South Carolina Law Review

Volume 44 | Issue 4 Article 9

Summer 1993

Towards a Model of a Bankruptcy Administration

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TOWARDS A MODEL OF BANKRUPTCY ADMINISTRATION

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I. INTRODUCTION

Two of the principal goals of the 1978 Bankruptcy Reform Act[1] were to separate the administrative and judicial functions of bankruptcy judges and to establish a strong administrative system to fill the void left by the removal of bankruptcy judges from administrative and supervisory tasks.[2] The United States trustee system was supposed to fill that void. The 1978 Act, however, provided only a framework for the role of the United States trustees. Congress established policy and form, but not mechanics or procedures for bankruptcy administration. Furthermore, Congress relied on the Department of Justice and the United States trustee system to implement the program in a manner that carried out Congress's policy of strong, forceful administration and supervision. However, Congress failed to define adequately a theoretical basis for, or a model of, bankruptcy administration that would give guidance to those charged with implementing the program. As a result, the nature of bankruptcy case administration and the interrelationships among the players and the process remains unclear. In addition, the statute provides no policy guidance on the proper roles of the bankruptcy judges and the United States Trustees.

This Article attempts to develop an appropriate model for bankruptcy administration. In addition, it strives to refine the distinction between "administrative" and "judicial" functions that precipitated the establishment of the United States trustee system in the 1978 bankruptcy legislation. This is not intended as an Article about how or why bankruptcy judges or United States trustees (or both) are doing too much or too little in bankruptcy administration, although in various districts either or both are. Nor is it intended to propose a restructuring of either of those institutions or a redefinition of their roles. Rather, it is a conceptual piece, designed to explore the nature of decisions in bankruptcy cases—both liquidations and reorganizations—as well as the appropriateness of the decision-making institution and the decision-making process to the task at hand.

II. TOWARDS A MODEL OF BANKRUPTCY ADMINISTRATION

A. The Nature and Function of a Model

A model of bankruptcy administration can provide structure and functioning guidelines to the current system and can suggest ways to

1. Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C. §§ 101-1330 (1988 & Supp. IV 1992), and in scattered sections of 28 U.S.C., and in other titles) [hereinafter "Bankruptcy Code" or "Code"].

2. H.R. REP. NO. 595, 95th Cong., 1st Sess. 4, 107 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 5965-66, 6068-69.

improve it. A model also can provide concepts and context for a more principled evaluation of particular proposals. A model cannot, however, provide substantial guidance to those who practice under the current system. It is a developmental tool most useful for evaluating reform proposals and setting the direction for improvement.

In developing a model, one must identify and describe the functions to be performed in administering a bankruptcy case, rather than merely describe the institutions (such as the United States trustee or the court) that will perform those functions. A model should describe the parties, and the powers, duties and responsibilities inherent in a bankruptcy proceeding. In addition, the model should describe the allocation of powers, duties and responsibilities among the parties and articulate some principled reasons for the allocation.

This Article uses the existing substantive bankruptcy law[3] and the existing bankruptcy court system[4] as the context for the model. Neither the terms of the substantive bankruptcy law, nor the manner of selecting judges, their tenure, jurisdiction, or venue, nor the appellate structure for bankruptcy court decisions should affect the analysis or allocation of the administrative functions discussed in this Article.

B. The Historical Model

Historically, bankruptcy has been considered a judicial proceeding. This view seems more a result of the assignment of bankruptcy cases to the courts for the adjudication of bankruptcy and for the supervision of case administration from the earliest times[5] rather than a result of anything inherent in the nature of the process, or of any conscious decision based on an analysis of the functions performed by the process. To the contrary, after the declaration or adjudication of bankruptcy, the process appears to be one more of administration than dispute resolution, despite the placement of the function in the courts. Indeed, both the statutes and the courts have so treated the bankruptcy process. Each bankruptcy statute authorizes courts of

3. 11 U.S.C. §§ 101-1330 (1988 & Supp. IV 1992).

4. 28 U.S.C. §§ 151-158, 1334 (1988 & Supp. IV 1992).

5. Act of April 4, 1800, ch. 19, 2 Stat. 19 (repealed 1803). Until the Act of March 2, 1867, ch. 176, § 11, 14 Stat. 517, 521, voluntary bankruptcy was not permitted. When bankruptcy was commenced as an action against an absconding trader, a judicial forum may have been the most appropriate.

bankruptcy to appoint commissioners,[6] assignees,[7] registers,[8] trustees,[9] receivers,[10] and referees[11] to handle the actual administration of bankruptcy cases. The judge's role after adjudication has been more of a supervisory role in reviewing the administration of the case. Disputes often arose in the course of settling the affairs of a bankrupt. Therefore, it was convenient to have the court (or its adjunct, the referee) at hand for summary resolution of those disputes. Still, the case itself was more of an administrative process of liquidating or reorganizing assets and reviewing claims than one of adjudicating disputes. By its nature, the overall case was not a dispute suitable for judicial resolution.[12]

C. The Model Under the 1978 Bankruptcy Reform Act

The "separation of administrative and judicial functions currently performed by bankruptcy judges" was one of the principal goals of the 1978 legislation.[13] The Bankruptcy Commission[14] identified the combination of those functions as a problem facing the bankruptcy system as it existed in the 1970s,[15] and Congress sought to solve that problem. The simple manner in which the problem was stated, however, defined the simple model for the solution. As a result, the solution failed to comprehend the

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6. Act of April 4, 1800, § 2, 2 Stat. at 21-22.

7. Act of August 19, 1841, ch. 9, § 3, 5 Stat. 440, 442-43; Act of March 2, 1867, § 13, 14 Stat. at 522.

8. Act of March 2, 1867, § 3, 14 Stat. at 518.

9. Act of July 1, 1898, ch. 541, §§ 33, 47, 30 Stat. 544, 555, 557.

10. *Id.* § 2(5), 30 Stat. at 546.

11. *Id.* §§ 33, 38-39, 30 Stat. at 555-56.

12. *Cf. In re* Saco Local Devel. Corp., 711 F.2d 441, 443-45 (1st Cir. 1983) (holding that the proper "judicial unit" for determining finality for purposes of appellate jurisdiction is "the traditional 'proceeding' *within* the overall bankruptcy case, not the overall case itself").

13. H.R. REP. NO. 595, *supra* note 2, at 107, *reprinted in* 1978 U.S.C.C.A.N. at 6068-69.

14. Congress established the Commission on the Bankruptcy Laws of the United States to study the bankruptcy laws and recommend to Congress proposals for reform. Joint Resolution of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468. The Commission's report, REPORT OF THE COMM'N ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93d Cong., 1st Sess. (1973) [hereinafter COMMISSION REPORT], was filed upon the completion of the Commission's work and formed the basis for the hearings and debate that led to the enactment of the Bankruptcy Reform Act. *See H. R. Rep. No. 595*, *supra* note 2, at 2-3, *reprinted in* 1978 U.S.C.C.A.N. at 5963-64; Kenneth N. Klee, *Legislative History of the New Bankruptcy Law*, 28 DEPAUL L. REV. 941, 943 (1979).

15. COMMISSION REPORT, *supra* note 14, pt. I, at 92-94.

underlying nature of the functions involved.

The 1978 Bankruptcy Reform Act attempted to address the problem by recharacterizing the proceeding and emphasizing its administrative nature. It removed many of the bankruptcy courts' "administrative" responsibilities and lodged them with the United States trustees.[16] This administrative structure established under the Reform Act was based on a simple model of bankruptcy administration. It divided functions into two categories, judicial and administrative, based solely on whether there was a dispute about a particular issue. If a dispute existed, the matter was considered proper for judicial attention and was directed to the bankruptcy court for decision. If there was no dispute, then the court was not supposed to become involved,[17] regardless of the subject matter of the dispute or whether the dispute was appropriate for judicial resolution.[18]

Nevertheless, long history and established practice created heavy chains.[19] Thus, despite the apparently simple and absolute bifurcation of functions, the Code requires or permits court involvement in certain matters, either for historical reasons or because some matters were felt to be too "important" to escape court supervision or intervention.[20] The structuring, filing, and processing of cases generally follows the historical model and detracts from straight implementation of the simple reform model.[21] For example, petitions are still required to be filed in the bankruptcy court, thus invoking the court process.[22] Conversion of cases from one chapter to another is court-controlled.[23] Notices of proposed actions are filed with the court, whether or not the action involves an actual or expected dispute at the time the notice is given.[24] The courts continue to maintain a complete case

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16. H.R. REP. NO. 595, *supra* note 2, at 100-101, 107, *reprinted in* 1978 U.S.C.C.A.N. at 6061-63, 6068-69.

