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Essays

Bankruptcy's Uncontested Axioms

Douglas G. Baird†

Debates about the law of corporate reorganizations often seem to be debates about facts.[1] From this it might seem that good empirical research can resolve the large differences that exist between competing camps of bankruptcy scholarship. First-rate empirical work has, of course, been done.[2] It has also changed the way some have thought about bankruptcy law.[3] Nevertheless, it would be a mistake to think that empirical studies will

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1. Indeed, some of the most acerbic debates in bankruptcy scholarship have centered around the wealth effects of the Bankruptcy Reform Act of 1978, 11 U.S.C. §§ 101-1330 (1994), on shareholders, a question that is ultimately a factual one. *See* Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1054-77 (1992) (examining empirically the validity of the theoretical analysis of court-supervised reorganizations); Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 YALE L.J. 437, 479 (1992) ("Credible empirical data, more than anything else scholars bring to the table, can drastically change the terms of a debate.").

2. The massive studies of the reorganization of publicly traded firms by Lynn M. LoPucki and William C. Whitford are among the most important. *See* Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125 (1990); Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669 (1993); Lynn M. LoPucki & William C. Whitford, *Patterns in the Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597 (1993). For important work on the costs of corporate reorganizations, see Gregor Andrade & Steven N. Kaplan, *How Costly Is Financial (Not Economic) Distress? Evidence from Highly Leveraged Transactions That Became Distressed*, 53 J. FIN. 1443 (1998); Steven N. Kaplan, *Federated's Acquisition and Bankruptcy: Lessons and Implications*, 72 WASH. U. L.Q. 1103 (1994); and Vojislav Maksimovic & Gordon Phillips, *Asset Efficiency and Reallocation Decisions of Bankrupt Firms*, 53 J. FIN. 1495 (1998). Comparative work has also been done. *See, e.g.*, Theodore Eisenberg & Shoichi Tagashira, *Should We Abolish Chapter 11? The Evidence from Japan*, 23 J. LEGAL STUD. 111 (1994); Timothy C.G. Fisher & Jocelyn Martel, *The Creditors' Financial Reorganization Decision: New Evidence from Canadian Data*, 11 J.L. ECON. & ORG. 112 (1995).

3. For an account of what empirical research has shown us, see William C. Whitford, *What's Right About Chapter 11*, 72 WASH. U. L.Q. 1379 (1994). I count myself among those whose work

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do much to end the current debates. To be sure, new information requires scholars and policymakers to update their prior beliefs, but rarely will so much information be available that differences can be resolved among those who begin at separate starting places. Strongly held prior beliefs will converge only if new information is plentiful. Among modern bankruptcy scholars, the starting places are far apart and the chance that new information will do much to bring them closer together is remote.

If it is unlikely that new information can bring scholars closer together, it might seem that nothing can. Prior beliefs can be compared to postulates in geometry. Euclidean geometry is based on the notion that only one line can run parallel to another through any given point. This idea is neither true nor false. One can build a coherent geometry either with this postulate, or with the postulate that multiple lines can run parallel to another line through a given point, or with the postulate that none can. Neither is more or less true than the other. All axioms in mathematics have this character.

It is a mistake, however, to assume that axioms are incontestable, even in mathematics. Axioms can be more or less interesting. Axioms can be more or less consistent with each other. They can be more or less complete.[4] Even in the world of pure mathematics, axioms can be assessed according to how useful they are.[5] In the messy universe of the law, it is not only even easier to cast a critical eye, it is also more important. In this Essay, I set out the two different sets of axioms now current among bankruptcy scholars, examine each, and suggest why people are drawn to one set or the other. I do not try to bridge the gap between the two camps, but rather to assess its implications, both for the future of scholarship and the dynamics of bankruptcy legislation.

In this Essay, I attempt to look at this problem as a neutral observer who comes to these questions without preconceptions. Nevertheless, these

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has changed in the wake of such efforts. For example, Lawrence A. Weiss, *Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims*, 27 J. FIN. ECON. 285 (1990), showed me that the direct costs of bankruptcy were lower than I (and many others) had thought. This affected how I thought about Chapter 11 and its alternatives. *Compare* Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127, 141 (1986) (recognizing that the direct costs of bankruptcy are high relative to corporate control transactions, such as initial public offerings), *with* Douglas G. Baird, *Revisiting Auctions in Chapter 11*, 36 J.L. & ECON. 633, 641-42 (1993) (acknowledging that the direct costs of bankruptcy are low). Many other scholars have, of course, made use of empirical data in their work. *See, e.g.*, Barry E. Adler, *A Theory of Corporate Insolvency*, 72 N.Y.U. L. REV. 343, 380-82 (1997); Eisenberg & Tagashira, *supra* note 2, at 120-54; Ronald J. Mann, *Explaining the Pattern of Secured Credit*, 110 HARV. L. REV. 625, 675-80 (1997).

4. The virtues of consistency and completeness are comparative only. Even in systems as simple as ordinary arithmetic, one cannot have a set of axioms that is both consistent and complete. *See* KURT GÖDEL, ON FORMALLY UNDECIDABLE PROPOSITIONS OF PRINCIPIA MATHEMATICA AND RELATED SYSTEMS 70 (B. Meltzer trans., Oliver & Boyd 1962) (1931).

5. A good example is matrix algebra. It defines multiplication in a way that makes it easier to solve many important problems in linear algebra. *See* G. HADLEY, LINEAR ALGEBRA 64-65 (1961). Other definitions of multiplication are possible, but they are not as useful.

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questions hold an interest for me precisely because I have been involved in these debates for a long time and have been strongly identified with the ranks of those whom I call proceduralists.[6] Hence, I must remind both myself and the reader of the difficulties I face in trying to assume the vantage point of a disinterested observer.[7]

My aim is twofold. First, I set out the ways in which these two sets of axioms have created the world in which bankruptcy scholars now find themselves—one in which there are two discrete groups, yet few in either group pay much attention to the other. Second, I explore the foundations of each set of axioms, quite apart from testing their empirical assumptions. The different axioms, I suggest, stem not from different political beliefs but rather from radically different views of the underlying normative bases of the role of bankruptcy law and the aims of legal scholarship.

Part I of the Essay identifies the two competing groups and outlines in general terms their different axioms. The next three Parts examine each competing axiom in turn. Part V connects the tensions between these competing axioms with the purposes the law serves and the politics of

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6. *See, e.g.*, Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 722-25 (1991).

7. I think of myself as a "law and economics" scholar, but I am not sure that "law and economics" is the best label for my approach—although it is not a bad one. I am, I think, perhaps more of an instrumentalist. I want to understand how changes in the law affect the way people behave. Will a change make people more likely to invest in new businesses? Will a change benefit those who work at this firm? How will it affect workers elsewhere? Will the firm take account of the harm its activities cause to others? If policymakers make this change in bankruptcy law, what changes should they make in the law elsewhere?

These kinds of questions do not admit of precise answers. Often we can talk in general only about the kind of effect, not its magnitude. Frequently the best that legal scholars can do in advising policymakers is to tell them why a particular law will not (or may not) have an effect they think it will have. The consumer bankruptcy legislation recently debated in Congress provides a good example.

The provisions of the various bills that came close to being enacted in 1998, in the aggregate, sharply curtail the ability of individual debtors to discharge debt in bankruptcy. *See* Bankruptcy Reform Act of 1998, H.R. 3150, 105th Cong. (1998); Consumer Bankruptcy Reform Act of 1997, S. 1301, 105th Cong. (1998). Advocates of the bills suggest that these changes will reduce the number of bankruptcy filings, of which there are now more than a million per year. *See, e.g.*, 144 CONG. REC. S9917-18 (daily ed. Sept. 3, 1998) (statement of Sen. Grassley). Bankruptcy filings, however, are affected most by the amount of debt individuals carry relative to their annual income. *See, e.g.*, *The Increase in Personal Bankruptcy and the Crisis in Consumer Credit: Hearing Before the Subcomm. on Admin. Oversight and the Courts of the Senate Comm. on the Judiciary*, 105th Cong. 32, 39-44 (1997) (statement of Kim Kowalewski, Chief, Financial and General Macroeconomic Analysis Unit, Congressional Budget Office). The higher this ratio, the more likely individuals will be unable to pay their debts if they encounter economic misfortune.

These changes, by making bankruptcy less attractive, may make people less inclined to borrow. Everything else being equal, this will tend to reduce the number of defaults and the number of bankruptcy filings. But these same changes will also make lenders more likely to extend credit. They will lend more money and thus increase the ratio of debt to annual income, the number of defaults, and the number of bankruptcy filings. Unless there is some reason to think that the first effect will dominate the second (and there is not), a policymaker who wants to reduce the number of bankruptcy filings should hesitate before supporting this legislation.

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bankruptcy reform. Part VI concludes with observations about why these two groups start in such different places.

