individual courts within the same circuit, are so wide that more savvy debtors have begun to attempt to “game” the system, forum-shopping in a bid to have their case heard in the jurisdiction in which they feel most confident in being able to attain a favourable outcome:<sup>158</sup> as one judge, commenting extra-judicially, conceded, “the variance among the judges [on issues of good faith] is so considerable that to the extent debtors can choose [which court to file their petition in], they *are choosing*.”<sup>159</sup>

45. Admittedly, the reliance on personal predilections and the absence of a unitary unifying principle is, to a large extent, the invariable result of the employment of the “good faith”

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<sup>153</sup> See, e.g., *In re James Wilson Assoc.*, 965 F.2d 160, 170 (7th Cir. 1992) (“It is not bad faith to seek to gain an advantage from declaring bankruptcy, why else would one declare it?”); and *In re Bofill*, 25 B.R. 550, 552 (Bankr. S.D.N.Y. 1982) (rejection of contract constituted sole purpose for bankruptcy filing).

<sup>154</sup> See *In re Integrated Telecom* 384 F.3d 108, 128 (3rd Cir. 2004).

<sup>155</sup> By very definition, any Court that utilizes §362 of the Code to lift the stay as a result of a determination of bad faith must necessarily accept that the good faith doctrine is *not* jurisdictional, since if it were, it must follow that §362 cannot apply (as §362 is predicated upon the assumption that a valid bankruptcy proceeding were in force). See Smith & Haines, *supra* note 98, at 506–07.

<sup>156</sup> For further information on the personal predilections of bankruptcy judges and how it might affect filing rates and reorganizations, see Tom Chang & Antoinette Schoar, *The Effect of Judicial Bias in Chapter 11 Reorganization*, Unpublished manuscript, available at <http://mitsloan.mit.edu/finance/pdf/schoar-080106.pdf>.

<sup>157</sup> See Miller, *supra* note 57, at 188.

<sup>158</sup> As discussed earlier, this is not something particularly difficult to do in light of the fact that some courts have developed a reputation of being more “pro-debtor” than others. See LoPucki, *supra* note 39.

<sup>159</sup> See Gross, *supra* note 52, at 36. Another commentator argues that a more benign reason, namely subject matter expertise, may serve to inform the choice of forum in which a debtor may choose to file a Chapter 11 application: see Terry Brennan, *NY’s Record Lures Enron Bankruptcy*, DAILY DEAL, December 3, 2001. Whatever the *bona fides* of the motivation underlying the decision to file in one jurisdiction as opposed to another, it does not detract from the fact that a debtor can, by strategizing appropriately, file for Chapter 11 in a venue where it feels it is likely to be able to obtain the most efficient or desirable outcome.

appellation. In this regard, it is worthy to note that the problem is not one that is peculiar to the Code and has reared its ugly head in other aspects of the law that utilizes any variation of the good faith doctrine.<sup>160</sup> Good faith, by its very nature, is an inherently nebulous concept that eludes definition or easy characterization. Be that as it may, given the patent absence of any legislative provision that mandates the use of such an open-ended and vague standard, it is important not to forget that recourse to the good faith doctrine represents a judicial gloss on the Code.<sup>161</sup> To the extent that such judicial gloss has become unprincipled and lacks a strong conceptual foundation, it detracts from its own *raison d'être*, for, at its core, the doctrine is only of utility “if it has some expository convenience – [that is] if it can help counsel and litigants to understand just what they should and should not do in any given case.”<sup>162</sup> It should be plainly evident that as things stand, the ad-hoc, divergent, and often inconsistent paths traversed by different circuits and courts on an idiosyncratic basis has done precious little to provide any sort of useful guidance to counsel, creditors and debtors alike,<sup>163</sup> or, indeed, inspire confidence in the prospects of the eventual development of a coherent and principled doctrine in the near future.

46. In this connection, in response to the criticisms of idiosyncrasy and arbitrariness levelled against the good faith filing requirement (such as the ones advanced above), numerous commentators have retorted with the argument that such precise standards are not to be expected: they argue that the bankruptcy court is a court of equity, and, accordingly should not feel constrained to work within the four walls of the Code and should be allowed to incorporate extrinsic elements if so doing achieves the ends of justice insofar as it allows the Courts to

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<sup>160</sup> For a more in-depth exposition of the problems inherent in the use of the “good faith” doctrine elsewhere, see Flaccus, *supra* note 57, at 435 – 441.

<sup>161</sup> This should be seen in contrast with the situation in 11 U.S.C. §1129(a), where Congress has specifically instructed the Courts to keep in mind “good faith” considerations. In that particular situation, the Court’s assessment of the *bona fides* of the filing is not predicated upon the Court’s unilateral desire to undertake such a cumbersome and value-laden inquiry, but based on the Congressional instruction for them to undertake that inquiry.

<sup>162</sup> *In re Victory Const. Co., Inc.*, 42 B.R. 145, 148 – 9 (Bankr. D. Cal. 1984).

<sup>163</sup> This is not to say that there has been a lack of attempts, particularly within academia, to distil a coherent theory of corporate reorganization that serves as a workable analytical model to govern the consideration of the *bona fides* of all bankruptcy applications. Nonetheless, such analytical models have, however conceptually sound, been completely unworkable in practice. An example would serve to prove the point: one commentator, after surveying the problems inherent in the numerous tests presently being advanced as an analytical framework with which to gauge the *bona fides* of an application, *i.e.* the objective-subjective, objective, subjective and totality of the circumstances tests, arrived at the view that the objective-subjective test should be applied uniformly as the defining test of whether an application should be rejected on the basis of lack of “good faith”, a test the commentator admits is necessarily wide and encompasses, *inter alia*, any and all of the factors that fall within the “totality of the circumstances” test. See Carlos J. Cuevas, *Good Faith and Chapter 11: Standard that Should be Employed to Dismiss Bad Faith Chapter 11 Cases* 60 TENN. L. REV. 525 (1993). With respect, such a test ignores the point that was advanced in *In re Victory Const. Co., Inc.*, namely that for a “good faith” test to be of utility, it must not only be underpinned by a coherent policy but must simultaneously be informed by commercial realities in that it must be sufficiently precise to guide the behaviour of the parties involved in a Chapter 11 application.