17. *See generally* H.R. REP. NO. 595, *supra* note 2, at 107-08, 315, *reprinted in* 1978 U.S.C.C.A.N. at 6068-70, 7272; *Bankruptcy Act Revision: Hearings on H.R. 31 and H.R. 32 Before the Subcomm. on Civ. and Const. Rights of the House Comm. on the Judiciary*, 94th Cong., 1st Sess., pt. I, at 586-87 (1975) [hereinafter *House Hearings*] (statement of George M. Treister, Vice-Chairman, National Bankruptcy Conference)

18. *In re* Curlew Valley Assocs., 14 B.R. 506, 511 (Bankr. D. Utah 1981) (". . . the decision calls for *business* not *legal judgment*.").

19. John D. Ayer, *How to Think About Bankruptcy Ethics*, 60 AM. BANKR. L.J. 355, 396 (1986).

20. *House Hearings*, *supra* note 17, pt. I, at 587 ("sensitive" matters).

21. Some of these features were imposed by the Bankruptcy Rules as they existed in 1978 and under the "Interim Rules" that were adopted as local rules and intended to govern cases and proceedings until the rewriting and adoption of the new rules in 1983.

22. 11 U.S.C. §§ 301, 302(a), 303(b), 304(a) (1988).

23. *Id.* §§ 706, 1112, 1208, 1307.

24. *See* FED. R. BANKR. P. 2002(a) (providing that "the clerk, or some other person as the court may direct" shall give notices); FED. R. BANKR. P. 6004(f) (requiring an

file and require that all papers, including even those concerning only administrative matters in which no dispute arises, be filed with the court.[25] Furthermore, the courts and their clerks remain responsible for ensuring that all necessary administrative steps in a case are completed before the case is closed. In short, the paper flow continues to make the process appear judicial, even where no disputes arise in the case.

As a result, many bankruptcy judges continue to view themselves as responsible for the overall management and supervision of the cases on their dockets. To some degree, the judges perceive the United States trustees as merely assisting the courts in securing prompt administration of the cases. Some judges may even perceive the United States trustees as irrelevant to that responsibility. The judges often move to fill any vacuums in the administration or management of the cases, because they continue to feel responsible for the expeditious resolution of their cases.

In addition, many matters remain subject to court approval, even when no dispute arises. For example, the assumption or rejection of executory contracts and unexpired leases requires court approval.[26] Such matters that relate to the liquidation or reorganization of the estate, or its business, are clearly administrative, even under the 1978 model; however, because the rights of the other party to the contract or lease, and perhaps the overall assets and liabilities of the estate, are implicated, the Code imposes the requirement of court supervision. Approval of the employment of professionals, as well as their compensation, also remains with the court, whether or not any matter is disputed.[27]

Also, the courts must still approve Chapter 11 disclosure statements. Even when all of the parties, the Securities and Exchange Commission (SEC), and the United States trustee approve a Chapter 11 disclosure statement, the bankruptcy court must still determine whether it contains "adequate information."[28] Determining whether a disclosure statement contains adequate information requires, at a minimum, a knowledge of the

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accounting of sale to be filed with court).

25. *See* FED. R. Bankr. P. 5005(a).

26. 11 U.S.C. § 365(a); *see* Arizona Appetito's Stores, Inc. v. Paradise Village Inv. Co. (*In re* Arizona Appetito's Stores, Inc.), 893 F.2d 216, 219 (9th Cir. 1990); NLRB v. Bildisco & Bildisco, 465 U.S. 513, 526-27 (1984).

27. 11 U.S.C. §§ 326-331. Employment and compensation of professionals by the estate had long been subject to criticism because of the apparent ability of professionals to be paid when all other constituencies lose money. Employment and compensation are clearly matters of the administration of the case itself; yet, Congress was not willing to trust the United States trustee system to supervise this aspect of bankruptcy cases. Therefore, the Code requires courts to review and approve all facets of the employment and compensation of professionals.

28. 11 U.S.C. § 1125(b); *See id.* § 1125(a) (defining "adequate information").

business as well as the Chapter 11 case, an understanding of the needs of those receiving the information, and an appreciation of the terms and implications of the reorganization plan and the matters that could derail the plan.[29] These matters require more than administration of the case. They require active involvement in the Chapter 11 reorganization, or at least an opportunity to investigate, rather than a role of merely resolving disputes. Nevertheless, Congress determined that the disclosure statements are too "important" to pass without court scrutiny.[30]

Some of the most significant departures from the strict disputed/undisputed bifurcation model of the Bankruptcy Code occurred in consumer bankruptcy. The original version of the Code required all individual debtors to appear before the bankruptcy judge to "receive" the discharge, hear a "warning" about reaffirmation of debts, and obtain approval of any reaffirmation agreements, which were by their nature undisputed.[31] In exercising that duty, the bankruptcy judge acted as social worker. In addition, Chapter 13 plan-confirmation hearings rarely involve disputes; nevertheless, Congress requires a court hearing and confirmation of Chapter 13 plans.[32]

Thus, the Bankruptcy Code's simple administrative model, which bifurcated disputed (judicial) from nondisputed (administrative) matters, was implemented imperfectly. Despite its simplicity, the model could have been

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29. *See* Kirk v. Texaco, Inc., 82 B.R. 678 (S.D.N.Y. 1988); *see also In re* The Stanley Hotel, Inc., 13 B.R. 926 (Bankr. D. Colo. 1981) (holding that disclosure statement was sufficient because it gave creditors and interested parties enough information to make a decision about whether to vote for a proposed plan, and because enclosing all legal documents would have been impractical).

30. This view may have been premised on the practice under former Chapter X of the Bankruptcy Act, 11 U.S.C. §§ 501-676 (1976) (repealed 1978). Former Chapter X provided an exemption from the securities laws for the solicitation of the vote, *id.* § 664 (1976) (repealed 1978); *see* 11 U.S.C. § 1145 (1988), but required court approval of the plan before it could be sent out for a vote. 11 U.S.C. §§ 574-576 (1976) (repealed 1978). Under Chapter X, the process of court approval began with the submission of the plan to the SEC for an advisory report. 11 U.S.C. §§ 572-573 (1976) (repealed 1978).

Congress designed the Chapter 11 disclosure statement process to take the place of these cumbersome protective features. H.R. REP. NO. 595, *supra* note 2, at 227, *reprinted in* 1978 U.S.C.C.A.N. at 6186-87. However, Congress may have felt that approval by a new and untested administrative agency (the United States trustee system) without experience in the securities area would be inadequate, even though the Bankruptcy Commission proposed that the Bankruptcy Administration occupy the role of the SEC in reorganization cases. COMMISSION REPORT *supra* note 14, pt. I, at 249.

31. 11 U.S.C. § 524(c), (d) (1982) (amended 1984). The current provision still requires a hearing, a warning, and court approval if the debtor decides to reaffirm a discharged debt. *Id.* § 524(c), (d) (1988).

32. 11 U.S.C. § 1325(a) (1988).

implemented strictly and consistently. Although any such implementation would have improved the plan Congress actually enacted, the model still would have been inadequate, primarily because it was incomplete. In allocating responsibility in the system, the Code fails to acknowledge that, in most of the kinds of matters described above, decisions are and must be made even when there is no dispute. Moreover, the Code does not address the nature of the decisions that must be made or the suitability of the decision-maker to the particular kind of decision. Therefore, an additional concept is needed to describe the kind of decisions being made and the suitability of both the decision-maker and the decision-making process to the decisions that must be made.

D. A Better Model of Judicial/Administrative Bifurcation

1. Defining the Nature of the Decision

Any parent with more than one child is well schooled in the dual roles of judicial and administrative decision-maker. The parent is all too familiar with the difference between these two roles, illustrated by the following examples. On the one hand, the parent assumes a judicial role when asking and then deciding "what happened?" and "what are the consequences?" following a sibling conflict. On the other hand, the parent acts a administrator when asking and deciding "what should we do today?" following expressions of differing interests for the day's activities. Even though both types of questions might be equally hotly disputed, the questions that are asked and the solutions that are brought to bear are inherently different in these two situations and require different kinds of information and skills.

Unlike ordinary civil or criminal litigation, which focuses almost solely on "what happened?" and "what are the consequences?," bankruptcy cases involve both judicial and administrative decisions. A bankruptcy case must accomplish a complete settlement of all of the debtor's affairs and existing legal relationships, many of which may involve disputes akin to ordinary civil litigation.[33] However, the case must also manage the business of the estate, whether the business is liquidation or operation.

Thus, a concept that distinguishes between decisions based on past events (who did what, when, how, and to whom?) and decisions based on judgments about the future (what should be done?) might better describe the kinds of decisions that must be made in the course of a bankruptcy case. Such a concept can better define the distinction between the judicial and administrative functions that the Bankruptcy Code sought to implement. This concept is useful because it recognizes the differences in the kinds of

33. *See* H.R. REP. NO. 595, *supra* note 2, at 180, *reprinted in* 1978 U.S.C.C.A.N. at 6140-41.

decisions to be made, the information they require, and the remedies that must be fashioned. A more complete model of the bankruptcy system should clearly define this distinction and allocate responsibility based on these factors.

