U.S. Department of Justice

*Washington, D.C. 20530*

September 9, 1982

MEMORANDUM

TO : The Deputy Attorney General

FROM : Tex Lezar

RE : Bankruptcy Speech Final Draft

Attached is a large-print final draft of your bankruptcy speech for the Federal Bar Association luncheon tomorrow. I have incorporated most of the suggestions that I have received -- including those forwarded for you by Bruce Fein. I have, for example, tried to diminish the tilt by inference toward Article III.

If you would let me know of any further changes you make by early tomorrow, I will have a press release copy prepared for Public Affairs.

cc: Rex Lee
Jon Rose
Ted Olson
Paul McGrath
Bob McConnell
Ken Starr
Stan Morris
John Roberts
Carolyn Kuhl
Bruce Fein
Steve Brogan

REMARKS BY THE DEPUTY ATTORNEY GENERAL
ANNUAL CONVENTION OF THE FEDERAL BAR ASSOCIATION
SEPTEMBER 10, 1982

I AM, OF COURSE, DELIGHTED TO BE HERE -- AND TO ADDRESS THE ANNUAL CONVENTION OF THE FEDERAL BAR ASSOCIATION. SPEAKING AT A LUNCHEON IS, HOWEVER, ALWAYS DANGEROUS. I CAN'T HELP RECALLING THE STORY OF A POLITICIAN WHO WAS INVITED TO SPEAK AT A BANQUET IN A SMALL TOWN. IT WAS QUITE AN OCCASION, AND EVERYONE WAS ENJOYING THE MEAL. AFTER A WHILE, THE MAYOR TURNED TO THE SPEAKER AND ASKED: "SHALL WE LET THEM ENJOY THEMSELVES A LITTLE LONGER OR HAD WE BETTER HAVE YOUR SPEECH NOW?"

MY TOPIC TODAY IS EXCEEDINGLY IMPORTANT, BUT IT IS NOT HIGH ON ANYONE'S LIST OF ENJOYABLE PASTIMES. BANKRUPTCY IS A TOPIC GUARANTEED TO MAKE THE EYES OF ANY BUT THE MOST STALWART PRACTITIONER GLAZE OVER. NEVERTHELESS, THE RECENT DECISION OF THE SUPREME COURT IN NORTHERN PIPELINE CONSTRUCTION CO. V. MARATHON PIPE LINE CO. MAKES THE TOPIC OF BANKRUPTCY -- AND THE NEED FOR REFORM -- MANDATORY.

THROUGHOUT HISTORY, BANKRUPTCY HAS BEEN, TO SAY THE LEAST, CURIOUS. UNDER EARLY ROMAN LAW, CREDITORS WHO COULD NOT OBTAIN SATISFACTION FROM A DEBTOR WERE ALLOWED TO CUT UP HIS BODY AND DIVIDE THE PIECES. RECOGNIZING THAT LAW ALWAYS DESIRES AN ALTERNATIVE, THE ROMANS ALSO ALLOWED CREDITORS TO LEAVE THE DEBTOR ALIVE AND SELL HIM INTO SLAVERY. EVEN IN THIS COUNTRY IN MORE

RECENT TIMES THE PROCEDURES OF BANKRUPTCY WERE OFTEN LESS THAN ENLIGHTENED. WELL INTO THE 19TH CENTURY, MANY DEBTORS WERE SENT TO PRISON WHEN UNABLE TO PAY EVEN TRIVIAL DEBTS. AS LATE AS 1820, NEARLY 1500 DEBTORS WERE SENT TO JAIL IN BOSTON ALONE. AS LAWRENCE FRIEDMAN RECOUNTS IN HIS A HISTORY OF AMERICAN LAW:

> "IN RHODE ISLAND, IN 1830, A WIDOW FROM PROVIDENCE WAS PUT IN JAIL FOR A DEBT OF SIXTY-EIGHT CENTS; IN 1827 AND 1828, A SICK, 67-YEAR-OLD LABORER NAMED FREEBORN HAZARD WAS KEPT IN PRISON FOR FOUR MONTHS, AND LATER RECOMMITTED FOR A DEBT OF ONE DOLLAR AND COSTS OF $3.22."

