

THE IMPROPER APPLICATION OF THE CLEAR-AND-CONVINCING STANDARD OF PROOF: ARE BANKRUPTCY COURTS DISTORTING ACCEPTED RISK ALLOCATION SCHEMES?

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*While the significance of the choice of standards [of proof] cannot be overstated, in practice the distinction between the standards is often lost.*²

INTRODUCTION

In all litigation, there exist obvious limitations in factfinding that affect a court's ability to conclusively determine material details of any dispute. This limitation produces a risk of error that all litigants must take into account.³ Naturally, litigants do not always bear equally the allocation of this risk of error. Society's interest in the dispute – an interest based on the costs to society of an incorrect decision, society's desire to deter certain conduct or the value of the right that is at issue – will determine the allocation of risk and the interest will be represented, at least in part, by the standard of proof that is applied.⁴ In general, the application of a standard of proof represents an adjustment to the probability that factually inaccurate evidence will be recognized as truth. In attempting to achieve this end, the chosen standard of proof “serves to . . . indicate the relative importance attached to the ultimate decision”⁵ and inform the factfinder of the degree of confidence our society thinks the factfinder should have in the correctness of factual conclusions in a particular case.⁶

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² Timothy J. Martens, *The Standard of Proof for Preliminary Questions of Fact Under the Fourth and Fifth Amendment*, 30 ARIZ. L. REV. 119, 122 (1988).

³ See *Speiser v. Randall*, 357 U.S. 513, 525-26 (1958).

⁴ See *Addington v. Texas*, 441 U.S. 418, 423 (1979).

⁵ *Id.*

⁶ See *In re Winship*, 397 U.S. 358, 370 (1970) (Harlan, J., concurring).

The implementation of these concepts has evolved over time and produced three standards of proof.⁷ Primarily, in a criminal proceeding where an individual's liberty or freedom is at stake – interests of “transcending value” – the risk of error is reduced as to the defendant by placing on the prosecuting party the burden of persuading the factfinder of the defendant's guilt beyond a reasonable doubt.⁸ At the other end of the spectrum is the typical civil case involving the mere loss of money that, while certainly important to the litigants, fails to implicate society's primary interests.⁹ Consequently, since society has only a minimal concern with the outcome, the risk of error is allocated in a relatively equal manner and the appropriate standard of proof is the preponderance-of-the-evidence standard.¹⁰ An intermediate standard of proof has also evolved. The clear-and-convincing standard of proof is the intermediate standard and has been applied in civil cases where the interests at stake are more substantial than a mere loss of money¹¹ and to protect particularly important individual interests and various civil rights.¹²

The significance of understanding and applying the correct standard of proof is apparent in the history of these standards and their treatment in American jurisprudence. Adopting the correct standard of proof is not an “empty semantic exercise.”¹³ The rationale of and policy behind mandating application of such evaluation mechanisms unfortunately appears to remain a mystery to many courts, including bankruptcy courts.

Bankruptcy proceedings tend to involve civil disputes where nothing more than money is at stake. As noted above, in such instances, the application of the preponderance-of-the-evidence standard of proof offers the greatest utility and is aligned with the comparatively minimal importance society places on purely monetary disputes. However, bankruptcy courts are not viewed as typical civil courts. Rather, many view these courts as “courts of equity”¹⁴ and this perception serves as a crutch that many bankruptcy judges use in advocating the application of

⁷ Some bankruptcy courts have used a standard which has been described as the “fair preponderance” standard. *See, e.g., In re Wightman*, 36 Bankr. 246, 250 (Bankr. D.N.D. 1984). This standard is meant to require a level of certainty that is greater than that found under the preponderance standard but perhaps not as high as that found under the clear-and-convincing standard. Some statutes have used language seeming to require the use of a clear preponderance standard of proof. *See* 29 U.S.C. § 1401(c) (2000); 29 U.S.C. § 1401(a)(3)(A). The necessity of another intermediate standard of proof is questionable. Consequently, the creation of this additional standard may be the product of oversight, poor word choice or careless drafting, as opposed to the well-reasoned attempt by a court to fashion yet another intermediary standard. *See* John Gamino, *Tax Controversy Overburdened: A Critique of Heightened Standards of Proof*, 59 TAX LAW. 497, 508 (Winter 2006).

⁸ *See Speiser*, 357 U.S. at 526.

⁹ *See Addington*, 441 U.S. at 423.

¹⁰ *See id.*

¹¹ *See id.* at 424.

¹² *See, e.g., Woodby v. INS*, 385 U.S. 276, 285 (1966) (deportation); *Chaunt v. United States*, 364 U.S. 350, 353 (1960) (denaturalization); *Schneiderman v. United States*, 320 U.S. 118, 125 (1943) (denaturalization).

¹³ *Tippett v. Maryland*, 436 F.2d 1153, 1166 (4th Cir. 1971).

¹⁴ *See, e.g., N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 527 (1984) (“The Bankruptcy Court is a court of equity.”); *Heiser v. Woodruff*, 327 U.S. 726, 732 (1946) (“It is true that a bankruptcy court is also a court of equity.”); *Pepper v. Litton*, 308 U.S. 295, 304 (1939) (“[F]or many purposes ‘courts of bankruptcy are essentially courts of equity.’”).

the clear-and-convincing standard of proof to customary civil disputes. These actions distort the accepted risk allocation schemes implicit in standards of proof; the consequence of which often is inequitable results.

A lack of direction by the Supreme Court is a key factor in this process failure. The Court has addressed the application of standards of proof infrequently and, when it has, the holding has been narrowly tailored. On January 15, 1991, the Court issued a ruling in *Grogan v. Garner*¹⁵ that appeared to provide guidance. Unfortunately, as of late, the ruling has been misinterpreted by a number of courts and has led to additional confusion on an issue that was already elusive.

In this Article, I propose a new, comprehensive normative approach to determine which standard of proof is applicable in disputes involving debtors in possession under chapter 11 of Title 11 of the United States Code.¹⁶ My approach is based on a coextensive reading of applicable Supreme Court precedent that honors the narrow basis on which many of these rulings are made. I urge use of an approach that will engender greater uniformity on this fundamental issue. Further, I analyze some key forms of relief available under the Bankruptcy Code in which courts have advocated the application of the clear-and-convincing standard of proof but failed to provide any explanation for this action. By applying my approach, I evaluate bankruptcy case law and attempt to isolate instances where bankruptcy courts impermissibly distort accepted risk allocation schemes. In doing so, I show that some unexplained applications of the clear-and-convincing standard of proof are justified.

Part I of this Article explores the history, rationale and effect of applying varying standards of proof. Part II of this Article explores the Supreme Court precedent shaping the debate regarding the applicable standard of proof in bankruptcy disputes. This section begins by exploring the nuance of *Grogan v. Garner* and presenting the myriad of reasons why this ruling is not as broad or simple as lower courts would hope. This treatment is followed by a brief explanation of other applicable Supreme Court precedent and concludes with a presentation of a normative approach by which courts can determine which standard of proof is applicable in a bankruptcy dispute. My normative approach demands that courts consider the legislative history of the provision at issue, as well as thoroughly explore the interests at stake and balance these interests. The normative approach I propose will generally lead to the application of the preponderance-of-the-evidence standard of proof. However, the process allows for the application of the heightened standard of proof to certain disputes by requiring courts to consider the elements of these disputes that make the requested relief and the interests at stake unique.

In Part III, I endeavor to present an explanation of the legislative history and the importance and effect of some of the fundamental relief offered by the Bankruptcy Code. This exploration is necessary in order to make a proper evaluation under my normative approach. This section also demonstrates that, as to the fundamental relief I have selected, bankruptcy courts are decidedly split over what standard of proof is applicable. More troubling, these courts consistently fail to follow any methodology in determining which standard to apply. Invariably,

¹⁵ 498 U.S. 279 (1991).

¹⁶ Hereinafter, the "Bankruptcy Code."

courts tend to cite non-binding precedent that begets a string of citation that leads to a fountainhead case that provides no logic or rationale for the choice made. The crumbling foundation upon which courts are basing their decisions highlights the need for a normative approach.

Finally, in Part IV, I apply the normative approach proposed in Part II to the detailed information collected in Part III to determine which standard of proof should be applied to the selected fundamental bankruptcy relief.

Ultimately, many courts incorrectly assume that the standard of proof will be of little consequence to the final ruling on a dispute. However, standards of proof represent essential risk allocation devices that are fundamental to our jurisprudence, and the application of one standard over another can oftentimes be dispositive.¹⁷ The haphazard manner in which many courts choose which standard to apply represents a process failure. The normative approach I advocate attempts to address this failure based on an exploration of policy as well as precedent.

I. STANDARDS OF PROOF

The significance of understanding and applying the correct standard of proof is apparent in the history of these standards and their treatment in American jurisprudence. Adopting the correct standard of proof is not an “empty semantic exercise.”¹⁸

A. Rationale Behind Application

Application of standards of proof represents an attempt to reduce errors. But the type of errors targeted by application of the preponderance standard differs from the type targeted by application of the heightened standards. The preponderance standard represents an almost equal allocation of risk between the parties. The use of the standard is optimal where the social disutility of error in either direction is roughly equal.¹⁹ The standard increases the probability that the correct judgment is reached. Reducing the risk of an incorrect judgment is the goal in applying this standard. However, when the disutility of error in one direction discernibly outweighs the disutility of error in the other direction, courts rely on heightened standards of proof to reduce the likelihood of the more onerous outcome.²⁰ Though heightened standards of proof represent a fundamental element of our jurisprudence, the rationale behind their application is oftentimes misunderstood. Use of heightened standards of proof serves to decrease

¹⁷ See, e.g., *In re Watkins*, 90 B.R. 848, 851 n.7 (Bankr. E.D. Mich. 1988) (where Judge Spector was faced with applying either the preponderance-of-the-evidence standard or the clear-and-convincing standard and explained that the choice would be dispositive as to which party would be granted relief).

¹⁸ *Tippett*, 436 F.2d at 1166.

¹⁹ See *Santosky v. Kramer*, 455 U.S. 745, 790 (1982) (Rehnquist, J., dissenting); see also John Kaplan, *Decision Theory and the Factfinding Process*, 20 STAN. L. REV. 1065, 1072 (1968) (commenting on “the assumption of equal disutilities that the preponderance-of-the-evidence test reflects”).

²⁰ See *id.*

the risk that a party found to have satisfied the standard relied on an incorrect factual basis.²¹ So heightened standards of proof increase the likelihood that a judgment in favor of the party carrying the burden of persuasion is correct. However, the application of heightened standards of proof is “accompanied by increasing rates of decisional error”²² For example, the beyond-a-reasonable-doubt standard used in criminal proceedings allocates nearly all risk of error to the prosecuting party. This allocation leads to many guilty individuals being found innocent. The probability of a correct judgment is decreased by use of this standard as opposed to the preponderance standard. But increasing the number of correct decisions is beyond the scope of this standard of proof; an issue more effectively addressed by other aspects of our civil procedure.²³ Ultimately, the use of the beyond-a-reasonable-doubt standard increases the probability that a conviction is accurate.²⁴

B. Beyond-a-Reasonable-Doubt Standard of Proof

The term “beyond a reasonable doubt” speaks for itself. Indeed, the term “is almost incapable of any definition which will add much to what the words themselves imply.”²⁵ Unless specifically requested by a jury, most courts will not attempt to define the phrase as such attempts invariably lead to more questions than answers.²⁶ Though the phrase is considered a fundamental element of our criminal justice system, the United States Constitution does not explicitly require that proof of a criminal charge be established beyond a reasonable doubt. The Constitution contains various explicit mandates²⁷, but nowhere in the document is there any statement that conviction of a crime requires proof of guilt beyond a reasonable doubt. Rather, such a requirement has been read into the document.²⁸ The Fifth Amendment provides that no person shall be “deprived of life, liberty, or property, without due process of law.” Based on the history²⁹ and accepted meaning of this phrase prior to and at the time the Constitution was

²¹ See *id.* at 512-13.

²² Gamino, *supra* note 7, at 511.

²³ See *Santosky v. Kramer*, 455 U.S. 745, 757 n.9 (1982) (“Notice, summons, right to counsel, rules of evidence, and evidentiary hearings are all procedures to place [the correct] information *before* the factfinder.”).

²⁴ A similar rationale underlies the use of the clear-and-convincing standard of proof. However, use of any procedure that increases the risk of decisional error is discouraged in our jurisprudence, especially in a civil dispute. Consequently, use of the clear-and-convincing standard of proof is limited.

²⁵ See *State v. Sauer*, 38 N.W. 355 (Minn. 1888).

²⁶ See 2 CHARLES MCCORMICK, HANDBOOK OF THE LAW OF EVIDENCE § 341 (6th ed. 1954).

²⁷ Including the right to counsel in criminal trials, right to indictment, right of a defendant to be informed of the nature of the charges against him (Amendments V, VI) and right to trial by jury (Art. III, section 2, clause 3; Amendment VI).

²⁸ See *In re Winship*, 397 U.S. 358, 364 (1965) (“we explicitly hold that the Due Process Clause protects the accused against conviction except upon proof beyond a reasonable doubt . . .”).

²⁹ For a detailed explanation of the history behind this standard of proof, see Steve Sheppard, *The Metamorphoses of Reasonable Doubt: How Changes in the Burden of Proof Have Weakened the Presumption of Innocence*, 78 NOTRE DAME L. REV. 1165 (2003); see also May, *Reasonable Doubt in Civil and Criminal Cases*, 10 AM. L. REV. 642, 656 (1876), *quoted in* Note, 69 U.S. L. REV. 169, 172 (1935) (“[The standard’s] first appearance, so far as we have been able to determine, was in the high-treason cases

written, the Supreme Court has concluded that the Fifth Amendment requires the beyond-a-reasonable-doubt standard in federal and state criminal proceedings.³⁰

As noted above, this standard allocates the risk of error almost entirely to the prosecuting party. This allocation is designed to reduce “the risk of convictions resting on factual error.”³¹ However, the standard does not reduce the likelihood of an erroneous judgment. In fact, the standard greatly increases the likelihood of an erroneous judgment. The logic of the application may very well be that the social disutility from convicting an innocent man has been deemed to be far greater than the disutility of releasing a guilty one. In fact, the difference is so great that one could argue that our judicial system rests on the maxim that it is “[b]etter that ten guilty persons escape, than one innocent suffer.”³² This deviation, and the attendant use of the beyond-a-reasonable-doubt standard, is a reflection of the value that society places on individual liberty. The accused in a criminal proceeding has at stake an interest of staggering importance. With this in mind, there would be a lack of fundamental fairness if an accused could be “adjudged guilty and imprisoned for years on the strength of the same evidence as would suffice in a civil case” where his liberty was not at stake.³³ Further, application of this heightened standard of proof is

indispensable to command the respect and confidence of [society] It is critical that the moral force of the criminal law not be diluted by a standard of proof that leaves people in doubt whether innocent men are being condemned [There must be confidence that the government] cannot adjudge [an individual] guilty of a criminal offense without convincing a proper factfinder of his guilt with utmost certainty.³⁴

Ultimately, the value that society and the Constitution place on personal liberty and freedom is honored by use of this heightened standard. Use of this standard deters frivolous prosecutions and avoids forcing juries to make a decision on an evenly balanced case. The most significant disadvantage of applying this standard is the fact that the application increases the likelihood of an incorrect judgment. The number of guilty defendants who are not convicted may be unnecessarily high.³⁵ This high false-negative rate serves to undermine confidence in

tried in Dublin in 1798, as reported by MacNally [Rules of Evidence on Pleas of the Crown; Dublin, 1802], who was himself counsel for the defense. ‘It may also,’ he says, ‘at this day, be considered a rule of law, that, if the jury entertain a reasonable doubt upon the truth of the testimony of witnesses given upon the issue they are sworn well and truly to try, they are bound’ to acquit.”).