I. COMPETING AXIOMS

Sorting legal scholars into distinct camps is a dangerous business. Successful academics have views that are too complex and too modulated to be rigidly categorized. Moreover, each axiom identifies positions that themselves may be more or less strongly held. Notwithstanding these qualifications, however, there are two distinct camps. In the first are traditional bankruptcy lawyers and scholars whose views are largely reflected in the recent report of the National Bankruptcy Review Commission.[8] They focus on the rich store of bankruptcy cases that has developed over time. The traditionalists' basic approach stems from a conviction that bankruptcy law plays a special role in our legal system and advances substantive goals that are both important and distinctive.[9] This group contains not only scholars firmly ensconced in the academy but also practitioners and judges who write and are active in legal reform.[10] The second group consists almost entirely of academics, including an unusually large number of scholars whose primary work as academics lies elsewhere.[11] The group's distinctive characteristic is its focus on

8. *See* NATIONAL BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS (1997).

9. *See, e.g.*, KAREN GROSS, FAILURE AND FORGIVENESS: REBALANCING THE BANKRUPTCY SYSTEM 248-49 (1997); Korobkin, *supra* note 6, at 722-25; Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 795-97 (1987); Elizabeth Warren & Jay Lawrence Westbrook, *Searching for Reorganization Realities*, 72 WASH. U. L.Q. 1257, 1265-86 (1994); Whitford, *supra* note 3, at 1381 n.6.

10. *See, e.g.*, Samuel L. Bufford, *What Is Right About Bankruptcy Law and Wrong About Its Critics*, 72 WASH. U. L.Q. 829 (1994); Harvey R. Miller, *The Changing Face of Chapter 11: A Reemergence of the Bankruptcy Judge as Producer, Director, and Sometimes Star of the Reorganization Passion Play*, 69 AM. BANKR. L.J. 431 (1995) [hereinafter Miller, *Changing Face*]; Harvey R. Miller, *Harvey's Outburst: A Rejoinder to Professor White's Comment*, 69 AM. BANKR. L.J. 481 (1995) [hereinafter Miller, *Harvey's Outburst*].

11. Work done by members of this group includes THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (1986); Barry E. Adler, *Finance's Theoretical Divide and the Proper Role of Insolvency Rules*, 67 S. CAL. L. REV. 1107 (1994); Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311 (1993); James W. Bowers, *Groping and Coping in the Shadow of Murphy's Law: Bankruptcy Theory and the Elementary Economics of Failure*, 88 MICH. L. REV. 2097 (1990); Frank Easterbrook, *Is Corporate Bankruptcy Efficient?*, 27 J. FIN. ECON. 411 (1990); Thomas H. Jackson & Robert E. Scott, *On the Nature of Bankruptcy: An Essay on Bankruptcy Sharing and the Creditors' Bargain*, 75 VA. L. REV. 155 (1989); Randal C. Picker, *Security Interests, Misbehavior, and Common Pools*, 59 U. CHI. L. REV. 645 (1992); Randal C. Picker, *Voluntary Petitions and the Creditors' Bargain*, 61 U. CIN. L. REV. 519 (1992); Robert K. Rasmussen, *The Ex Ante Effects of Bankruptcy Reform on Investment Incentives*, 72 WASH. U. L.Q. 1159 (1994); George G. Triantis, *A Theory of the Regulation of Debtor-in-Possession Financing*, 46 VAND. L. REV. 901 (1993); and Michelle J. White, *Corporate Bankruptcy as a Filtering Device: Chapter 11 Reorganizations and Out-of-Court Debt Restructurings*, 10 J.L. ECON. & ORG. 268 (1994).

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procedure[12] and its belief that a coherent bankruptcy law must recognize how it fits into both the rest of the legal system and a vibrant market economy.[13]

The traditionalists and proceduralists have different beliefs that emerge from the divergent ways in which they answer three sets of questions. As the rest of this Essay shows, much of the work of traditionalists and proceduralists can be derived from different starting places, and these two starting places can in turn be described by setting out for each group three simple propositions. In their simplicity and the way they organize so many of the issues in corporate reorganization, they resemble the axioms of mathematics. Nevertheless, these propositions are more normative than positive, and alternative formulations (with more or fewer propositions) might do as well.[14]

First, what role should bankruptcy law play in keeping a firm intact as a going concern? Should that role be anything more than determining whether keeping the firm intact makes economic sense (that is, to ask the same question, whether a sole owner would keep the firm intact if she had the choice)?[15] The traditionalists believe that bankruptcy law serves an important purpose in rehabilitating firms that, but for bankruptcy protection, would fail. Jobs would be lost and communities damaged, economically and otherwise, if the protections that bankruptcy law provides were unavailable.[16] By contrast, the proceduralists deny that bankruptcy can

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Major scholars who belong to this group, but whose principal work has been outside of corporate reorganizations, include Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775 (1988); Robert C. Clark, *The Interdisciplinary Study of Legal Evolution*, 90 YALE L.J. 1238 (1981); Mark J. Roe, *Bankruptcy and Debt: A New Model for Corporate Reorganization*, 83 COLUM. L. REV. 527 (1983); and Alan Schwartz, *Bankruptcy Workouts and Debt Contracts*, 36 J.L. & ECON. 595 (1993). As I have noted above, much of my work fits squarely in this camp. *See, e.g.*, Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987).

12. *See* Thomas H. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857, 907 (1982).

13. *See* Douglas G. Baird, *A World Without Bankruptcy*, 50 J.L. & CONTEMP. PROBS. 173, 183-85 (1987).

14. One must be cautious, however, about extending the analogy to mathematics too far. First, ideas in law never have the hard-edged quality of a proposition in formal logic. *See* John Stick, *Can Nihilism Be Pragmatic?*, 100 HARV. L. REV. 332, 366 n.146 (1986). Second, and as important, the axioms themselves turn on the domain of the problem being addressed. The domain of this Essay—corporate reorganizations—is not the same as the domain of all the cases in Chapter 11. Corporate reorganizations can occur in Chapter 7 and outside of bankruptcy court altogether. More importantly, Chapter 11 includes defunct firms that are liquidating and single-asset real estate ventures that have no ongoing operations to speak of, as well as filings by individuals. One might argue that my focus on troubled firms rather than everyone in a certain legal proceeding is symptomatic of my instrumentalist bias.

15. The "sole owner" paradigm is set out in 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 (1984).

16. *See* GROSS, *supra* note 9, at 235-43; Korobkin, *supra* note 6, at 766-68.

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work any special magic.[17] Firms must live or die in the market. All bankruptcy can do is ensure that fights among creditors and other investors of capital do not accelerate a firm's liquidation. For them, one does more harm than good by doing anything more to protect a firm from the forces of the market.[18]

Second, to what extent can one consider bankruptcy a closed or an open system? To what extent should bankruptcy rules be crafted with an eye to the way they affect the incentives of those who are involved with firms that are not in bankruptcy and have no immediate prospect of getting there? To what extent does bankruptcy law affect the way investors and entrepreneurs behave when a firm is in good financial health? Or, to put the matter differently, to what extent can courts shape bankruptcy law by focusing almost entirely on the parties before them and making sure that all the relevant interests are dealt with sensibly? To what extent should the legal system focus on making the best of a bad situation that no one anticipated and in which the rights of all the players must be balanced along with those of the community as a whole?[19]

For the traditionalists, the breathing space that bankruptcy law gives distressed firms and the other costs it imposes on the participants have only a modest effect on how creditors and others behave ex ante.[20] Creditors' interests must be taken into account, of course, along with those of others, but very little of bankruptcy law and procedure affects the decisions of creditors or anyone else to do business with a firm in the first place.[21] The bankruptcy process is self-contained.

The proceduralists, on the other hand, worry intensely about how rules in bankruptcy affect behavior elsewhere. Substantive rules implemented exclusively in bankruptcy are suspect because of the effects they may have on investment beforehand.[22] Conversely, if a social policy is worth implementing in bankruptcy, it should be implemented everywhere. Inconsistency may do more harm than good, even for the particular group one is trying to protect.[23]

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17. *See, e.g.*, DOUGLAS G. BAIRD, THE ELEMENTS OF BANKRUPTCY 64 (rev. ed. 1993).

18. *See* Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEX. L. REV. 51, 81-82 (1992) [hereinafter Rasmussen, *Debtor's Choice*]; Robert K. Rasmussen, *An Essay on Optimal Bankruptcy Rules and Social Justice*, 1994 U. ILL. L. REV. 1, 42; Alan Schwartz, *A Contract Theory Approach to Business Bankruptcy*, 107 YALE L.J. 1807, 1814-20 (1998).

19. For two expositions of the idea of bankruptcy as a closed system in which a balance must be struck after taking account of all interests, see GROSS, *supra* note 9, at 235-43; and Warren, *supra* note 9, at 796.

20. *See, e.g.*, Whitford, *supra* note 3, at 1383.

21. *See* GROSS, *supra* note 9, at 238-39.

22. *See* Baird, *supra* note 11, at 824-28; Rasmussen, *supra* note 11, at 1162-65.

23. *See* Baird & Jackson, *supra* note 15, at 102.

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Third, once a society settles on a particular substantive policy, how does it implement that policy? These competing axioms begin with different visions of the role the judge should play in the process. The traditionalist believes that each individual case, with its rich and textured facts, is not reducible to a common metric or capable of fitting the same Procrustean bed.[24] Implementing the goals of bankruptcy requires investing the judge with broad discretion to ensure that bankruptcy's goals are vindicated. The bankruptcy judge is a shepherd, whose job it is to push the flock in the desired direction.[25] Under the constraints of the law, the judge works with all the players to move them towards bankruptcy's substantive goals.