GRADUALLY, THE LAW CHANGED.

OUR CONSTITUTION GAVE CONGRESS THE POWER "TO ESTABLISH UNIFORM LAWS ON THE SUBJECT OF BANKRUPTCIES THROUGHOUT THE UNITED STATES." CONGRESS WAS, HOWEVER, SLOW TO ACT FULLY. BEFORE THE CIVIL WAR, ONLY TWO FEDERAL BANKRUPTCY ACTS WERE PASSED -- AND BOTH WERE SHORT-LIVED. THE ACT OF 1800 LASTED ONLY TWO AND ONE-HALF YEARS, AND THE ACT OF 1841 LESS THAN TWO YEARS. IN ADDITION, THE U.S. SUPREME COURT UNDER JOHN MARSHALL RULED IN 1819 THAT THE BANKRUPTCY CLAUSE OF THE CONSTITUTION DID NOT PRE-EMPT THE FIELD. HENCE, FEDERAL BANKRUPTCY LAW WAS LEFT TO COMPLEMENT STATE ENACTMENTS.

AS COMMERCE BECAME MORE NATIONAL IN DIMENSIONS, HOWEVER, THE DESIRE FOR SOME FORM OF NATIONAL UNIFORMITY GREW. THE FEDERAL BANKRUPTCY ACT OF 1898 WAS THE FIRST LASTING AND COMPREHENSIVE NATIONAL EFFORT. THOUGH AMENDED IN NEARLY EVERY SESSION OF

CONGRESS AND EXTENSIVELY REVISED IN 1938, THE 1898 ACT PERSISTED UNTIL 1978. AT THAT TIME, THE CONGRESS ACTED TO MAKE FEDERAL BANKRUPTCY PROCEEDINGS MORE EFFICIENT AND ENCOMPASSING.

IT IS THE ALL-ENCOMPASSING NATURE OF THE 1978 ACT THAT THE SUPREME COURT HAS RECENTLY STRUCK DOWN. THE BANKRUPTCY ACT OF 1978 SOUGHT TO IMPROVE THE EFFICIENCY OF THE FEDERAL COURTS IN DEALING WITH BANKRUPTCY AND ALL ATTENDANT MATTERS. THE DIMENSIONS OF THAT UNDERTAKING ARE READILY APPARENT. ON MARCH 31 OF THIS YEAR NEARLY 700,000 ESTATES WERE PENDING BEFORE THE FEDERAL BANKRUPTCY COURTS -- A NUMBER NEARLY FOUR TIMES GREATER THAN THE NUMBER OF ALL CIVIL FILINGS MADE IN FEDERAL DISTRICT COURTS IN 1981. AS MOST OF YOU KNOW, THE SUPREME COURT'S DECISION IN THE NORTHERN PIPELINE CASE MEANS, HOWEVER, THAT SOME REVISIONS IN THE FEDERAL SYSTEM SHOULD BE IN PLACE TO DEAL WITH BANKRUPTCY LESS THAN ONE MONTH FROM NOW -- BY OCTOBER 4, WHEN THE COURT'S MANDATE WILL ISSUE.

THE SUPREME COURT DECIDED NORTHERN PIPELINE CONSTRUCTION CO. V. MARATHON PIPE LINE CO. JUST OVER TWO MONTHS AGO. IN THAT CASE, THE COURT INVALIDATED THE BROAD GRANT OF JURISDICTION MADE TO THE BANKRUPTCY COURTS BY THE BANKRUPTCY REFORM ACT OF 1978. IN ORDER TO PREVENT CHAOS FROM OVERCOMING THE ADMINISTRATION OF THE BANKRUPTCY LAWS, HOWEVER, THE COURT STAYED ITS JUDGMENT UNTIL OCTOBER 4, 1982, TO GIVE CONGRESS TIME TO RECONSTITUTE THE BANKRUPTCY COURTS IN A CONSTITUTIONAL MANNER. IF NO ACTION IS TAKEN BY THE CONGRESS BY THAT TIME, AND THE SUPREME COURT DOES NOT EXTEND THE STAY, THE CURRENT BANKRUPTCY COURTS WILL CEASE TO

FUNCTION. INDEED, THERE IS SOME QUESTION WHETHER ANY FEDERAL BANKRUPTCY JURISDICTION WILL EXIST AFTER THAT DATE. EVEN IF THE FEDERAL DISTRICT COURTS DO RETAIN JURISDICTION, HOWEVER, THEY WOULD NOT BE EQUIPPED AT PRESENT TO HANDLE THE OVER ONE-HALF MILLION PROCEEDINGS NOW BEING FILED ANNUALLY IN OUR BANKRUPTCY COURTS.