³⁰ See, e.g., *Winship*, 397 U.S. at 361-62; *Speiser*, 357 U.S. at 525-26 (1958); *Holland v. United States*, 348 U.S. 121, 138 (1954); *Leland v. Oregon*, 343 U.S. 790, 795 (1952); *Brinegar v. United States*, 338 U.S. 160, 174 (1949); *Wilson v. United States*, 232 U.S. 563, 569-570 (1914); *Holt v. United States*, 218 U.S. 245, 253 (1910); *Davis v. United States*, 160 U.S. 469, 488 (1895); *Miles v. United States*, 103 U.S. 304, 312 (1881).

³¹ *Winship*, 397 U.S. at 363.

³² 4 WILLIAM BLACKSTONE, COMMENTARIES 358 (1765) (describing what became known as the “Blackstone Doctrine”).

³³ *Winship*, 397 U.S. at 363.

³⁴ *Id.* at 364.

³⁵ See Alexander Volokh, *n Guilty Men*, 146 U. PA. L. REV. 173 (1997).

our judicial system, which may lead individuals to rely on self-help approaches to address perceived wrongs.

C. Clear-and-Convincing Standard of Proof

In contrast to the beyond-a-reasonable-doubt standard of proof, the definition of the clear-and-convincing standard of proof is not implied by the name nor easily defined by reference to precedent.³⁶ The Supreme Court has described the standard as “demanding but not insatiable”³⁷ but also as a standard that requires “evidence which does not leave the issue in doubt”³⁸ and that the ultimate factfinder possess “an abiding conviction that the truth of its factual contentions are [sic] highly probable.”³⁹ Lower courts have struggled to discern a clear definition from Supreme Court precedent, and the standard has emerged as a subjective one that floats somewhere between the other two standards of proof.⁴⁰ The effect of applying this standard is to essentially afford the party contesting the relief sought a presumption of validity.

The origins of the clear-and-convincing standard of proof explain its limited use. The standard is a product of the English courts of equity during the 18th century.⁴¹ In instances where the common law courts could not correct a gross injustice or redress an aggravated and intolerable grievance, an aggrieved party could petition for review by the Court of Equity. The Courts of Equity in England were

established “to detect latent frauds and concealments which the process of the Court of Law [was] not adapted to reach; to enforce the execution of such matters of trust and confidence as [were] binding in conscience, though not cognizable in a Court of Law; to deliver from such dangers as [were] owing to misfortune or oversight; and to give a more specific relief, and more adapted to the circumstances of the case than [could] . . . be obtained by the generality of the rules of the positive or common law.”⁴²

Courts of Equity provided plaintiffs flexibility by looking not just to the letter of the law but to the “reason and spirit” and considered evidence that courts of law would not.⁴³ Further,

³⁶ See James Brock, *Inevitable Errors: The Preponderance of the Evidence Standard in Civil Litigation*, 18 TULSA L.J. 79, 85 (1982).

³⁷ *Miller-El v. Dretke*, 545 U.S. 231, 240 (2005).

³⁸ *Schneiderman v. United States*, 320 U.S. 118, 135 (1943).

³⁹ *Colorado v. New Mexico*, 467 U.S. 310, 316 (1984).

⁴⁰ See, e.g., *Brown v. Bowen*, 847 F.2d 342, 346 (7th Cir. 1988); *Aetna Ins. Co. v. Paddock*, 301 F.2d 807 (5th Cir. 1962).

⁴¹ See 1 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE IN ENGLAND AND AMERICA 42-63 (W.H. Lyon, Jr. ed., 14th ed. 1918).

⁴² *Id.* at 64 (quoting Justice Blackstone).

⁴³ *Id.* at 7 (footnote omitted).

these courts were able to provide plaintiffs unique forms of relief including, but not limited to, injunctions, enforcement of trusts, assignment of claims, specific performance and rescission and reformation of contracts and other documents.⁴⁴ Therefore, while representing a court of last resort for many claimants, these courts possessed a great deal of power and flexibility which held the potential for erroneous judgments with staggering consequences. Equity courts sought to minimize this risk and the risk that they would become overrun by individuals asserting baseless claims, seeking escape from bad deals or those willing to fabricate evidence. Consequently, these courts required many plaintiffs to make the necessary showing with clear-and-convincing evidence and not by a preponderance of the evidence, the customary standard for civil disputes under the common law.⁴⁵ The use of this heightened standard gained widespread acceptance and remained part of the American judicial system after the adoption of the Federal Rules of Civil Procedure and the merging of the courts of law and equity.⁴⁶

Just as with the beyond-a-reasonable-doubt standard, a reduction in decisional errors is not the motivation in applying the clear-and-convincing standard of proof. Rather, the motivation behind applying this heightened standard of proof has evolved since the 18th century. Today, the application of this heightened standard of proof to civil proceedings is invariably based on one or more of the following: (i) the implication of a fundamental right in a civil dispute; (ii) the interests at stake in the proceeding implicate society's interests and are more substantial than a mere loss of money; or (iii) the balance of the interests justify deviating from the preponderance-of-the-evidence standard.⁴⁷ The clear-and-convincing standard decreases the

⁴⁴ See *id.* at 24-25; RICHARD D. FREER & WENDY COLLINS PERDUE, CIVIL PROCEDURE: CASES, MATERIALS, AND QUESTIONS 14-15 (1996).

⁴⁵ See *Herman & MacLean v. Huddleston*, 459 U.S. 375, 389 n.27 (1983).

⁴⁶ See *id.*; see also FREER & PERDUE, *supra* note 44, at 16.

⁴⁷ For example, the contexts in which the clear-and-convincing standard of proof are applied include, but are not limited to, the following civil disputes: (a) charges for fraud and undue influence; (b) suits on oral contracts to make a will and suits to establish the terms of a lost will; (c) suits for the specific performance of an oral contract; (d) proceedings to set aside, reform or modify written transactions or official acts on grounds of fraud, mistake or incompleteness; and (e) miscellaneous types of claims and defenses varying from state to state, where there is thought to be special danger of deception, or where the court considers that the particular type of claim should be disfavored on policy grounds. See John Terrance A. Rosenthal & Robert T. Alter, *Clear and Convincing to Whom? The False Claims Act and Its Burden of Proof Standard: Why the Government Needs a Big Stick*, 75 NOTRE DAME L. REV. 1409, 1435 (2000). Furthermore, a number of tax code provisions specifically invoke the clear-and-convincing standard, including the golden parachute rules of section 280G, the section 467 lease rules and section 613A dealing with percentage depletion. There are a number of regulatory provisions that invoke the standard without explicit statutory support. See *Gamino*, *supra* note 7, at 522. In addition, the heightened standard is used in a variety of other contexts. See, e.g., *SSIH Equip. S.A. v. U.S. Int'l Trade Comm'n*, 718 F.2d 365 (Fed. Cir. 1983); *Connell v. Sears, Roebuck & Co.*, 722 F.2d 1542 (Fed. Cir. 1983) (presumption of validity of a patent can be overcome only by clear-and-convincing evidence even when relevant prior art was not considered by the Patent and Trademark Office); *In re Seagate Tech., LLC*, 497 F.3d 1360 (Fed. Cir. 2007), *cert. denied*, 128 S. Ct. 1445 (2008) ("To establish willful infringement, a patentee must show by clear and convincing evidence that the infringer acted despite an objectively high likelihood that its actions constituted infringement of a valid patent."); *Norian Corp. v. Stryker Corp.*, 363 F.3d 1321, 1326 (Fed. Cir. 2004) (parties seeking to invalidate a recognized patent must make the necessary showing by clear-and-convincing evidence); *Orient Exp. Trading Co., Ltd. v. Federated Dept. Stores, Inc.*, 842 F.2d 650, 653 (2d Cir. 1988) ("A party seeking cancellation of a registered trademark on grounds of fraud must demonstrate the alleged fraud by 'clear and convincing evidence.'"); *Hammerton, Inc. v. Heisterman*, 2008 WL

probability that the party found to have satisfied its burden of proof relied on factually inaccurate evidence. The standard also discourages frivolous lawsuits and encourages alternative dispute resolution.

The disadvantages of using this heightened standard of proof are similar to those found in using the beyond-a-reasonable-doubt standard; namely, the risk of incorrect judgments increases. Further, due to the vagaries of its definition, application of the standard may unnecessarily inject confusion into the judicial system, which can only further erode confidence and increase the risk of incorrect judgments.

D. Preponderance-of-the-Evidence Standard of Proof

The preponderance-of-the-evidence standard has been read to require a trier of fact “to believe that the existence of a fact is more probable than its nonexistence”⁴⁸ The standard focuses on what the factfinder objectively believes most probably happened, not which party submitted the most persuasive or weighty evidence.⁴⁹ Preponderance of the evidence is the traditional standard of proof in civil litigation.⁵⁰ The almost equal allocation of risk properly represents society’s interest in pure monetary disputes and increases the probability of correct judgments. In the nineteenth century, scholars began describing the use of the standard which had already become ubiquitous in courts of law.⁵¹

4057010, at *4 (D. Utah Aug. 25, 2008) (ruling that in order to receive attorneys fees under either the Lanham Act or the Patent Act, claimant must make the necessary showing by clear-and-convincing evidence though such a requirement does not appear in either statute); *Katzenberg v. First Fortis Life Ins. Co.*, 500 F. Supp. 2d 177, 194 (E.D.N.Y. 2007) (“In a dispute over long-term disability benefits, a plaintiff ‘has the burden of proving by clear and convincing evidence that he is totally disabled within the meaning of the plan.’”); *see also* *King v. Allied Vision, Ltd.*, 65 F.3d 1051, 1058 (2d Cir. 1995) (“[a] contempt order is warranted only where the moving party establishes by clear and convincing evidence that the alleged contemnor violated the district court’s edict”). The bankruptcy code also mandates application of the clear-and-convincing standard of proof in section 362(c)(3)(C) (presumption that case is not filed in good faith can be rebutted by clear-and-convincing evidence) and section 502(k)(2) (showing of noncompliance by creditor must be demonstrated by clear-and-convincing evidence).

⁴⁸ *Winship*, 397 U.S. 358, 371-72 (J. Harlan, concurring) (quoting FLEMING JAMES, CIVIL PROCEDURE 250-51 (1965)).

⁴⁹ *See Id.*; *see also* Peter W. Murphy, *Some Reflections on Evidence and Proof*, 40 S. TEX. L. REV. 327, 348 (1999) (“The burden of proving a fact by the preponderance of the evidence is the burden of proving, not that the fact is more likely to be true than a countervailing fact asserted by the opponent, but that the fact asserted is more likely than not to be true”); Fleming James, *Burdens of Proof*, 47 VA. L. REV. 51, 53 (1961) (“[W]hat counts is the jury’s belief in the existence (or non-existence) of the disputed fact, and the extent to which the evidence actually produces that belief”).

⁵⁰ *See, e.g.,* *Jury Determination of Punitive Damages (Development in the Law)*, 110 HARV. L. REV. 1513, 1531-32 (1997) (recognizing that preponderance of the evidence is the traditional civil standard of proof).

⁵¹ *See* William Paley, *Moral and Political Philosophy, reprinted in* THE WORKS OF WILLIAM PALEY 27, 141 (Philadelphia, J.J. Woodward 1831) (advocating for use of the preponderance-of-the-evidence standard in criminal trials); 1 SIMON GREENLEAF, A TREATISE ON THE LAW OF EVIDENCE 16-18 (13th ed., Boston, Little, Brown & Co. 1876) (explaining that jurors should decide civil cases “in favor of the party on whose side the weight of the evidence preponderates, and according to the reasonable probability of truth”); *see*

The application of the preponderance-of-the-evidence standard is an error-minimizing strategy. Overall, the standard seeks to minimize the probability of an incorrect judgment. This application is an acknowledgment that, in the vast majority of civil disputes, the disutility of error in favor of the plaintiff is no worse than the disutility of an error in favor of the defendant. However, this standard best serves the goals of our judicial system by keeping the amounts mistakenly awarded to a minimum. The standard serves to provide a level playing field for civil litigants – a fundamental goal of our judicial system which is only overridden in unique situations.⁵²

Of course, the standard allows for judgments to “swing from no recovery to full recovery on the basis of a slight shift in the weight of evidence.”⁵³ Also, the standard fails to deter frivolous lawsuits or encourage alternative dispute resolution.

II. A NEW NORMATIVE APPROACH

A. Case Law Guiding This Issue: *Grogan v. Garner*

The Supreme Court has addressed the application of standards of proof infrequently and, when it has, the issue has often times been a tangential one. However, on April 30, 1990, the Court agreed to hear *Grogan v. Garner*, a case in which the primary issue was the applicable standard of proof a moving party must satisfy in arguing that a debt is nondischargeable under section 523 of the Bankruptcy Code. The case offered the Court the opportunity to provide instruction on an issue in dire need of definition.

In *Grogan v. Garner*, Coy R. Grogan and his fellow investors (the “Petitioners”) brought an action against Frank J. Garner alleging that Garner had defrauded them in the sale of certain corporate securities.⁵⁴ The trial court’s jury instructions authorized a recovery based on the preponderance of the evidence. The jury returned a verdict in favor of the Petitioners. Garner appealed the judgment on the verdict and, while his appeal was pending, he filed a petition for relief under the Bankruptcy Code.⁵⁵ Garner listed the fraud judgment as a dischargeable debt. The fraud judgment was affirmed on appeal. Petitioners filed a complaint in Garner’s bankruptcy case requesting a determination that their claim should be exempted from discharge pursuant to section 523 of the Bankruptcy Code, which exempts claims based on actual fraud. The bankruptcy court found that all of the elements required to establish actual fraud had been proven and that the doctrine of collateral estoppel required a holding that the debt was not dischargeable.

also Harold J. Berman & Charles J. Reid, Jr., *The Transformation of English Legal Science: From Hale to Blackstone*, 45 EMORY L.J. 437, 481-83 (1996).

⁵² See Kevin M. Clermont, *Standards of Proof in Japan and the United States*, 37 CORNELL INT’L L.J. 263, 270-71 (2004).

⁵³ See *id.* at 270.

⁵⁴ See 498 U.S. 279, 281 (1991).

⁵⁵ See *id.* at 281-82.

Garner appealed this ruling to the district court, arguing that collateral estoppel did not apply because the jury instructions merely required that fraud be established by a preponderance of the evidence, whereas section 523 requires proof by clear-and-convincing evidence. The district court rejected this argument, and Garner appealed to the Eighth Circuit Court of Appeals.⁵⁶ In relying on circuit precedent, the court of appeals explained that though section 523 is silent as to the applicable burden of proof, two factors indicated that the clear-and-convincing standard of proof was appropriate in cases involving fraud.⁵⁷ Primarily, though Congress chose not to specify a standard of proof when it adopted section 523, the court presumed that Congress was aware that “the prevailing view at the time of adoption was that fraud, for both section 523 and state common law purposes, had to be proved by clear and convincing evidence.”⁵⁸ Further, the court explained that the higher standard protects the “fresh start” policy that is the crux of the Bankruptcy Code. The Petitioners appealed to the Supreme Court, which granted certiorari due to a circuit split.