The proceduralists, by contrast, see the judge as a disinterested arbiter. In a corporate reorganization, none of the players alone has the combination of knowledge, expertise, and neutrality necessary to put a firm back on its course. The creditors tend to favor immediate liquidation because they have little to gain if things improve. The managers have the knowledge of the firm that may be required to make the firm profitable, but they are hardly neutral.[26] They want to keep their jobs and may also be substantial shareholders. These competing forces have to be understood, but ultimately these parties have to make their own decisions; the judge is not to make choices for them. Rather than being committed to any particular outcome, the judge should control the process to ensure that the biases of the parties are taken into account and all relevant information is gathered and disclosed.

In short, the traditional bankruptcy experts believe that: (1) the preservation of firms (and therefore jobs) is an important and independent goal of bankruptcy; (2) contemplation of the rights and needs of the parties before the court matters more than the effects on incentives before the fact; and (3) bankruptcy judges should enjoy broad discretion to implement bankruptcy's substantive policies. The proceduralists, on the other hand, believe that: (1) the preservation of firms is not an independent good in

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24. *See, e.g.*, Korobkin, *supra* note 6, at 722 (describing bankruptcy as a kind of "group therapy," or "a system with varied contours and dimensions, having the distinct function of facilitating the expression and recognition of those diverse values important in dealing with financial distress"); Warren, *supra* note 9, at 811 ("I have offered a dirty, complex, elastic, interconnected view of bankruptcy from which I can neither predict outcomes nor even necessarily fully articulate all the factors relevant to a policy decision."); Warren & Westbrook, *supra* note 9, at 1260 (describing Bebchuk's model of corporate reorganization as "speculation without reference to reality").

25. *See* Miller, *Changing Face*, *supra* note 10, at 433-40, 464-65.

26. In describing the debtor in possession this way, I am echoing the words of Henry Friendly. *See* Otte v. Manufacturers Hanover Commercial Corp. (*In re* Texlon Corp.), 596 F.2d 1092, 1098 (2d Cir. 1979) ("The debtor in possession is hardly neutral. Its interest is in its own survival, even at the expense of equal treatment of creditors, and close relations with a lending institution tend to prevent the exploration of other available courses in which a more objective receiver or trustee would engage.").

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itself; (2) ex ante effects are important; and (3) the judge, after controlling for the biases and weaknesses of the parties and resolving the legal disputes, must allow the parties to make their own decisions and thereby choose their own destinies.

In the next three Parts, I examine each of these ideas in turn—the value of preserving firms, whether the bankruptcy system should be closed or open, and whether the judge should be a positive force in the process or a disinterested arbiter. I do not follow the obvious path and assert either that decisionmakers should chart a middle course or that answers must await additional empirical work. Rather, I explore the source of these differences, show that it is not likely to change, and suggest their implications for bankruptcy scholarship and bankruptcy reform.

II. REHABILITATION

A. *Two Views of the Distressed Firm*

Chapter 11 of the Bankruptcy Code helps ensure that firms in distress survive. Stated at this level of abstraction, its goal is uncontroversial. The views of traditionalists and proceduralists, however, soon diverge.

The proceduralist begins with the cold realities of a market economy: Success is rewarded and failure is brutally punished. Most firms fail. Keeping firms intact that cannot effectively compete results in more harm than good over the long run. The paradigmatic firm is a restaurant in a large city. When the restaurant closes, workers lose their jobs, but they can find work elsewhere. A new restaurant or another firm can move into the space, and life goes on. If a bad restaurant is replaced by a much better one, employment levels in the city may even increase. Keeping a bad restaurant in business postpones the inevitable and delays a desirable shift of labor and capital to somewhere the inputs can be put to better use. Hence, bankruptcy law is useful only when the restaurant is good and would be able to survive in the market but for fights among creditors and other investors.

For the proceduralist, the concept of a "troubled firm" is insufficiently specified. A firm may be troubled because it cannot succeed in the marketplace, since competitors produce a better product at a lower cost. On the other hand, a firm may be distressed because it cannot generate sufficient revenue to pay its debts. This first kind of adversity is called "economic" distress. It exists regardless of a firm's capital structure. The sole owner of a business that attracts no customers will shut it down, even if there are no banks or other creditors in the picture.

The second kind of trouble is "financial" distress, meaning the firm's income is not enough to pay back what it has borrowed. For example, a toy manufacturer borrowed a large amount of money to develop and market a

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toy tied to a movie that later flopped. The people responsible for this debacle have left the firm. The current managers are now the best in the business. Nevertheless, this huge loan and the firm's other obligations exceed the value of the firm itself. The firm is in fine shape with respect to everything it now does, but it cannot pay its debts. This firm is in financial distress.

Financial distress exists only if a firm has creditors. If the creditors disappeared, the problem would disappear and the firm would thrive. Not so for a firm in economic distress: Its assets fail to bring in sufficient revenue, relative to the costs of operating the firm and the alternative ways in which they could be used. Eliminating creditors would not change the fundamental problem the firm faces.

To be sure, many firms face financial distress *because* they are in economic distress. The restaurant cannot pay its creditors because no one wants to eat there. There can also be a feedback loop between the two, such that financial distress causes economic distress. For example, a restaurant that is insufficiently capitalized may, in order to pay its bills, cut corners on food and service. As a result, patrons eat elsewhere and the restaurant encounters economic distress, which in turn aggravates its problem of financial distress.

To understand matters conceptually, one must recognize that there is no necessary link between financial and economic distress.[27] A firm can be well-run yet unable to pay creditors. For example, a well-run firm may have huge tort liabilities.[28] Alternatively, a railroad tunnel may have cost more to build than expected and thus now is unable to pay off the creditors who financed its construction, but the tunnel may, nonetheless, be worth keeping.[29] No one advocates closing down the English Channel Tunnel, even though it may not be able to pay back its investors.

For the proceduralist, bankruptcy law exists to solve the problem of *financial* distress. Outside of bankruptcy, our legal system does not intervene to keep firms in economic distress in business. When a firm encounters financial distress, however, there is a potential for investors with diverse interests to take actions that are contrary to the interests of creditors as a whole. Senior creditors want to seize the firm's assets, even if it means

27. The distinction between financial and economic distress has become commonplace among economists. *See, e.g.*, Andrade & Kaplan, *supra* note 2, at 1444.

28. Two high-profile Chapter 11 cases of the 1980s are conspicuous examples. *See* Kane v. Johns-Manville Corp. (*In re* Johns-Manville Corp.), 843 F.2d 636 (2d Cir. 1988); Committee of Dalkon Shield Claimants v. A.H. Robins Co., 828 F.2d 239 (4th Cir. 1987).

29. Indeed, railroads in the country at the turn of the last century are a paradigmatic example of financial distress. In 1893 alone, 27,000 miles of track in the United States went into receivership—more than existed in all of Britain at that time. *See* ALFRED D. CHANDLER, JR., SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM 53 (1990); STUART DAGGETT, RAILROAD REORGANIZATION at v (Augustus M. Kelley Publishers 1967) (1908).

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the firm collapses. Equityholders want to hold on and wait for things to take a turn for the better, even if it is in the interests of the investors as a whole to cut their losses.[30]

From this perspective, bankruptcy law should have a bias toward neither liquidation nor reorganization. Rather, the aim should be to ensure that a firm's assets are put to their best use; the best way to do this is to ask what someone would do if that person were the firm's sole owner. If a firm had no debt (and hence no creditors), it could not enter bankruptcy. The firm's sole owner could close the firm or keep it in business. The mission of bankruptcy is to ensure that firms do not fail simply because they have creditors they cannot pay. A market economy works when firms that cannot compete effectively are allowed to fail. The happenstance that the capital structure of a firm includes debt as well as equity should not change the view that the market in the end decides which firms fail. In short, one cannot justify a bankruptcy law whose goal is to prolong the life of the bad restaurant.

For the proceduralist, problems in a firm's capital structure ought to shape the law of corporate reorganizations. If a firm is in economic distress (but not financial distress), it does not belong in bankruptcy. If a firm is in economic distress but is properly in bankruptcy because of financial distress, there is still no justification to intervene for reasons unrelated to financial distress.[31]

By contrast, traditionalists assume that keeping a firm intact has independent value.[32] They do not distinguish sharply between economic and financial distress. The disputes a firm has with its creditors present a court with an opportunity to solve a number of different problems. For traditionalists, the paradigmatic firm is a large, closely held company in a

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30. This tension among creditors and other investors (including shareholders) and its connection to financial distress are explored in Baird & Jackson, *supra* note 15, at 101-09.

31. The Modigliani-Miller irrelevance propositions illustrate that conflating a firm's economic position and its financial position is a tricky undertaking, because it is difficult to connect questions of how assets are used with questions of how they are financed. These propositions demonstrate that, at first approximation, a change in a firm's capital structure has no effect on the value of the firm as a whole. *See* Franco Modigliani & Merton H. Miller, *The Cost of Capital, Corporation Finance and the Theory of Investment*, 48 AM. ECON. REV. 261 (1958); *see also* Merton H. Miller, *The Modigliani-Miller Propositions After Thirty Years*, 2 J. ECON. PERSP. 99 (1988) (describing the development of the literature over the 30 years since the propositions were first articulated).