2. Forensic Decisions

Decisions based on past events are the kinds of questions involved in a typical, classic civil action. These decisions require proof of existing facts and events that have already occurred and the application of governing law to those facts. The decision-maker in a civil case decides "what happened?," determines the substantive rights of the parties to the action at a particular time ("what are the consequences?"), and enforces those rights. The outcome is often the award of money damages or the issuance of an order requiring or prohibiting a party from taking some future action. While fashioning a remedy in some instances may require looking into the future to determine the likely effectiveness of the proposed remedy, the determination of the substantive rights of the parties seeking the decision generally does not.[34] These decisions will be referred to as "forensic decisions" in this Article to avoid confusion with the common term "judicial decisions," which possesses too much independent meaning in the debate over bankruptcy administration.

Forensic decisions typically arise from disputes about the facts or the meaning or application of the relevant law (although disputes about remedies may also arise). They are typically suitable for resolution by judicial forms and procedures, such as the introduction of disputed evidence to permit the court to find facts.[35] Forensic disputes arise in bankruptcy cases over such things as the allowability of claims,[36] the validity and priority of liens,[37] entitlements to property of the estate (*i.e.*, "who is the owner?"),[38] exemptions,[39] discharge,[40] and dischargeability.[41] Indeed, the Bankruptcy

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34. Although courts issue injunctions and other remedies that require court supervision of prisons, schools, hospitals, and the like, that function differs from the role of a bankruptcy court in supervising the administration of an estate. An injunction is designed to protect a specific right and should go only so far as is necessary to protect that right. 7 JAMES W. MOORE ET AL., MOORE'S FEDERAL PRACTICE ¶ 65.08, at 65-116 to -117 (2d ed. 1988) ("An injunctive decree does not create but only protects a right . . . ."). By contrast, the bankruptcy process is responsible for the entire administration of the estate, including the operation of any business of the estate.

35. FED. R. Bankr. P. 7052 (incorporating FED. R. CIV. P. 52(a), which requires the court to make separate findings of fact and conclusions of law).

36. *See, e.g.*, 11 U.S.C. § 502 (1988); FED. R. Bankr. P. 3007.

37. *See, e.g.*, 11 U.S.C. §§ 544-550; FED. R. Bankr. P. 7001(2).

38. 11 U.S.C. § 541.

39. *Id.* § 522; FED. R. Bankr. P. 4003.

Rules require that adversary proceedings be brought to resolve all of these kinds of disputes except disputes over claims and exemptions.[42]

3. Nonforensic Decisions

The other kind of decisions are those about the future. They require an exercise of judgment as to the course of action that should be taken. The decision-maker may rely heavily on historical facts and the existing substantive rights of the parties in order to set the context for the decision. Furthermore, the decision-maker may rely on historical events and past performances to assist in evaluating the likely outcome of uncertain future events. However, the critical bases for these decisions are primarily predictions of future events (how will a decision one way or the other affect the course of administration or obtain a desired result?). These decisions require an evaluation of risks and a balancing of competing risk/reward preferences among those involved in the case. Decisions of this kind relate more to administration, either of the case or of an operating business, and will be referred to in this Article as "nonforensic decisions."

In administering a case, the trustee must make a variety of nonforensic decisions that are influenced very little by the past: What should be done to preserve and protect assets? What procedure should be followed to dispose of assets—private sale, auction, listing with a broker, or otherwise?[43] Which broker or auctioneer should be used? These decisions are common elements of the liquidation of a Chapter 7 estate as well as the administration of an operating business. Often, a Chapter 11 trustee or debtor-in-possession will liquidate surplus or unprofitable assets that are not essential to the reorganized business.[44] In addition, there are the daily operating decisions that management of any business must make and the less frequent decisions that boards of directors must make—whether to sell, retain, or redeploy certain assets, whether to enter or terminate certain lines of business, and so on.

Many of the daily, ordinary-course decisions are routine and made without much thought. Many of the decisions out of the ordinary course are also clear and easily reached without much controversy or debate. As the

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40. 11 U.S.C. § 523; FED. R. Bankr. P. 4004.

41. *See, e.g.*, 11 U.S.C. § 727; FED. R. Bankr. P. 4007.

42. FED. R. Bankr. P. 7001(1),(2),(4),(6),(8).

43. *See* FED. R. Bankr. P. 6004(f); Karbach Enters. v. Exennium, Inc. (*In re* Exennium, Inc.), 23 B.R. 782, 788-89 (Bankr. 9th Cir. 1982) (finding that lower court abused its discretion in not reopening a sale when trustee failed to apply to the court to conduct a private sale), *rev'd on other grounds*, 715 F.2d 1401 (9th Cir. 1983).

44. *See, e.g.*, Committee of Equity Sec. Holders v. Lionel Corp. (*In re* Lionel Corp.), 722 F.2d 1063 (2d Cir. 1983).

cases get bigger and more complex, however, decisions on many of these issues can have serious implications for the values to be realized and the time required for administration of the case.[45] When these decisions may have a significant effect on the amount that creditors or equity holders will recover in the case, disputes can and do arise. Whether or not there is a dispute, however, a decision must still be made by someone.

Moreover, even if there is a dispute, nonforensic decisions are fundamentally different from forensic decisions. Nonforensic decisions do not involve determining what the facts were at a particular time in the past and applying the law to those facts to determine the rights and entitlements of the parties. Rather, they involve the exercise of considered judgment, typically business judgment, about a future course of action.[46] As a result, disputes over these decisions often involve disagreement about a prediction of the future—events both within and beyond the control of the participants in the administrative process—and about what constitutes an acceptable level of risk and reward. The following three examples show how disagreement about the future and about an acceptable level of risk and reward arises in bankruptcy cases.

First, a trustee in a liquidation case may prefer a private sale or retaining a broker instead of a public auction because the trustee believes (*i.e.*, predicts the future) that the private or brokered sale will avoid the depressing effect on price that a bankruptcy auction often has.[47] There is clearly a risk that the trustee may be wrong and that the competition of an auction sale may in fact bring more than a private sale. However, the bankruptcy system relies on the trustee's experience and judgment to make the decision as to how to proceed, as long as the trustee exercises reasonable judgment. If a party in interest disagrees with the trustee's decision, which kind of sale to hold is neither a question of "fact" nor a question of law.[48] Rather, it is a question of whether the trustee acted reasonably in balancing the risks of the decision against the possible rewards.

Second, a Chapter 11 debtor-in-possession might be willing to risk

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45. *See, e.g.*, *id.*; Institutional Creditors of Continental Airlines v. Continental Airlines (*In re* Continental Airlines), 780 F.2d 1223 (5th Cir. 1986); *In re* Public Serv. Co., 90 B.R. 575 (Bankr. D.N.H. 1988).

46. *See generally In re* Curlew Valley Assocs., 14 B.R. 506 (Bankr. D. Utah 1981) (holding that trustee's decision to use hay bailing instead of hay cubing was a business decision within the trustee's discretion).

47. *See generally*, IRVING SULMEYER ET AL., COLLIER HANDBOOK FOR TRUSTEES AND DEBTORS IN POSSESSION ¶¶ 11.01-.02 (5th ed. 1991).

48. Whether the trustee is authorized to sell at a private sale, however, may be a question of law. *See* Karbach Enters. v. Exennium, Inc. (*In re* Exennium, Inc.), 23 B.R. 782, 788-89 (Bankr. 9th Cir. 1982) (requiring public sale), *rev'd on other grounds*, 715 F.2d 1401 (9th Cir. 1983).

estate funds on a particular venture in the hope of achieving a favorable outcome.[49] Without a favorable outcome, the debtor would likely recover little or nothing in the Chapter 11 case. Thus, the debtor's interest in the estate's current value is limited. By contrast, creditors may prefer to forego the risk, preferring instead to take the available funds as a recovery rather than venture them in the hope of increasing their recovery. Despite this dispute, the evaluation still comes down to the accuracy of the risk/reward evaluation and to risk preference, for which there is no external standard.

Third, a decision about whether to keep a Chapter 11 business operating may be based on the perceived ability of the debtor's management to be effective and to accomplish the results that it projects. Undoubtedly, management will have confidence in its own ability to succeed; however, creditors may disagree. Any decision about whether to proceed must evaluate the future likelihood of success—*i.e.*, the risk of proceeding. This evaluation will be based in part on management's past performance record, whether anything has happened (again, in the past) that would reliably predict (in the future) a change in the management's ability or the likelihood of success, and the effect of such dynamic, uncertain, and unpredictable external factors as markets, competition, and costs. The decision-maker must balance the risks against the likely rewards to determine whether the risks are worth taking.