In reversing the ruling of the court of appeals, the Court noted that a determination of the appropriate standard of proof under section 523 would initially require an examination of the language of the statute and the legislative history.⁵⁹ However, neither the language nor the legislative history of the section indicated which standard of proof was appropriate. The Court noted that “[t]his silence is inconsistent with the view that Congress intended to require a special, heightened standard of proof.”⁶⁰ The Court did not hold that this silence foreclosed the possibility of a heightened standard of proof being applicable. Nevertheless, the Court explained that it presumed that the lower standard is applicable in civil actions between private litigants unless “particularly important individual interests or rights are at stake.”⁶¹

A number of factors influenced the Court’s decision. Primarily, the Court noted that it had previously “held that a debtor has no constitutional or ‘fundamental’ right to a discharge in bankruptcy.”⁶² In rejecting the primary basis for the circuit court’s ruling, the Court stated that it was “unpersuaded by the argument that the clear-and-convincing standard is required to effectuate the ‘fresh start’ policy of the Bankruptcy Code.”⁶³ The Court also balanced the interests involved in the case in overturning the circuit court’s ruling; namely, that section 523 represented a decision by Congress to exclude certain claims from the Bankruptcy Code’s general policy of discharge for individual debtors, and it was “unlikely that Congress, in fashioning a standard of proof that governs the applicability of these provisions, would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting

⁵⁶ See *id.* at 282-83.

⁵⁷ See *Matter of Van Horne*, 823 F.2d 1285, 1287 (8th Cir. 1987).

⁵⁸ *Henson v. Garner*, 881 F.2d 579, 582 (8th Cir. 1989).

⁵⁹ See 498 U.S. at 286 (“[W]e begin our inquiry into the appropriate burden of proof under § 523 by examining the language of the statute *and* its legislative history.”) (emphasis added).

⁶⁰ See *id.*

⁶¹ *Id.* (approvingly citing *Huddleston*, 459 U.S. at 389-90).

⁶² See *id.* (citing *United States v. Kras*, 409 U.S. 434, 445-46 (1973)).

⁶³ *Id.*

victims of fraud.”⁶⁴ Ultimately, requiring the lower standard of proof represented a fair balance between these conflicting interests.⁶⁵

Furthermore, the Court returned to the language of the Bankruptcy Code to bolster its ruling. Section 523 groups together a variety of exceptions to discharge within the same subsection. As noted, the standard of proof is not specified. “The omission of any suggestion that different exemptions have different burdens of proof implies that the legislators intended the same standard to govern [all exceptions]. Because it seems clear that a preponderance of the evidence is sufficient to establish the nondischargeability of some of the [enumerated exceptions], it is fair to infer that Congress intended the ordinary preponderance standard to govern the applicability of all the discharge exceptions.”⁶⁶

The Court noted that the fact that most states required fraud claims be proven by clear-and-convincing evidence does not support the conclusion that Congress intended to follow suit in fashioning relief under federal law.⁶⁷ In fact, Congress has regularly chosen the preponderance standard when it has created substantive federal causes of action for fraud.⁶⁸

Finally, the Court noted that application of the lower standard of proof would allow for the nondischargeability of fraud claims that have been reduced to judgment outside of bankruptcy; a result which comports with the historical development of the discharge exceptions.⁶⁹

⁶⁴ *Id.* at 287.

⁶⁵ *See id.*

⁶⁶ *Id.* at 287-88.

⁶⁷ *See id.* at 288.

⁶⁸ *See id.* (noting 31 U.S.C. § 3731(c) (False Claims Act); 12 U.S.C.A. § 1833a(e) (1988 ed., Supp. I)(civil penalties for fraud involving financial institutions); and 42 C.F.R. § 1003.114(a) (1989) (Medicare and Medicaid fraud under 42 U.S.C. § 1320a-7a), among others).

⁶⁹ *See id.* at 290.

B. Understanding the Nuance of *Grogan* and Other Applicable Supreme Court Rulings

Grogan is an often cited but consistently misunderstood case. Lower courts have taken the narrow holding of *Grogan* and applied it in a number of other contexts based on interpretations that are unsupported by the language of the ruling. Indeed, one court has interpreted *Grogan* to hold that in the event that Congress does not specify a heightened standard of proof in a statutory provision, requests for relief based on that provision in a civil dispute cannot be reviewed under a heightened standard of proof.⁷⁰ Another court has interpreted *Grogan* to hold that if no particularly important individual interests or rights are at stake in the case, the application of a heightened standard is never appropriate.⁷¹ Finally, the Seventh Circuit has proclaimed that *Grogan* holds that “heightened burdens of proof do not apply in civil cases unless a statute provides or the Constitution requires” an elevated burden.⁷² However, these rulings and many like them fail to appreciate the nuances of *Grogan* or consider Supreme Court precedent.

⁷⁰ See *In re Altman*, 230 B.R. 6 (Bankr. D. Conn. 1999), *vacated in part on other grounds by* 254 B.R. 509 (D. Conn. 2000). In *Altman*, the bankruptcy court was faced with the issue of whether a valuable piece of artwork was part of the bankruptcy estate. An art gallery which claimed an ownership interest in the artwork moved for the appointment of a trustee in the event that the artwork was in fact part of the bankruptcy estate. In determining that appointment was warranted, the bankruptcy court interpreted *Grogan* to “establish[that] a preponderance of the evidence standard [is] the requisite burden of proof in bankruptcy litigation . . .” and ruled that only express congressional direction could overcome this. *Id.* at 16-17. Failing to find such express congressional direction, the *Altman* court ruled that the applicable standard was the preponderance of the evidence.

⁷¹ See *Tradex v. Morse (In re Tradex)*, 339 B.R. 823, 830-31 (D. Mass 2006). In *Tradex*, Tradex Corp. sought bankruptcy protection under chapter 11 and became a debtor in possession. Charles Gitto, Jr. was the president and sole shareholder of Tradex Corp. Various prepetition activities by Mr. Gitto caused concern on the part of the United States Trustee who sought to have a chapter 11 trustee appointed. The bankruptcy court granted this request, and the debtor appealed to the district court. In affirming the bankruptcy court’s ruling, the district court noted that a question remained as to the standard of proof applicable for motions seeking the appointment of a trustee. The First Circuit has not addressed this issue, but the district court noted that the Third and Fifth Circuits have endorsed the “clear and convincing” standard of proof and this view has been endorsed by a number of bankruptcy courts. However, in reviewing the case law, the district court concluded that the factual predicates for appointment of a trustee need only be made by a preponderance of the evidence. The district court relied heavily on the “implications” of *Grogan*; following a unique interpretation of the Court’s reasoning in expanding the reach of the ruling. The district court noted that there was no express congressional direction in section 1104 to use the heightened standard of proof. Further, the district court explained that since no “particularly important individual interests or rights [were] at stake,” application of a heightened standard of proof was unnecessary. *Id.* at 830 (quoting *Huddleston*, 459 U.S. at 389-90 (1983)). The district court rejected the argument that section 1104, by defining “cause” in a way that includes fraudulent conduct, required the use of a heightened standard.

⁷² *Ridge Chrysler Jeep, LLC v. DaimlerChrysler Fin. Serv. Americas LLC*, 516 F.3d 623, 625 (7th Cir. 2008); *Wade v. Soo Line R.R. Corp.*, 500 F.3d 559 (7th Cir. 2007). If this was in fact the holding of *Grogan*, the case would overrule or render incorrect a number of cases in addition to *Addington* and *Huddleston*. See footnote 47, *supra*.

Primarily, *Grogan* dealt with section 523(a) which provides that “[a] discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of [the Bankruptcy Code] does not discharge an individual debtor from any [of the following] debt”⁷³ A detailed list of nondischargeable debt follows. The statutory language establishes that the section strictly involves individual debtors and has absolutely no application to a corporate debtor.⁷⁴ The rights of an individual debtor were at stake in *Grogan*, and the Court addressed the instances where such individuals may be afforded additional protections through application of a heightened standard of proof; namely, when “particularly important individual interests or rights are at stake.”⁷⁵ However, the Court does not provide that this is the only instance when a heightened standard of proof may be applied. The holding of *Grogan* is narrow and limited to the issue of dischargeability for individual debtors. *Grogan* speaks only to the creditor’s, not the debtor’s, burden of proof with regard to dischargeability.⁷⁶ Furthermore, application of a holding from a dispute involving individual parties to cases involving public and private corporate entities may be misguided. One can reasonably assume that the Court’s language, while helpful, did not foreclose the possibility that there may be instances involving a corporate entity in which the use of the clear-and-convincing standard would be appropriate. The Court’s language does not indicate an intention to destroy precedent set with regard to the standard of proof in other contexts. Indeed, the *Grogan* court approvingly cites to *Addington v. Texas*⁷⁷ and *Herman & MacLean v. Huddleston*⁷⁸, which both indicate that the clear-and-convincing standard of proof can be applied broadly.

In *Addington*, the Court addressed which standard of proof is appropriate in committing an individual to a state mental hospital. In exploring the clear-and-convincing standard of proof, the Court noted that the standard “is no stranger to the civil law.”⁷⁹ The Court explained that the typical use of the heightened standard in civil proceedings involves allegations of fraud or some other quasi-criminal wrongdoing because the “interests at stake in those cases are deemed to be more substantial than mere loss of money”⁸⁰ The Court then explained that, on a separate note, the Court has also used the heightened standard of proof “to protect particularly important individual interests in various civil cases.”⁸¹ The Court’s language establishes that there is more than one basis justifying the use of a heightened standard of proof in a civil case.

⁷³ 11 U.S.C. § 523(a) (emphasis added).

⁷⁴ Discharge for debtors in possession under chapter 11 is provided exclusively by section 1141.

⁷⁵ *Grogan*, 498 U.S. at 286.

⁷⁶ Note that section 523 deals with the nondischargeability of a single debt. Other forms of bankruptcy relief (such as section 727 which allows a bankruptcy court to find that none of the debtor’s debts may be discharged) may be far more severe and necessitate a more stringent analysis.

⁷⁷ 441 U.S. 418 (1979).

⁷⁸ 459 U.S. 375 (1983).

⁷⁹ 441 U.S. at 424 (citing *Woodby* at 276); see also MCCORMICK, *supra* note 26, at §320 (1954); 9 J. WIGMORE, TREATISE ON EVIDENCE § 2498 (3d ed. 1940).

⁸⁰ *Id.* at 424 .

⁸¹ *Id.*

In *Huddleston*, the Court addressed what standard of proof was applicable in a securities fraud case under Section 10(b) of the Securities Exchange Act of 1934. The defendant in that case was an accounting firm. In determining which standard of proof was most appropriate, the Court explicitly balanced the interests of the affected parties. Indeed, the court explained

The balance of interests in this case warrants use of the preponderance standard. On the one hand, the defendants face the risk of opprobrium that may result from a finding of fraudulent conduct, but this risk is identical to that in an action under Section 17(a), which is governed by the preponderance-of-the-evidence standard. The interests of defendants in a securities case do not differ qualitatively from the interests of defendants sued for violations of other federal statutes such as the antitrust or civil rights laws, for which proof by a preponderance of the evidence suffices. On the other hand, the interests of plaintiffs in such suits are significant. Defrauded investors are among the very individuals Congress sought to protect in the securities laws. If they prove that it is more likely than not that they were defrauded, they should recover.⁸²

The Court proceeded to explain that if the balance of the equities had weighed differently, the Court may have “depart[ed] from the preponderance-of-the-evidence standard generally applicable in civil actions.”⁸³

Grogan does not attempt to overrule *Addington* or *Huddleston*. In fact, *Grogan* cites to both cases approvingly and engages in the balancing of the interests prescribed by *Huddleston*.⁸⁴ As established by the Supreme Court itself, unless the Supreme Court explicitly overrules a previous ruling, all applicable Supreme Court cases must be interpreted so that they can be read

⁸² *Id.* at 691-92; *see also Grogan*, 498 U.S. at 287 (engaging in a similar balancing of the interests and concluding that “it [is] unlikely that Congress, in fashioning the standard of proof that governs the applicability of these provisions, would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud”).

⁸³ *Id.* at 692.

⁸⁴ *See Grogan*, 498 U.S. at 286-87 (“We also do not believe that . . . a debtor has an interest in discharge sufficient to require a heightened standard of proof Congress evidently concluded that the creditors’ interest in recovering full payment of debts in these categories outweighed the debtors’ interest in a complete fresh start. We think it unlikely that Congress . . . would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud. Requiring the creditor to establish by a preponderance of the evidence that his claim is not dischargeable reflects a *fair balance* between these conflicting interests.”) (emphasis added).

coextensively.⁸⁵ Naturally, courts should follow Supreme Court precedent that directly controls an issue. However, as noted above, the holding of *Grogan* is narrow and does not directly deal with issues raised outside of a dischargeability context. Consequently, any reading of *Grogan* which serves to marginalize the ruling in either *Addington* or *Huddleston* outside the context of a section 523(a) case must be rejected.

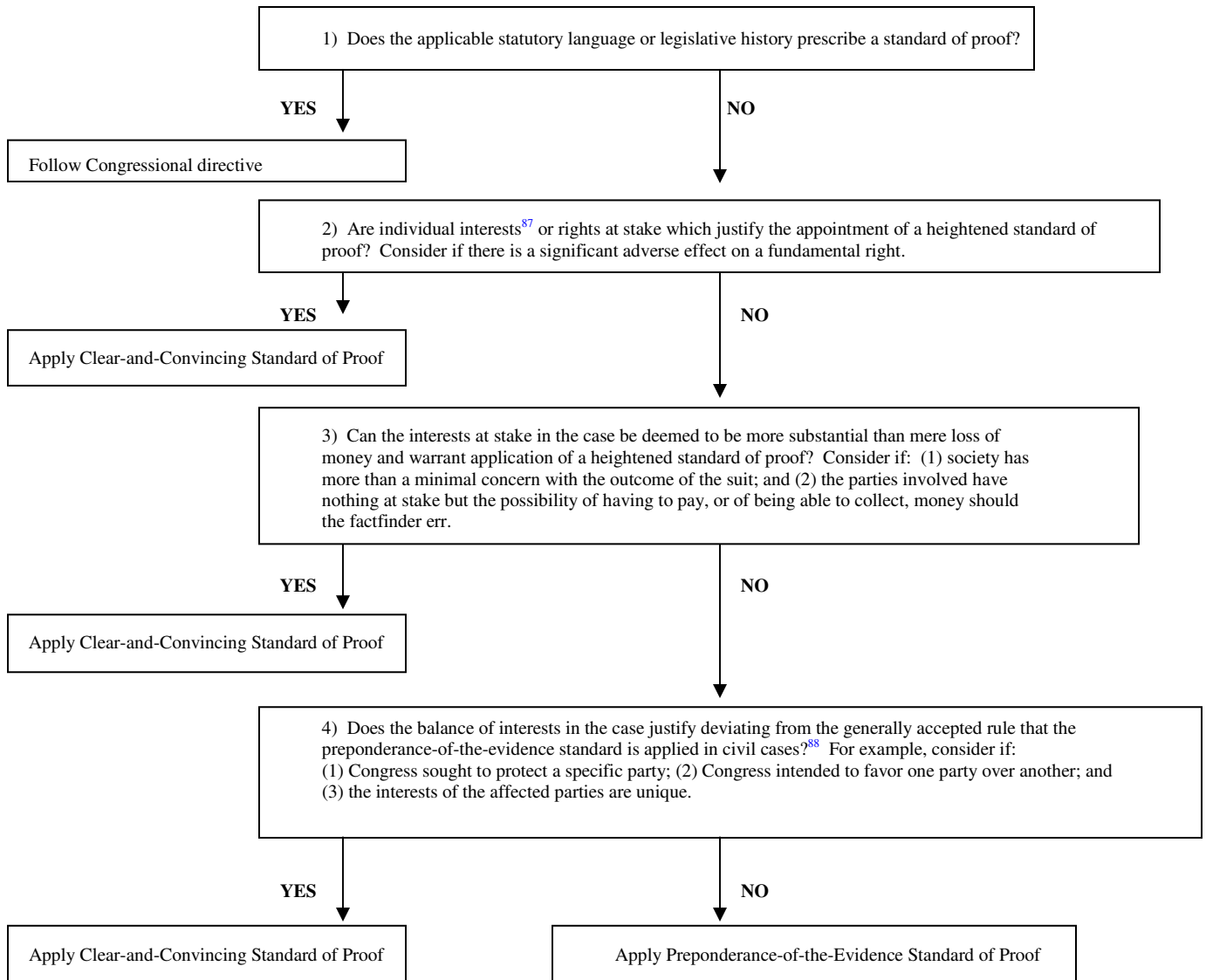
Finally, the *Grogan* Court began its analysis by examining the language of section 523 and its legislative history and placed significant weight on the lack of instruction from either. Indeed, silence or ambiguity in the statutory language may apparently be offset by instruction in the legislative history.⁸⁶