ensure that their powers are not improperly invoked.<sup>164</sup> Such an argument is predicated upon the rectitude of two related arguments: first, that the Bankruptcy Court is, to begin with, a court of equity, and second, if that is in fact the case, that a court of equity should, and would, derogate from the strictures of the Code in the manner that the Bankruptcy Courts have hitherto. Neither of these dual-fold assumptions bears out on closer analysis. Turning first to the contention that the Bankruptcy Court is a court of equity (that is accordingly endowed with broad powers), while such a view is a pervasive one, with numerous academic, judicial and Congressional commentaries<sup>165</sup> all alluding to the Court's inherent ability to marshal proceedings to ensure that the Code is not being utilised in a manner that is inconsistent with its underlying intent, the logic of such a contention is debatable. Indeed, until very recently, the received wisdom that the bankruptcy court is a court of equity eluded sharp judicial and academic focus, with the lack of scholarship critically analyzing the veracity of the appellation of the Court as an "equitable" one over time further entrenching the time-worn perception of the Bankruptcy Court as a court of equity, one that is not restricted by the strictures of statute in its overriding goal of doing justice. Two recent comprehensive studies of the genesis of the bankruptcy laws in the United States, by a judicial and academic commentator respectively,<sup>166</sup> however, have quite convincingly questioned the veracity of such prevailing sentiment, noting that US bankruptcy laws did not originate from the practices of the English chancery courts, but are, in fact, the direct descendants of creatures of statute. Such a conclusion mirrors the oft-forgotten observation of the Fifth Circuit some sixty years back that the Bankruptcy Court "is not strictly a court of equity, but a statutory court created by [statute], and governed by it."<sup>167</sup> If the Bankruptcy Courts are not courts of equity, it would follow that it is not endowed with the power to dismiss a Chapter 11 filing for "bad faith" if such powers cannot be implied to fall within the statutory structure of the Code. Put another way, as the Bankruptcy Court is a court with statutorily-defined powers, it is

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<sup>164</sup> See Miller, *supra* note 57, at 193 ("The bankruptcy court itself is a court of equity and the concept of good faith and fair dealing is the overriding concern for equity").

<sup>165</sup> For representative commentaries emanating from each of these constituents that rely on this concept, see *id.* as well as *In re Victory Construction Co Inc* 9 B.R. 549, 558 (Bankr. CD. Cal. 1981) ("That borderline is patrolled by courts of equity, armed with the doctrine of "good faith": the requirement that those who invoke the reorganization or rehabilitation provisions of the bankruptcy law must do so in a manner consistent with the aims and objectives of bankruptcy philosophy and policy must, in short, do so in "good faith"); *SEC v. US Realty & Improvement Co* 310 U.S. 434 (1940) ("[A] bankruptcy court is a court of equity...and is guided by equitable doctrines and principles...") and H.R. REP. NO. 95 – 595, at 395 (1977), reprinted in 1978 U.S. CODE CONG. & AD. NEWS 5963, 6315 ("The bankruptcy court will remain a court of equity").

<sup>166</sup> See Marcia Krieger, "The Bankruptcy Court is a Court of Equity": What Does that Mean? 50 S.C. L. REV. 275 (1999) and 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 (2005).

<sup>167</sup> *Berry v. Root* 148 F. 2d 945, 946 (5<sup>th</sup> Cir. 1945).



not seized of any non-statutory equitable authority,<sup>168</sup> and to that end, is not endowed by unlimited inherent powers to dismiss a suit for bad faith solely on the premise of “equitable considerations” that are devoid of any coherent or consistent conceptual foundation that is not inimical to the legislative schema of the Code. In any event, it should be observed that the notion that a court of equity is not circumscribed by any restrictions is misleading, indeed, fallacious, for it erroneously equates equity with capriciousness and arbitrariness, a contention that is wholly inconsistent with the fundamental and oft-repeated maxim that *equity follows the law*.<sup>169</sup> As has been observed elsewhere, such sweeping notions of the powers of the Bankruptcy Courts to facilitate “individualised justice” are in blatant disregard of legal norms and betray a rather simplistic view of “equity”.<sup>170</sup> Having regard to these considerations, there is little probative force in the contention that Bankruptcy Courts, as courts of equity, should arrive at conclusions in their decisions in a manner that reflects no consistent unifying or overarching principle.

47. More importantly, the considerable vagaries of the good faith filing requirement raises the separate, albeit related, matter of the fact that the ills that are sought to be redressed *via* recourse to the good faith filing requirement are, in fact, better addressed by way of recourse to the plethora of provisions that exist under the Code that were put in place in order to ensure that the bankruptcy regime is not abused. In contending that the good faith filing doctrine is essential to the long-term health of the bankruptcy regime, one typical argument canvassed in favour of the status quo is that without it, secured debtors would find themselves prejudiced as a result of being unable to foreclose on properties, force unsecured creditors to refrain from suing for damages or enforcing judgments, and provide the debtor the opportunity to “conceal, impair or waste assets or otherwise defraud creditors”.<sup>171</sup> Such arguments necessarily presuppose the inefficacy of the other provisions of the Code as a cumulative (and rigorous) tool to cater to the situations that the good faith filing requirement is primarily directed towards. In reality, however, many of the provisions in the Code are, in fact, able to marshal the boundaries of the Code and restrict illegitimate debtor behaviour relatively well. For example, addressing one of the concerns articulated earlier, *i.e.* the concern that postponement of the good faith inquiry until confirmation

<sup>168</sup> See Ahart, *supra* note 166, at 50.

<sup>169</sup> See, for example, *Graf v. Hope Building Corporation* 254 N.Y. 1, 9 (1930), *per* Cardozo J (“Equity works as a supplement for law and does not supersede the prevailing law”). This would also explain the decisions of the Supreme Court in both *Taylor v. Freeland & Kronz* and *Toibb v. Radloff*, as discussed at some length above, insofar as an unrestrained Court would have been free to decide that it should not be bound by the provisions of the Code in the manner that the Supreme Court, in both those cases, decided.

<sup>170</sup> See Krieger, *supra* note 166, at 310 (“Not understanding the historical or jurisprudential meaning of the phrase “court of equity”, litigants use it to request a result which they perceive as fair and just. In colloquial terms, one might call this “Burger King justice” or “justice my way.”)