There is no standard in the Bankruptcy Code, nor would it be easy to create one, that could be applied in an adversarial setting to answer these kinds of questions.[50] Moreover, the solution may be a synthesis of various nonlegal factors, such as devising means to reduce the risk or limit the exposure of the estate if the venture is unsuccessful. These approaches

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49. *See, e.g.*, *In re* Simasko Prod. Co., 47 B.R. 444 (D. Colo. 1985) (allowing debtor-in-possession to borrow money to fund oil drilling operations); *In re* BKW Sys., Inc., 69 B.R. 81 (Bankr. D.N.H. 1987) (denying debtor-in-possession's motion to enter into software distribution agreement, after evaluating relative risks and benefits); *In re* Southern Biotech, Inc., 37 B.R. 318 (Bankr. M.D. Fla. 1983) (allowing debtor-in-possession to purchase all outstanding shares of nondebtor corporation whose business was essential to debtor's business).

50. In other areas where courts apply future-looking remedies, there are at least some existing standards to apply. First, the court must find a violation of an existing statutory, constitutional, or common-law rights. 7-Pt.2 MOORE, *supra* note 34, ¶ 65.04[1] ("[T]he . . . court may, in the exercise of its discretion, properly grant an interlocutory injunction when it is satisfied that there is a probable right and a probable danger and that the right may be defeated . . . ."). Then, the court must fashion a remedy to protect those rights. Although the court must predict the future in analyzing whether the proposed remedy will protect the threatened rights, the rights themselves are a guide and benchmark for what the court is trying to protect. There is no such fixed beacon in bankruptcy administration. Instead, there is a wide range of solutions, all of which might make business sense.

require constructive business strategies. No amount of evidence can enable the decision-maker to "find facts"[51] about the future. In fact, because the objective facts are rarely in dispute, litigation over these matters often involves the testimony of managers and consultants concerning why a particular proposed course of action is likely to succeed or fail.

4. Disputed vs. Nondisputed Decisions

Many decisions in bankruptcy cases, both forensic[52] and nonforensic, simply do not involve disputes at all. In some situations, the parties are simply in agreement or have been brought to an agreement by a party with an ability to influence others in the case. For many decisions, the amounts involved are too small relative to the bankruptcy case, or the parties' investment in it, to warrant the necessary time and attention for a dispute.[53] Many decisions are undisputed simply because creditors or other parties with potentially adverse interests have lost interest in the case. Once their debtor is in bankruptcy, they would rather focus on more productive ventures than attempt to supervise the debtor in the hopes of maximizing a meager recovery.[54] Often, creditors refrain from reviewing decisions because they have confidence in the decision-maker (trustee or debtor-in-possession). Thus, the identity of the initial decision-maker may heavily influence the decision and whether it is challenged or disputed.

Not all decisions in bankruptcy cases can be neatly categorized as forensic or nonforensic. The disputed-undisputed categorization is much simpler and easier to apply. Nevertheless, bifurcating decision-making, as the Bankruptcy Code does, based solely or primarily on whether the matter is disputed or undisputed, without regard to whether the decision is forensic

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51. *See* FED. R. Bankr. P. 7052 (making applicable in adversary proceedings FED. R. CIV. P. 52, which provides "the court shall find the facts specially").

52. For example, the trustee may decide that a creditor's claim is allowable or may, after some investigation, discussion, or negotiation, decide to reach an agreement with the creditor over allowability. Because one of the trustee's duties is to review claims and determine their allowability, 11 U.S.C. § 704(5) (1988), administration is not complete until the trustee has, either by affirmative action or by acquiescence, decided how to treat each filed claim. If the trustee decides to challenge the claim, a dispute will arise. Until someone makes an authoritative decision on the trustee's challenge (either the creditor, by acquiescing, or the court, by ruling), the case cannot be closed. *See id.* § 350(a).

53. *See* FED. R. Bankr. P. 6004(d) (allowing trustee to sell property worth less than $2500 with more limited notice).

54. COMMISSION REPORT, *supra* note 14, pt. I, at 98 (quoting COUNSEL TO THE PETITIONERS IN THE MATTER OF INQUIRY INTO THE ADMINISTRATION OF BANKRUPT ESTATES, 71ST CONG., 3D SESS., ADMINISTRATION OF BANKRUPT ESTATES, ix-x, 36-37 (Comm. Print 1931) (known as the "Donovan Report")).

or nonforensic, does not address who is best qualified to make the initial decision, to review the decision, or to supervise the decision-maker. The disputed-undisputed bifurcation also fails to address what effect the nature of the review has on the decision itself. Despite some overlap between forensic and nonforensic decisions, most decisions should be predominantly of one kind or the other. Thus, the forensic-nonforensic dichotomy can help to determine the function of the decision-maker, assist in the development of a model, and allocate tasks among bankruptcy officials.

However, categorizing decisions does not complete the model. A bankruptcy case is not just forensic dispute resolution; it is a process. Each activity in the process requires an *authoritative* decision. To return to the parent/child example discussed above, each of the disputing siblings might have decided "what shall we do today?"; but that decision is unlikely to get them out the door and to the activity without the parent's authorization. Thus, any participant in the process may make a decision, but that decision will not affect the outcome of the process unless the decision is authoritative. The decision-maker must be invested with some authority under the Bankruptcy Code so the decision either binds other parties or causes the process to advance in the direction dictated by the decision.

There are fully authoritative and partially authoritative decisions. A fully authoritative decision is one that affects the progress of the case without intervention by other decision-makers. For example, a trustee's decision about where to deposit or invest estate funds or to sell an asset in the ordinary course of business disposes of those matters.[55]

A partially authoritative decision affects case progress in that it starts a course of action, but is not fully authoritative because it requires the approval of another decision-maker in the system who must be influenced by the partially authoritative decision in making the fully authoritative decision. For example, a trustee's decision to employ a professional at the estate's expense or to assume or reject an executory contract must be approved by the court before it becomes effective; but the court must give deference to the trustee's decision under the business judgment rule.[56] If the fully authoritative decision-maker is not influenced by the partially

55. *See* 11 U.S.C. §§ 345(a), 363(c)(1).

56. *See id.* § 327; Lubrizol Enters. v. Richmond Metal Finishers, Inc. (*In re* Richmond Metal Finishers, Inc.), 756 F.2d 1043 (4th Cir. 1985) (finding that district court improperly substituted its own business judgment for that of the debtor, in allowing debtor to reject an executory contract), *cert. denied*, 475 U.S. 1057 (1986); *In re* Public Serv. Co., 86 B.R. 7 (Bankr. D.N.H. 1988) (acquiescing in New Hampshire debtor's decision to retain counsel from California despite availability of less expensive local attorneys); *In re* Heck's Inc., 83 B.R. 410 (Bankr. S.D. W. Va. 1988) (holding that lower court abused its discretion in denying motion of equity committee to hire counsel of its choice).

authoritative decision, then the underlying decision is not partially authoritative, because it has no effect on advancing the case or on its outcome.[57]

E. Allocation of Decision-Making Responsibility

Determining the nature of the decisions that must be and are made daily in the bankruptcy system is only the first step. To develop the model further requires an allocation of the responsibility for decision making and a brief examination of the suitability of the decision-maker to the decision. The task of allocating decision-making responsibility in the bankruptcy system is the determination of who can make the first authoritative decision about a particular matter.

Responsibility should be allocated, in part, based upon the effect the allocation will have on advancing the progress of the case. That effect is defined by the authority the decision will carry in the process. The critical issue of the applicable standard of review to be used by higher (second or third) level decision-makers in reviewing a first-level authoritative decision both determines and is determined by how much authority is or should be vested in the first-level decision-maker.

The forensic-nonforensic dichotomy can be used in allocating fully authoritative decision-making responsibility, even though historical factors that have established habit and usage might suggest otherwise. In a model, however, history is less important than function. The allocation of responsibilities in any system is based on the ability of institutions to carry out their assigned duties. Thus, the model bifurcates decision-making responsibility along forensic-nonforensic lines.