⁸⁵ See, e.g., *Agostini v. Felton*, 521 U.S. 203, 237 (1997) (“We do not acknowledge, and we do not hold, that other courts should conclude our more recent cases have, by implication, overruled an earlier precedent.”); see also *Bach v. Pataki*, 408 F.3d 75, 86 (2d Cir. 2005) (quoting *Agostini* and explaining that “courts should [not] conclude [that] more recent [Supreme Court] cases have, by implication, overruled an earlier precedent.”); *United States v. Garrett*, 122 Fed. Appx. 628, 633-34 (4th Cir. 2005) (*unpublished*) (*same*); *Grutter v. Bollinger*, 288 F.3d 732, 743-44 (6th Cir. 2002) (*same*); *Coeur D’Alene Tribe of Idaho v. Hammond*, 384 F.3d 674, 683 n.6 (9th Cir. 2004) (*same*); [Note: in this case, the Ninth Circuit incorrectly cited to language that was not actually part of the Court’s ruling but was written by Westlaw and included in its “Syllabus” of the case. The correct citation is 521 U.S. 237 (1997)].

⁸⁶ In reviewing legislative history, the Supreme Court has “repeatedly recognized that the authoritative source for legislative intent lies in the Committee Reports on the bill.” *Thornburg v. Gingles*, 478 U.S. 30, 44 n.7 (1986); see also *United States v. Awadallah*, 349 F.3d 42, 54 (2d Cir. 2003) (“[T]he authoritative source for finding the Legislature’s intent lies in the Committee Reports on the bill, which represent the considered and collective understanding of those Congressmen involved in drafting and studying proposed legislation.”) (internal quotation marks omitted). Statements by an individual legislator, even a sponsor or conferee, do not have controlling effect on statutory interpretation. However, when such statements are consistent with the statutory language and other legislative history, they provide evidence of Congressional intent. See, e.g., *Brock v. Pierce County*, 476 U.S. 253, 263-64 (1986); *Federal Energy Admin. v. Algonquin SNG, Inc.*, 426 U.S. 548, 564 & n. 17 (1976); *Nat’l Woodwork Mfr. Ass’n v. N.L.R.B.*, 386 U.S. 612, 639-40 (1967); *Monterey Coal Co. v. Fed. Mine Safety & Health Review*, 743 F.2d 589, 596 (7th Cir. 1984); *In re Garofalo’s Finer Foods, Inc.*, 117 B.R. 363, 369 (Bankr. N.D. Ill. 1990).

C. My Normative Approach to Determine Which Standard of Proof is Applicable in Disputes Involving Chapter 11 Debtors in Possession

Based on the above-cited Supreme Court cases, I have developed a simple process that guides the determination of the applicable standard of proof in a typical dispute involving a chapter 11 debtor in possession. A shorthand, graphical representation is as follows:



⁸⁷ In cases dealing with individuals, the Supreme Court has noted the following: (1) termination of parental rights; (2) involuntary commitment for mental illness; (3) deportation; and (4) denaturalization.

⁸⁸ The third and fourth questions are related but cannot be collapsed into one. Indeed, the Supreme Court has established differences between the two queries, and that guidance is honored in this chart.

III. AN EXPLANATION OF SOME OF THE KEY FORMS OF RELIEF UNDER TITLE 11

The allure of the Bankruptcy Code is that the forms of relief offered therein are oftentimes unique; relief that is not only difficult to obtain outside of bankruptcy but, in the vast majority of cases, explicitly forbidden on a number of practical and policy grounds. The central fixture of the Bankruptcy Code is the automatic stay that, upon the filing of a bankruptcy petition, acts to cease all creditor collection activities, even those explicitly permitted by applicable nonbankruptcy law and/or contract. Similarly unique and powerful are the preference recovery powers available under section 547, the fraudulent conveyance recovery powers under section 548, the strong-arm powers afforded by section 544 and the ability to reject executory contracts under section 365 and potentially pay damages with pennies on the dollar. These provisions of the Bankruptcy Code, along with numerous others, work collectively to create a vast arsenal at the disposal of a chapter 11 debtor in possession.⁸⁹

Among the Bankruptcy Code's extensive and varied forms of relief exists a subset where the applicable standard of proof is unclear. As to these forms of relief, courts fail to follow a uniform procedure in determining the proper application and, not surprisingly, reach different conclusions as to which standard is applicable. For the purpose of this article, I have selected three prominent forms of relief from this subset to which I apply my normative approach. However, before a proper application of my normative approach can occur, there must be full understanding of the relief being requested and its effect, as well as the legislative history of the provision. To this end, a full exploration of sections 1113, 1104 and 547 of the Bankruptcy Code appears below.

A. Rejection of a Collective Bargaining Agreement under Section 1113

Pursuant to section 1113 of the Bankruptcy Code,

(a) The debtor in possession . . . may assume or reject a collective bargaining agreement only in accordance with the provisions of this section.

(b)(1) Subsequent to filing a petition and prior to filing an application seeking rejection of a collective bargaining agreement, the debtor in possession or trustee (hereinafter in this section "trustee" shall include a debtor in possession), shall – (A) make a proposal to the authorized representative of the employees covered by such agreement, based on the most complete and reliable information available at the time of such proposal, which provides

⁸⁹ Please note, many provisions of the Bankruptcy Code specifically reference a "trustee." Pursuant to section 1107, the debtor in possession has "all the rights, . . . powers, and shall perform all the functions and duties . . . of a trustee" unless otherwise stated in the section. Debtors in possession are the focus of this article and will be referenced herein even where quoted sections of the Bankruptcy Code may refer to a "trustee."

for those necessary modifications in the employees benefits and protections that are necessary to permit the reorganization of the debtor and assures that all creditors, the debtor and all of the affected parties are treated fairly and equitably; and (B) provide, subject to subsection (d)(3), the representative of the employees with such relevant information as is necessary to evaluate the proposal.

(2) During the period beginning on the date of the making of a proposal provided for in paragraph (1) and ending on the date of the hearing provided for [herein], the trustee shall meet, at reasonable times, with the authorized representative to confer in good faith in attempting to reach mutually satisfactory modifications of such agreement.

(c) The court shall approve an application for rejection of a collective bargaining agreement only if the court finds that – (1) the trustee has, prior to the hearing, made a proposal that fulfills the requirements of subsection (b)(1); (2) the authorized representative of the employees has refused to accept such proposal without good cause; and (3) the balance of the equities clearly favors rejection of such agreement.

Further, under section 1113(a), a bankruptcy court may authorize a debtor in possession to make unilateral interim changes to the terms, conditions, wages, benefits, or work rules provided by a collective bargaining agreement “[i]f . . . the collective bargaining agreement continues in effect, and [the changes are] . . . essential to the continuation of the debtor’s business, or in order to avoid irreparable damage to the estate”

1. *Bildisco* and Legislative History⁹⁰

*N.L.R.B. v. Bildisco & Bildisco*⁹¹ is the *sine qua non* of any discussion regarding the legislative history behind section 1113 and warrants a brief summary.⁹² In that case, the debtor

⁹⁰ In 1968, a sub-committee of the Senate Judiciary Committee decided that a special commission was necessary in order to recommend changes to the Bankruptcy Act. See Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153, 173 (2004). In 1970, the National Bankruptcy Review Commission (the “Commission”) was formed. In 1973, the Commission issued a report which proposed various changes and explained the policy arguments behind many of these changes [hereinafter, the Commission Report]. The Commission Report served as the basis for many of the changes embodied in the 1978 Bankruptcy Code.

⁹¹ 465 U.S. 513 (1984).

⁹² See Statement by the Hon. Robert J. Dole, a ranking majority member of the senate committee on the judiciary and a senate conferee on H.R. 5174, 130 Cong. Rec., S. 8889, June 29, 1984 (“The House [of

sought bankruptcy protection under chapter 11. At the time, approximately 40 to 45 percent of the debtor's labor force was represented by Local 408 of the International Brotherhood of Teamsters, Chauffeurs, Warehousemen and Helpers of America (the "Union"). The members of the Union who were employed by the debtor were working pursuant to a collective bargaining agreement. The debtor sought to reject this agreement once in bankruptcy, arguing that rejection would save the company approximately \$100,000.⁹³ Further, after filing its bankruptcy petition, the debtor had unilaterally changed some of the terms of the collective bargaining agreement. At that time, the Bankruptcy Code did not contain a provision which specifically addressed the rejection of a collective bargaining agreement, but section 365 provides for the rejection of executory contracts in certain cases. The bankruptcy court allowed the debtor to reject the collective bargaining agreement. The Union appealed the ruling but the district court upheld the order. The Union then appealed to the Court of Appeals for the Third Circuit. Due to the unilateral changes the debtor had made, the National Labor Relations Board ("NLRB") issued an order finding that the debtor had violated the National Labor Relations Act ("NLRA"). The NLRB petitioned the Court of Appeals for the Third Circuit to enforce its order.

The Court of Appeals consolidated the Union's appeal of the bankruptcy court's order and the NLRB's petition for enforcement. In affirming the bankruptcy court's ruling and denying the NLRB's petition, the Court of Appeals held that a collective bargaining agreement was an executory contract subject to rejection under section 365. This power was not restricted by the NLRA. To effectuate a rejection, the debtor needed to demonstrate that under the debtor's business judgment, the collective bargaining agreement was burdensome to the estate and that the equities balanced in favor of rejection. The Union and the NLRB appealed the Circuit Court's ruling to the Supreme Court where they argued that the standard for rejection should be stricter than that which was advocated by the Court of Appeals; that, in light of the special nature of rights created by labor contracts, the debtor should not be permitted to reject the collective bargaining agreement unless it could demonstrate that its reorganization would otherwise fail.

The Supreme Court affirmed the Circuit Court's ruling. The Court explained that all collective bargaining agreements, except those subject to the Railway Labor Act, were subject to rejection under section 365.⁹⁴ The Court agreed that collective bargaining agreements are of a special nature and that "a somewhat stricter standard should govern the decision of the Bankruptcy Court to allow rejection of a collective bargaining agreement."⁹⁵ Ultimately, the Court adopted the standard proposed by the Circuit Court, but the Court provided additional guidance.⁹⁶ The Court explained that before determining whether to allow for the rejection of a collective bargaining agreement, "the bankruptcy court should be persuaded that reasonable efforts to negotiate a voluntary modification had been made and [were] not likely to produce a

Representatives] was spurred into action [and drafted what became section 1113] by the Supreme Court decision in *Bildisco*"

⁹³ See *Bildisco*, 465 U.S. at 517-18. Presumably, after the debtor rejected the collective bargaining agreement, it would be able to offer new terms on a take it or leave it basis.

⁹⁴ See *id.* at 522-23.

⁹⁵ *Id.* at 524.

⁹⁶ See *id.*

prompt and satisfactory solution.”⁹⁷ Once the bankruptcy court made such a determination, the court was obligated to balance the equities and consider the interests of the affected parties, including the debtor, creditors and employees.⁹⁸ Further,

[t]he Bankruptcy Court must consider the likelihood and consequences of liquidation for the debtor absent rejection, the reduced value of the creditors’ claims that would follow from affirmance and the hardship that would impose on them, and the impact of rejection on the employees. In striking the balance, the Bankruptcy Court must consider not only the degree of hardship faced by each party, but also any qualitative differences between the types of hardship each may face. . . . [T]he Bankruptcy Court must focus on the ultimate goal of Chapter 11 when considering these equities. The Bankruptcy Code does not authorize free-wheeling consideration of every conceivable equity, but rather only how the equities relate to the success of the reorganization.⁹⁹

This aspect of the ruling represented Parts I and II of the decision and received the support of all justices on the Court. However, Part III was supported by only five of the justices. In that aspect of the ruling, the Court held that the debtor had not violated the NLRA by unilaterally changing the terms of the collective bargaining agreement between the date of the filing of the bankruptcy petition and the date on which the bankruptcy court authorized rejection of the collective bargaining agreement.¹⁰⁰ The Court reasoned that the NLRB’s enforcement of a violation of the NLRA “would run directly counter to the express provisions of the Bankruptcy Code and to the Code’s overall effort to give a [debtor in possession] some flexibility and breathing space. [The Court] conclude[d] that from the filing of a petition in bankruptcy until formal acceptance, the collective-bargaining agreement [was] not an enforceable contract within the meaning of [the] NLRA”¹⁰¹

Naturally, the *Bildisco* ruling had a profound effect on labor relations. The ruling “placed the continued viability of the act of collective bargaining . . . in great doubt [and further eroded] labor’s membership and influence, and [worked to extinguish] employees’ rights which were bargained for in good faith and earned in service to the employer”¹⁰² Employers relied on the ruling and the threat of unilaterally imposed terms in fashioning a “new collective bargaining weapon.”¹⁰³ In response, union leaders called upon Congress to pass legislation addressing the

⁹⁷ *Id.* at 526.

⁹⁸ *See id.* at 527.

⁹⁹ *Id.*

¹⁰⁰ *See id.* at 528-29.

¹⁰¹ *Id.* at 532.

¹⁰² *See* Rosalind Rosenberg, *Bankruptcy and the Collective Bargaining Agreement – A Brief Lesson in the Use of the Constitutional System of Checks and Balances*, 58 AM. BANKR. L.J. 293, 312 (1984).

¹⁰³ Daily Labor Report, October 5, 1983, at A-6.

perceived inequities of *Bildisco*.¹⁰⁴ They argued that “unless [the] disgraceful and unfair situation [created by the ruling was] corrected, unscrupulous employers [would] increasingly begin to use the threat of bankruptcy to force workers to accept rewriting of their contracts to incorporate concessions in their wage levels and working conditions.”¹⁰⁵

The opportunity to address the effect of *Bildisco* came as a result of the Supreme Court’s ruling in *Northern Pipeline Construction Co. v. Marathon Pipe Line*,¹⁰⁶ in which the Court found the Bankruptcy Act of 1978 unconstitutional. Congress sought to address the issues raised in the *Marathon* ruling by drafting the Bankruptcy Amendments and Federal Judgeship Act of 1984.¹⁰⁷ In doing so, the Supreme Court agreed to extend a stay of the *Marathon* decision to December 25, 1982, but refused to stay the ruling beyond that date. Consequently, the district courts adopted an “interim rule” and the bankruptcy courts were kept in operation while the 1984 Bankruptcy Code was debated.