IN THE NORTHERN PIPELINE CASE, THE NORTHERN PIPELINE CONSTRUCTION CO. HAD FIRST FILED A PETITION FOR REORGANIZATION IN A BANKRUPTCY COURT. IN THAT SAME BANKRUPTCY PROCEEDING, IT LATER FILED A SUIT AGAINST MARATHON PIPE LINE CO. SEEKING DAMAGES FOR ALLEGED BREACH OF CONTRACT AND WARRANTY, MISREPRESENTATION, COERCION, AND DURESS. ALL OF NORTHERN'S CLAIMS WERE TRADITIONAL COMMON-LAW CLAIMS. MARATHON SOUGHT DISMISSAL OF THE SUIT ON THE GROUND THAT SUCH CLAIMS COULD NOT BE HEARD BY JUDGES WHO LACKED THE LIFE TENURE AND PROTECTION AGAINST SALARY DIMINUTION REQUIRED BY ARTICLE III OF THE CONSTITUTION. THE BANKRUPTCY COURT DENIED THE MOTION TO DISMISS, BUT ON APPEAL THE FEDERAL DISTRICT COURT GRANTED THE MOTION. THE SUPREME COURT AFFIRMED THE DISTRICT COURT. IN SUM, THE SUPREME COURT AGREED WITH MARATHON'S CONTENTIONS. THE COURT FOUND THAT THE BANKRUPTCY COURT'S JURISDICTION WAS, IN FACT, UNCONSTITUTIONAL BECAUSE NON-ARTICLE III JUDGES WERE PERMITTED TO TRY LAWSUITS THAT INVOLVED TRADITIONAL COMMON-LAW CLAIMS SOLELY BECAUSE A BANKRUPT WAS A PARTY TO THE SUIT. THE COURT HELD THAT SUCH CLAIMS CAN ONLY BE HEARD BY ARTICLE III JUDGES.

THE NORTHERN PIPELINE CASE IS, OF COURSE, ONE MORE CHAPTER IN THE FAIRLY LENGTHY HISTORY SURROUNDING THE ADMINISTRATION OF THE BANKRUPTCY LAWS. THE 1978 ACT WAS ARRIVED AT ONLY AFTER TEN YEARS OF STUDY, INVESTIGATION, AND INTENSIVE LOBBYING AND DEBATE. BEFORE THE 1978 ACT, THE FEDERAL DISTRICT COURTS SERVED AS BANKRUPTCY COURTS AND EMPLOYED A "REFEREE" SYSTEM. BANKRUPTCY PROCEEDINGS WERE GENERALLY CONDUCTED BEFORE THESE "REFEREES" -- CALLED "BANKRUPTCY JUDGES" AFTER 1973 -- EXCEPT IN THE RARE INSTANCE IN WHICH A DISTRICT COURT PRESIDED. IT IS GENERALLY AGREED THAT MOST FEDERAL DISTRICT COURT JUDGES REGARDED BANKRUPTCY PROCEEDINGS AS "LESSER" PROCEEDINGS AND ACCORDINGLY DELEGATED THE "COUNTING" OF ASSETS AND CLAIMS TO THE REFEREES. THE DECISIONS OF THE REFEREES WERE APPEALABLE TO THE DISTRICT COURT.