1. Forensic Decisions

Authoritative forensic decisions in bankruptcy cases are the kind of decisions that are typically delegated to the court system, and they have long been placed there. The responsibility for making authoritative forensic decisions should be allocated, however, only when a dispute exists. A trustee makes a nonauthoritative forensic decision by evaluating the facts and the law and deciding what position to take on any particular forensic issue in the case. When no dispute exists between the parties involved in that issue, either all of the parties or none of the parties actually "make" the

57. One might suggest that the only fully authoritative decision-maker is the United States Supreme Court because any decision can be carried upward to that body. However, as used here, the concept is intended to encompass any decision that advances the process, whether or not that decision might eventually be changed. For this purpose, a decision is fully authoritative if it may or must be acted upon.

decision. Instead, all of the parties agree on the operative facts, the applicable law, the law's application to the facts, and the result.[58]

When there is a dispute, making a fully authoritative forensic decision involves evaluating adverse parties' disputed views of the facts or the law. A dispute typically involves an issue that is subject to judicial resolution, such as the rights, entitlements, or liabilities of a party. The formal, adversarial process is appropriate for this kind of fact finding and resolution of disputed legal issues.[59]

Thus, for purposes of the model, authoritative decisions about disputed forensic matters in bankruptcy cases should be made in the judicial system. That is, when a disputed forensic decision must be made, one of the disputants should bring an action in court, where a judge having full authority to resolve the dispute can resolve the issue, uninfluenced by the decision either disputant made before bringing the issue to the court for resolution. These decisions should be reviewed by ordinary appeals, as they are now.[60]

2. Nonforensic Decisions

Authoritative nonforensic decisions in bankruptcy cases are, by their nature, more often made unilaterally. A decision about how to advance the case is often made by the representative of the estate without any formal, and often without even informal, consultation with other parties in the case, and generally without any public notice or hearing. Because nonforensic decisions are managerial, and because the disadvantages of "management by committee" are well known, an efficient system could not be created otherwise. Thus, someone has to be responsible for managing the case and the estate's business and making the nonforensic decisions necessary to move the process forward. The allocation of nonforensic decision-making responsibility involves selecting an officer or institution to perform that managerial job.

Historically, the allocation of managerial responsibilities has been governed by a different policy choice, based on an unrelated principle. The bankruptcy system adopted the concept of private, as opposed to governmental, control in conducting the business and management of bankruptcy estates.[61] Private trustees administer both liquidations and reorganiza-

58. In a more commonly accepted sense, however, the decision is actually made only when a dispute is authoritatively resolved, because the trustee's (or any litigant's) "decision" is neither binding nor meaningful in advancing the process.

59. *See* FED. R. Bankr. P. 7001-7082. These adversarial proceeding rules incorporate many of the Federal Rules of Civil Procedure.

60. *See* 28 U.S.C. § 158 (1988); FED. R. Bankr. P. 8001-8019.

61. H.R. REP. NO. 595, *supra*, note 2, at 99-100, *reprinted in* 1978 U.S.C.C.A.N. at 6061; *see* Richmond Leasing Co. v. Capital Bank (*In re* Richmond Leasing Co.), 762

tions,[62] and private management generally remains in possession and control of a reorganizing company.[63] The bankruptcy system has never adopted the concept of governmentally employed trustees, receivers, or business managers, nor is it likely to do so now.

There is no reason to change this principle or the resulting system for purposes of the model. The principle is well ingrained, and there are independent reasons for leaving it in place. For example, private control promotes the use of reorganization law rather than threatening a reorganizing company's management and directors with immediate loss of control at the commencement of the case.[64] Furthermore, such a system is consistent with the general idea that most business failures are not caused by fraud, dishonesty, or gross mismanagement, but rather by factors often beyond the control of management.[65] In liquidations, as well as reorganizations, the system benefits from a general policy against the employment of governmental officers in matters adequately handled by the private sector. Thus, first-level nonforensic decisions have generally rested with the representative of the estate (trustee or debtor-in-possession),[66] who is a private (nongovernmental) party. The model retains this approach.

F. Supervision of Estate Representatives

1. The Need for External Supervision

A system of checks and balances ensures that ordinary business people and fiduciaries act with the interests of their businesses or trusts ahead of their own personal interests. This system includes not only the criminal laws, but also, perhaps more importantly, personal civil liability for corporate officers and directors, partners, and trustees who violate duties,[67] such as the duty of care and the duty of loyalty.[68] There is an implicit assumption that such deterrents are necessary to prevent misconduct.

Some form of deterrent or a system of checks and balances is equally necessary in regulating the conduct of decision-makers in the bankruptcy system.[69] There is reason to suspect, however, that the imposition of

F.2d 1303, 1311 (5th Cir. 1985).

62. *See* 11 U.S.C. §§ 701, 1104 (1988).

63. *See id.* § 1107.

64. H.R. REP. NO. 595, *supra* note 2, at 233-34, *reprinted in* 1978 U.S.C.C.A.N. at 6192-93.

65. *Id.* at 233, *reprinted in* 1978 U.S.C.C.A.N. at 6192-93.

66. 11 U.S.C. §§ 323(a), 1107(a).

67. *See generally* RESTATEMENT (SECOND) OF TRUSTS §§ 205-06 (1959).

68. 2A WILLIAM F. FRATCHER, THE LAW OF TRUSTS § 170 (4th ed. 1987) (duty of loyalty); *id.* § 174 (duty of care); *see* Revlon, Inc. v. MacAndrews & Forbes Holdings, Inc., 506 A.2d 173 (Del. 1985); Guth v. Loft, 5 A.2d 503, 510 (Del. 1939).

69. *See* H.R. REP. NO. 764, 99th Cong., 2d Sess. 18 (1986), *reprinted in* 1986

personal liability as a deterrent does not work effectively in bankruptcy.

External supervision is not, however, essential to the bankruptcy system. For example, if imposition of personal liability on bankruptcy fiduciaries were effective, it would provide substantial incentives to proper conduct. It does so effectively in the general law of fiduciaries. However, the imposition of personal liability on fiduciaries might not be as effective a deterrent to misconduct in bankruptcy cases. First, a bankruptcy fiduciary, such as a debtor-in-possession, might not have anything further to lose by the imposition of personal liability. While bankruptcy trustees are generally not judgment-proof, officers of debtors-in-possession often are, especially in smaller cases where the risk of malfeasance may run the highest. Second, a system based on personal liability might put trustees at too great a risk of being sued, even in the absence of actual wrong-doing or liability, so as to discourage people from serving as trustees. Finally, it is the beneficiaries in the nonbankruptcy context who typically bring actions to enforce the "rules" against a fiduciary.[70] In bankruptcy, however, the beneficiaries (creditors) often feel that they have little to gain by such actions. They prefer to devote their efforts to future business than to pursue a fiduciary who might have invaded an estate that was probably worth too little to worry about anyway. For the same reason, they will likely have difficulty obtaining counsel to prosecute an action on a contingency-fee basis. Experience has shown that, both inside and outside of bankruptcy, a fiduciary who is not answerable in practical terms to the beneficiaries of his trust has too great an opportunity for mischief, including lack of care and breach of trust. Accordingly, bankruptcy has developed a system of direct external supervision of the actions of trustees and debtors-in-possession, in addition to the ordinary deterrents.

The model accepts the premise of the existing system of bankruptcy administration that external supervision of nonforensic decisions is the best way to deter misconduct and keep the bankruptcy fiduciary true to his trust. The need for supervision is especially strong in business reorganizations, because it is often a lack of strong business acumen on management's part that caused the business to fail in the first place. To allow management to continue unsupervised could easily invite the same problems to recur.

2. Governmental Supervision of Estate Representatives

External supervision can be governmental or private. Private supervision can be accomplished through general creditor supervision of the activities of the estate's representative or through use of a private supervi-

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U.S.C.C.A.N. 5227, 5231.

70. *See* RESTATEMENT (SECOND) OF TRUSTS § 200.

sor, such as a receiver.[71] Neither method is likely to be successful. At one time, the law assumed that creditors would exert sufficient supervision and control over estate administration to maintain honesty, care, and sound business judgment. However, active creditor control has proven to be a myth in all but a few of the largest bankruptcies or reorganizations.[72]

Use of private supervisors (such as the receivership system under the Bankruptcy Act) has the advantage of providing the incentive of compensation for good work. However, compensating private supervisors from estate assets creates an equal incentive for misconduct, which in turn requires supervision of the estate representative. Thus, private supervisors would themselves need to be supervised, requiring the creation of a governmental supervision system in any event. While a governmental system created to monitor private supervisors would require less time and resources than one created to supervise estate representatives directly, the multiple layering of supervisory levels cannot be conducive to sound bankruptcy administration. Finally, the benefits of bankruptcy and protection from creditors that create the "trust" and the opportunity for breach of trust were created by the government. Thus, although private administration of cases appears to be appropriate, supervision of the private administration should be governmental.

3. The Governmental Supervisory Officer

The Bankruptcy Act vested courts with direct supervisory responsibility.[73] Under the Bankruptcy Code, courts retain some general supervisory authority over undisputed nonforensic decisions,[74] many administrative functions, and some tools for taking charge of bankruptcy cases. Moreover, bankruptcy judges, many of whom served as judges or lawyers under the former regime, feel obligated to fill any voids in administrative supervision, lest the bankruptcy system, especially operating Chapter 11 cases, run amok. As a result, bankruptcy judges actually take an active role in the administration and supervision of bankruptcy cases. There are at least four reasons why using courts for supervision of these matters is not ideal.