The most contested issue of the 1984 Bankruptcy Code proved to be the language of new section 1113.¹⁰⁸ Due to the stakes, representatives of organized labor and business management both aggressively lobbied members of Congress which, not surprisingly, led to a troubling divide which stalled passage of legislation. Various bills and amendments attempting to resolve the issue were introduced, but resolution proved to be elusive. The transition period and the interim rule were repeatedly extended. Conflicting resolutions passed the Senate and House of Representatives so the final drafting on the issue ultimately fell to the joint House-Senate conference committee.¹⁰⁹ A quick resolution was unattainable, and the interim rule was ultimately extended to July 28, 1984.¹¹⁰ The conference committee was unable to reach a compromise by midnight on July 27, 1984 so the emergency rule under which the bankruptcy system had been operating since December of 1982 finally expired.¹¹¹ In order to keep the courts operating, the United States Judicial Conference approved a second emergency plan which took effect on July 28th. Under this time pressure, on July 28th at approximately 3:00 a.m., the conference committee finally announced a compromise bill which represented section 1113. But due to the expedited timetable for passage of the 1984 Bankruptcy Code, section 1113 has only “a meager legislative history.”¹¹² Congress was unable to agree on an accompanying

¹⁰⁴ See Rosenberg, *supra* note 102, at 312.

¹⁰⁵ Letter from Legislative Director of the United Automobile, Aerospace & Agricultural Implement Workers of America, to Members of Congress (Mar. 9, 1984).

¹⁰⁶ 458 U.S. 50 (1982).

¹⁰⁷ Hereinafter, the “1984 Bankruptcy Code.”

¹⁰⁸ See Statement by the Hon. Peter W. Rodino Jr., Chairman of the House Committee on the Judiciary, upon the consideration of the Conference Report on H.R. 5174, 130 Cong. Rec. H. 7489, June 29, 1984 (“[Drafting section 1113] was the most serious matter that the conference had to deal with and we dealt with it over a long period of time and it was only after much deliberation and much exchange that we finally came to what we believe to be a very balanced provision”)

¹⁰⁹ See Rosenberg, *supra* note 102, at 318.

¹¹⁰ See *id.*

¹¹¹ See *id.*

¹¹² *In re Century Brass Products, Inc.*, 795 F.2d 265, 273 (2d Cir. 1986).

committee report.¹¹³ Consequently, there are no committee reports with respect to the House or Senate versions of section 1113. “[O]nly the comments read into the Congressional Record . . . on June 29, 1984 – the date the [1984 Bankruptcy Code] was enacted – are available.”¹¹⁴

No material changes have been made to the section since its enactment and no additional legislative history further explaining the applicable standard of proof is available.

2. Explanation and Effect of Section 1113

The importance of the collective bargaining agreement and the effect it has on the debtor in possession’s business and the lives of its employees cannot be overstated. The breadth and reach of such agreements are distinguishing characteristics and allow for a stabilizing force in the constant struggle between business and organized labor. The rejection of a collective bargaining agreement oftentimes affects tens of thousands of employees, a debtor’s creditors and its customers.¹¹⁵ This issue is far more substantial than a mere loss of money or customary two-party dispute. Indeed, “[s]ection 1113 attempts to reconcile the public policy that favors collective bargaining with the reality of bankruptcy, recognizing that Chapter 11 is not merely business as usual but an extremely serious process that can lead to liquidation and the loss of jobs of all the debtor’s employees as well as of the creditors’ opportunity for any meaningful recovery.”¹¹⁶ Section 1113 specifically requires the debtor to establish that all parties are being treated fairly and equitably in connection with the rejection. “The purpose of the fair and equitable requirement is to ‘spread the burden of saving the company to every constituency while ensuring that all sacrifice to a similar degree.’”¹¹⁷ Ultimately, “[a] collective bargaining agreement is an effort to erect a system of industrial self-government.”¹¹⁸ Section 1113 presents the blueprint for the overthrow of that government. At its heart, section 1113 is anarchy fueled by self-preservation.

The significance of section 1113 is staggering; at stake is not only the loss of the terms and conditions that were generally hard fought and earned through strikes, boycotts, walk-outs or dedicated service to the employer, but the imposition of terms that, on the whole, are less favorable and, in most cases, had been explicitly rejected by the union representatives or members.¹¹⁹ Indeed, section 1113 fails to specify whether a debtor in possession has the right to

¹¹³ See *id.*

¹¹⁴ See *id.*

¹¹⁵ See *In re Northwest Airlines Corp.*, 346 B.R. 307, 314 (Bankr. S.D.N.Y. 2006).

¹¹⁶ See *id.*

¹¹⁷ See *id.* at 325 (citing *Truck Drivers Local 807 v. Carey Transp.*, 816 F.2d 82, 90 (2d Cir. 1987)).

¹¹⁸ *United Steelworkers of America v. Warrior & Gulf Nav. Co.*, 363 U.S. 574, 580 (1960).

¹¹⁹ See, e.g., *In re Maxwell Newspapers*, 981 F.2d 85, 89-91 (2d Cir. 1992) (court allowed for rejection of collective bargaining agreement and allowed the union to accept the debtor’s last offer which had previously been rejected); *Northwest Airlines Corp.*, 346 B.R. 331-32 (allowing debtor to reject collective bargaining agreement and authorizing debtor to implement terms of a specific proposal which had been rejected by the union’s membership).

unilaterally implement changes following the successful rejection of a collective bargaining agreement. This oversight further fuels the anxiety caused by section 1113. The courts that have attempted to fill this gap have all found that in the event that a collective bargaining agreement is rejected, the debtor can unilaterally impose new terms, even terms had previously been rejected by union representatives or members.¹²⁰ This drastic course produces materially different terms and working conditions that can only further erode labor relations.¹²¹

3. Standard of Proof for Motions Under Section 1113

Section 1113 has been interpreted to require the showing of the following nine elements:

- 1) The debtor in possession made a proposal to the union to modify the collective bargaining agreement;
- 2) The proposal was based on the most complete and reliable information available at the time of the proposal;
- 3) The proposed modifications were necessary to permit the reorganization of the debtor;
- 4) The proposed modifications assured that all creditors, the debtor and all of the affected parties are treated fairly and equitably;
- 5) The debtor provided to the union such relevant information as is necessary to evaluate the proposal. (This requirement is very similar to the second requirement, although somewhat different. The second requirement dictates that the proposal be based on certain information and the fifth requirement requires the debtor to provide that information to the union);
- 6) Between the time of the making of the proposal and the time of the hearing on approval of the rejection of the existing collective bargaining agreement, the debtor met at reasonable times with the union;
- 7) At the meetings, the debtor conferred in good faith in attempting to reach mutually satisfactory modifications of the collective bargaining agreement;
- 8) The union refused to accept the proposal without good cause; and
- 9) The balance of the equities clearly favors rejection of the collective bargaining agreement.¹²²

¹²⁰ See *id.*

¹²¹ See *Northwest Airlines Corp.*, 346 B.R. at 314.

¹²² Collectively, the “*American Provision Test.*” See *In re American Provision Co.*, 44 B.R. 907, 909 (Bankr. D. Minn. 1984).

Section 1113 sets up a three-step process to encourage collective bargaining.¹²³ The process is well explained by the bankruptcy court in *In the Matter of K & B Mounting, Inc.*¹²⁴:

The first stage is the mandatory proposal by the debtor to the union. The debtor is obligated to make a proposal for modification of the labor contract to the collective bargaining representative after filing the Chapter 11 petition but before seeking court approval for rejection of the labor contract

The second step or stage of this process occurs in the interval between the presentation of the proposal to the union and the judicial hearing on the application for rejection. During that period the debtor must engage in good faith negotiations with the union, pursuant to the requirement of 11 U.S.C. § 1113(b)(2)

[A] union probably has good cause to reject “any proposal that is not necessary for the reorganization of the debtor or that unfairly burdens the unionized workers relative to other parties.”

The final stage is the debtor’s filing for court approval of rejection of the labor agreement. Although the application for rejection may be filed at any time after the proposal is made, there must be evidence of good faith negotiations with the union before the debtor turns to the court. It must be kept in mind that one of the main purposes of the new Code section is to encourage solution of the employer’s labor problems through collective bargaining rather than by means of the debtor’s unilateral action and recourse to the bankruptcy court.¹²⁵

In re American Provision Co. was the first case to address section 1113. The court noted that section 1113 does not establish which party bears the burden of proof.¹²⁶ In concluding that the debtor bore the burden of proof, the court then selected the preponderance-of-the-evidence standard of proof without explanation.¹²⁷ Though few subsequent rulings have addressed this issue, there exist bankruptcy courts that have similarly adopted this standard without explanation.¹²⁸

¹²³ See Richard H. Gibson, *The New Law on Rejection of Collective Bargaining Agreements in Chapter 11: An Analysis of 11 U.S.C. § 1113*, 58 AM. BANKR. L.J. 325, 328 (1984).

¹²⁴ 50 B.R. 460 (Bankr. N.D. Ind. 1985).

¹²⁵ See *id.* at 464-65 (citations omitted).

¹²⁶ See *American Provision Co.*, 44 B.R. at 909.

¹²⁷ See *id.*

¹²⁸ See, e.g., *In re Garofalo’s Finer Foods, Inc.*, 117 B.R. 363, 370 (Bankr. N.D. Ill. 1990) (“The [d]ebtor has the burden of proof with respect to all nine elements and must demonstrate each element by a preponderance of the evidence.”) (incorrectly citing *Matter of Walway Co.*, 69 B.R. 967 (Bankr. E.D. Mich. 1987) for support).

Judge Stanley B. Bernstein advocated that the preponderance standard could be applied for the showing of elements one through eight of the *American Provision Test*, but relied on the language of section 1113 to explain that since “debtor’s counsel has the burden of proving that the balance of the equities *clearly favors* rejection, [a showing of this element by a preponderance of the evidence would] not be sufficient.”¹²⁹ Various bankruptcy courts follow this reasoning.¹³⁰

The recent chapter 11 filings of Northwest Airlines,¹³¹ Delta Air Lines¹³² and Mesaba Aviation¹³³ presented bankruptcy courts in the Second and Eighth Circuits the opportunity to clarify the applicable standard of proof under section 1113. However, all three bankruptcy courts chose not to do so. Consequently, the issue remains unresolved.

Ultimately, few bankruptcy courts address this issue. Those that deny the request tend to find that the evidentiary showing was below even the lowest standard of proof that could be applicable, and those that grant the request tend to find that the evidentiary showing was above even the highest standard of proof that could be applicable. The only rulings directly commenting on the issue are all over 15 years old. The courts selecting the preponderance of evidence standard tend to offer no justification for this selection, and *Garofalo’s Finer Foods* relies on a case which actually disagrees with its conclusion.¹³⁴ Courts opting for the clear-and-convincing standard of proof tend to rely on the language of the section, though none address the issue of whether Congress would have intended two different standards of proof to apply as to evidence being proffered under the same subsection and as to the same request for relief.

¹²⁹ See S.B. Bernstein, *Bankruptcy Practice After the Amendments Act of 1984* (PEC 1984); see also *K & B Mounting, Inc.*, 50 B.R. at 467 (approvingly citing Bernstein in dicta).

¹³⁰ See *Walway Co.*, 69 B.R. at 974 (relying on the language of section 1113 to find that the debtor is required to prove by clear-and-convincing evidence that the equities balance in favor of rejection); *K & B Mounting, Inc.*, 50 B.R. at 467 (in dicta, agreeing with Judge Bernstein’s analysis and ruling that the debtor must prove elements one through eight of the *American Provision Test* by a preponderance of the evidence but has the burden of proving that the balance of the equities favored rejection by clear-and-convincing evidence).

¹³¹ 346 B.R. 307, 320-21 (Bankr. S.D.N.Y. 2006) (citing *Sheet Metal Workers’ Int’l Ass’n Local 9 v. Mile Hi Metal Sys., Inc. (In re Mile Hi Metal Sys. Inc.)*, 898 F.2d 887, 891-92 (10th Cir. 1990), which similarly fails to specify a standard of proof). However, [as to the “necessary” component of section 1113,] the *Northwest* court notes that “the evidence of record demonstrated *overwhelmingly* that the Debtors could not survive under their present labor contracts.” 346 B.R. at 322 (emphasis added). The court also speaks in terms of some elements being demonstrated with “sufficient” evidence or “ample” evidence. See 346 B.R. at 328.

¹³² 342 B.R. 685, 699 (Bankr. S.D.N.Y. 2006) (court notes at one point that the debtor has not sustained its burden as to one of the elements of section 1113, but fails to specify the applicable standard of proof).

¹³³ 341 B.R. 693, 703-04 (Bankr. D. Minn. 2006) (explaining that the debtor has the burden of persuasion but failing to specify the standard of proof).

¹³⁴ See *Garofalo’s Finer Foods*, 117 B.R. at 370.

B. Appointment of a Chapter 11 Trustee under Section 1104(a)

Pursuant to Section 1104(a) of the Bankruptcy Code, a bankruptcy court shall order the appointment of a chapter 11 trustee

(1) for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause, but not including the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; (2) if such appointment is in the interests of creditors, any equity security holders, and other interests of the estate, without regard to the number of holders of securities of the debtor or the amount of assets or liabilities of the debtor; or (3) if grounds exist to convert or dismiss the case under section 1112, but the court determines that the appointment of a trustee or an examiner is in the best interests of creditors and the estate.

11 U.S.C. § 1104. Furthermore, the United States Trustee must move for the appointment of a chapter 11 trustee “if there are reasonable grounds to suspect that current members of the governing body of the debtor, the debtor’s chief executive or chief financial officer, or members of the governing body who selected the debtor’s chief executive or chief financial officer, participated in actual fraud, dishonesty, or criminal conduct in the management of the debtor or the debtor’s public financial reporting.”¹³⁵

1. Legislative History¹³⁶

The Bankruptcy Act was the precursor to the Bankruptcy Code. Under the Bankruptcy Act, Chapter X applied to corporate reorganizations and was intended primarily for corporations with outstanding public debt or equity securities. Chapter X required the bankruptcy court to appoint a trustee upon approval of the bankruptcy petition in the event liquidated noncontingent debts in the case exceeded \$250,000.¹³⁷ If the debts were \$250,000 or less, the bankruptcy court had discretion in whether to appoint a trustee or allow the company’s management to continue on as debtor in possession. Due to management’s desire to remain in control, as noted in the

¹³⁵ 11 U.S.C. § 1104(e).

¹³⁶ In order to discern Congressional intent, courts are instructed to begin with the language of the statute. However, where the language is ambiguous and “the mind labours to discover the design of the legislature, it seizes every thing from which aid can be derived.” *United States v. Fisher*, 6 U.S. (2 Cranch) 358, 386, (1805) (Marshall, C.J.). This search will involve pre-Code practice, policy and legislative history. *See Price v. Delaware Police Federal Credit Union (In re Price)*, 370 F.3d 362, 369 (3d. Cir. 2004).

¹³⁷ Chapter X Rule 10-202(a) provided as follows: On approval of a petition, the court shall, if the indebtedness of a debtor, liquidated as to amount and not contingent as to liability, is \$250,000 or over, promptly and on its own initiative, appoint one or more trustees; if such indebtedness is less than \$250,000, the court may appoint one or more trustees or continue the debtor in possession.

