Abstract

This paper develops a normative theory of bankruptcy law called "procedure theory." The core of procedure theory is that bankruptcy law exists in order to maximize the recoveries for holders of legal entitlements ("rightsholders") in respect of a financially distressed debtor. Bankruptcy law in the United States is a branch of civil procedure and the jurisdiction of federal courts. Procedure theory holds that it generally is wrong in bankruptcy to redistribute a debtor’s wealth away from its rightsholders to benefit third-party interests, such as at-will employees and the general community. It also generally is wrong to rearrange priorities in bankruptcy as among a debtor’s rightsholders. Procedure theory explains what bankruptcy law is supposed to achieve, not how bankruptcy law is to achieve its proper ends.

Procedure theory draws support from three perspectives. First, it argues that it is incoherent to provide different substantive rules in bankruptcy when those substantive rules are equally applicable outside bankruptcy. This incoherence offends the interest of justice. Second, procedure theory is supported by the Erie doctrine in federal courts and considerations of federalism. Basic substantive law rules should not vary depending on the forum in which a proceeding is conducted—state court or bankruptcy court. Third, a public choice analysis reveals the enormous power of the bankruptcy bar. The Judiciary Committees in Congress and the bankruptcy courts are improper venues for the development of law that is not bankruptcy specific.

A justification for bankruptcy law must be that, as a collective proceeding, it can maximize or enhance recoveries and benefits for rightsholders when compared to nonbankruptcy law. This Article examines a number of important features of United States bankruptcy law that conflict with (or at least appear to conflict with) procedure theory. It generally rationalizes procedure theory with several of these features. In several other cases, procedure theory calls for a modification of current law.