Consider two firms in the same business with the same assets and workers. One has a sole owner and no creditors, while the other has many shareholders and multiple tiers of debt. Under specified assumptions, the value of the two firms is the same. Capital structure does not affect a firm's value. One cannot affect the value of a firm by changing the amount or type of debt it holds. Financial distress is a problem of capital structures, while economic distress is a problem of asset deployment. The two can be connected only if the Modigliani-Miller irrelevance propositions do not hold.

32. *See, e.g.*, Korobkin, *supra* note 6, at 745 (noting that a corporation is not "merely a pool of assets" but "a moral, political, and social actor").

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small town. If the firm closes, workers lose their jobs, suppliers lose a crucial customer, and the economy of the entire town is thrown into jeopardy. These spillover effects justify a bankruptcy law that prevents creditors from taking actions that destroy the firm in pursuit of their narrow self-interests.[33] To be sure, one cannot ignore market forces forever, but bankruptcy law creates a breathing space that mitigates the harshness of these forces and gives firms, their workers, and their communities a second chance.[34]

Both traditionalists and proceduralists recognize the difference between a bad restaurant in a large town and a large factory in a small one. Everyone would agree that the former is a less likely candidate for a successful reorganization than the latter. The difference lies in the presumptions one brings. For any given firm, the traditionalist is more likely to believe that the costs of shutting down the firm are large and hence is more likely both to favor efforts at rehabilitation and to think that the firm resembles the factory rather than the restaurant. It is therefore critical to identify the sources of these different beliefs. Before doing this, however, it will be useful to spell out the consequences that follow from holding them.

B. *Bankruptcy Policy from Two Different Vantage Points*

These two different views of rehabilitation immediately push in different directions with respect to many technical issues of bankruptcy law. The proceduralist concentrates on removing bias. A rule that allows anyone to take actions without bearing their full costs is unsound.[35] A creditor should not be able to seize assets and remove them from the firm if doing so will reduce the value of the remaining assets. Equityholders should not be able to drag out bankruptcy proceedings in the hope that the firm's fortunes will turn. To ensure that equityholders do not enjoy the upside without also bearing the cost on the downside, the equityholders should compensate the senior investors for the delay. As long as the judge forces those who make decisions and enjoy the benefits to bear their costs, the judge need not ask whether the decision would lead to liquidation or

33. *See, e.g.*, GROSS, *supra* note 9, at 14-24.

34. As noted, Chapter 11 contains many cases that do not involve ongoing firms. *See supra* note 14 and accompanying text. Among the most common of these cases is the small business that has already shut its doors or will do so shortly. Even in its best days, it had only a few employees beyond the owner and the owner's immediate family. The problems of this failed firm cannot be separated from the financial or other difficulties of its owner. As a group, traditionalists tend to believe that existing law—and in particular Chapter 11—does a good job of sorting out rights in such cases. *See* Bufford, *supra* note 10, at 833. Proceduralists do not deny the importance of such cases, but few have focused much attention on them.

35. *See* Baird & Jackson, *supra* note 15, at 101-09.

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rehabilitation. The challenge is rather one of creating a set of incentives such that the decisions made are the ones a sole owner would have elected.

By contrast, the traditional view of bankruptcy posits that rehabilitation is a good thing in itself. Bankruptcy judges are not naive Panglossians. Indeed, they know the players firsthand and have seen more than their share of stupidity, cupidity, and fraud. They are not under any illusions about how market economies work. Chapter 11 cannot be judged merely by counting the number of firms that reorganize successfully.[36] Moreover, judges understand that the rehabilitation goal must be balanced against other interests, including the need to recognize the rights of creditors. Nevertheless, from their perspective, a rule does not become suspect simply because it injects bias into the system. Giving a debtor additional time to create a plan of reorganization is a good idea if there is a reasonable chance that a confirmable plan can be created. Exactly how the costs are being borne is less important than giving the firm a chance to stay alive.

This tension is reflected in the debate over what is called the "new value exception" to the absolute priority rule.[37] A firm has debts that exceed what it owes its most senior creditor. Nevertheless, the business is still operating and the owner-manager would like to continue to run the firm. The senior creditor, who holds a security interest in all the firm's assets,

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36. *See* Bufford, *supra* note 10, at 833-34; Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 373-77 (1993).

37. This issue is now before the Supreme Court. *See In re* 203 N. LaSalle St. Partnership, 126 F.3d 955 (7th Cir. 1997), *cert. granted sub nom.* Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. Partnership, 118 S. Ct. 1674 (1998). The problem grows out of a series of Supreme Court cases that have together given shape to the law of corporate reorganizations. The three most important are *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106 (1939), *Kansas City Railway Co. v. Central Union Trust Co.*, 271 U.S. 445 (1926), and *Northern Pacific Railway Co. v. Boyd*, 228 U.S. 482 (1913).

The Supreme Court did not reach the issue in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203 n.3 (1988). The Ninth Circuit held that the new value exception rule existed in *Bonner Mall Partnership v. U.S. Bancorp Mortgage Co. (In re* Bonner Mall Partnership), 2 F.3d 899, 907 (9th Cir. 1993). The Supreme Court granted certiorari but later dismissed the case as moot after the parties settled. *See* U.S. Bancorp Mortgage Co. v. Bonner Mall Partnership, 513 U.S. 18, 20 (1994). Cases that discuss, but do not resolve, the question of whether the new value exception survived include *In re Snyder*, 967 F.2d 1126, 1128-31 (7th Cir. 1992), *Travelers Insurance Co. v. Bryson Properties (In re Bryson Properties)*, 961 F.2d 496, 503-04 (4th Cir. 1992), and *Kham & Nate's Shoes No. 2, Inc. v. First Bank of Whiting*, 908 F.2d 1351, 1360-62 (7th Cir. 1990).

A comprehensive review of the new value exception can be found in J. Ronald Trost et al., *Survey of the New Value Exception to the Absolute Priority Rule and the Preliminary Problem of Classification*, SB37 ALI-ABA 595 (1997). The academic literature on the new value exception is large and growing. *See, e.g.*, BAIRD, *supra* note 17, at 259-66; Charles W. Adams, *New Capital for Bankruptcy Reorganizations: It's the Amount That Counts*, 89 NW. U. L. REV. 411 (1995); John D. Ayer, *Rethinking Absolute Priority After* Ahlers, 87 MICH. L. REV. 963 (1989); Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. CHI. L. REV. 738 (1988); Bruce A. Markell, *Owners, Auctions, and Absolute Priority in Bankruptcy Reorganizations*, 44 STAN. L. REV. 69 (1991); Walter W. Miller, Jr., *Bankruptcy's New Value Exception: No Longer a Necessity*, 77 B.U. L. REV. 975 (1997); Elizabeth Warren, *A Theory of Absolute Priority*, 1991 ANN. SURVEY AM. L. 9; James J. White, *Absolute Priority and New Value*, 8 COOLEY L. REV. 1 (1991).

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asks for the automatic stay to be lifted so it can seize all the assets and sell them off—perhaps as a going concern, but more likely piecemeal.

The owner-manager wants to keep the firm in business with a plan of reorganization. The plan gives the most senior creditor a package of rights in the reorganized firm, typically debt instruments that are themselves secured by the firm's assets. Whatever form it takes, its value, in the view of the bankruptcy judge, is equal to the amount that the creditor would receive if it seized and sold off the assets. Other creditors are offered different packages and at least one group of creditors accepts the plan without asking for a review by the bankruptcy judge. The owner-manager retains the equity in the firm, but only after contributing an amount of new capital that, in the judge's view, is equal to the value of the equity retained.

In such a case, the only doubt about the plan of reorganization is whether it is permissible for the owner-manager to retain the equity. Participation would be unproblematic if each group of creditors consented to it. Participation would be flatly forbidden over the objection of a group of creditors if the old equity did not put in new cash equal, in the eyes of the bankruptcy judge, to the value of the equity received. The only open question is whether the law should allow the contribution of new value to be sufficient to overcome the objection of the creditors.

From the perspective of the traditionalists, bankruptcy law should allow the judge to confirm such a plan even when the firm's senior creditors want to liquidate the firm.[38] The senior creditor has nothing to complain about given that the court has found that it receives as much as it would realize if allowed to seize the assets and sell them. More to the point, employees keep their jobs, the community keeps its anchor, and the owner-managers keep their dignity.

Proceduralists, however, are skeptical of the owner-manager's plan. For proceduralists, there is a difference between liquidating a firm for cash and having a package of rights in the reorganized firm that a bankruptcy judge says is worth the same amount. The decision of the senior creditor to shut down the firm when it controls the entire firm is a deliberate judgment that the firm is not worth saving by a party who, in theory, bears the full costs of a wrong decision. If the senior creditor is correct and the firm is worth less alive than dead, the senior creditor's share of the reorganized firm cannot be equal in value to what it would have received in liquidation. In the world of positive numbers, if x is less than y, then a fraction of x is less than y as well.