Commission Report upon which much of the 1978 Bankruptcy Code was based,¹³⁸ debtors tended to wait too long to seek bankruptcy relief and this delay diminished the prospects of a successful reorganization.¹³⁹ Chapter XI of the Bankruptcy Act was intended for small, generally private, businesses.¹⁴⁰ Under Chapter XI, the debtor was generally allowed to continue in possession of the bankruptcy case.¹⁴¹

Consequently, drafting section 1104 and developing a standard for the appointment of a trustee proved to be difficult.¹⁴² Chapter X and Chapter XI of the Bankruptcy Act presented two extreme approaches. Furthermore, there was no comparable provision in current law which could have served as a reference.¹⁴³ In fashioning the new section, the Commission noted that serious abuses of the 1930s led to the rigid rules of Chapter X.¹⁴⁴ But those abuses were successfully addressed by the adoption of the securities laws and the enforcement powers given to the Securities and Exchange Commission.¹⁴⁵ Consequently, at the time of adoption and even today, the need for a reorganization is most often the result of business cycles, market forces or the honest mismanagement of a company.¹⁴⁶ The Commission noted that “the twin goals of the standard for the appointment of a trustee should be *protection of the public interest and the interests of creditors . . .* and the facilitation of a reorganization that will benefit both the creditor and the debtors”¹⁴⁷ The Commission determined that the most reasonable course in achieving this end was allowing for the appointment of a trustee to be at the discretion of a bankruptcy judge with general guidance by the Bankruptcy Code.¹⁴⁸

Subsequent changes to the section were made in 1986, 1994 and 2005, but none of these changes altered the substance of the provision and no legislative history for these amendments addresses the applicable standard of proof.

¹³⁸ As noted in footnote 90, *supra*, the drafting of the 1978 Bankruptcy Code began with the establishment of the National Bankruptcy Review Commission which produced the Commission Report in 1973.

¹³⁹ Commission Report, pt. I, 190-91; *see also* H.R. Rep. No. 595, 95th Cong., 1st Sess. 232 (1977) (“current law, in Chapter X, requires the appointment of a trustee in [essentially] every case; chapter XI [for all intents and purposes] never permits appointment of a trustee.”).

¹⁴⁰ *See* H.R. Rep. No. 95-595, at 233 (1977) (hereinafter, House Report on Section 1104).

¹⁴¹ *See id.*

¹⁴² *See id.* at 232.

¹⁴³ *See id.*

¹⁴⁴ *See id.* at 233.

¹⁴⁵ *See id.*

¹⁴⁶ *See id.*

¹⁴⁷ *Id.* at 232 (emphasis added).

¹⁴⁸ *See id.*

2. Explanation and Effect of Section 1104

The Commission realized that the goals of section 1104 were best effected by creating a scheme which more closely resembled that found in Chapter XI of the Bankruptcy Act. Indeed, the Commission chose to adopt a policy of “flexibility, in place of the absolute rules . . . contained in Chapter X and [allow the courts to make a] determination of the needs of each case on the facts of the case.”¹⁴⁹ Indeed, the Commission acknowledged that “very often . . . creditors [of a debtor] will be benefited by continuation of the debtor in possession”¹⁵⁰ Furthermore, as the Commission noted, “though instruction is provided in section 1104, it may be difficult . . . to [draft section 1104 to] determine the precise contours of the standard [for appointment], because in any particular case, the projection of the cost of the protection afforded by a trustee will be uncertain. However, a case law will quickly develop defining the circumstances in which a trustee should be appointed.”¹⁵¹

Picking up on the clear intent of the legislature, courts have ruled that the appointment of a trustee is an extraordinary and disfavored remedy which should be considered a last resort.¹⁵² A strong presumption exists that the debtor in possession should be permitted to remain in control of its chapter 11 case.¹⁵³ This presumption exists because, based on its familiarity with the business, “current management is generally best suited to orchestrate the process of rehabilitation for the benefit of creditors and other interests of the estate.”¹⁵⁴ The import of this justification cannot be overstated. Indeed, for debtors in possession that represent complex, highly sophisticated corporate enterprises, the proposition that a trustee¹⁵⁵ could be appointed and run a sprawling, multi-national business without any familiarity of that company is an anathema – a curse on the debtor’s creditors, shareholders and employees. Furthermore, the trustee and her professionals would require a significant amount of time to familiarize themselves with the business before any meaningful reorganization effort could begin.¹⁵⁶ The additional cost of this education could potentially be staggering and threaten the debtor’s successful reorganization. Finally, if appointment of a trustee were not considered an extraordinary remedy, there exists the risk that managers and officers of a troubled company would resist filing a petition under chapter 11 out of fear of losing control of the company; the

¹⁴⁹ See *id.* at 233.

¹⁵⁰ *Id.*

¹⁵¹ See *id.* at 234.

¹⁵² See, e.g., *In re Marvel Entm’t Group Inc.*, 140 F.3d 463, 471 (3d Cir. 1998); *In re Sharon Steel Corp.*, 871 F.2d 1217, 1225-26 (3d Cir. 1989); Official Comm. of Asbestos Personal Injury Claimants & Official Comm. of Asbestos Property Damage Claimants v. Sealed Aire Corp. (*In re W.R. Grace & Co.*), 285 B.R. 148, 158 (Bankr. D. Del. 2002).

¹⁵³ See *Marvel Entm’t Group*, 140 F.3d at 471.

¹⁵⁴ *Id.* (quoting *In re V. Savino Oil & Heating Co.*, 99 B.R. 518, 524 (Bankr. E.D.N.Y. 1989)).

¹⁵⁵ Although the trustee must be a “disinterested person,” there is no requirement that the trustee be an individual. Section 101 defines the term “person” to include individuals, partnerships and corporations.

¹⁵⁶ See House Report on Section 1104, at 233.

Commission decided that this phenomenon (that existed under Chapter X) should not be promulgated as it served to disadvantage all constituencies.¹⁵⁷

3. Standard of Proof for Motions Under Section 1104

The vast majority of courts which have addressed requests for relief under section 1104 have ruled that a party moving for the appointment of a trustee bears the burden of making the necessary showing by clear-and-convincing evidence.¹⁵⁸ However, in adopting the clear-and-convincing standard of proof, none of these courts provides a reasoned justification; that is not to say that one does not exist, but, unfortunately, one is not propounded. Rather, in adopting the heightened standard of proof, these courts note that there is a strong presumption against appointment of a trustee and appointment of a trustee is an extraordinary remedy. Unfortunately, no explanation supporting this rationale is provided. Instead, in support of this result, the courts tend to cite a long list of other courts which have advocated such action. However, tracing this line of cases leads to an unfortunate dead end.

Indeed, the Third Circuit Court of Appeals in both the *Marvel* and *G-I Holdings* cases cites to *Sharon Steel* – another Third Circuit case – for support. *Sharon Steel* provides no explanation and, instead, merely cites to *In re Clinton Centrifuge*,¹⁵⁹ *In re Paolino*¹⁶⁰ and *In re General Oil Distributors, Inc.*¹⁶¹ This apparent fountainhead of cases fails to provide justification for the application of the heightened standard of proof. *Clinton Centrifuge* cites back to *Paolino* and *General Oil*. *Paolino* exclusively cites *General Oil*. *General Oil* cites to *In re Tyler*¹⁶² and *In the Matter of Liberal Market*.¹⁶³ *Tyler* provides no explanation or citation for its choice. *Liberal Market* provides no citation but explains, without any justification, that “there

¹⁵⁷ See *id.* at 233-34.

¹⁵⁸ See *Marvel Entm't Group.*, 140 F.3d at 471; *In re Sharon Steel Corp.*, 871 F.2d 1217, 1226 (3d Cir. 1989); see also *In re Adelphia Commc'ns Corp.*, 336 B.R. 610, 655-56 (Bankr. S.D.N.Y. 2006); *In re Sanders*, 2000 WL 329574, at *2 (Bankr. N.D. Ill. March 2, 2000) (citing *In re Bellevue Place Assocs.*, 171 B.R. 615, 623 (Bankr. N.D. Ill. 1994)); *In re Nautilus of N.M. Inc.*, 83 B.R. 784, 788 (Bankr. D.N.M. 1988); *In re William A. Smith Constr. Co.*, 77 B.R. 124, 126 (Bankr. N.D. Ohio 1987). But see *Tradex*, 339 B.R. at 830-31 (finding that a preponderance-of-the-evidence standard is more appropriate as Congress failed to specify a heightened standard of proof in the Bankruptcy Code); *Altman*, 230 B.R. at 16-17 (ruling that “a preponderance-of-the-evidence standard is the requisite burden of proof in bankruptcy litigation . . .” and only express congressional direction could overcome this).

¹⁵⁹ 85 B.R. 980, 984 (Bankr. E.D. Pa. 1988).

¹⁶⁰ 53 B.R. 399, 401 (Bankr. E.D. Pa. 1985).

¹⁶¹ 42 B.R. 402, 408 (Bankr. E.D.N.Y. 1984).

¹⁶² 18 B.R. 574, 577 (Bankr. Fla. 1982) (no citation or explanation).

¹⁶³ 13 B.R. 748, 751 (Bankr. Ohio 1981) (“this Court concurs with the findings that there must be clear-and-convincing evidence to exercise an ‘extra-ordinary remedy’.”).

must be clear and convincing evidence to exercise an ‘extra-ordinary remedy.’”¹⁶⁴ Following other lines of cases leads to similar dead ends.¹⁶⁵

C. Preference Action Under Section 547

To those unfamiliar with bankruptcy law, section 547 represents one of the more confusing provisions. The section allows a debtor in possession, under certain specific circumstances, to recover a valid payment made to a creditor shortly before the filing of the bankruptcy petition. Though this action would appear inequitable, at its core, preference liability is premised upon “the prime bankruptcy policy of equality of distribution among creditors of the debtor.”¹⁶⁶ Creditors that receive payment, even on valid invoices, at a time when the debtor is already insolvent have been improperly preferred to the detriment of creditors who did not receive payment. Section 547 serves to correct this failure and provides:

(b) Except as provided in subsections (c) and (i) of this section, the trustee may avoid any transfer of an interest of the debtor in property – (1) to or for the benefit of a creditor; (2) for or on account of an antecedent debt owed by the debtor before such transfer was made; (3) made while the debtor was insolvent¹⁶⁷; (4) made – (A) on or within 90 days before the date of the filing of the petition; or (B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and (5) that enables such creditor to receive more than such creditor would receive if – (A) the case

¹⁶⁴ See *id.*

¹⁶⁵ Indeed, *In re Sanders*, 2000 WL 329574, at *3 (Bankr. N.D. Ill. March 2, 2000) provides no insight and merely cites to *In re Bellevue Place Assocs.*, 171 B.R. 615, 623 (Bankr. N.D. Ill. 1994) and *In re Madison Mgmt. Group, Inc.*, 137 B.R. 275, 281 (Bankr. N.D. Ill. 1992). *Bellevue Place* provides no explanation and cites to *Madison Mgmt.*, 137 B.R. at 280, *In re Cardinal Indus., Inc.*, 109 B.R. 755, 765 (Bankr. S.D. Ohio 1990), and *In re Ionosphere Clubs, Inc.*, 113 B.R. 164, 167 (Bankr. S.D.N.Y. 1990). *Madison Mgmt.* provides no explanation and merely cites to *In re PMH Corp.*, 116 B.R. 644, 646 (Bankr. N.D. Ind. 1989)). *PMH* provides no explanation but cites to *Sharon Steel*. *In re Cardinal Indus.* provides no explanation and merely cites to *Liberal Market*. *In re Ionosphere Clubs* provides no explanation and merely cites to *In re Evans*, 48 B.R. 46, 47 (Bankr. W.D. Tex. 1985) and *In re Tyler*. *In re Evans* similarly provides no explanation and merely cites to *Tyler*. *In re Rivermeadows Assocs., Ltd.*, 185 BR 615, 617 (Bankr. Wyo. 1995), notes that appointment of a trustee is an extraordinary step and then cites to *In re Colorado-Ute Elec. Ass’n, Inc.*, 120 B.R. 164, 173 (Bankr. D. Colo. 1990) which also notes that appointment of a trustee is an extraordinary step before citing to *Evans*. Furthermore, some courts rely on Collier on Bankruptcy (5 COLLIER ON BANKRUPTCY ¶1104.01, 1104-20 (15th ed. 1988)) as justification for their action. See, e.g., *Sharon Steel*, 871 F.2d at 1226; *Cajun Elec. Power*, 69 F.3d at 749. Collier justifies the application of a heightened standard by noting that courts that follow this application recognize that appointment of a trustee is an extraordinary remedy. Collier cites to some of the cases addressed above as well as *In re St. Louis Globe-Democrat, Inc.*, 63 B.R. 131, 138 (Bankr. E.D. Mo. 1985) (no explanation provided), *In re Evans*, 48 B.R. at 47 (no explanation, cites to *Tyler*) and *In re F.A. Potts & Co.*, 20 B.R. 3, 5 (Bankr. E.D. Pa. 1981) (focusing on fraud aspect to appointment determination). These cases are similarly unhelpful.

¹⁶⁶ H.R. Rep. No. 95-595, pt. 1, at 177-78 (1977).

¹⁶⁷ This element is presumed during the relevant preference period.

were a case under chapter 7 of this title; (B) the transfer had not been made; and (C) such creditor received payment of such debt to the extent provided by the provisions of this title.

Subsections 547(c) and (i) list certain transfers which a debtor in possession may not avoid, including those where: (a) the debtor and the transferee intended for a contemporaneous exchange and such an exchange was substantially achieved; and (b) the transfer was made in the ordinary course of business or financial affairs of the debtor and the transfer was made according to ordinary business terms.

1. Legislative History

The concepts underlying section 547 date back to early English law.¹⁶⁸ In the 16th Century, the King's Bench introduced the idea of a pro rata distribution among creditors and the need to seize preference payments in order to achieve such a distribution.¹⁶⁹ An uneven distribution among creditors was the result of the preference payment and that is what England's bankruptcy law sought to avoid.¹⁷⁰ The debtor's intent in preferring one creditor over another and the transferees knowledge of this intent were ultimately deemed irrelevant, and the law did not require a showing as to either issue.¹⁷¹ The law did focus on when the transfer was made. For centuries, the look-back period hovered around three months prior to the bankruptcy filing but was expanded to six months in 1947.¹⁷²

U.S. bankruptcy law closely resembled English bankruptcy law as to preferences but came in various iterations prior to the Bankruptcy Act.¹⁷³ One significant difference was that U.S. bankruptcy law, depending on the point in time, required some sort of determination regarding the state of mind of the debtor, the transferee-creditor or both.¹⁷⁴ U.S. law also required the trustee to show that the creditor had reasonable cause to believe that the debtor was insolvent.¹⁷⁵

¹⁶⁸ See Vern Countryman, *The Concept of a Voidable Preference in Bankruptcy*, 38 VAND. L. REV. 713, 714 (1985).

¹⁶⁹ See *The Case of the Bankrupts*, 36 Eng. Rep. 441, 473 (K.B. 1584) (explaining that the law provided for disposition among creditors so that everyone receives "a portion, rate and rate alike, according to the quantity of their debts . . . [And] if, after the debtor became a bankrupt, he may prefer one [creditor] . . . and defeat and defraud many other poor men of their true debts . . . it would be a great defect in the law").

¹⁷⁰ See Countryman, *supra* note 168, at 716-17.

¹⁷¹ See *id.*

¹⁷² See *id.* at 717-18.

¹⁷³ See *id.* at 719-23. The basic elements of a preference action appeared in Sections 60a and b of the former Bankruptcy Act of 1898.

¹⁷⁴ See *id.*; see also Commission Report, H.R. Doc. No. 93-137, pt. 1, at 202-03 (1973).