THE 1978 ACT ELIMINATED THE REFEREE SYSTEM AND ESTABLISHED A BANKRUPTCY COURT IN EACH JUDICIAL DISTRICT. THE CURRENT JUDGES OF THESE BANKRUPTCY COURTS WERE, FOR THE MOST PART, THE PRE-1978 REFEREES, WHOSE APPOINTMENTS AS BANKRUPTCY JUDGES WERE EXTENDED UNTIL APRIL 1984. BY THAT TIME, THE PRESIDENT WAS TO HAVE NOMINATED AND THE SENATE CONFIRMED NEW BANKRUPTCY JUDGES FOR FIXED TERMS OF FOURTEEN YEARS. THESE NEW JUDGES WOULD HAVE SUPPLANTED THE CURRENT BANKRUPTCY JUDGES APPOINTED BY THE DISTRICT COURTS. THE EXACT STATUS OF THESE PRESIDENTIAL APPOINTMENTS IS NOW, OF COURSE, ALONG WITH THE FUTURE ADMINISTRATION OF THE BANKRUPTCY LAWS, VERY UNCERTAIN.

THE JUSTICE DEPARTMENT HAS IDENTIFIED THREE BASIC OPTIONS FOR THE CONGRESS TO PURSUE IN LIGHT OF THE NORTHERN PIPELINE CASE. UNFORTUNATELY, EACH OF THESE OPTIONS PRESENTS SIGNIFICANT DISADVANTAGES.

THE FIRST OPTION, OBVIOUSLY, IS TO RECONSTITUTE THE BANKRUPTCY COURTS AS ARTICLE I COURTS, BUT TO NARROW THEIR JURISDICTION SUFFICIENTLY TO ELIMINATE THE CONSTITUTIONAL PROBLEMS OUTLINED IN THE NORTHERN PIPELINE DECISION. ELIMINATING CONSTITUTIONAL INFIRMITIES IN THIS SYSTEM, HOWEVER, IS MUCH EASIER SAID THAN DONE. ALTHOUGH THE NORTHERN PIPELINE DECISION IS PARTICULARLY OPAQUE SINCE THERE IS NO MAJORITY OPINION, IT APPEARS REASONABLY CERTAIN THAT THE PLURALITY OPINION BY JUSTICE BRENNAN AND THE CONCURRING OPINION BY JUSTICE REHNQUIST HAVE CAST CONSIDERABLE DOUBT ON THE CONSTITUTIONALITY OF ANY SUBSTANTIAL GRANT OF BANKRUPTCY JURISDICTION TO AN ARTICLE I COURT. MOST BROADLY READ, THOSE OPINIONS COULD ARGUABLY REQUIRE THE CONCLUSION THAT BANKRUPTCY PROCEEDINGS ARE SO INTERTWINED WITH ARTICLE III QUESTIONS OF LAW AND EQUITY THAT SUCH PROCEEDINGS, OF CONSTITUTIONAL NECESSITY, CANNOT BE HANDLED BY AN ARTICLE I JUDGE. IT IS AT LEAST CLEAR THAT ANY LIMITED-JURISDICTION ARTICLE I SOLUTION WILL NOT ACHIEVE ONE OF THE PRIMARY GOALS OF THE 1978 REFORMS -- THAT IS, TO CONSOLIDATE IN ONE COURT ALL MATTERS RELATING TO A BANKRUPTCY PROCEEDING, INCLUDING CLAIMS THAT DO NOT ARISE UNDER THE BANKRUPTCY ACT BUT TO WHICH THE BANKRUPT DEBTOR IS A PARTY.

THE SECOND OPTION WOULD BE TO RESTRUCTURE THE BANKRUPTCY COURTS SOMEWHAT ALONG THE PRE-1978 LINES, WITH BANKRUPTCY ADJUNCTS SERVING UNDER THE SUPERVISION OF FEDERAL DISTRICT COURT JUDGES. SEVERAL IMPROVEMENTS IN THE 1978 ACT COULD BE PRESERVED. FOR EXAMPLE, TO AVOID THE CHARGE OF CRONYISM LEVELED AGAINST THE PRE-1978 SYSTEM IN WHICH DISTRICT COURT JUDGES APPOINTED REFEREES, BANKRUPTCY JUDGES COULD BE APPOINTED TO FIXED TERMS BY THE PRESIDENT.