38. *See, e.g.*, GROSS, *supra* note 9, at 129 ("[R]ehabilitation is facilitated by curtailing creditors' options and is justified because debtor rehabilitation trumps creditor choice."); *see also* Bufford, *supra* note 10, at 848 (noting that one of the essential purposes of Chapter 11, as well as other aspects of bankruptcy law, is "to provide an economic safety net for an economic system under stress").

Because the senior creditor bears the entire costs of the decision, proceduralists believe courts should think twice before overriding its wishes. In theory, the new value plan leaves the senior creditor as well off as it would have been had it been allowed to seize the assets. Hence, it might seem that proceduralists should be indifferent between the two options. Both are mechanisms that decide the future of the firm. Neither the senior creditor nor the owner-managers are fully informed and free from bias. For the proceduralists, however, the focus should be on the question of who is likely to be the best decisionmaker under these circumstances. They reject the traditionalists' claim that the owner-manager should be favored *because* the owner-manager is the one who wants to keep the firm intact as a going concern. There is no reason to assume, without more, that such a decision is the correct one.

C. *Reconciling Two Views of Rehabilitation*

As long as traditionalists and proceduralists have different views of rehabilitation, they will differ on concrete issues of bankruptcy policy.[39] It might seem that answers to empirical questions could close the differences. After all, no one believes in preserving firms that are destined to fail anyway. Moreover, some of the elements of the empirical calculus are easy enough to articulate. Researchers can, for example, ask concrete questions about the dislocation costs that arise when a firm fails. How often do displaced workers have firm-specific skills that they cannot take with them if the firm closes? A senior technician in a factory that makes sophisticated machine tools is fundamentally different from a waiter in a hotel restaurant. It is also important to inquire about the costs of finding new jobs. How hard is it for a worker to find a new job? Trained technicians are again different from waiters. Which type of worker is most often at risk when firms are in bankruptcy?

Concerted efforts to answer these questions, however, are not likely to bring traditionalists and proceduralists much closer. First, for an issue to be an empirical question in a meaningful sense, there must be a reasonable chance that a serious and unbiased research effort would significantly alter each side's beliefs. The messy world of bankruptcy cannot yield empirical data powerful enough to change minds to the extent that they embrace a different set of axioms. The kinds of firms in bankruptcy and the kinds of jobs at stake might well demonstrate something about the appropriate

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39. Another example is the debate about whether opportunity cost should be treated as a component of adequate protection under 11 U.S.C. § 362 (1994). *Compare* Baird & Jackson, *supra* note 15, at 129 (arguing it should), *with* Warren, *supra* note 9, at 808-11 (arguing it should not). This narrow issue was resolved in the traditionalists' favor in *United Savings Ass'n v. Timbers of Inwood Forest Associates*, 484 U.S. 365 (1988).

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paradigm. They might help determine whether the bankruptcy laws should have as their focal point the large firm in a small town or the bad restaurant in a large city. Given that both types exist, however, one cannot expect definitive answers to the more global questions. While it is easy to observe those who lose jobs when a firm fails, it is virtually impossible to identify with any specificity those who indirectly gain from a new job when the failed firm's assets are redeployed. Moreover, even if such information were at hand, striking this balance would require overcoming one of the most persistent and intractable problems of cognitive bias.

As human beings, we tend to weigh more heavily the events immediately before us.[40] As a result, we have a natural tendency to underestimate the effects of bankruptcy on those who are not in court and whose stories cannot be told with particularity. We can try to correct for this built-in bias when we use our intuitions, but there are few reliable benchmarks to help us. Different beliefs rest on foundations that are as normative as they are empirical. A traditionalist might prefer a society in which workers do not go through the indignity of losing their livelihoods even if the effect of bankruptcy law is to increase slightly the overall level of unemployment. The benefit of getting a new job is not commensurate with the cost of losing an existing one.[41] For their part, the proceduralists begin with a faith in markets working effectively or, more precisely, not being subject to improvement through the intervention of a legal mechanism such as bankruptcy law. For them, bankruptcy law works best when it interferes as little as possible with the operation of markets.

With respect to their axioms about the virtue of reorganizing a distressed firm, it is not readily apparent what traditionalists and proceduralists can say to each other. Traditionalists may be at their best when deciding cases rather than debating first principles. While many traditionalists support the new value exception in the abstract, the case law shows that the bankruptcy judges often reject its application in practice.[42]

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40. *See* Daniel Kahneman et al., *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325, 1342-46 (1990); Amos Tversky & Daniel Kahneman, *Availability: A Heuristic for Judging Frequency and Probability*, 5 COGNITIVE PSYCHOL. 207, 208 (1973); Amos Tversky & Daniel Kahneman, *Judgment Under Uncertainty: Heuristics and Biases*, 185 SCIENCE 1124, 1127-28 (1974). This cognitive bias makes people feel that flying in an airplane is more dangerous than driving a car. Airplane crashes are more vivid and visible than automobile crashes. The same bias makes individuals more aware of Chernobyl and Three Mile Island than the countless coal mine accidents that have led to greater loss of life.

There is an irony here. Cognitive biases such as these frequently underpin critiques of economic models and their dependence on individuals to act rationally. These same cognitive biases in this context make policymakers less likely to take seriously the claims of economically oriented bankruptcy scholars.

41. *Cf.* Daniel Kahneman & Amos Tversky, *Choices, Values, and Frames*, 39 AM. PSYCHOL. 341, 342 (1984) (noting findings of loss aversion).

42. For a discussion of the various requirements courts have imposed on new value plans, see Trost et al., *supra* note 37, at 645-65. For two examples of cases in which courts found the value

They are less likely to let a debtor play for time and more likely to grant lift-stay motions when an effective reorganization is not in prospect. Moreover, they have become increasingly adventurous in invoking market mechanisms when those markets exist.[43]

The proceduralist must be able to explain how her approach helps decide the disputes bankruptcy judges face. The benchmark of the sole owner is abstract and the general tenets of corporate finance, such as the difference between financial distress and economic distress, may not connect well with the gritty realities that can be seen in a particular bankruptcy court.[44] The proceduralists ultimately base their belief that the role of bankruptcy law is not to help distressed firms survive on the principle that bankruptcy law must defer to market forces to the same extent as other laws.[45]

The traditionalists, however, face an equal challenge. They also must be able to explain how bankruptcy can be credibly distinguished from problems legal scholars routinely encounter elsewhere. If a conscious effort to help firms stay in business and preserve jobs, notwithstanding the wishes of the players, works in bankruptcy, why not do it elsewhere?[46] In other words, both proceduralists and traditionalists depend crucially on another axiom, a set of prior beliefs about bankruptcy's uniqueness and how it can be sensibly distinguished from the many other problems the legal system faces. It is to that issue that I now turn.

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proposed to be insufficient, see *In re Applied Safety, Inc.*, 200 B.R. 576, 590-91 (Bankr. E.D. Pa. 1996); and *In re Graphic Communications*, 200 B.R. 143, 151 (Bankr. E.D. Mich. 1996).

43. *See* Trost et al., *supra* note 37, at 666-67.

44. Harvey Miller makes the point this way:

> Chapter 11 is not a perfect or wholly efficient process or institution, but neither are law schools or the capital markets which are so admired by the efficiency obsessed academics. These same academics don't dirty their hands in the surgery, distress, and human pain that is a part of every business failure and properly initiated Chapter 11 case.

Miller, *Harvey's Outburst*, *supra* note 10, at 482. Other traditionalists look at the proceduralists in the same way. *See, e.g.*, Warren & Westbrook, *supra* note 9, at 1260 (characterizing the work of Bebchuk and its progeny as a "form of speculation without reference to reality").

45. Although some proceduralists believe that the law should interfere relatively little with the free market as a general matter, not all do. One can think that many substantive policies ought to check market forces without thinking that there should be particular substantive policies in bankruptcy. Indeed, the proceduralists occupy a variety of points along the political spectrum, as do the traditionalists. It would be flatly wrong to assume that proceduralists are on the right of the political spectrum and traditionalists on the left.

46. For example, when Congress passed a plant-closing law several years ago, its scope was quite modest, requiring principally only advance notice. *See* Worker Adjustment and Retraining Notification Act, 29 U.S.C. §§ 2101-09 (1994).

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III. BANKRUPTCY AS A CLOSED OR OPEN SYSTEM

A. *The View from Inside Bankruptcy*

Traditionalists tend to spend their lives looking at bad firms and investors who made bad decisions. In bankruptcy court, courts encounter too often not the sophisticated investor who makes new businesses possible, but the bank whose loan officer made a stupid loan and behaved vindictively when the firm faced trouble. If one focuses on such people (and they are not hard to find in bankruptcy courts), one can easily believe that bankruptcy law has only a trivial effect on how loans are made.