¹⁷⁵ See Commission Report, at 202-04.

Ultimately, in drafting the Bankruptcy Act, the legislature realized that none of these requirements honored the purpose of the preference laws.¹⁷⁶ The harm of the preference is realized by the act itself. The Commission Report which accompanied the 1978 Bankruptcy Code explained that the purpose of the preference section is two-fold:

First, by permitting the trustee to avoid prebankruptcy transfers that occur within a short period before bankruptcy, creditors are discouraged from racing to the courthouse to dismember the debtor during his slide into bankruptcy. The protection thus afforded the debtor often enables him to work his way out of a difficult financial situation through cooperation with all of his creditors. Second, and more important, the preference provisions facilitate the prime bankruptcy policy of equality of distribution among creditors of the debtor.¹⁷⁷

The Commission further explained that certain impediments affect the proper functioning of these policies.¹⁷⁸ Namely, the law required the bankruptcy trustee to prove that the debtor was insolvent at the time of the transfer. This often proved difficult due to the fact that debtors' books and records were rarely properly maintained. Further, debtors were rarely ever solvent in the three months leading up to a bankruptcy filing. Consequently, the Commission determined that the law "require[d] the trustee to prove a fact that nearly always exist[ed] yet never [could] be prove[n] with certainty."¹⁷⁹ Failure to successfully prosecute preference actions undermined the goal of the provision. Another obstacle was the requirement that the trustee had to show that the "creditor for whose benefit the preferential transfer was made had 'reasonable cause to believe the debtor was insolvent at the time of the transfer.'"¹⁸⁰ The Commission explained that "the creditor's state of mind has nothing whatsoever to do with the policy of equality of distribution and whether or not he knows of the debtor's insolvency does little to comfort other creditors similarly situated who will receive that much less from the debtor's estate as a result of the prebankruptcy transfer to the preferred creditor."¹⁸¹ Further, proving this element was extremely difficult and similarly led to many failed preference actions, which, as noted above, undermined the goal of the provision. Consequently, the Commission recommended the removal of these two aspects of the law.¹⁸²

Many of the Commission's recommendations found their way into section 547, as enacted in 1978. The legislative history on the section provides a detailed explanation of the

¹⁷⁶ See Countryman, *supra* note 168, at 725.

¹⁷⁷ Commission Report, at 177-78.

¹⁷⁸ See *id.* at 178.

¹⁷⁹ See *id.*

¹⁸⁰ *Id.* (citing §60(b), 11 U.S.C. 96(b) (1970)).

¹⁸¹ *Id.* at 178.

¹⁸² As noted above, the legislative history of the 1984 Bankruptcy Code is meager. Furthermore, subsequent amendments to section 547 have not altered the core aspects of the section or been accompanied by any judiciary committee reports.

application of the preference recovery mechanism but contains no other information that would otherwise be pertinent in evaluating the proper standard of proof. The 1984 Amendments made a variety of changes to section 547, including the addition of section 547(g) which provides that the debtor in possession has the burden of proving the avoidability of a transfer. However, section 547(g) fails to specify a standard of proof and none of the other changes altered the substance of the provision. Further, as noted above, no committee or conference reports were produced and no floor statements shed light on the issues relevant to this article. Subsequent changes to the section were made in 1994 and 2005, but none of these changes altered the substance of the section and no legislative history for these amendments addresses the applicable standard of proof.

2. Effect and Explanation of Section 547

One of the primary assets of any bankruptcy estate are preference causes of action. As noted above, the preference provisions are necessary in order to achieve an equitable distribution among creditors. Without these provisions, “there would be a scramble among the most diligent creditors, those with inside information and those with the greatest leverage over the debtor to obtain payment immediately before an impending bankruptcy, which would frequently leave nothing for the less favored creditors.”¹⁸³ Further, without this provision, “the estate available for distribution to creditors in the bankruptcy proceedings could be seriously depleted (or perhaps eliminated)”¹⁸⁴ Section 547 affords debtors in possession the ability to take action which would be unimaginable outside of bankruptcy. The section is intentionally broad, encompassing a wide array of direct and indirect¹⁸⁵ transfers which include payment of money, as well as creation of a lien, retention of title as a security interest, foreclosure of a debtor’s equity of redemption, judicial liens and other disposition of property or interests in property.¹⁸⁶ Ultimately, the reach of the section is to be “as broad as possible.”¹⁸⁷ Further, the reach-back period is considerable: 90 days from the petition date for non-insiders and up to one year for insiders. As noted above, in fashioning section 547, the legislature intended to remove many of the evidentiary requirements that had frustrated preference recovery attempts under the Bankruptcy Act. However, an allegedly preferred creditor still has many defenses to a preference claim.¹⁸⁸

¹⁸³ Commission Report, at 19.

¹⁸⁴ *Id.* at 19

¹⁸⁵ A simple example of a direct transfer is a payment of cash to a creditor on an antecedent debt. An example of an indirect transfer is where a debtors “transfer[s] . . . collateral to a bank to secure a letter of credit issued for the benefit of a creditor to satisfy an antecedent obligation of the debtor to the creditor” 5 COLLIER ON BANKRUPTCY ¶547.03[1][a] (15th ed. 1993), at 547-16.

¹⁸⁶ *See* 11 U.S.C. § 101.

¹⁸⁷ S. Rep. No. 95-989, at 27 (1978)

¹⁸⁸ *See* 11 U.S.C. § 547(c).

3. Standard of Proof Under Section 547

The case law on this issue suffers from a familiar defect: a standard of proof is propounded but the application is not explained or justified and the case law cited for its precedential value similarly fails to offer an explanation regarding the choice.

The case law supporting the application of a heightened standard of proof is scant. *In re Service Bolt & Nut Co., Inc.*¹⁸⁹ and *In re Cleveland Graphic Reproduction, Inc.*¹⁹⁰ both unequivocally rule that the party seeking to avoid a transfer must establish the necessary¹⁹¹ elements of section 547(b) by clear-and-convincing evidence. Neither case offers any explanation justifying this aspect of the ruling nor are any cases cited in support.¹⁹²

On the other end, a number of circuit courts have addressed this issue and found the preponderance-of-the-evidence standard to be appropriate. Most recently, the Tenth Circuit Court of Appeals in *In re Robinson Bros. Drilling, Inc.*¹⁹³ ruled that “a trustee seeking to avoid an allegedly preferential transfer under § 547(b) ‘has the burden of proving by a preponderance of the evidence every essential, controverted element resulting in the preference.’”¹⁹⁴ The court cited to *Collier on Bankruptcy*¹⁹⁵ and *Sloan v. Zions First Nat’l Bank (In re Castletons, Inc.)*.¹⁹⁶ *Collier on Bankruptcy* provides that the burden of proof in preference avoidance actions is preponderance of the evidence but fails to explain this position or cite to any supporting case law. *Castletons* does not advocate the preponderance-of-the-evidence standard and is silent on the issue. In *In the Matter of John B. Prescott*,¹⁹⁷ the Seventh Circuit Court of Appeals advocated the use of the preponderance standard and cited two cases outside their circuit: *In re The Music House, Inc.*¹⁹⁸ and *In re Hogg*.¹⁹⁹ *Music House* offers no explanation and merely cites to *Collier on Bankruptcy*. *Hogg* simply cites to *In re Gruber Bottling Works, Inc.*²⁰⁰ *Gruber*

¹⁸⁹ 97 B.R. 892, 893 (Bankr. N.D. Ohio 1989) (“[t]he burden of proof in a preference action is upon the party seeking to avoid the transfer. In the matter at bar, The [sic] Trustee has that burden, which must be met by clear and convincing evidence.”).

¹⁹⁰ 78 B.R. 819, 822 (Bankr. N.D. Ohio 1987) (“the burden of persuasion as to all five elements [of 547(b)] is to be borne by the debtor. That burden is to be carried by clear and convincing evidence.”)

¹⁹¹ As noted above, the insolvency requirement of section 547(b)(3) is presumed during the relevant preference period.

¹⁹² See also *In re Georgia Scale Co., Inc.*, 1989 WL 1113437, at *1 (Bankr. S.D. Ga. June 30, 1989).

¹⁹³ 6 F.3d 701, 703 (10th Cir. 1993)

¹⁹⁴ *Id.* at 703 (citing 4 COLLIER ON BANKRUPTCY ¶ 547.21[5] at 547-93 (15th ed. 1993) and *Sloan v. Zions First Nat’l Bank (In re Castletons, Inc.)*, 990 F.2d 551, 555 (10th Cir. 1993)).

¹⁹⁵ 4 COLLIER ON BANKRUPTCY ¶ 547.21[5] at 547-93 (15th ed. 1993).

¹⁹⁶ 990 F.2d 551, 555 (10th Cir. 1993).

¹⁹⁷ 805 F.2d 719, 726 (7th Cir. 1986).

¹⁹⁸ 11 B.R. 139, 140 (Bankr D. Vt. 1980).

¹⁹⁹ 35 B.R. 292, 294 (Bankr. S.D. 1983).

²⁰⁰ 16 B.R. 348, 351 (Bankr. E.D. Pa. 1982).

cites to two cases,²⁰¹ neither of which support the application of the preponderance-of-the-evidence standard of proof in this instance. Following other lines of cases leads to similar dead ends.²⁰²

IV. THE APPROPRIATE STANDARD OF PROOF FOR SOME KEY FORMS OF BANKRUPTCY RELIEF

As noted above, “Chapter 11 is not merely business as usual but an extremely serious process that can lead to liquidation and the loss of the jobs of all the debtor’s employees as well as of the creditors’ opportunity for any meaningful recovery.”²⁰³ “The fundamental purpose of reorganization is to prevent a debtor from going into liquidation with an attendant loss of jobs and possible misuse of economic resources.”²⁰⁴ Naturally, there are some actions and forms of relief which are more likely to precipitate these dire consequences and those matters deserve deference. I have selected three fundamental forms of bankruptcy relief and attempted to determine if they fall into this subcategory of protected relief that warrant application of the clear-and-convincing standard of proof. The information contained in Section III above coupled with a coextensive application of the precepts propounded by the Supreme Court in *Grogan v. Garner*, *Addington v. Texas* and *Herman & MacLean v. Huddleston* and use of the graphical chart found in Section II.C will facilitate this determination.

A. Rejection of a Collective Bargaining Agreement Under Section 1113

Few bankruptcy courts have addressed which standard of proof should be applied to motions under section 1113. Those that have addressed the issue are all over 15 years old. Unfortunately, most of the cases offer no explanation regarding their respective choice.

1. Congressional Directive

The Supreme Court in *Bildisco* acknowledged that collective bargaining agreements are of a special nature and explained that “a somewhat stricter standard should govern the decision

²⁰¹ See *In re Denaburg*, 7 B.R. 274, 275 (Bankr. N.D. Ala. 1980); *Mizell v. Phillips*, 240 F.2d 738, 740 (5th Cir. 1957).

²⁰² *In re Meritt*, 7 B.R. 876, 879 (Bankr. Mo. 1980), and *In re The Music House, Inc.*, 11 B.R. 139, 140 (Bankr. Vt. 1980), are two early cases to address the issue and both explain that “[t]he law places upon the trustee the unmistakable burden of proving by a fair preponderance of all the evidence” the necessary elements of section 547(b). Both cases cite to *Collier on Bankruptcy* to support this position and *Meritt* additionally cites to *Barry v. Crancer*, 192 F.2d 939 (8th Cir. 1951). However, *Crancer* does not advocate the use of the preponderance-of-the-evidence standard of proof. *In re Smith’s Home Furnishings, Inc.*, 265 F.3d 959, 967 (9th Cir. 2001) does not explicitly support the application of the preponderance-of-the-evidence standard of proof but cites to *In re Robinson Bros. Drilling, Inc.* and quotes language which does advocate the use of the preponderance standard. Several cases cite to *Mizell*, 240 F.2d at 740-41, but, as noted above, *Mizell* is silent as to the standard of proof.

²⁰³ *In re Northwest Airlines Corp.*, 346 B.R. 307, 314 (Bankr. S.D.N.Y. 2006).

²⁰⁴ *N.L.R.B. v. Bildisco & Bildisco*, 465 U.S. 513, 528 (1984).

of the Bankruptcy Court to allow rejection of a collective bargaining agreement.”²⁰⁵ The Congressional response to the *Bildisco* ruling underscores the fact that collective bargaining agreements are unique.²⁰⁶ In fact, treatment of these agreements warranted a separate code provision. The consequences of a premature rejection of these agreements is apparent in the language of the section. The overarching requirements of section 1113 appear in subsection (c),²⁰⁷ and the subsection is described as the crux of any rejection analysis. The subsection mandates that “the balance of the equities [must] *clearly* favor[] rejection of [a collective bargaining agreement].”²⁰⁸ The use of the word “clearly” has been construed to be a Congressional mandate for the clear-and-convincing standard of proof.²⁰⁹

2. Individual Rights at Stake

The typical individual rights that the Supreme Court has found warrant application of heightened standards of proof in civil disputes are not at stake under section 1113.

3. Interests at Stake

The interests at stake in a section 1113 motion are extremely unique. As noted above, the legislative response to *Bildisco* acknowledges this fact. The process established by section 1113 “honors the purpose of reorganization without ignoring the interests of any creditor, employee, or debtor.”²¹⁰ Section 1113 affects the fundamental relationship between business and organized labor and implicates the interests of companies and their individual employees, as well as communities and cities. The dispute over a rejection of a collective bargaining agreement is the antithesis of a simple two-party dispute. The parties affected are varied and numerous. The language of section 1113 affords the bankruptcy court judge wide latitude, but the language of the section when considered with the attendant consequences of a unjustified rejection

²⁰⁵ *Bildisco*, 465 U.S. at 524.

²⁰⁶ As fully explored in Section III.A, *supra*.

²⁰⁷ Section 1113(c) provides that “[t]he court shall approve an application for rejection of a collective bargaining agreement only if the court finds that – (1) the trustee has, prior to the hearing, made a proposal that fulfills the requirements of subsection (b)(1); (2) the authorized representative of the employees has refused to accept such proposal without good cause; and (3) the balance of the equities clearly favors rejection of such agreement.”

²⁰⁸ Emphasis added.

²⁰⁹ *See* Bernstein, *supra* note 129; *Walway Co.*, 69 B.R. at 974 (relying on the language of section 1113 to find that the debtor is required to prove by clear-and-convincing evidence that the equities balance in favor or rejection); *K & B Mounting, Inc.*, 50 B.R. at 467 (approvingly citing Bernstein in dicta). However, it could be argued that Congress has explicitly required the use of the clear-and-convincing standard of proof in various sections of the Bankruptcy Code, see footnote 47, *supra*, so its failure to specifically refer to the heightened standard of proof in section 1113 indicates that the modifier serves another purpose.

²¹⁰ Statement by the Hon. Orrin G. Hatch, a ranking member of the senate committee on the judiciary and a senate conferee, on H.R. 5174, 130 Cong. Rec. S. 8891, June 29, 1984; *see also* Statement by the Hon. Strom Thurmond, Chairman of the Senate Committee on the Judiciary, upon consideration of the Conference Report on H.R. 5174, 130 Cong. Rec. S. 8887, June 29, 1984 (explaining that the phrase “all of the affected parties” found in section 1113 “is intended to encompass those parties directly affected [and] clearly includes . . . all nonunion employees of the debtor, whose interests should be as carefully considered by the court as those of any union employees”).

acknowledges an imbalance in disutility. Indeed, the disutility of a bankruptcy court allowing for a premature and poorly justified rejection of a collective bargaining agreement far outweighs the disutility of preventing a justifiable rejection and forcing additional negotiations between the parties. Further, rejection of a collective bargaining agreement implicates society's interest; premature, unjustified rejection of a collective bargaining agreement threatens jobs and serves to erode labor relations which negatively effect businesses and the communities in which they operate.