<sup>171</sup> Di Donato, *supra* note 9, at 4.

may fail to effectively police debtor behaviour in the interim, thus providing debtors with the opportunity to defraud creditors, can be effectively addressed by seeking the appointment of a trustee or an examiner under Section 1104.<sup>172</sup> In a related vein, where assets have been transferred to a new entity, which is a distinguishing feature of the relatively common “new debtor” cases (which is, in most instances, a subset of the single asset cases), and where such transfers were made in the absence of fair consideration, fraudulent transfer laws can surely be relied upon for such transactions to be unwound.<sup>173</sup> Indeed, as already alluded to at some length earlier, many of the factors that have hitherto been cited by the Courts as factors that warrant the dismissal of petitions on the back of the implied “good faith” exception can be similarly utilized to facilitate dismissal under Section 1112(b).<sup>174</sup> Although this is an observation that has not escaped judicial focus, curiously enough, such is the exalted status accorded to the good faith filing requirement that even in instances where the Bankruptcy Court does, in fact, take cognizance of the fact that petition can be dismissed pursuant to an *explicit statutory provision* (which, one would have logically assumed, would have been the proper course to take where such provision exists); it is nonetheless an option that is given short shrift, with the Court apparently guided by the viewpoint that recourse to the *implied* good faith filing requirement should constitute the first port of call when dismissing such petitions.<sup>175</sup>

48. The lack of judicial reticence to utilize the good faith concept liberally and in a manner that apparently usurps the role that Congress had intended the carefully-crafted provisions to play even when such provisions may be directly on point and squarely applicable brings to fore a related problem plaguing the application of the good faith doctrine *vis-à-vis* the Code: by placing considerable reliance on the doctrine, and using it as a crutch of sorts, the Courts may have inadvertently obfuscated the fact that many of its practices have, over time, deviated significantly from their *normative* underpinnings, thus shielding such practices from the glare of judicial scrutiny, thereby hindering *genuine* and *effective* reform. This is an important consideration in the present debate not only because of the importance of ensuring the alignment of bankruptcy

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<sup>172</sup> Indeed, in this regard, it is worthy to point out that the Bankruptcy Courts in the United States have often appointed examiners for a wide variety of tasks, tasks that, very often, appear to veer considerably off the statutory boundaries of what they are empowered to do. See WARREN & WESTBROOK, *supra* note 51, at 437.

<sup>173</sup> Either by recourse to state law (in the form of the state-equivalent of §4 of the Uniform Fraudulent Conveyances Act or §5 of the Uniform Fraudulent Transfer Act) or to federal bankruptcy law (*i.e.* §544(b) or §548 of the Code). For a deeper insight on how those provisions could stymie “bad faith” transactions, see Flaccus, *supra* note 57, at 431 – 432. Needless to say, if in fact, *fair* consideration was provided, the question of “abuse” becomes moot, since the creditors can then seek to claim against the new value that had been furnished by the debtor.

<sup>174</sup> See Smith & Haines, *supra* note 98, at 505 – 506.

<sup>175</sup> See, *e.g.*, Gross, *supra* note 52, at 20 (Comments of Judge Robert Mark, Bankruptcy Judge of the South District of Florida).

laws with societal norms of the day, but, perhaps more pertinently, because although creditors invariably formulate their objections to a filing under the nomenclature of bad faith, in truth, it is their patent dissatisfaction with some of the Bankruptcy Court's practices that motivate such challenges on the premise that the debtor's application was made in bad faith. At bottom, creditors whose actions are primarily motivated by their bottom-line, are not, and have never been, genuinely concerned with the *bona fides* of a debtor filing the petition except where such appellations can be effectively utilised by them as a convenient vehicle to escape from the clutches of what they perceive to be a partial bankruptcy regime, a regime which, in the eyes of such creditors, possesses a putative "tendency to fudge the answers"<sup>176</sup> in a manner that invariably leaves them (*i.e.* the creditors) short-changed.<sup>177</sup> These considerations play out in different ways and stem from disparate animating sources of dissatisfaction. For example, it has been suggested in many cases, and particularly in single asset real estate cases, where the motives underlying the filing of the petition are questioned by a secured creditor, providing relief *via* a finding of bad faith does no more than alleviate the symptoms caused by the *real* problem, namely the perception of an overly-conservative interpretation of what amounts to "adequate protection" under Section 362 of the Code and a perceived systematic over-valuation of collateral, both of which acts to the prejudice of creditors.<sup>178</sup> In many strategic bankruptcies on the other hand, the real concern on the part of creditors is not whether there is bad faith underlying the application, since in many such filings, the equity-holders themselves are unlikely

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<sup>176</sup> See Tyukody, Jr, *supra* note 9 at 803. It warrants mention at this juncture that the author of this paper disagrees with Tyukody's characterization of the tendency of bankruptcy courts to fudge the situation in his paper as "unfortunate" – on the contrary, the author takes the view that one of the key strengths of the American bankruptcy regime lies in its ability to achieve a expeditious and definitive resolution of a debtor's financial status; in the author's view, sacrificing complete accuracy at the altar of expediency (by estimating contingent claims and valuations of security etc) is not necessarily a negative thing. Be that as it may, it should also be stressed that this point is, of course, quite separate from the point being proposed here, namely the perception that most of such estimates invariably come out in favour of the debtor, thus raising wariness and suspicion on the part of creditors as to the bankruptcy process.

<sup>177</sup> This point speaks, in part, to the related longstanding debate in the academic world on the extent of discretion that the Bankruptcy Court should be endowed with. While one school of thought questions the ability of bankruptcy judges to fairly adjudicate over competing interests in a manner that ensures efficient asset deployment, the opposing school of thought argues that bankruptcy judges, as impartial decision makers, are the best placed to make such difficult decisions. See generally Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV 775 (1987) and, in response, Douglas G. Baird, *Loss Distribution, Forum Shopping and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV 815 (1987).