Traditionalists account for the effects that bankruptcy has elsewhere by employing the idea of "balance."[47] In other words, one must take account of the creditor's interests in order to give the creditor the incentive to lend again. That the traditionalists do not even discuss ex ante effects directly shows how unimportant they think ex ante effects are. Traditionalists are able to pay ex ante effects so little heed because of the sheer difficulty of identifying these effects with any certainty. Hard evidence that these matter is elusive.[48] Indeed, altering the relative rights of the parties from the nonbankruptcy baseline is often merely a question of setting priorities among investors. Many of the proceduralists have tried to identify the benefits of establishing priorities among different owners, and all agree that they are not easily found.[49]

The traditionalists believe that bankruptcy law can largely ignore ex ante effects and that it can push parties in beneficial directions in which they would not otherwise go. These beliefs cannot be easily attacked on empirical grounds. The proceduralist critique of this traditionalist belief that

47. *See, e.g.*, GROSS, *supra* note 9, at 235-50. To the proceduralists, however, the idea of "balance" misses the point. If the rules are clear entering into a transaction, creditors can decide whether to lend and at what rate. If they do not like U.S. bankruptcy laws. they can invest their capital overseas or in riskless treasury bills. As long as the rules are not changed midstream, they make a competitive return on their capital regardless of the bankruptcy laws. Sophisticated creditors can take any bankruptcy policy, however inane, and adjust to it, provided it applies only prospectively. If the rule is spelled out in advance, favoring creditors in a bankruptcy regime does not, at first approximation, increase their profits or improve their welfare.

48. For recent work showing how hard it is to identify these benefits, see Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 913-23 (1996).

49. *See, e.g.*, Thomas H. Jackson & Anthony T. Kronman, *Secured Financing and Priorities Among Creditors*, 88 YALE L.J. 1143, 1144 (1979) (concluding that "the analytic justification for many of [U.C.C.] Article 9's most important priority rules remains obscure"); Saul Levmore, *Monitors and Freeriders in Commercial and Corporate Settings*, 92 YALE L.J. 49, 52 (1982) ("The existence of secured financing might seem counterintuitive at first . . . ."); Alan Schwartz, *Security Interests and Bankruptcy Priorities: A Review of Current Theories*, 10 J. LEGAL STUD. 1, 37 (1981) (arguing that "no plausible showing that secured debt actually increases welfare exists"); René M. Stulz & Herb Johnson, *An Analysis of Secured Debt*, 14 J. FIN. ECON. 501, 501 (1985) (noting that the current literature lacks convincing explanations for the use of security).

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bankruptcy should be a closed system is emblematic of the wide gulf that separates the two groups. It is the subject of the next Section.

B. *The Role of Law Inside and Outside of Bankruptcy*

Economists have demonstrated that a significant change in demand follows a change in price—even one so small that consumers never notice it in their own day-to-day experience. Proceduralists believe the traditionalists are much too quick to ignore economic forces that they cannot see. Furthermore, proceduralists maintain that the traditionalists should be open to the possibility that the economic forces at work in bankruptcy are at least as strong as economic forces elsewhere that cannot be seen directly. The beliefs one holds about bankruptcy ultimately must be reconciled with one's more general beliefs about the legal system. Traditionalists support a type of judicial intervention and judicial activism that legal scholars do not encounter elsewhere. More to the point, the traditionalists themselves do not seem to advocate elsewhere the kind of legal system they want for firms in bankruptcy. They do not suggest, for example, that judges should be able to prevent entrepreneurs from shutting down firms as a general matter to protect jobs or communities. Hence, they have an obligation to explain what is special about bankruptcy.[50]

Proceduralists think traditionalists are out of step with legal scholarship elsewhere. Political rhetoric may condemn those who close firms and leave workers in the cold, but judges have no power to intervene in such cases, and the statutes that govern such cases are usually very narrow in scope.[51] The rhetoric of the traditionalists often seems outdated to the proceduralists, particularly to those whose principal academic field is elsewhere. For example, the idea that antitrust law should protect "small dealers and worthy men" has long disappeared from antitrust opinions.[52] Debates about whether Microsoft violates the antitrust laws quickly become sophisticated discussions of network externalities and how inefficient standards can hurt consumers.[53] Few talk about keeping other manufacturers in business as an

50. Donald Korobkin is one traditionalist scholar who has confronted this challenge squarely. *See* Korobkin, *supra* note 6, at 789 (describing bankruptcy law as "creating conditions for a discourse in which values of participants may be rehabilitated into a coherent and informed vision of what the enterprise shall exist to do"). In contrast to mine, Korobkin's view of what bankruptcy should be is decidedly noninstrumentalist.

51. *See, e.g.*, Worker Adjustment and Retraining Notification Act of 1988, 29 U.S.C. §§ 2101-09 (1994) (requiring notice prior to plant closings or mass layoffs).

52. The phrase was used in *United States v. Trans-Missouri Freight Ass'n*, 166 U.S. 290, 323 (1897). The Supreme Court last used this expression in *United States v. Von's Grocery Co.*, 384 U.S. 270, 274 (1966).

53. *See, e.g.*, S.J. Leibowitz & Stephen E. Margolis, *Should Technology Choice Be a Concern of Antitrust Policy?*, 9 HARV. J.L. & TECH. 283, 286-88, 290-95 (1996); Mark A. Lemley, *Antitrust and the Internet Standardization Problem*, 28 CONN. L. REV. 1041, 1045-1049 (1996);

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independent virtue. Similarly, debates in corporate law now assume a different posture. Rather than assuming that the law should protect people from themselves as well as the forces of the market, most judges now take as their starting place the ideas of enforcing contracts and letting the market work.[54]

The judicial activism the traditionalists embrace is hard to find elsewhere. No longer front and center are those cases in which judges use their discretion to remedy market failures and the exploitation of powerless and ill-informed consumers. Few now argue that judges can advance the interests of consumers by striking disclaimers, cross-collateralization clauses, and other proposals they think are unfair. For better or worse, consumer protection legislation has supplanted common law adjudication in this arena. Cases such as *Williams v. Walker-Thomas Furniture Co.*[55] have been dropped as principal cases from casebooks, and their legacy is not a general charter for judges to do equity, but rather an assortment of narrowly tailored administrative regulations.[56]

Those who advocate health and safety regulations used to claim that the interests being protected were not commensurable with dollars. These scholars now are more likely to start with the observation that, in any kind of regulation, tradeoffs have to be made and one cannot privilege any particular set of interests over another with claims of incommensurability. For example, if the FDA delays the widespread introduction of a drug to the market, it may ensure that the drug is safe, but, at the same time, patients who might benefit from it must wait. Most of the time, it is not a question of dollars versus lives, but how society makes tradeoffs within groups that need the protection of the law.[57]

When traditionalists advance legal rules that check market forces for reasons independent of financial distress, proceduralists want to know why so few scholars and policymakers think legal rules should play this role

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John E. Lopatka & William H. Page, *Microsoft, Monopolization, and Network Externalities: Some Uses and Abuses of Economic Theory in Antitrust Decision Making*, 40 ANTITRUST BULL. 317 (1995).

54. E. Norman Veasey, Chief Justice of the Delaware Supreme Court, describes it in this way: "Although the contract analogy—like the other analogies—is imperfect, it comes reasonably close to a working hypothesis. I think courts might consider using *as a point of departure*—but not necessarily a controlling principle—what they perceive to be the investors' reasonable contractual expectations." E. Norman Veasey, An Economic Rationale for Judicial Decisionmaking in Corporate Law 4 (Mar. 1998) (unpublished manuscript, on file with *The Yale Law Journal*) (internal citation omitted).

55. 350 F.2d 445 (D.C. Cir. 1965) (refusing to enforce a contract where an element of unconscionability was present at the time the contract was entered into). For an example of a casebook that has dropped *Williams* as a principal case, see JOHN P. DAWSON ET AL., CONTRACTS: CASES AND COMMENT 692-93 (7th ed. 1998). The casebook does, however, include a brief summary and extract from Judge Wright's famous opinion. *See id.*

56. The cross-collateralization of household goods that was at issue in *Williams* is now an unfair trade practice under FTC Credit Practices Rule, 16 C.F.R. § 444.2(a)(4) (1998).

57. *See* CASS R. SUNSTEIN, FREE MARKETS AND SOCIAL JUSTICE 298-317 (1997).

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outside of bankruptcy. Even if bankruptcy were a closed system, it would still need only legal rules that dealt with the special problems of bankruptcy. Policymakers could import the rules that already exist elsewhere for other matters. Indeed, if they do not do this, parties will behave strategically and waste resources searching out the place where they will receive the most favorable treatment.[58]

For the traditionalists, however, asking questions about ex ante effects and insisting on the need to have a consistent policy across the board are scarcely distinguishable from completely rejecting the rights of atypical creditors in bankruptcy. To the traditionalists, the proceduralists often seem lost in speculation[59] or simply disingenuous.[60] Yet the traditionalists ignore the virtues of implementing reforms in bankruptcy that political, economic, and social forces do not allow elsewhere.

In the end, the traditionalists are skeptical that the tools exist that would allow the proceduralists to do what they claim. For them, the proceduralists are too eager to believe in economic forces that cannot be seen and too quick to think they understand how changes in the law will affect the way people behave. For traditionalists, the tools of microeconomics and game theory are too primitive.[61] Bankruptcy judges should have aims in mind other than ensuring that markets work effectively. These different views naturally lead to different conceptions of what bankruptcy judges should be doing. These are the subject of the next Part.

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58. The basic idea is a straightforward one: If there are two different legal regimes, parties will invest considerable energy in finding the legal regime that most favors them. A rule that applies only in bankruptcy necessarily invites some parties to resolve the issue someplace else. Resources are wasted in the battle over where the fight takes place. More importantly, when the non-bankruptcy forum is actually used, any substantive policy put in place only in the bankruptcy forum will be irrelevant. For a discussion of the problem of forum shopping, see Baird, *supra* note 11, at 824-28.