First, courts are not designed to make decisions in the absence of a dispute. Courts are designed by their very nature to resolve disputes. They do not have independent investigatory arms. While they can and do conduct independent legal research, they cannot and do not conduct independent

71. Receivers were common under the Bankruptcy Act. *See* Bankruptcy Act § 2a(3), 11 U.S.C. § 11(a)(3) (1976) (repealed 1978).

72. COMMISSION REPORT, *supra* note 14, at 104.

73. Bankruptcy Act § 39a, 11 U.S.C. § 67(a) (1976) (repealed 1978).

74. *See supra* text accompanying notes 20-30.

factual research.[75] Nonforensic decisions about the conduct of a bankruptcy case or the operation of a business are heavily fact based. In making decisions, courts must rely on factual presentations of the parties. The adversary system assumes that the presentations before a court will be sharpened by the underlying dispute and that a court will be able to distill the facts from the contending positions and presentations. In the absence of a dispute, courts are ill-equipped to become fully informed. There is no check or balance on the information that is being presented to the court. Moreover, the court does not have the machinery to go beyond what is affirmatively presented, other than what the court can learn from questioning the presenter directly. An individual judge or member of the judge's staff might "leave" the courthouse to make inquiries; however, such conduct is not judicial.[76] Individuals who otherwise conduct themselves according to judicial norms and procedures should not have to break from that model and play an entirely different role.

Second, even when a dispute arises, the adversary system is not a particularly satisfactory way to make, or supervise the making of, nonforensic decisions. The adversary system is, by nature, formal. The system does not encourage the disputing parties to cooperate in developing solutions to nonforensic problems. Also, the adversary system does not promote collegiality or the exchange of ideas in developing solutions. While the parties may engage in such conduct in an effort to settle a matter, the judge in an adversary system does not utilize such techniques in reaching decisions when disputes are litigated rather than settled. Judges could hold conferences and reach decisions the way business managers do, but nothing about a court system suggests that such a role should be imposed on judges instead of on those who regularly perform that role.

Third, courts have no particular expertise in the substance of nonforensic decisions, nor do they have the ability to become sufficiently involved in the particular estate or business to make sensible decisions. Nonforensic decisions require frequent contact with the issues involved, often from a business person's or administrator's perspective. Judges cannot sit in board rooms while decisions are being made, and they typically do not have access to the wide array of management factors that bear on any particular decision. At best, the judges get an adversarial presentation of the highlights instead of the complete picture.

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75. *In re* EWC, Inc., 138 B.R. 276, 280 (Bankr. W.D. Okla. 1992) ("The bankruptcy court has neither the obligation nor the resources to investigate the truthfulness of the information supplied, or to seek out conflicts of interest not disclosed.").

76. *See* FED. R. Bankr. P. 9003 (prohibiting ex parte communication between the court and parties in interest).

Bankruptcy Judge Ralph Mabey captured all of these reasons in his seminal decision refusing to second-guess a trustee's decisions:

> [D]isagreements over business policy are not amenable to judicial resolution. The courtroom is not a board room. . . . While a court may pass upon the legal effect of a business decision, (for example, whether it violates the antitrust laws), this involves a process and the application of criteria fundamentally different from those which produce the decision in the first instance. In short, the decision calls for business not legal judgment.[77]

Based on this reasoning, most courts approve transactions by a trustee that involve "a business judgment made in good faith, upon a reasonable basis, and within the scope of his authority under the Code."[78] Judge Mabey offered the following in explanation: "[S]o long as the trustee can articulate reasons for his conduct (as disinct [sic] from a decision made arbitrarily or capriciously), the court will not inquire into the basis for those reasons."[79] Application of this standard may amount to no supervision at all, but it may be the best the courts can do without becoming sufficiently involved in the business itself to give them a proper background and feel for the decisions they are charged with reviewing.

Finally, no legal standards exist to guide courts in making nonforensic decisions. There is neither a fixed set of rights to protect nor a right or wrong answer to the issues presented in a nonforensic decision.

If the court is not an appropriate or adequate supervisor for the representative of the estate, then an alternative must be found. To be effective, the supervisory function must be performed by an independent official who is able to investigate facts on his own, rather than relying on a formal presentation of facts and analysis by the representative of the estate, who has no particular incentive to explain why a proposed course of action might not be wise. The supervisory officer must be familiar with the administration of the estate, including the operation of any business, in order to have a context in which to evaluate decisions about proposed courses of action. Also, the supervisory officer must be able to follow the bankruptcy from beginning to end in order to understand and properly evaluate the context in which decisions are being made. This Article will refer to this proposed governmental supervisory official as the Administrative Officer.

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77. *In re* Curlew Valley Assocs., 14 B.R. 506, 511 (Bankr. D. Utah 1981).

78. *Id.* at 513-14 (footnote omitted).

79. *Id.* at 514 n.11a.

4. Matters Subject to the Administrative Officer's Review

This model assumes private administration of cases and estates. Such a system is more susceptible to breaches of the duties of care and loyalty than is a governmentally administered system.[80] Therefore, there is a greater need for "professional" supervision. As such, the Administrative Officer should be authorized to supervise or review all nonforensic decisions of the estate representative, with only minor exceptions. These decisions involve not only the business decisions of liquidating and reorganizing trustees or debtors-in-possession, but also decisions relating to the case itself, such as the timing and extent of required notices, the "pace" of the case, and virtually all other nonforensic decisions. The estate is susceptible to loss from these types of decisions. If governmental supervision of these activities is needed, the scope should not be severely restricted. There is no reason to limit the Administrative Officer's review only to major decisions.

This system does not suggest, however, that the Administrative Officer should be involved in the day-to-day administration of the estate or the operation of a reorganizing business. The Administrative Officer should realistically be able to monitor decisions in the ordinary course of administration of the estate or the operation of a business from regular reports, periodic reviews, and assessments of the estate representative's ability. The estate representative should be required to notify the Administrative Officer in advance of decisions that do not arise in the ordinary course of business[81] because, by definition, these decisions would not be anticipated. Also, such decisions tend to involve larger transactions, larger commitments of resources, and larger exposure of the estate.[82] Advance notification of such decisions promotes adequate supervision and generally will not interfere with the estate's business because unusual transactions usually are anticipated in advance.

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80. *See generally In re* BKW Sys., Inc., 69 B.R. 81, 82 (Bankr. D.N.H. 1987) ("As long as there is a debtor-in-possession, . . . the court has no independent verification that present management is not taking the course more favorable to itself and less favorable to the creditor body in general.").

81. *See, e.g.*, 11 U.S.C. § 363(b) (1988) (requiring notice and a hearing before the sale or use of property out of the ordinary course of business); *id.* § 364(b) (requiring notice and a hearing before incurring debt out of the ordinary course of business).

82. *See* Burlington N. R.R. v. Dant & Russell, Inc. (*In re* Dant & Russell, Inc.), 853 F.2d 700 (9th Cir. 1988) (finding that postpetition leases executed by the debtor were within ordinary course of debtor's business and that estate was liable for environmental cleanup costs necessitated by debtor's operating wood treatment facility on leases premises).

G. Review of Decisions

1. Standard of Review of the Estate Representative's Decisions

Because the model relies on private administration through trustees or debtors-in-possession, the initial decisions for nonforensic matters should remain with the private representatives. The Administrative Officer's role should be limited to reviewing those decisions. Consequently, how much discretion should the estate's private representative have in making nonforensic decisions, and what standard of review should the Administrative Officer apply to these decisions?

One alternative is to give the Administrative Officer plenary authority to overrule any decision made by a private trustee or debtor-in-possession. This approach would give the Administrative Officer the power to substitute his own judgment and discretion for that of the private representative. The Administrative Officer would not necessarily exercise this authority in every case. More than likely, the Administrative Officer would only overrule a decision when he or she strongly disagreed with the trustee or debtor-in-possession.

This alternative has serious drawbacks. First, the parties would quickly realize that the real authority lies with the Administrative Officer, not the trustee or debtor-in-possession, thereby undercutting the trustee's ability to conduct the business of the estate. Second, a system that is designed to undercut the trustee's ability to act will not attract capable, independent trustees with sound judgment. Admittedly, many estate representatives are debtors-in-possession who have little or no qualifications for estate administration other than having presided over a business failure. However, to the extent that a debtor-in-possession is incapable of effectively performing that role, other remedies exist that are not so drastic as a system that effectively removes decision-making authority from all trustees and debtors-in-possession.[83] Third, such a system contravenes the policy of encouraging debtors to seek rehabilitation early, rather than later, by imposing a loss-of-control disincentive to filing for relief under Chapter 11.[84] Fourth, different Administrative Officers would undoubtedly exercise their authority with varying degrees of involvement. Some would review all significant decisions in detail and exercise their own authority with respect to all of them, while others would give more latitude to the trustee or debtor-in-

83. *See, e.g.*, 11 U.S.C. § 324(a) (providing for the removal of a trustee "for cause"); *id.* § 1104(a)(1) (allowing the appointment of a trustee, and ouster of the debtor from possession, "for cause, including fraud, dishonesty, incompetence, or gross mismanagement").