4. Balance of Interests

Section 1113 was a response to the *Bildisco* ruling. As noted above, the ruling “placed the continued viability of the act of collective bargaining . . . in great doubt [and further eroded] labor’s membership and influence, and [worked to extinguish] employees’ rights which were bargained for in good faith and earned in service to the employer”²¹¹ Employers relied on the ruling and the threat of unilaterally imposed terms in fashioning a “new collective bargaining weapon.”²¹² In response, union leaders called upon Congress to pass legislation addressing the perceived inequities of *Bildisco*.²¹³ They argued that “unless [the] disgraceful and unfair situation [created by the ruling was] corrected, unscrupulous employers [would] increasingly begin to use the threat of bankruptcy to force workers to accept rewriting of their contracts to incorporate concessions in their wage levels and working conditions.”²¹⁴ Though section 1113 represents a compromise of sorts between business and organized labor, the section’s clear intent was to address the uneven bargaining power that the *Bildisco* decision afforded business. The section intended to restrict the instances where a collective bargaining agreement could be rejected and new employment terms (which had oftentimes already been explicitly rejected) unilaterally imposed. The interests of organized labor in this instance were unique and this fact is recognized by Congress’ actions and the language of section 1113. In drafting section 1113, Congress sought to provide organized labor additional protections and “stimulate collective bargaining [by limiting] the number of cases when a judge will have to authorize the rejection of a labor contract.”²¹⁵

5. Proper Standard of Proof Under My Normative Approach

In *Bildisco*, the Supreme Court acknowledged that collective bargaining agreements are of a special nature and that “a somewhat [higher] standard should govern the decision of the Bankruptcy Court to allow rejection”²¹⁶ Further, the language of section 1113 provides that “the balance of the equities *clearly* favors rejection”²¹⁷ This element of the section is the

²¹¹ See Rosenberg, *supra* note 102, at 312.

²¹² Daily Labor Report, Oct. 5, 1983, at A-6.

²¹³ See Rosenberg, *supra* note 102, at 312.

²¹⁴ Letter from the Legislative Director of the United Automobile, Aerospace & Agricultural Implement Workers of America to Members of Congress (March 9, 1984).

²¹⁵ Testimony of Sen. Packwood, 130 Cong. Rec. S. 8898 (June 29, 1984).

²¹⁶ See 465 U.S. at 524.

²¹⁷ 11 U.S.C. § 1113(c)(3) (emphasis added).

crux of any rejection analysis and application of a heightened standard of proof is arguably mandated by the language of the section.

The interests at stake in such a dispute are more substantial than a mere loss of money and involve a myriad of parties. Organized labor has a unique interest in maintaining the primary document upon which its system of industrial self-government rests. This interest is shared not only by the affected employees but communities and society as a whole. Society's interest in avoiding a premature or unjustified rejection is unquestionable and is apparent in the enactment of section 1113 and the section's legislative history. The section itself is an attempt by Congress to limit the effect of *Bildisco* and create an orderly three-step procedure to encourage collective bargaining and deter arbitrary rejection.²¹⁸ The application of the preponderance standard in this context would undermine this objective. Further, as noted above, the disutility of a bankruptcy court allowing for a premature and poorly justified rejection of a collective bargaining agreement far outweighs the disutility of preventing a justifiable rejection and forcing additional negotiations between the parties. Ultimately, section 1113 offers protection to organized labor from the uneven bargaining field that *Bildisco* created.

In light of the language of the subsection (c)(3), the interests at stake and the balance of those interests, an argument that the fundamental document upon which labor relations rest could be rejected by a preponderance of the evidence rings hollow. Ultimately, rejection of a collective bargaining agreement should only be considered after the stages of negotiation mandated by subsections (c)(1) and (c)(2) have occurred and the detailed requirements for these stages have been satisfied. Rejection of a collective bargaining agreement should only be permitted where a company seeking to reject its collective bargaining agreement is able to establish, by clear-and-convincing evidence, that the balance of the equities favors rejection.²¹⁹

B. Appointment of a Trustee Under Section 1104

As noted above, the vast majority of courts apply the clear-and-convincing standard of proof in ruling on motions seeking the appointment of a trustee under section 1104. But the explicit justification for such action is not apparent in these rulings. Some recent rulings have

²¹⁸ See Testimony of Sen. Packwood, 130 Cong. Rec. S 8898 (June 29, 1984) (“[Section 1113] overrules the 5-4 portion of the Supreme Court’s *Bildisco* decision and means that the labor contract is enforceable and binding on both parties until a court-approved rejection or modification.”).

²¹⁹ Based on *Grogan*, an argument could be made that the structure of section 1113 indicates that one standard of proof would apply to subsections 1113(c)(1), (c)(2) and (c)(3). The Court in *Grogan* noted that section 523(a) listed a number of exceptions to discharge. The Court found it clear that a preponderance of the evidence was sufficient to establish the nondischargeability of some of the types of claims covered by section 523(a). Therefore, since Congress had omitted any suggestion that different exemptions mandated different burdens of proof, “it [was] fair to infer that Congress intended the ordinary preponderance standard to govern the applicability of all the discharge exceptions.” 498 U.S. at 287-88. This argument fails to apply to section 1113 because the language of subsection (c)(3) contains a strong indication that the subsection mandates a heightened standard of proof, though the other subsections do not.

questioned this application based on an incomplete reading of *Grogan*.²²⁰ A full analysis of this issue is necessary.

1. Congressional Directive

The primary goal of section 1104 is to protect the public interest and the interest of creditors while facilitating a reorganization that will benefit both the debtor and its creditors.²²¹ The section is a response to the rigidity of Chapter X of the Bankruptcy Act which mandated the appointment of a trustee in every large-scale bankruptcy case.²²² The legislative history makes clear that the section was written to afford courts the flexibility to determine, on a case-by-case basis, when appointment of a trustee is appropriate.²²³ By doing so, the legislature believed that “a case law would quickly develop defining the circumstances in which a trustee should be appointed.”²²⁴ This language implies that the legislature willingly deferred to the courts’ discretion on significant aspects of the section 1104 analysis. The legislature failed to prescribe or indicate a standard of proof in the language of the section or in the legislative history.

2. Individual Rights at Stake

The typical individual rights that the Supreme Court has found warrant application of heightened standards of proof in civil disputes are not at stake under section 1104.

3. Interests at Stake

The interests at stake in a section 1104 motion are somewhat unique. The legislative history acknowledges this fact, explaining that the section is intended to not only protect the debtor and its employees and creditors, but also the public at large. Indeed, these disputes are not mere two-party disputes involving money. The grant or denial of a motion seeking the appointment of a trustee does not lead to a transfer of money. Rather, the motion addresses the issue of whether the retention of current management is so detrimental to the survival of the company that a new management team is necessary, even though this new team will have little, if any, familiarity with the debtor’s business operations. Section 1104 asks the factfinder to balance the equities involved in taking this drastic action. The consequences of an error by the factfinder could very well threaten the viability of the debtor, which implicates society’s interest. The disutility from improperly replacing debtor’s management with a trustee has been deemed to be far greater than the disutility of allowing those who have committed mismanagement or fraud – but are otherwise best suited to run the debtor – from continuing in their management roles.

²²⁰ See *Tradex*, 339 B.R. at 830-31 (finding that a preponderance-of-the-evidence standard is more appropriate as Congress failed to specify a heightened standard of proof in the Bankruptcy Code); *Altman*, 230 B.R. at 16-17 (ruling that “a preponderance-of-the-evidence standard is the requisite burden of proof in bankruptcy litigation . . .” and only express congressional direction could overcome this).

²²¹ See House Report on Section 1104, at 232.

²²² See *id.* at 232. Chapter X required the bankruptcy court to appoint a trustee upon approval of the bankruptcy petition in the event liquidated noncontingent debts in the case exceeded \$250,000.

²²³ See *id.* at 233.

²²⁴ See *id.* at 234.

Consideration of this issue requires the juxtaposition of the public's and creditor's interests in allowing companies to successfully reorganize with these parties' interest in preventing: (i) wrongdoers from precluding investigations into their wrongdoings through their management positions with debtors in possession; and (ii) those who commit gross mismanagement which necessitates a reorganization from continuing in power and preventing a successful reorganization. Society's interest in a successful reorganization stems from the jobs at risk and the diverse impact that a prominent company's failure has on a community. Society also has an interest in prosecuting those who commit fraud.

4. Balance of Interests

As noted above, the primary goal of section 1104 is to protect the public interest and the interest of creditors while facilitating a reorganization that will benefit both the debtor and its creditors.²²⁵ Congress sought to protect a number of parties through section 1104. However, the means of providing this potential relief under section 1104 offers greater protection to the debtor's management than they enjoyed under the Bankruptcy Act. In drafting section 1104, the legislature sought to move away from the rigid rule of Chapter X of the Bankruptcy Act. Indeed, the Committee chose to adopt a policy of "flexibility, in place of the absolute rules . . . contained in Chapter X and [allow the courts to make a] determination of the needs of each case on the facts of the case."²²⁶ On the surface, such actions appear to have benefited the debtor's management. But the intended beneficiaries of this approach are the debtor and its creditors and employees. As explained by numerous courts, the presumption that current management is best suited to guide a debtor to a successful reorganization is well founded.²²⁷ Consequently, in an effort to protect these constituencies, section 1104 moved away from the rigid rules of Chapter X and favored debtor's current management; a gap into which the courts have propounded a presumption against appointment of a trustee.

5. Proper Standard of Proof Under My Normative Approach

Though neither the statute nor the legislative history prescribe a standard of proof, an argument could be made that the legislature chose to defer to the courts' discretion in crafting the particulars of the analysis under section 1104(a); this deference could be seen as extending to the applicable standard of proof. The vast majority of courts appear to take this view and have decided, without explanation, to apply the clear-and-convincing standard of proof. The foundation supporting such a decision is not flawless but can be reconciled with Supreme Court precedent. Indeed, the interests at stake are varied and certainly more substantial than a mere loss of money. The consequences of a decisional error by the factfinder are greater than a mere misallocation of money. Further, Congress sought to protect the interests of the debtor and its employees and creditors by adopting language that moved away from the rigidity of Chapter X and decreased the likelihood that a trustee would be appointed. Though this appears to be a benefit to the debtor's management, the legislature and the courts have established that

²²⁵ See *id.* at 232.

²²⁶ *Id.* at 233.

²²⁷ See, e.g., *Marvel Entm't Group*, 140 F.3d at 471 (quoting *Savino Oil & Heating Co.*, 99 B.R. at 524).

replacement of debtor’s management is often times an anathema to a successful reorganization. The courts have acknowledged this fact and adopted a presumption against appointment of a trustee. In light of this presumption – as explained in the legislative history to section 1104 – as well as the interests at stake and the balance of these interests, parties seeking the appointment of a trustee under section 1104 should be required to make the necessary showing with clear-and-convincing evidence.

C. Preference Action Under Section 547

As noted above, few rulings address the issue of the appropriate standard of proof under a preference action. Rulings that have specified the standard of proof do so without any rationale or explanation.

1. Congressional Directive

The legislative history of section 547 is devoid of any instruction regarding the applicable standard of proof or any language indicating the need for a heightened standard of proof.

2. Individual Rights at Stake

The typical individual rights that the Supreme Court has found warrant application of heightened standards of proof in civil disputes are not at stake under section 547.

3. Interests at Stake

The preference recovery powers are a central aspect of the bankruptcy process, but individual preference actions tend to be of an insignificant value relative to the overall liabilities of a debtor and have little effect on the debtor’s ability to reorganize. In many respects, an individual preference action represents the typical two-party dispute. Naturally, a recovery by the debtor could potentially increase the recovery for other creditors, but the increase will generally be nominal. The interests at stake are no more substantial than a mere loss of money. As explored in Section I above, society’s interest in such disputes is minimal. The disutility of an error in favor of the allegedly preferred party is no worse than the disutility of an error in favor of the debtor.

4. Balance of Interests

The changes made to the preference recovery mechanism by the 1978 Bankruptcy Code sought to “facilitate the prime bankruptcy policy of equality of distribution among creditors”²²⁸ In order to accomplish this, section 547 removed many aspects of the law which proved to frustrate attempts to recover preferences.²²⁹ Since the passage of the 1978 Bankruptcy Code, Congress has modified section 547 to allow for more defenses to a preference charge. However, the core elements of the preference recovery mechanism have remained

²²⁸ Commission Report, at 177-78.

²²⁹ See Section III.C.1, *supra*.

unchanged. The primary goal of the section is to allow for the bankruptcy estate to recover payments which undermine the equality of distribution among creditors. Congress sought to protect the creditor class as a whole by disadvantaging individual creditors. The interests of an individual creditor affected by a preference action are not unique.

5. Proper Standard of Proof Under My Normative Approach

Neither the statute nor the legislative history prescribe a standard of proof for section 547's requirements. Recent case law has supported the application of the preponderance-of-the-evidence standard but fails to explain this choice. However, the application of this standard of proof is accurate. Indeed, the interests at stake in preference actions are limited. Preference actions are two-party disputes where the consequence of a decisional error by the factfinder is a mere misallocation of money. Further, in enacting section 547, Congress sought to honor the policy of equality of distribution among creditors and facilitate preference recoveries. However, the application of the clear-and-convincing standard of proof would undermine these objectives. Ultimately, a preference action has the trappings of most civil disputes that exist outside of bankruptcy. The legislative history of section 547 contains no indication that a heightened standard of proof need be applied. Therefore, in order to recover a payment made during the applicable preference period, a debtor in possession should make the necessary showing under section 547 by a preponderance of the evidence. Any creditor defense under section 547 should satisfy the same standard of proof.

V. CONCLUSION

Application of the correct standard of proof is a fundamental step in the litigation process. However, as to many key forms of bankruptcy relief, courts fail to follow a uniform procedure in determining the proper application and, not surprisingly, reach different conclusions as to which standard is applicable. The effect of this process failure is not an insignificant one. As noted repeatedly in my article and illustrated by the forms of relief I chose to explore, “[c]hapter 11 is not merely business as usual but an extremely serious process that can lead to liquidation and the loss of jobs of all the debtor’s employees as well as of the creditors’ opportunity for any meaningful recovery.”²³⁰ Distortion of accepted risk allocation schemes can alter rulings and lead to inequitable results for a staggering number of constituencies.

The lack of direction from the Supreme Court is a key factor in this process failure. Further complicating matters is a misunderstanding and misapplication of the holding of *Grogan v. Garner*. In this Article, I have attempted to address many of the puzzling aspects of this issue. In order to achieve more uniformity in the selection process for standards of proof, I have proposed a new, comprehensive normative approach to determine which standard of proof is applicable in bankruptcy disputes involving chapter 11 debtors in possession. My approach is based on a coextensive reading of applicable Supreme Court precedent and requires a consideration of the text of the bankruptcy code and the legislative history and, if necessary, the

²³⁰ *In re Northwest Airlines Corp.*, 346 B.R. 307, 314 (Bankr. S.D.N.Y. 2006).

interests at stake in the dispute. By methodically considering all these elements, courts properly honor Supreme Court precedent and legislative intent to produce more reasoned and consistent decisions on an issue that, while fundamental to our jurisprudence, is invariably misunderstood.