THE BENEFIT OF INITIALLY CONFINING THE BANKRUPTCY PROCEEDING TO ONE COURT ALSO COULD BE MAINTAINED. NEVERTHELESS, THIS APPROACH WOULD STILL REQUIRE-MULTIPLE LEVELS OF REVIEW, SINCE DECISIONS OF THE BANKRUPTCY ADJUNCT WOULD BE SUBJECT TO DE NOVO REVIEW BY THE DISTRICT COURT. SUCH A SYSTEM WOULD ALSO INCREASE THE ALREADY BURDENSOME CASELOAD OF THE FEDERAL DISTRICT COURTS. MOREOVER, AN ADJUNCT SYSTEM MIGHT NOT ATTRACT JUDICIAL CANDIDATES OF AS HIGH A PROFESSIONAL STATURE AS WOULD A SYSTEM ALLOWING JUDGES GREATER INDEPENDENCE.

THE THIRD OPTION WOULD BE TO CREATE ARTICLE III BANKRUPTCY JUDGES. ONE SUCH APPROACH IS THE BILL SPONSORED BY CHAIRMAN PETER RODINO. THAT PROPOSAL, WHICH HAS BEEN FAVORABLY REPORTED BY THE HOUSE JUDICIARY COMMITTEE, WOULD CREATE ARTICLE III BANKRUPTCY JUDGES WHO COULD SIT BY DESIGNATION IN OTHER TYPES OF CASES AS THE NEED AROSE. SUCH AN APPROACH WOULD FINALLY SETTLE THE CONSTITUTIONAL PROBLEMS RAISED BY THE NORTHERN PIPELINE DECISION, BUT WOULD ALLOW RETENTION OF THE PROCEDURAL REFORMS OF THE 1978 BANKRUPTCY ACT. THERE HAVE BEEN TWO PRINCIPAL CONCERNS EXPRESSED ABOUT THIS OPTION. FIRST IS A CONCERN THAT THE INFUSION OF APPROXIMATELY 220 SPECIALIZED ARTICLE III BANKRUPTCY JUDGES WOULD LESSEN THE PRESTIGE AND STATURE OF AN ARTICLE III JUDGESHIP. SECOND, IS THE PHILOSOPHICAL CONCERN THAT SUCH A STEP WOULD ACCELERATE A PROCESS OF RADICALLY AND MATERIALLY ALTERING THE FEDERAL DISTRICT BENCH FROM A GROUP OF GENERALISTS CAPABLE OF HANDLING ALL TYPES OF LAWSUITS TO A COLLECTION OF SPECIALIZED JUDGES WHO WOULD, FOR THE MOST PART, ENTERTAIN CLAIMS ONLY IN THEIR NARROW AREA OF EXPERTISE.

THE FEDERAL BENCH AS WELL AS MOST LEADING MEMBERS OF THE TRIAL BAR BELIEVE DEEPLY THAT THE FEDERAL DISTRICT BENCH SHOULD RETAIN ITS GENERALIST STATUS.

THE OPTIONS I HAVE DISCUSSED TODAY DEMONSTRATE SEVERAL IMPORTANT POINTS. REVISING OUR SYSTEM OF BANKRUPTCY LAW UNDER THE GUN OF NORTHERN PIPELINE IS CLEARLY NO EASY MATTER. TIME IS SHORT, AND A CHOICE AMONG THE OPTIONS IS DIFFICULT. NO OPTION CLEARLY PRESENTS ITSELF AS BEST OR WHOLLY FREE FROM DISADVANTAGES.

OPTION THREE -- THE CREATION OF ARTICLE III BANKRUPTCY COURTS -- WOULD THEORETICALLY MEET THE DESIRE BOTH FOR INCREASED EFFICIENCY AND CLEAR CONSTITUTIONALITY. IT WOULD ALSO, HOWEVER, DRAMATICALLY ALTER THE NATURE OF OUR FEDERAL COURT SYSTEM AND ENTAIL CONSIDERABLE EXPENSE. IN ADDITION, THE APPOINTMENT OF SO MANY NEW ARTICLE III JUDGES WOULD REQUIRE A SUBSTANTIAL AMOUNT OF TIME -- CERTAINLY BEYOND THE OCTOBER 4 DEADLINE. OPTION ONE -- THE CREATION OF ARTICLE I COURTS TO ADJUDICATE PUBLIC RIGHTS -- AND OPTION TWO -- THE CREATION OF BANKRUPTCY REFEREES AS ADJUNCTS TO ARTICLE III COURTS -- WOULD BOTH SACRIFICE SOME EFFICIENCY TO ENSURE CONSTITUTIONALITY. BOTH OPTIONS ONE AND TWO WOULD REQUIRE THE INVOLVEMENT OF AN ARTICLE III COURT BEYOND OR ADDITIONAL TO THE BANKRUPTCY JUDGE'S ACTION.