84. H.R. REP. NO. 595, *supra* note 2, at 233-34, *reprinted in* 1978 U.S.C.C.A.N. at 6193.

possession. Also, the potential excitement of supervising a mega-case could tempt an Administrative Officer to take over management of a large company, while smaller cases could languish from lack of attention. A system that has so much flexibility as to foster nonuniformity does not constitute sound bankruptcy administration. Finally, a system in which the Administrative Officer has full authority to make all decisions is not significantly different from a governmentally administered bankruptcy system, which was rejected for the reasons described above.[85]

Thus, the estate representative should be responsible for nonforensic decisions, but also should be subject to some form of review by the Administrative Officer in order to give some weight to the representative's decision. The standard of review should be stringent enough to avert the dangers of an unsupervised bankruptcy system—lack of adequate care and breach of fiduciary duty; but the standard should not be so stringent as to remove the decision-making authority from the estate representative.

A standard of review such as "abuse of discretion" would probably provide far too much latitude to the estate representative. The standard of "sound exercise of business judgment," however, should serve the stated goals. First, a breach of trust would not constitute a sound exercise of business judgment.[86] Second, sound exercise of business judgment would require due care by the estate representative in the administration of the estate and the operation of the business.[87] Because sound business judgment and due care nearly always encompass a wide variety of reasonable options in any given situation,[88] the sound business judgment standard of review would provide latitude to the estate representative to select from a range of reasonable alternatives. The representative would not be overruled if the decision were supportable.[89] This standard would provide the estate representative the control and authority necessary for sound administration

85. *See supra* text accompanying notes 75-79.

86. *See* Guth v. Loft Inc., 5 A.2d 503, 510 (Del. 1939).

87. *See* Thomas v. Kempner, 398 A.2d 320, 323-24 (Del. Ch. 1979) (holding that refusal to consider better offer was a failure to act with due care).

88. *In re* Lifeguard Indus., 37 B.R. 3, 17 (Bankr. S.D. Ohio 1983) ("It is not this Court's responsibility to determine whether Lifeguard should increase its tolling operations, change its product lines, increase its distributing activities, cut back its sales force, or manufacture vinyl siding."); *see* Dennis J. Block & H. Adam Prussin, *The Business Judgment Rule and Shareholder Derivative Actions: Viva Zapata?*, 37 BUS. LAW. 27 (1981).

89. *See* Institutional Creditors of Continental Air Lines v. Continental Air Lines (*In re* Continental Air Lines), 780 F.2d 1223, 1226 (5th Cir. 1986) ("[I]mplicit in § 363(b) is the further requirement of justifying the proposed transaction") (citing *In re* Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983)); *In re* Southern Biotech, Inc., 37 B.R. 318, 322 (Bankr. M.D. Fla. 1983) ("well articulated reasons supported by facts").

of the estate, without permitting conduct outside of the bankruptcy system's stated goals. This standard also has the additional benefit of being well known in the bankruptcy field. Bankruptcy officials, as well as the courts, have substantial experience in its application.[90]

The only significant exception to the business judgment standard should be for notices. Parties other than the Administrative Officer should be entitled to notice of events, including out-of-the-ordinary-course transactions, during the case. When an event does not involve a forensic decision (*i.e.*, when the event does not determine the rights between the estate and one or more parties), the extent of notice is judgmental and is not likely regulated by the same strict due process requirements that apply to forensic decisions.[91]

Under the current system, the bankruptcy court's role in regulating notices of administrative matters relates to undisputed matters that involve only the administration of the bankruptcy.[92] These matters are outside the bankruptcy court's primary responsibility of resolving forensic disputes. But decisions about notice should not be left to the estate representative, because the purpose of notice is to permit scrutiny of the estate representative's activities. Thus, the estate representative might have a conflicting interest, which could encourage unduly limited notice for decisions that might be controversial.

In general, judgments about the extent of notice of nonforensic decisions require an overall knowledge of the bankruptcy case and of the business. The officer responsible for supervising the administration of the estate should have a thorough understanding of who the parties are, what their interests are, and whether they should receive notice of particular administrative matters. In addition, the officer should be familiar with the pace of the bankruptcy and the major business and estate administration events, in order to determine the appropriate time for notice of a particular matter.[93] For these reasons, the Administrative Officer should have full authority to determine whether a proposed form of notice is adequate, whether the notice period should be shortened, and who should receive the notice. The estate representative should propose the appropriate scope and extent of the notice, and the Administrative Officer should review the

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90. *See, e.g.*, Richmond Leasing Co. v. Capital Bank, N.A. (*In re* Richmond Leasing Co.), 762 F.2d 1303 (5th Cir. 1985).

91. *But see* Credit Alliance Corp. v. Dunning-Ray Ins. Agency, Inc. (*In re* Blumer), 66 B.R. 109 (Bankr. 9th Cir. 1986) (raising to a constitutional level the issue of notice of *unsecured* creditors of a proposed secured borrowing under 11 U.S.C. § 364), *aff'd mem.*, 826 F.2d 1069 (9th Cir. 1987).

92. FED. R. Bankr. P. 2002.

93. *See* FED. R. Bankr. P. 9006(c) (permitting reduction of time for notices of certain matters "for cause shown").

proposal without giving any particular weight to the estate representative's recommendation. As long as all notice decisions by the Administrative Officer are reviewable by the bankruptcy court, such decisions are best made in the first instance by the Administrative Officer who possesses detailed knowledge of the administration of the bankruptcy.

2. Review of the Administrative Officer's Decisions

The Administrative Officer's decisions should be reviewable by the bankruptcy court. The level of review should meet the goals stated above—that the Administrative Officer be primarily responsible for administration and review of nonforensic decisions, and that the office play a meaningful role, not a subservient role to the court, in the areas of its responsibilities.[94] These goals suggest that the Administrative Officer's decisions should be subject to review by the bankruptcy court under a standard that grants the Officer substantial discretion. The bankruptcy court should not second-guess the Officer's decisions any more than the Officer should second-guess the estate representative's decisions. As discussed above, courts and the adversary system are not adept at making initial nonforensic decisions.[95]

A court could employ three different standards of review in analyzing an Administrative Officer's decisions. First, the court might consider the business judgment of the estate representative and apply the court's own analysis of whether that decision constituted a sound exercise of business judgment. Such an analysis would duplicate the Officer's analysis and would give the estate representative a second chance to prove the soundness of his decision. An estate representative who did not agree with the Officer's evaluation could ask the court for a more favorable evaluation. Obviously, such a system would undermine the Administrative Officer's work and would render the initial decision ineffective. Furthermore, such a system would not add credence or confidence to the Administrative Officer and should be rejected for that reason alone.

Second, the court might apply a business judgment standard to the Administrative Officer's decision rather than to the estate representative's decision. Such a standard would give weight to the Officer's analysis and would require the estate representative to meet a reasonably heavy burden when trying to take action over the objection of the Administrative Officer. This standard, however, would likely be difficult to apply. Because the Administrative Officer acts as a supervisor and not as the prime decision-maker for the estate, the Officer is more likely simply to disapprove

94. *See supra* text accompanying notes 80-82.

95. *See supra* text accompanying notes 75-79.

proposed actions rather than propose alternatives. Consequently, the court would not really have an Administrative Officer's business judgment to evaluate. The court would have to evaluate the business judgment the Officer exercised in evaluating the business judgment of the estate representative. Such a standard would not be easy to implement in practice and should be rejected for that reason.

Finally, the court might consider whether the Administrative Officer abused his discretion or applied an incorrect legal standard in evaluating the nonforensic decision of the estate representative. This is a familiar standard, especially in the bankruptcy appellate context,[96] and its application is well understood. This standard affords proper weight to both the Administrative Officer's decisions and the estate representative's decisions. For example, if the Administrative Officer substituted his own business judgment for that of the estate representative on a particular matter, that would constitute application of an incorrect legal standard and would be reversible.[97] Often the court should be able to make such a determination, at least in part, by evaluating the underlying decision of the estate representative and the nature of the Administrative Officer's objection. To assist the court in deciding what standard the Officer used in evaluating the estate representative's decision, the Officer should be required to state why he objects to the decision.