<sup>178</sup> For a listing of examples alluding to this putative bias, see Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV 97, 103 (1984). It should be noted; however, that the point the author is canvassing is informed more by the *perception* of bias, than it is about the *existence* of *actual* bias (or, indeed, the ability to prove the existence of such bias): it should be clear beyond peradventure that as long as a creditor *perceives* he is not going to get a fair outcome within the bankruptcy framework, and as long as such perceptions are not disabused, the matter of whether he is, or is not going to, in fact, get a fair deal in bankruptcy becomes superfluous and wholly moot, since such perceptions themselves would, *ipso facto*, portend a spike in "bad faith" applications.

to receive more in a “bad faith” bankruptcy than they would have received as part of their rights under state law,<sup>179</sup> but the concern on the part of the creditor opposing the petition that the Bankruptcy Court would invariably undervalue their contingent claims.<sup>180</sup> Seen in the light of such concerns, the implied good faith filing requirement, a vehicle that was no doubt conceived in order to uphold the laudable values and objectives of the Code ironically becomes nothing more than a veneer masking the Code’s, and bankruptcy practice’s, other, more severe, inadequacies. By not confronting such perceived lack of confidence in the bankruptcy framework directly, the continued employment of the good faith filing requirement to sandpaper over such problems may inadvertently serve to diminish the relevance of the Code and the federal bankruptcy framework in the longer term.<sup>181</sup> At the risk of stating the obvious, such an argument resonates with equal force in the international realm – by allowing the good faith filing requirement to shield from critical scrutiny other crucial provisions that form part of the intricate gestalt that is Chapter 11, other countries contemplating the move towards a Chapter 11-like framework would become blinded to the numerous problematic aspects of the US model that are sandpapered over as a result of the overarching (and erroneous) application of the “good faith” filing requirement and are, as a result, given a more pristine view of the Chapter 11 framework than the practical realities may otherwise suggest.<sup>182</sup>

49. In the interest of completeness, it should be stressed that in the absence of empirical evidence that suggests otherwise, the inflated rhetoric that parties have to incur additional expenses (for having to partake in an “unnecessary” Chapter 11 proceeding) in the absence of a good faith filing requirement is highly speculative and, in any event, unconvincing, for it ignores the considerable costs that are incurred as a result of the copious amounts of satellite litigation stemming from the uncertainty and confusion that have formed part of the bankruptcy landscape by virtue of the vague and consistently shifting standards of what amounts to bad faith.<sup>183</sup> Indeed, the vagaries of the good faith doctrine may very well have imposed more exacting costs

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<sup>179</sup> Baird, *supra* note 177, at 818.

<sup>180</sup> *Id.* at 815 – 819.

<sup>181</sup> Indeed, there is already some empirical evidence suggesting that the Chapter 11 model is buckling under the not-inconsiderable pressures of such perceptions of the problems plaguing its effectiveness. One commentator, for example, in coming to the conclusion that the mechanism has “failed”, noted that there was increasingly infrequent use of the mechanism by public companies in the five years preceding 2007. See Miller, *supra* note 110, at 376 – 377 (“The winter of our discontent [in relation to Chapter 11] began in 2003 and has continued almost to date [*i.e.* 2007]”).

<sup>182</sup> *Supra* note 29.

<sup>183</sup> As one study of 227 reported opinions show, almost one in every two such applications fail. Given the large “failure” rate, the costs imposed on debtors and creditors as a result of such satellite litigation can be considerable. See Flaccus, *supra* note 57, at 438.

on the bankruptcy regime through protracted litigation than the costs that are likely to be imposed on all of the parties concerned through the increase in the absolute number of bankruptcy proceedings that would invariably result from the elimination of the good faith doctrine.<sup>184</sup> In any event, arguments surrounding costs stemming from increasingly prolific use of Chapter 11 may be misguided: the very fact that there would be more Chapter 11 proceedings surely cannot, in and of itself, be indicative of a failure of the entire framework – indeed, if a recent World Bank study that suggests the existence of a discernable link between the frequency of bankruptcy filings *per capita* with the country’s economic development serves as any sort of barometer,<sup>185</sup> an increase in the number of parties willing to seek recourse to Chapter 11 may very well be a *good thing*, not a *bad thing*.<sup>186</sup> To that end, even if one could blithely assume that more would be spent on Chapter 11 proceedings if the good faith filing requirement is abolished than from satellite litigation *vis-à-vis* the matter of whether an application is filed in good faith, such statistics would be of relatively little persuasive force in supporting any argument *for* the acceptance of the good faith filing requirement since the *absolute* costs of Chapter 11 proceedings must not be seen *in vacuo* and must, instead, be viewed in contrast to the tangible and intangible benefits that would accrue from the likely increase in restructurings (and accrual in value from the fact that debtor corporations need not be sold in pieces through Chapter 7 bankruptcy) as a result.<sup>187</sup>

50. Drawing the various threads of analyses together then, quite apart from the arguments that had already been canvassed earlier, the vague and consistently shifting standards of what amounts to a lack of good faith incurs a prohibitively high cost in a field of law where certainty and clear guidelines are of considerable, if not paramount, importance and, to that extent, serves as an additional argument against the continued employment of the good faith filing doctrine under Chapter 11. Furthermore, by placing primary reliance on judicial gloss rather than the

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<sup>184</sup> *Id.* at 435–441.

<sup>185</sup> It should be stressed though that any such conclusion is by no means determinative, since it is recognized that such a conclusion is subject to a variety of infirmities and that a complex amalgam of factors, too complex to be ventilated completely here, must surely be considered before any such conclusion can be given considerable weight.

<sup>186</sup> See Stijn Claessens & Leora Klapper, “Bankruptcy Around the World: Explanations of its Relative Use”, online: <[http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2002/10/12/000094946\\_02080204172482/Rendered/PDF/multi0page.pdf](http://www-wds.worldbank.org/servlet/WDSContentServer/WDSP/IB/2002/10/12/000094946_02080204172482/Rendered/PDF/multi0page.pdf)> (last visited Feb. 15, 2010). See also Symposium, *Resolved: The 1978 Bankruptcy Code Has Been a Success (A Debate)* 12 AM. BANKR. INST. L. REV. 273, 274 (2004) (Where it was argued that “...one measure of the successful contribution of our business bankruptcy system to general economic health lies in the fact that there are, in fact, a lot of business bankruptcies in [the United States]. The system is actually used”)

<sup>187</sup> If the inherently unobjectionable point that different judges applying their minds may arrive at different conclusions as to whether particular factual matrixes would amount to “bad faith” or otherwise is accepted, it must necessarily follow that the complete rejection of the good faith filing requirement would, *ipso facto*, increase the number of restructurings under Chapter 11. As for the tangible and intangible benefits of restructuring, such benefits have been discussed in length *in extenso* elsewhere and need not be repeated here.

express provisions of the Code, the Courts have ignored the fact that, in a large majority of instances, the provisions of the Code would cumulatively serve as a sufficient bulwark against potential abuse, and where they do not, only serves to deviate attention from the necessary reform that should be effected to various provisions in the Code as well as to undesirable court practices in order to develop a bankruptcy regime that is able to align the motivations of the different parties without recourse to considerations or motivations extrinsic to the Code.