It is worth pointing out that this concern about forum shopping comes in both a strong and a weak form. Some proceduralists think that a different substantive rule in corporate bankruptcy requires a rationale peculiarly linked to the bankruptcy process itself. *See, e.g.*, *id.* Others believe that creating such policies imposes a cost that must be taken into account like any other cost. *See, e.g.*, Rasmussen, *Debtor's Choice*, *supra* note 18, at 81-83.

59. As Warren and Westbrook observe,

> We enjoy thinking about reality. We find great satisfaction in struggling to impose some coherence upon its unruly facts. We relish being utterly surprised .... We find it exhilarating to bring fact and theory together to speculate about the power of law to affect the world we observe. By contrast, we find reading purely theoretical articles rather like playing anagrams.

Warren & Westbrook, *supra* note 9, at 1262-63.

60. *See, e.g.*, Warren, *supra* note 9, at 812 ("Although he purports to avoid difficult normative questions and he ignores empirical issues, Baird's conclusions are nonetheless driven by normative values and empirical assumptions. By hiding these values and assumptions, Baird simply makes the debate a shadow game that offers little real illumination.").

61. *See* Warren & Westbrook, *supra* note 9, at 1269 ("Our science is at the early stage of observation, description, and classification—not at the later stage of refined experiments testing ever narrower hypotheses . . . .").

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IV. THE BANKRUPTCY PROCESS AND THE BANKRUPTCY JUDGE

A bankruptcy case has dynamics that distinguish it from other types of litigation. Thurman Arnold once described the negotiations surrounding the reorganization of a corporation as a "combination of a municipal election, a historical pageant, an antivice crusade, a graduate-school seminar, a judicial proceeding, and a series of horse trades, all rolled into one."[62] Most of the action takes place in discussions and negotiations among the various players, mediated by the bankruptcy judge who decides discrete issues of law while steering the players in the right direction. By setting deadlines, approving the fees and the hiring of professionals, and appointing examiners, the bankruptcy judge brings parties to the bargaining table. The judge forces them to negotiate and compromise, while simultaneously ensuring that rights are protected and that the substantive goals of bankruptcy are vindicated.[63]

For the traditionalists, this process is itself one of the great virtues of bankruptcy law. When things work well, the participants have a chance to be heard, come to understand the realities of the debtor's situation, and leave believing they have been treated fairly. The judge has sufficient discretion to ensure that the outcome incorporates not only the legal rules, but also the richly textured complications that each case presents.[64]

Proceduralists think this view of bankruptcy is hopelessly sentimental. Recall that the central goals for proceduralists are ensuring that problems of financial distress do not distort the operation of the firm and harmonizing the bankruptcy process with the legal rules that function elsewhere. From the proceduralists' perspective, negotiations among the interested parties—far from being good—are costs to be avoided. Giving discretion to the judge makes sense only when she is well-positioned to use it. The judge has no magical ability to make business decisions, let alone to outwit the market.

One can see this tension play itself out in a similar fashion in the current debate over rules governing the classification of claims.[65] The current rule has at times been read to mean that in any plan of reorganization all unsecured claims must be lumped together into a single class.[66] The effect of this interpretation can be seen in a fact pattern that

62. THURMAN W. ARNOLD, THE FOLKLORE OF CAPITALISM 230 (1937).

63. *See* Korobkin, *supra* note 6, at 770-72.

64. *See* GROSS, *supra* note 9, at 238; Warren, *supra* note 36, at 351-52.

65. *See* 11 U.S.C. § 1122 (1994).

66. *See, e.g., In re* 500 Fifth Ave. Assocs., 148 B.R. 1010, 1019 (Bankr. S.D.N.Y. 1993) ("That GECC's secured claim may drive the manner in which it casts its unsecured deficiency claim . . . is no reason to separately classify GECC's deficiency claim. Such a rationale improperly focuses on the motives and agenda of the claim holder rather than on the nature of the underlying claim."). The claim of the principal lender for the unsecured portion of the debt is a

arises repeatedly under existing law: The debtor's sole asset is an office building, a bank (the sole secured creditor) is owed much more than the property is worth, and a handful of unsecured trade creditors are owed just a few thousand dollars. Under this interpretation, the plan of reorganization can have only two classes of claims: One class would contain only the secured portion of the bank's claim, while the other would combine the unsecured portion of the bank's claim with the claims of the trade creditors.

For a class to approve a plan, those holding two-thirds of the value of the claims in that class must approve it.[67] Moreover, the Bankruptcy Code requires that at least one impaired class of claims approve a plan.[68] If unsecured claims must be classified together, the debtor in the office building case would not be able to confirm a plan. The bank's unsecured claim is more than one-third of the value of all the unsecured claims combined. Thus, under this interpretation of the Bankruptcy Code, the bank could veto any plan of reorganization.

The National Bankruptcy Review Commission has proposed that plan proponents have the ability to propose separate classification for claims with legally identical rights, provided there is some "rational business justification."[69] Separate classes can receive their payout in a different form, unless the class objects and the court finds it "discriminates unfairly" against that class.[70]

The new rule makes sense to the traditionalist on two different grounds. First, the rule makes it easier to confirm a plan of reorganization and hence makes it more likely that a firm will leave bankruptcy intact as a going concern. Second, it gives more discretion to the bankruptcy judge—something that is unproblematic if agency problems in bankruptcy are small and affirmatively good to the extent one believes the purpose of bankruptcy is to balance competing interests on an ad hoc basis.

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general claim against the debtor that has the same legal attributes as the claims of trade creditors and must therefore be put in the same class.

Some courts have allowed general claims to be put in different classes, but these courts have typically faced the claims of creditors whose nonlegal interests were much different from those courts encounter in the typical one-asset case. *See, e.g., In re* Jersey City Med. Ctr., 817 F.2d 1055 (3d Cir. 1987) (separating claims of physicians, medical malpractice victims, employee benefit plan participants, and trade creditors); Teamsters Nat'l Freight Indus. Negotiating Comm. v. U.S. Truck Co. *(In re* U.S. Truck Co.), 800 F.2d 581 (6th Cir. 1986) (affirming the separation of claims of collective bargaining unit members).

Everyone agrees that unsecured claims cannot be put into separate classes solely to satisfy 11 U.S.C. § 1129(a)(10), and in many one-asset cases little else seems to be happening. Some courts, however, have found other explanations and have allowed the separate classification of the claims of trade creditors in single-asset real estate cases because, for example, the trade creditors' rights against the general partners were different from those of the principal lender. *See, e.g., In re* 222 Liberty Assocs., 108 B.R. 971, 989-90 (Bankr. E.D. Pa. 1990).

67. *See* 11 U.S.C. § 1126(c).

68. *See id.* § 1129(a)(10).

69. NATIONAL BANKR. REVIEW COMM'N, *supra* note 8, § 2.4.16, at 578-82.

70. 11 U.S.C. § 1129(b)(1).

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From the proceduralist's point of view, however, the Commission's proposal is muddled and its justifications are unsound. Modern finance theory has taught us to be skeptical of links between the capital structure of a firm and its operations. It is not obvious under what circumstances, if any, the way that old contributors of capital were paid out would have anything to do with the operations of the business, yet this division is all that is at issue when we classify claims. The idea that "rational business justifications" determine how different claims should be treated seems, at first blush, incoherent. Claims deal with the division of the assets; business decisions deal with choices that affect the value of the assets. Changing the size of the slices does not ordinarily change the size of the pie.

To the traditionalists, granting discretion to the bankruptcy judge empowers the judge to assess competing claims on a case-by-case basis. Bankruptcy courts are courts of equity. Proceduralists, by contrast, see no particular virtue in such fine-tuning, doubt the ability of the judge to assess claims effectively, and worry that vagueness in the rules merely gives the parties more cause for litigation and hence increases the cost of the reorganization without providing any offsetting benefit.

V. THE LIMITS OF INSTRUMENTALISM

A. *The Purposes of Bankruptcy*

One may be able to explain the differences between proceduralists and traditionalists not by identifying their axioms, but by examining their beliefs about what it is they think the bankruptcy laws can and should do. For the proceduralists, bankruptcy law should be treated the same as any other area of law, and other laws are conventionally justified on instrumentalist grounds. We justify tort law because it deters negligent behavior.[71] We justify criminal law in large measure because it reduces the amount of crime.[72] We enforce contracts because we want people to be able to count on promises that others make.[73] Outside of bankruptcy, the legal

71. *See, e.g.*, GUIDO CALABRESI, THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS 26 (1970) ("I take it as axiomatic that the principal function of accident law is to reduce the sum of the costs of accidents and the costs of avoiding accidents.").

72. *See, e.g.*, WAYNE R. LAFAVE & AUSTIN W. SCOTT, JR., CRIMINAL LAW § 1.1(b), at 3 (2d ed. 1986) (suggesting that lawyers "conceive of punishment for violation of the criminal law as a device for preventing such conduct—by deterring prospective offenders by threat of punishment and by preventing repetition by incapacitating and if possible reforming those who have already committed crimes").