H. Form of Proceedings

Currently, many disagreements over nonforensic matters could be resolved by negotiation among the parties. However, the Code and the Bankruptcy Rules effectively require a court-based procedure, under which notices of nonforensic matters are filed with the court whether or not they are likely to be disputed. Objections to these matters are filed with the court, even when the objector is the United States trustee.[98] Consequently,

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96. *See, e.g.*, Boddy v. United States Bankr. Court (*In re* Boddy), 950 F.2d 334 (6th Cir. 1991) (holding that lower court applied improper standard in reviewing award of attorneys' fees); Davis v. Columbia Constr. Co. (*In re* Davis), 936 F.2d 771 (4th Cir. 1991) (reviewing extension of time for filing proof of claim granted by lower court); *In re* Sharon Steel Corp., 871 F.2d 1217 (3d Cir. 1989) (reviewing appointment of a trustee in a Chapter 11 case); Martin v. Kane (*In re* A & C Properties), 784 F.2d 1377 (9th Cir.) (reviewing court approval of compromise agreement), *cert. denied*, 479 U.S. 854 (1986); *In re* Chung King, Inc., 753 F.2d 547 (7th Cir. 1985) (reviewing approval of sale).

97. *See e.g., In re* Chicago, M., St. P. & P. R.R., 841 F.2d 789 (7th Cir. 1988) (stating that bankruptcy court's ruling would be upheld in the absence of error of law or unless based upon clearly erroneous factual findings).

98. *See, e.g.*, FED. R. BANKR. P. 3017(a) (allowing objections to approval of

the court's process is set in motion, even when a dispute is and could be resolved by negotiation. If the trustee, debtor-in-possession, or other proponent of an action, the Administrative Officer, and other parties in interest were to could consult with each other before a proposed administrative action they would often obviate any objections.

Therefore, the Administrative Officer's decision-making should be informal and interactive with the estate representative and other interested parties. The Administrative Officer should review or consult on proposed transactions before a "proposal" or "objection" is finalized and formalized. Also, parties other than the estate representative may wish to consult with the Administrative Officer in analyzing or reviewing proposed transactions.

The judicial-like procedures of the Administrative Procedures Act,[99] designed primarily for proceedings before hearing officers or administrative law judges to find facts and reach conclusions of law, are not appropriate for the Administrative Officer's function and should not apply to decisions made by the Administrative Officer in carrying out his supervisory responsibilities.[100] Ultimately, the bankruptcy court will resolve any disputes in compliance with full judicial procedures that comport with the requirements of due process.

When the Administrative Officer disapproves of proposed action by an estate representative, he should be able to prevent such action by filing a written notation of disapproval in the case file (with a copy mailed to the estate representative), rather than by filing an objection with the court.. The estate representative will have to meet a high standard, described above,[101] to overturn the Administrative Officer's recommendation in court. That burden, coupled with prior informal consultation, will likely result in the estate representative's acquiescing in the Administrative Officer's decision or reaching an accommodation with the Officer before the matter ever gets to court. Thus, the Administrative Officer should not need to initiate court proceedings because, in many cases, the matter will not go that far.

When the estate representative disagrees with the Administrative Officer's decision, the estate representative should seek affirmative authority from the court to proceed. To obtain that authority, the estate representative would have to demonstrate a sound basis for his nonforensic decision, and that the Administrative Officer abused his discretion or applied an incorrect legal standard. This procedure would have the additional benefits of bolstering the credibility of the Administrative Officer and framing the

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disclosure statements), 6004(b) (allowing objections to proposed sales), 6007(a) (allowing objections to proposed abandonments of estate property).

99. 5 U.S.C. §§ 500-596 (1988 & Supp. IV 1992).

100. *See supra* text accompanying notes 75-79.

101. *See supra* text accompanying notes 96-97.

dispute in a way that a court can address.

While this procedure could operate efficiently when the Administrative Officer opposes the estate representative's action, it may be more difficult to implement if the Administrative Officer is concerned that the estate representative is not taking action that is required (for example, pursuing an avoiding power cause of action or closing an unprofitable part of a reorganizing business). Without some enforcement mechanism, the Administrative Officer could not compel the estate representative to take such an action. Some federal administrative agencies must invoke the jurisdiction of a court to enforce their "orders."[102] Thus, the Administrative Officer could not issue formal orders because such a procedure might require application of the Administrative Procedures Act or some other form of due process, at least if the orders were to be given presumptive validity in a subsequent enforcement action. Therefore, an alternative is necessary to prevent the Administrative Officer supervisory system from turning into a formal administrative procedure that would be inconsistent with its purpose.

Written notations in the Administrative Officer's case file could serve a similar purpose in requiring actions as they could in preventing actions, even without formal enforcement powers. If a case trustee regularly disregards such written notations or "recommendations" from the Administrative Officer without seeking court validation, the case trustee would not likely continue to receive appointments.[103] A debtor-in-possession who disregards such notations would likely find himself the subject of a motion to appoint a trustee.[104]

The nature of the Administrative Officer system, which promotes informal consultation and communication prior to any "formal" objection to an estate representative's actions, should result in similar consultation prior to the Administrative Officer's attempting to require action by the estate representative. Such consultation would provide the first line of defense for the estate representative in contesting the Administrative Officer's objections to his actions or inactions.

Trustees and debtors-in-possession could more formally protect themselves by seeking bankruptcy court approval of any proposed inaction that the Administrative Officer disputes in the same manner that the estate

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102. *See, e.g.*, National Labor Relations Act § 10(e), 29 U.S.C. 160(e) (1988). *But see* NLRB v. Brooke Indus., 867 F.2d 434, 435 (7th Cir. 1989) (Posner, J.) (characterizing this procedure as "antiquated").

103. *See* 11 U.S.C. § 701(a)(1) (1988) (providing that the United States trustee designates a member of the panel of private trustees to serve as interim trustee in Chapter 7 cases).

104. *See supra* note 83.

representative would seek court authorization for actions to which the Administrative Officer objects. The standard of review should be the same—*i.e.*, whether the estate representative exercised sound business judgment in making the decision not to take the action that the Administrative Officer recommended in the file notation. The court's review of the Administrative Officer's decision would also be the same—*i.e.*, whether the Administrative Officer abused his discretion or applied an incorrect legal standard in recommending the proposed action.

The estate representative would not need to challenge immediately every file notation that recommends action. The representative could await an attempt by the Administrative Officer to use the representative's disregard of the recommendation to remove the trustee or to replace the debtor-in-possession with a trustee. The Administrative Officer would rely on the file to support such a removal, and the estate representative could then challenge the recommendation. If the recommendations were not substantially justified under the proper standard of review, then the grounds for removal would not exist.

Generally, however, the estate representative would first attempt resort to informal consultation. In a system based on consultation and communication, it is unlikely that the Administrative Officer would arbitrarily impose case-specific requirements without adequate investigation or inquiry. Nor is a court likely to find grounds for removal if the estate representative fails to follow recommendations made by the Administrative Officer without inquiry or consultation. If the Administrative Officer makes a recommendation after consultation, the estate representative could then seek immediate court review, rather than risking his position on the outcome of litigation involving a whole series of disagreements during the case.

This proposal may be a cumbersome way to implement the principle that the Administrative Officer should not issue "orders" to parties in a bankruptcy case. While this proposal is more complex than is desirable, it seems preferable to a system that permits such orders, but requires compliance with the Administrative Procedure Act or other due process procedures in making decisions about all the activities in a bankruptcy case. The latter system would needlessly slow bankruptcy administration and increase its cost without any corresponding benefit to the interested parties.

III. CONCLUSION

The nature of a model is to attempt to describe the ideal. Whether the model suggested in this Article in fact describes an ideal administrative system may well be open to question. Undoubtedly, a significant criticism of this model will be that the existing administrative system, the United States trustee system, is bureaucratic, inflexible, cumbersome, expensive, and staffed by people whose competence is less than desirable. Another

criticism will likely be that bankruptcy practitioners would never willingly cede such authority to an Administrative Officer; it is, after all, the person in the black robe who is really in charge. To these potential criticisms, I offer the following response.

These criticisms are not of the model itself, as an ideal, but of bankruptcy administration and of the feasibility of the model. To that extent, the criticism is misdirected. If a model is worth developing to help examine facets of bankruptcy administration as concepts, then this criticism should have no place in the debate. The ability, integrity, and dedication of personnel is the key to success in any system, whether in bankruptcy administration, the bankruptcy courts, the Presidency, or the Congress. This model assumes that persons equal to the task—both as administrators and as practitioners—will administer it in the spirit in which it was designed.

The model is intended to provide flexibility rather than bureaucratic rules that would stifle case administration with countless diverse facts and challenges. It is intended to impose a structure that permits supervision of bankruptcy cases, and of the bankruptcy system, by experienced individuals with the tools and authority to become knowledgeable about the matters that come before them, without reliance on the adversary system for education. Whether well used or abused, the referee system under the Bankruptcy Act empowered the referees adequately to supervise cases with flexibility and an understanding of the underlying facts, even though that system also had serious deficiencies. The referees' black robes and appearance of judicial power may have increased their effective authority and may have made them more palatable supervisors to lawyers, who would prefer to practice before judges than before administrators. Nevertheless, something was lost in the transition to the United States trustee system under the Bankruptcy Code. Something other than an adversary system is necessary to replace it and to protect the functioning of the bankruptcy system.