## VI. OPTIONS FOR REFORM & PRACTICAL OBSTACLES IN THE UNITED STATES

51. From the above discussion, it should be plainly apparent that the good faith filing requirement is “contrary to the statute, illogical, and unworkable in its application”<sup>188</sup> and that, properly conceived, the ills that plague the good faith filing requirement brings into sharp focus the poverty of any justification for its continued existence in its present construct. This, of course, raises the attendant query: if the good faith filing doctrine in its present form should not serve as a singular lodestar that Courts utilize as the guardian to the gates of Chapter 11, what are the appropriate means by which to effect reform to the present *status quo*? Though opinions on the consonance of the good faith doctrine with the Code can be said to broadly be divided into two, diametrically opposed schools of thought, recommendations for reform lie on a much broader spectrum, with suggestions ranging from eliminating the good faith doctrine altogether,<sup>189</sup> to pushing for the promulgation of an explicit good faith requirement,<sup>190</sup> to placing an additional caveat to the good faith filing requirement such that it becomes a test applicable solely to Chapter 11 “restructurings” and not Chapter 11 “liquidations”,<sup>191</sup> to the reconceptualization of the good faith doctrine such that it plays an even more central role in furthering the ever-changing policy and social objectives of bankruptcy.<sup>192</sup> Though an in-depth discussion of each of these different approaches to possible reform in the United States falls outside the intended scope of this paper, it is nonetheless an issue that is worthy of brief consideration, since the approaches to reform in the United States are of considerable value insofar as they may simultaneously serve as possible options to explore by other jurisdictions erecting analogues to Chapter 11 and which are seeking to tamper with the good faith filing requirement in a manner that ensures its consonance with the reorganizational thrust of the

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<sup>188</sup> MARTIN BIENENSTOCK, BANKRUPTCY REORGANIZATION 28 (1987).

<sup>189</sup> See Flaccus, *supra* note 57, at 435 – 445.

<sup>190</sup> See generally Miller, *supra* note 57.

<sup>191</sup> See generally Mojdehi & Gertz, *supra* note 43.

<sup>192</sup> See generally Ponoroff & Knippenberg, *supra* note 5.

mechanism. In this regard, this paper would argue that all the approaches, save for the call to eliminate the good faith doctrine altogether, would serve to further obfuscate, rather than clarify, the law and invite further ambiguity and capriciousness into the restructuring framework: while the recommendation to impose an additional caveat (*i.e.* that the doctrine should apply only to “restructurings” and not “liquidations”) adds a further layer of complexity to an already fractured and incoherent structure, the proposal to re-conceptualize the good faith doctrine such that it be embraced as a policy tool fares little better, not only by contravening the division of responsibilities envisioned by the Constitution (a point which of course may be of little relevance to other jurisdictions), but effectively granting a *carte blanche* license to justify and promote the use of personal predilections by the Bankruptcy Courts in a field where coherence and consistency are, for reasons already alluded to at length earlier, of considerable importance.<sup>193</sup> In the interest of completeness, it should be highlighted that the recommendation to entrench the good faith filing requirement in the Code would, for self-evident reasons in light of the preceding discussion, solve none of the problems caused by the continuing existence of the doctrine, and indeed, will only serve to further exacerbate them. By process of elimination therefore, the only solution that has been canvassed by the academic world hitherto that appears worthy of further exploration would be the abolition of the doctrine altogether.

52. Whilst the direction of reform in the United States is clear, the prospect of such reform is, unfortunately, less so. Indeed, the recommendation proposed above, whilst easy enough to appreciate in theory, is, unfortunately, near impossible to implement, for it conveniently ignores the compendium of practical considerations that stand in the way of reform. In fact, conventional wisdom suggests that, notwithstanding its faults as canvassed above, the good faith filing requirement is likely to persist and “continue to be invoked when the Court finds that the system is being abused.”<sup>194</sup> This stems from the confluence of a few disparate factors. For one, even if it could be quite convincingly canvassed that, as a matter of law, the doctrine conflicts fundamentally with the bankruptcy framework and with historical analysis, the fact that the Circuit Courts that have had the opportunity to confront the matter have thus far spoken with one voice and the lack of even a singular Circuit Court decision that departs from the prevailing wisdom of the propriety of the imposition of a good faith filing requirement renders it inevitable that clarity in the state of the law is unlikely to emanate from the apex of this country’s judicial

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<sup>193</sup> Indeed, such a recommendation renders §1112(b) otiose, for if the Court is essentially allowed to decide policy in a broad, overarching way, and sees itself as the arbiter of social and economic policy, why would it matter how §1112(b) serves to circumscribe its discretion?

<sup>194</sup> See BROUDE, *supra* note 8, at ¶ 7 – 27.

system, at least not for the foreseeable future.<sup>195</sup> Exacerbating this situation is the reality that even though Circuit Courts are not bound by their own prior determinations, previous experience suggests that such a judicially-imposed requirement is invariably viewed by the Courts as being so intuitively “fair and unexceptionable”<sup>196</sup> that it is difficult to imagine any Circuit Court willing to take such a bold step<sup>197</sup> – as one judge puts it, rather succinctly, “good faith, like apple pie, is hard to oppose.”<sup>198</sup> Unfortunately, similar practical problems are likely to plague any attempt by Congress to clarify the law: quite apart from the obvious point that it would be contrary to conventional wisdom to legislate in the negative, *i.e.* to articulate what is *not* a prerequisite to seeking relief under the Code, as opposed to what *is*, in fact, a requirement, the fact that the term “good faith” is imbued with a connotation of an innate sense of fairness and fair play makes it unlikely that any such reform would be readily embraced or perceived positively by the public and may be seen to be an overly-risky move that may considerably erode the legislature’s political capital.<sup>199</sup>

53. The reality therefore is that notwithstanding the powerful arguments discussed above that plainly speak to the need for reform, arguments informed not just by academic theories but by the practical ramifications that would stem from the continued retention of the good faith filing requirement, it is unlikely that any action would be taken by either the upper echelons of the Courts in the United States, or by Congress, to disabuse the Courts in the United States of the

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<sup>195</sup> For an example of the difficulties of appealing to the Supreme Court on the question of whether a good faith filing requirement exists, *see* Trident Assocs. Ltd. Partnership v. Metropolitan Life Ins. Co. (*In re* Trident Assocs.), 52 F.3d 127 (6<sup>th</sup> Cir. 1995), *cert denied*, in which a petition for cert was denied.