73. E. Allan Farnsworth has argued in this vein. He observes:

> From the perspective of society as a whole, the function of the law of contracts might have been seen as furthering the general economic good by encouraging parties to enter into such productive transactions. From the perspective of the parties themselves, the

system does not empower judges to protect individuals from disruptions of the market economy beyond the narrow constraints of unconscionability.[74] Proceduralists believe that judges are singularly ill-equipped to make such interventions, since judges are poor social planners.

The traditionalists believe the world of bankruptcy can be meaningfully separated from every other part of our legal universe. In other words, the traditionalists' axioms reflect a conviction that bankruptcy is fundamentally different from other kinds of legal regimes. This position is difficult for an instrumentalist to hold. But traditionalists are not instrumentalists; in much of their analysis, they rely more on intuition than cold reason. Traditionalists might even concede as much, though they might also add—with some justification—that the leap of faith the proceduralists make in embracing the efficacy and importance of markets relies on intuition every bit as much.

Empirical data will not do much to advance such a debate, one that is at bottom normative. The kinds of cases that matter the most in this debate—the small businesses whose owner-managers want to continue to run them—are the hardest firms to study.[75] The financial data that has been used to look at the effects of takeovers and the like is not usually available for small firms. One cannot draw inferences from changes in share price when a company's stock is not publicly traded.[76]

There is another problem with the repeated calls for additional empirical information. While both sides call for more empirical analysis, on closer examination the two camps want different information for different purposes. The proceduralists see their task as one of generating falsifiable hypotheses about questions such as how different bankruptcy regimes affect the availability of capital for small businesses. They seek data as benchmarks against which to assess the work of others, as well as their own.[77] The traditionalists believe that the available tools are too primitive and that the hypotheses put forward by the proceduralists are "almost defiantly far removed from reality and therefore untestable by empirical

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function might have been viewed more narrowly as aiding them in planning for the future by protecting their expectations.

1 E. ALLAN FARNSWORTH, FARNSWORTH ON CONTRACTS § 1.3, at 10 (2d ed. 1998).

74. Most unconscionability cases involve problems of both procedural and substantive unconscionability. *See* 1 *id.* § 4.28, at 560-61. Plaintiffs typically prevail only when the circumstances surrounding the original bargain involve a level of advantage-taking and misrepresentation that borders on fraud and misrepresentation. Any case in bankruptcy whose facts parallel those in the typical case under U.C.C. § 2-302 (1989) is likely to be one in which a lender liability action exists. Moreover, most unconscionability cases involve consumers, not merchants or corporate entities. *See* 1 *id.* § 4.28, at 563-65.

75. *See* Douglas G. Baird, *The Reorganization of Closely Held Firms and the "Opt Out" Problem*, 72 WASH. U. L.Q. 913, 926 (1994); Bufford, *supra* note 10, at 834-35.

76. *See* Warren, *supra* note 1, at 440-43.

77. For examples of such empirical research, see sources cited *supra* note 3.

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research."[78] Traditionalists think that, at this point, empirical data-gathering at best gives one a sense of the landscape. They seek empirical data because it allows them to tell a richer and deeper story about the sorts of people who find themselves in bankruptcy court.[79] Proceduralists gravitate towards the work of economists who do multivariate regressions; traditionalists want case studies that give a sense of the different kinds of dramas that play out in bankruptcy court. Similarly, proceduralists are drawn to the large Chapter 11 cases; traditionalists are attracted to the small ones.

B. *The Politics of Bankruptcy*

The two different sets of beliefs also determine the two groups' chances of success in the political arena. In the world of sound bites, traditionalists will always have an advantage, since their rhetoric has fewer hard edges. They have less need to point out the harsh realities of a market economy and the imperfections of our legal systems. Proceduralists, on the other hand, consistently find themselves in a more awkward spot. They cannot explain their position without emphasizing the inevitability of mistake and error. There is little political appeal in an approach that begins by pointing out the dark side of capitalism—that most firms fail, many people lose jobs in the process, and nothing can be done about it.

The point extends beyond rhetoric and sound bites. The interests of entrepreneurs who cannot find investors or workers who remain unemployed may be underrepresented in the political process. Those most disadvantaged by the traditionalists' approach do not even know who they are. Public choice theory warns that it is exactly these sets of interests that are likely to be underrepresented in the legislative process.[80]

Particularly in times of economic unrest, bankruptcy law has figured prominently in political discourse.[81] Proceduralists are not, for the most part, engaged in debates about legislative reforms, while traditionalists often are. Moreover, the proceduralists' hostility toward current law may not be easy to justify, even by their own benchmarks. Investors can anticipate how different legal regimes will treat them and adjust interest rates and lending patterns accordingly. Thus, bankruptcy's effect on investment may be small. Empirical evidence suggests that the costs of

78. Warren & Westbrook, *supra* note 9, at 1287. Proceduralists would respond by pointing to examples of their work that have been shaped by empirical studies. *See* sources cited *supra* note 3.

79. *See, e.g.*, Whitford, *supra* note 3, at 1405 (arguing that studies of specific Chapter 11 cases "point to the most basic truth about Chapter 11—it is a highly flexible procedure capable of many different uses").

80. For an analysis of bankruptcy through the lens of public choice, see Eric A. Posner, *The Political Economy of the Bankruptcy Reform Act of 1978*, 96 MICH. L. REV. 47 (1997).

81. The insolvency legislation of the 1930s is one of several conspicuous examples. *See, e.g.*, Frazier-Lemke Act of 1934, Pub. L. No. 73-486, 48 Stat. 1289 (1934) (expired 1949).

Chapter 11, at least for large firms, are relatively minor.[82] Moreover, in assessing Chapter 11, one must take into account all of the cases it treats, not just those of interest to the proceduralists.

Proceduralists often slight the virtues of a regime like Chapter 11 that, to some extent, gives small entrepreneurs a sense that their rights are respected and that they are treated fairly. Such effects may be important, and noninstrumentalist aims may be as legitimate as instrumentalist ones. Upon reflection, proceduralists might concede that a bankruptcy law with such aims is far better than the alternatives political forces might establish if noninstrumentalist aims were neglected. For example, the government might provide public subsidies for failed enterprises. Relative to such a system, our current laws may do far less harm at a much smaller cost.

In short, the proceduralists may owe the traditionalists a debt they never acknowledge. Like the traditionalists, the proceduralists accept most of existing law as sound policy, but they lack the tools to defend it in political debates. The traditionalists' axioms, in other words, make politically palatable ninety percent of the law that proceduralists want but could not defend outside the academic arena. The political character of the traditionalist approach has been noted before. In particular, it lies at the heart of *The Law and Language of Corporate Reorganization*, Walter Blum's classic 1950 analysis of these issues.[83]

82. In addition to resolving disputes among creditors, a Chapter 11 plan of reorganization is a complete recapitalization of the firm. Its marketplace equivalent is an offering of all the debt and equity of the firm at the same time. For publicly traded firms in Chapter 11 in the 1980s, these costs ranged between 0.9% and 7.0% of the book value of the assets before the filing of the bankruptcy petition. The average was 2.8%. *See* Weiss, supra note 3, at 289; Michelle J. White, *Bankruptcy Liquidation and Reorganization*, *in* HANDBOOK OF MODERN FINANCE 35-34 (Dennis E. Logue ed., 1984) (noting that the costs of a representative sample of all firms that successfully reorganized were only 3%). By contrast, the direct cash costs of initial public offerings for amounts greater than $10 million were approximately 10%. *See* Jay R. Ritter, *The Costs of Going Public*, 19 J. FIN. ECON. 269, 272 (1987). Some of these cash outlays, however, may have been rents captured by investment bankers and not social costs.

83. Walter J. Blum, *The Law and Language of Corporate Reorganization*, 17 U. CHI. L. REV. 565 (1950). Blum observed:

> Renegotiation through reorganization . . . may be the least unsatisfactory adjustment to economic instability. This perhaps is the most persuasive justification for our system of corporate reorganization. But the effects and accomplishments of the system should not be overstated. At most the system results in what is thought by many to be a more equitable way of adjusting rights among those who have a financial interest in distressed companies. Beyond this its demonstrable reach is almost negligible. . . . In the end its most significant aspect for society as a whole may be a negative one: The junior interests who are relieved by it from the judgments of the market are rescued without the direct disbursement of public funds for their benefit.

Id. at 602-03.

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VI. CHOOSING AXIOMS

The greatest deficiency of traditionalist methodology for proceduralists is that it lacks the rigor or coherence needed to make it useful for their enterprise. Similarly, proceduralist methodology is often too much in the mode of pure, as opposed to applied, science to find a convenient place in the realities and particularities of practical discourse.

The fundamental difference between traditionalists and proceduralists lies in the questions they think are worth asking and the problems they think are worth studying. Bridging the gap between them has little to do with empirical research. Neither is it a task for which either traditionalists or proceduralists are well-equipped. Such an undertaking "must ultimately dissolve into a study of aesthetics and morals."[84]

84. Here I am, of course, invoking Ronald Coase, who in turn invoked Frank H. Knight. R.H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 43 (1960) ("[P]roblems of welfare economics must ultimately dissolve into a study of aesthetics and morals.").

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