ALTHOUGH THE PROBLEM OF DESIGNING AN EFFICIENT AND CONSTITUTIONAL FEDERAL BANKRUPTCY SYSTEM IS DIFFICULT, THE DIFFICULTIES ARE NOT UNFAMILIAR ONES UNDER OUR CONSTITUTION, WHICH FURTHERS OTHER GOALS BESIDES EFFICIENCY. FOREMOST AMONG THE LATTER IS THE PRESERVATION OF DEMOCRACY AND PRINCIPLES OF FEDERALISM. THE CONSTITUTION SEEKS TO ENSURE THAT GOVERNMENT

POWER WILL BE CAREFULLY CHECKED AND BALANCED. ONE SUCH CHECK IS THE REQUIREMENT THAT COURTS EMPOWERED TO ADJUDICATE PRIVATE RIGHTS WILL CONSIST OF JUDGES WHO ARE PROTECTED IN TENURE AND SALARY AGAINST LEGISLATIVE AND EXECUTIVE REACTION. ALL OF YOU KNOW THAT THIS ADMINISTRATION HAS SPOKEN OUT AGAINST WHAT WE VIEW AS EXCESSES BY THE JUDICIARY WHEN IT OVERSTEPS ITS CONSTITUTIONAL BOUNDS TO EXERCISE AUTHORITY CONFERRED UPON OTHER BRANCHES OF THE FEDERAL GOVERNMENT OR THE STATES. AT THE SAME TIME, WE FULLY SUPPORT THE CONSTITUTIONAL GUARANTEES THAT ENSURE THE INDEPENDENCE OF OUR COURTS IN THEIR PERFORMANCE OF THE JUDICIAL FUNCTION. IN NORTHERN PIPELINE THE SUPREME COURT HAS SPOKEN AND DRAWN ANOTHER LINE MARKING THE SEPARATION OF POWERS. ALTHOUGH MANY MAY DISAGREE WITH WHERE THAT LINE WAS DRAWN -- AND ALTHOUGH THAT LINE MAKES IT MORE DIFFICULT TO DESIGN AN EFFICIENT BANKRUPTCY SYSTEM -- WE HAVE SET ABOUT THE TASK OF ATTEMPTING TO MEET THE TWIN GOALS OF EFFICIENCY AND CONSTITUTIONALITY. THOUGH DIFFICULT, THAT PROCESS IS AS OLD AS OUR NATION -- AND IT CLEARLY DEMONSTRATES AGAIN THAT OUR SYSTEM REMAINS ONE DEVOTED TO THE CONSTITUTION AND THE RULE OF LAW.

AS JUSTICE BRANDEIS OBSERVED MORE THAN HALF A CENTURY AGO:

> "THE DOCTRINE OF THE SEPARATION OF POWERS WAS ADOPTED BY THE CONVENTION OF 1787, NOT TO PROMOTE EFFICIENCY BUT TO PRECLUDE THE EXERCISE OF ARBITRARY POWER. THE PURPOSE WAS, NOT TO AVOID FRICTION, BUT, BY MEANS OF THE INEVITABLE FRICTION INCIDENT TO THE DISTRIBUTION OF THE GOVERNMENTAL POWERS AMONG THREE DEPARTMENTS, TO SAVE THE PEOPLE FROM AUTOCRACY."

CLEARLY, THE NORTHERN PIPELINE CASE HAS AT LEAST GENERATED A SUBSTANTIAL AMOUNT OF FRICTION. NEVERTHELESS, THE GEARS OF GOVERNMENT ARE MOVING FORWARD. AND I FEEL CERTAIN THAT THE ADMINISTRATION AND CONGRESS WILL DEVELOP THE BEST FEDERAL BANKRUPTCY SYSTEM THAT IS CONSTITUTIONALLY POSSIBLE.