<sup>196</sup> BIENENSTOCK, *supra* note 188, at 28.

<sup>197</sup> That Courts would be extremely slow to be seen rejecting the good faith doctrine even when confronted with evidence suggesting that the good faith doctrine does not exist is perhaps most obvious when seen in the context of the immediate aftermath of the Massachusetts Bankruptcy Court decision of *In re* Victoria Ltd. Partnership, 187 B.R. 54, 54 (Bankr. Mass. 1995). In that case, the Court gave extensive reasons as to why the good faith doctrine is inconsistent with the Code and should not be invoked. In two cases heard almost immediately thereafter in Colorado and New Jersey respectively, the Court was urged to utilize the reasoning adopted in *In re* Victoria Ltd. Partnership and to conclude that there was no good faith filing requirement. In neither case was an exposition into the motivations of the good faith filing doctrine even attempted, with one Court merely suggesting rather unconvincingly that “[t]he concerns expressed by the Victoria Court are not an issue in the present case” (*In re* Y.J. Sons & Co., Inc 212 B.R. 805 (D.N.J. 1997)) and the other deciding to simply allude to the “well-established” power of the Court to dismiss a bad faith petition without more (*In re* Pacific Rim Investments, LLP, 243 B.R. 768 (D. Colo. 2000)), in effect taking the very step of “following one another like sheep without ever questioning the underlying authority of the leader” that *In re* Victoria Ltd. Partnership explicitly warns against.

<sup>198</sup> *In re* Victoria Ltd. Partnership, 187 B.R. 54, 54 (Bankr. Mass. 1995).

<sup>199</sup> If the fear is that Congress would be uncomfortable with being seen to hinder the continued existence of a doctrine with undeniably laudable goals, then one possible middle-ground solution if Congress wishes to take the lead might be that rather than attempt to promulgate an express provision that bars the judicial consideration of the good faith doctrine, such reform could take the form of amendments to either Sections 1112 or 109 of the Code insofar as such amendments would serve to clarify that those provisions act as *exhaustive* grounds for whether a party has standing to seek the protection of Chapter 11. The author is, however, not optimistic about the prospects of such reform.



notion of the propriety of the continued application of the good faith filing requirement as a barrier to Chapter 11 relief.

**VII. INTERNATIONAL SOLUTIONS TO AN INTERNATIONAL PROBLEM: USING THE PROBLEMS SURROUNDING THE GOOD FAITH FILING REQUIREMENT IN THE UNITED STATES TO INFORM THE CHAPTER 11 REFORM MOVEMENT**

54. It would be apposite, at this juncture, for us to return to the international front and reflect upon the lessons that one can distil from the continued existence, and application, of the good faith filing requirement in the United States. It would, however, be important to preface any such discussion with the observation that the conclusion that the United States experience with the good faith filing requirement is able to impart pertinent lessons that the rest of the world, in particular, those seeking to reform their insolvency frameworks to incorporate Chapter 11-like mechanisms, can learn from, is predicated upon the assumption that lessons from one's mistakes in the realm of insolvency or bankruptcy laws are able to transcend geographical boundaries. Not everyone may necessarily agree with such a contention: indeed, it is worthy to note that it has become almost trite to observe that notwithstanding the considerable convergence of insolvency and bankruptcy frameworks internationally, fundamental differences remain across jurisdictions; seismic differences that are reflective of the cultural differences and societal attitudes to bankruptcy inherent across such jurisdictions<sup>200</sup> and that by extension, renders the experiences of one jurisdiction of limited applicability or guidance in informing the reform of another.

55. It is, however, germane to note that there is a marked distinction between *comparing different regimes predicated on discrete underlying beliefs* and *comparing one regime seeking to adopt a particular framework with the experiences of the regime on which it is modelled*: to be sure, in the former, having regard to the truism that bankruptcy remains, in large part, "one of those laws that cannot perform its function unless it is symmetrical to the market in which it operates,"<sup>201</sup> insofar as such differences in insolvency and bankruptcy regimes are, in fact, the result of marked societal and cultural distinctions<sup>200</sup>, there is considerable wisdom in the contention that such differences may necessitate vastly different approaches in answering the same

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<sup>200</sup> See, for example, Harry Rajak, *Editor's Introduction*, in HARRY RAJAK ED., *INSOLVENCY LAW: THEORY & PRACTICE* 1, 12 (1993).

<sup>201</sup> See Westbrook, *supra* note 11, at 2277. See also IAN FLETCHER, *INSOLVENCY IN PRIVATE INTERNATIONAL LAW: NATIONAL AND INTERNATIONAL APPROACHES* 4 (1999) ("There is a profound and intimate correlation between insolvency – whether individual or corporate – and the very wellsprings of policy and social order from which national law ultimately draws its inspiration. For this reason, despite numerous general resemblances, national insolvency laws and procedures differ from one another almost infinitely in ways both great and small").

question,<sup>202</sup> and, almost by definition, renders the experiences of one jurisdiction that is dependent on the context of that particular jurisdiction of limited guidance for another. Nonetheless, where such dissimilarities between jurisdictions are not, in fact, differences predicated upon different cultural norms or understanding,<sup>203</sup> and, indeed, where the reform being envisioned embraces the underlying philosophies of the legislative framework that is being replicated (as is the case here where other jurisdictions are explicitly attempting to incorporate the “rescue philosophy” underpinning the Chapter 11 regime into their respective jurisdictions), it must surely be advancing an uncontroversial proposition to suggest that there is much that can be learnt from the experiences of such jurisdictions in grappling with the problems inherent in that framework.<sup>204</sup> With that in mind, if, as most commentators do, this paper accepts that numerous other countries are, indeed, beginning to adopt reorganizational models predicated on some variation of Chapter 11 in their respective insolvency and bankruptcy frameworks,<sup>205</sup> how should the preceding discussion inform the international reform movement towards the erection of such legislative frameworks?

56. A few observations are, in the author’s view, plainly in order. First, if the discussion hitherto of the consonance of the good faith filing requirement with the historical development and underlying policy of the Code serves as any guide, notwithstanding the intuitive fair and meritorious nature of an appellation such as “good faith” to marshal the boundaries of the Code since it would appear to protect against *wrongful* and *objectionable* use of such a framework, countries seeking to replicate Chapter 11 in their respective jurisdictions should be slow to uncritically accept that the good faith filing requirement serves as an integral part of, and necessary prerequisite to, the success of any reorganizational, or Chapter 11-like, framework. After all, as the preceding discussion illustrates, the good faith filing requirement tends to impair, rather than promote, the fundamental tenets of Chapter 11 and has engendered the very problems its’ (attempted) abolishment had been intended to overcome, namely the development of considerable satellite litigation initiated by creditors more than willing to advance any plausible argument in the hope of frustrating the possibility of entering into a regime that is putatively

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<sup>202</sup> For example, the UK administration regime and the US reorganization regime would no doubt offer different answers for questions such as, “Should there be a threshold requirement for lack of funds before a debtor would be allowed to file for bankruptcy?” and “Who should generally be in charge of the company should it file for bankruptcy?”

<sup>203</sup> See DAVID BROWN, CORPORATE RESCUE: INSOLVENCY LAW IN PRACTICE 750 (1996).

<sup>204</sup> Germany, for example, has varied various aspects of the Chapter 11 model before introducing it into their legislative framework in order to attempt to address purported high failure rates and delays that Germany felt was symptomatic of the US framework. See Warren & Westbrook, *supra* note 10, at 605.

<sup>205</sup> See SKEEL, JR., *supra* note 33, at 126.

detrimental to its legal position, and the need for Bankruptcy Courts to assess the prospect of rehabilitation of a debtor at a far too premature juncture, where too little is known about the long-term future of the debtor seeking provisional protection. Second, as is evidenced by the continuing elusiveness of a unifying principle or criteria that governs the application of the doctrine and the reality that cases appear to be decided on individually-held idiosyncratic notions of what amounts to legitimate novelty as opposed to unacceptable abuse, the American experience is illuminating insofar as it highlights the fact that an amorphous appellation that is incapable of precise definition (*i.e.* “good faith”) does not constitute an effective tool to govern the threshold requirements in a field of law predicated primarily on certainty and set requirements. Exacerbating this is the reality that, particularly in larger jurisdictions where the court structure is decentralized, a trend of “forum shopping” would be likely to manifest, with debtors likely to find ways to file for bankruptcy not in the Court with the most apparent or clear nexus, but in the Court which would appear to possess an apparently lower threshold (*i.e.* a Court that is less inclined to conclude that a filing had been made in bad faith) for what constitutes a successful filing. All of these developments are likely to diminish the effectiveness of the Chapter 11 structure envisioned by these jurisdictions.

57. How should the practical impossibility of reining in the good faith filing requirement in the United States inform reform efforts to enact Chapter-11 like structures in other jurisdictions internationally? Well, for one, the unobjectionable nature of an appellation such as “good faith” that poses a significant hurdle to any reform in the United States renders it imperative that countries be acutely sensitive to the problems plaguing the US regime during the deliberation and discussion process as to the form of Chapter-11 like framework that they intend to adopt and consider the manner in which they would tackle the problem. If the US experience has taught us anything, it must surely be that the failure to tackle the problem head-on during the process of tinkering with the Chapter 11 framework in the process of adapting it for local use is likely to result in considerable problems in future years.

58. The problems encountered by the United States also point to another, related, matter that is worthy to keep in mind, namely that by allowing the good faith filing requirement to shield from critical scrutiny other crucial provisions that form part of the intricate gestalt that is Chapter 11, other countries contemplating the move towards a Chapter 11-like framework might invariably become blinded to the numerous problematic aspects of the US model that are sandpapered over as a result of the overarching (and erroneous) application of the “good faith”

filing requirement and are, as a result, given a more pristine view both of the Chapter 11 framework, and of individual provisions, than the practical realities may otherwise suggest. It would concomitantly follow then that in order for the reform efforts in other jurisdictions to reap considerable rewards from the erection of a reorganizational structure such as Chapter 11, a holistic approach needs to be adopted, in that not only must such jurisdictions take steps to ensure that the good faith filing requirement is not inadvertently imported, but concurrent steps must also be taken during the adaptation process for such jurisdictions to effect amendments that would serve to address the underlying motivations on the part of creditors to challenge the *bona fides* of an application, namely the perception amongst creditors that any form of reorganizational framework is inherently structured in a manner that is prejudicial to their economic interests. In order to do so, it is important for there to be a paradigm shift in the international perceptions that exist *vis-à-vis* Chapter 11: whilst there are no doubt significant virtues to Chapter 11, the US reorganization chapter does not represent a silver bullet, and it is important for countries seeking to replicate aspects of that framework into their respective jurisdictions to be considerably less parsimonious in their criticism of the problems that continue to plague various aspects of Chapter 11 model than they have been thus far, and indeed, as many of the critics in the United States plainly are.<sup>206</sup> Such critical analysis of the Code is necessary because the various provisions of the Code (much like its analogues in other jurisdictions) are necessarily highly integrated, and addressing the matter of the fiction of the prerequisite of good faith in their own regimes without simultaneously adopting measures to tackle the underlying concerns that have led to its diminished attractiveness to creditors in the United States would render such transplantation in those jurisdictions to be equally problem-fraught, since even with the rejection of the good faith filing requirement, innovative creditors (or, more accurately, innovative bankruptcy lawyers) in such jurisdictions are likely to be more than willing to venture down as yet unexplored paths to challenge bankruptcy filings if the underlying realities that have engendered the “pro-debtor” perception that presently afflicts the Bankruptcy Courts (and, by extension, the Code) in the United States are not adequately addressed in these Chapter-11 inspired frameworks.

## VIII. CONCLUSION

59. Although the worst of the recent economic downturn appears to be behind us, the US and, more generally, the world economies continue to face some of their greatest financial and

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<sup>206</sup> *Supra* note 29.

economic challenges since the Great Depression. Notwithstanding the problems surrounding the matter of the good faith filing requirement, and the decreased confidence in Chapter 11 on the part of creditors as a result of the developments alluded to earlier, it is unsurprising that all the economic indicators suggest that the number of bankruptcy applications in the United States are expected to continue to ascend, rather than abate.<sup>207</sup> In line with such developments, more than ever before,<sup>208</sup> otherwise-sound businesses can be expected to seek the provisional protective cloak of Chapter 11 bankruptcy to ride through these difficult times.<sup>209</sup> With the concomitant increase in filings that invariably ensues during such tumultuous times, the impulse to utilize the implied good faith filing requirement in a *bona fide* attempt to safeguard the Courts from becoming “a ‘7-11’ convenience store, where the debtor merely drops in and picks up that which the debtor wants”<sup>210</sup> becomes considerably amplified. To the extent that is the case, those who are not fully au fait with the intricacies of the US bankruptcy regime and the dissonance of the good faith filing requirement with the reorganizational thrust of the regime may view such a utilization of the good faith filing requirement positively, as a testament to the doctrine’s robustness and its’ ability to shield the Code from potential abuse.

60. Yet, as is clear from the preceding discussion, the arguments in favour of the continued existence of an implied good faith filing requirement in the United States are flawed and marinated with distracting fallacies and spurious suppositions that obscures the more important issues that are at stake. Whether one approaches the discussion by reference to the ancestry of the Code, through the application of proper canons of interpretation, from an understanding of the Constitutional divide intended by the country’s founding fathers, or even through the more practical path of ascertaining its concrete implications, the singular conclusion that one must necessarily arrive at is that the doctrine is untenable and should be abolished. Given that the doctrine is, at least in part, a response to other more deep-seated problems with bankruptcy jurisprudence and practice, the need for reform is, as suggested earlier, considerably urgent. Nonetheless, notwithstanding the persuasive arguments in support of its abolition, the reality is that given the inherently unobjectionable nature of the doctrine, coupled with the prevailing sentiment amongst the Courts that the bankruptcy framework would otherwise be subject to substantial abuse and the practical realities of the impossibility of reform through a legislative

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<sup>207</sup> *Supra* note 3.

<sup>208</sup> *See* Feintzeig, *supra* note 3.

<sup>209</sup> Especially since increasingly, given its inherent flexibility, large businesses are seeking to file for Chapter 11, rather than Chapter 7, even if management accepts that the business is bound to be liquidated.

<sup>210</sup> *In re Sikberkaus*, 253 B.R. 890, 903 (Bankr. C.D. Cal. 2000), *aff’d*, 336 F. 3d 864 (9<sup>th</sup> Cir. 2003).

amendment, the good faith filing requirement is likely to continue to feature prominently in jurisprudence emanating from the bankruptcy courts in the United States and, in the process, become further engrained into the bankruptcy milieu there. The failure to take up the clarion call for reform in the United States would invariably result in the already-considerable problems plaguing the Code to escalate further; problems which, if left unaddressed, could leave the Code facing the distinct, and unfortunate, possibility of being rendered a paper tiger to both creditors and debtors in years to come in the United States.

61. What then of the implications of the continued existence of the good faith filing requirement in Chapter 11 for the rest of the world? Although the continued existence of the good faith filing requirement plainly engenders numerous repercussions as a result of the potential reach of Bankruptcy Courts in the United States,<sup>211</sup> it would not be an over-exaggeration to suggest that it bears particularly weighty repercussions on the “reform” movement that is advocating the use of Chapter 11-like frameworks that has gained traction recently. It is perhaps inevitable that as the world recovers from its most serious economic shock in more than 70 years,<sup>212</sup> Chapter 11 will be increasingly be viewed as the panacea to cure the ills of insolvency frameworks worldwide, the sophisticated rescue regime that would be able to competently deal with economic shocks of similar magnitude in future. In light of the heightened international affinity with Chapter 11, it is imperative that reformist jurisdictions shed their uncritical acceptance of Chapter 11’s apparent virtues *in toto*,<sup>213</sup> and critically analyze the Code in order to introduce into their respective framework elements of Chapter 11 that are in line with its central purpose. The need for attention to detail in this regard is particularly acute in situations involving concepts such as the good faith filing requirement, for which there is no explicit legislative expression and therefore much less likely to animate the contours of the debate *vis-à-vis* the merits of its replication in another jurisdiction but, as can be seen above, no less important to consider and critically study. Crucially, having regard to the incontrovertible matter of Chapter 11 as a multi-faceted, and integrated, gestalt, the failure to completely understand the effects of the good faith filing requirement and the manner in which it can skew creditor

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<sup>211</sup> The continued persistence of the good faith filing requirement bears other repercussions on the international front: as noted at Para 8, this is in part a function of the wide jurisdiction conferred on the Bankruptcy Courts to administer bankruptcies that may have minimal nexus with the United States, and in part the result of the general profile of the sort of entities that file for Chapter 11, namely large international corporations that possesses considerable influence internationally.

<sup>212</sup> See Gan, *supra* note 6, at 19.

<sup>213</sup> See Westbrook, *supra* note 29. This appears to represent a seismic shift from the early 1990s, where the same author noted that it was still unclear as to whether the rescue mechanism of choice internationally would be administration or reorganization, or even some hybrid of the two. See Westbrook, *supra* note 12.

behaviour<sup>214</sup> would also invariably obfuscate other problematic aspects of Chapter 11 from the critical glare of scrutiny during the course of any such feasibility studies undertaken by those jurisdictions and, to that end, is unlikely to result in sufficient pause to query the effectiveness of such provisions to live up to the overarching goals that they purport to engage, and, by extension, is likely to precipitate the development of reorganization frameworks in those jurisdictions that are acutely less sensitive to the intended underlying policy objectives than initially envisioned. At bottom then, if left unchecked, the refusal on the part of these jurisdictions to confront aspects of the Chapter 11 framework, such as the good faith filing requirement in this instance, that are inimical to the values underlying the framework may very well end up precipitating the end of the world's otherwise healthy and understandable respect and affection for Chapter 11 and its reorganization ethos.

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<sup>214</sup> See Para 48 above.