Rethinking Preemption and Constitutional Parameters in Bankruptcy

Michelle M. Harner
RETHINKING PREEMPTION AND CONSTITUTIONAL PARAMETERS IN BANKRUPTCY

MICHELLE M. HARNER*

ABSTRACT

Chapter 11 of the U.S. Bankruptcy Code allows financially distressed businesses to reorganize and emerge from bankruptcy free of their pre-bankruptcy debts and obligations. In general, a business can achieve this kind of “fresh start” by confirming a plan of reorganization or pursuing a going-concern sale that typically facilitates a change in ownership, a reduction in leverage, and the elimination of most claims against the company’s assets. Through these kinds of transactions, a business can emerge from bankruptcy with a stronger balance sheet and often a new ownership structure. It also can streamline operations by, for example, assuming valuable contracts and rejecting burdensome ones under the relevant provisions of the Bankruptcy Code. Although creditors’ claims may lose value through the bankruptcy process, all similarly situated creditors are treated fairly and in a nondiscriminatory manner.

* Francis King Carey Professor of Law, University of Maryland Francis King Carey School of Law (at the time the Article was written and accepted for publication); U.S. Bankruptcy Judge for the District of Maryland (at the time of publication). The Article benefitted from the comments of, or discussions with, Honorable Thomas L. Ambro, Geoffrey L. Berman, Martha Ertman, S. Elizabeth Gibson, Donald Gifford, Mark Graber, Paul E. Harner, Robert W. Hamilton, Whitman L. Holt, Margaret Howard, Melissa B. Jacoby, Kenneth N. Klee, Richard Levin, Stephen Lubben, Vince J. Marriott III, Nancy B. Rapoport, Charles T. Tabb, Michael P. Van Alstine, Honorable Eugene R. Wedoff (ret.), and Richard I. Werder. In addition, I appreciate the research assistance of Jason Hawkins and Ashley Fellona. Nevertheless, all opinions, errors, and omissions in this Article are my own. I also thank the University of Maryland Francis King Carey School of Law for financial support. Finally, I want to note that this Article was written as an academic work during my tenure as a professor at the University of Maryland Francis King Carey School of Law and prior to my appointment to the bench. It does not express any opinions or positions regarding any issues that may arise, or any parties that may appear, in any cases before me.
Distressed companies and their creditors should not have to worry about variances in state law insolvency schemes that might facilitate similar going-concern sales, but treat creditors differently or allow a process without the same kind of court or creditor oversight. Yet, states are increasingly adopting debtor-creditor laws that mimic key provisions of the Bankruptcy Code and permit the kind of fresh start for business debtors historically available only under federal bankruptcy law. These state laws may also provide rights or distributions to creditors that differ from, and conflict with, the provisions and purposes of the Bankruptcy Code. These new, sweeping state law insolvency schemes raise serious constitutional questions under both the Bankruptcy Clause and the Contract Clause. Policymakers and courts need to rethink and rebalance the allocation of powers between Congress and the states with respect to bankruptcy laws. More specifically, they need to define more clearly the parameters of federal preemption and preserve Congress’s exclusive authority over laws affecting the rights of creditors and other stakeholders in the context of a fresh start for business debtors.
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INTRODUCTION

The concept of federal preemption is easy to articulate: laws enacted by Congress supersede similar or conflicting state laws under the Supremacy Clause of the U.S. Constitution. It often is, however, difficult to implement. For example, Congress has the power under the Bankruptcy Clause of the U.S. Constitution to enact uniform laws governing bankruptcy. Nonetheless, the U.S. Supreme Court has held that certain state laws governing debtors’ and creditors’ rights may coexist with legislation enacted by Congress under the Bankruptcy Clause. Some state and lower federal courts have extended this rationale to state laws that mimic, and in some instances conflict with, various provisions of the U.S. Bankruptcy Code. These provisions include the automatic stay of section 362 of the Bankruptcy Code; a trustee’s ability to assume or reject executory contracts and unexpired leases under section 365 of the Bankruptcy Code; and a trustee’s ability to sell a debtor’s assets as an operating entity (or going concern) free of all liens and interests under section 363 of the Bankruptcy Code. Are these extensions warranted? Are they consistent with the Bankruptcy Clause, the Contract Clause, and Congress’s intent in enacting the Bankruptcy Code?

Although states are increasingly refining their debtor-creditor laws to look more like mini Bankruptcy Codes, few scholars have analyzed the legitimacy or policy implications of this trend. But

1. U.S. Const. art. VI, cl. 2 (“Laws of the United States ... shall be the supreme Law of the Land.”).
2. U.S. Const. art. I, § 8, cls. 1, 4 (“The Congress shall have Power To ... establish ... uniform Laws on the subject of Bankruptcies throughout the United States.”).
3. See infra Part I.C.
5. Id. § 365.
6. Id. § 363; see also infra Part II.B.
these issues have never been more relevant or important to financially distressed companies and their creditors. As even the smallest of businesses now conduct operations on an interstate and global
basis, through the Internet and online platforms, parties need uniform and consistent bankruptcy laws.9

Consider the following scenario: a company experiences a liquidity crisis—it simply cannot pay its ongoing obligations from current cash flows, and creditors’ demands for payment or security of payment are increasing by the day. Traditionally, that company had several options: it could file a federal bankruptcy case,10 seek to achieve an out-of-court consensual workout with its creditors,11 or subject itself to a state law remedy (such as an assignment for the benefit of creditors or a receivership) that would liquidate the company’s assets to satisfy creditors’ claims.12 Each option provided slightly different advantages and disadvantages to the company and its creditors, as discussed more fully in Part II. Nevertheless, these distinctions have essentially disappeared, as companies exercise different means for reorganizing under federal bankruptcy laws, and as states have refined their debtor-creditor laws to mimic the relief available to companies under the Bankruptcy Code.13 Consequently, the company in our hypothetical could file a federal bankruptcy case, commence an assignment for the benefit of creditors, or consent to the filing of a state law receivership and achieve the same result. All options would result in a sale of the business free of all creditors’ claims with the assumption, assignment, and rejection of contracts and leases on a nonconsensual basis. This result allows a continuation of the distressed company’s business free of legacy costs and other pre-filing obligations.14

9. See Gavin, supra note 7, at 7 (noting potential issues with state insolvency laws, “plus the lack of transparency, slower pace and the state-by-state variations found in nonbankruptcy alternatives, increase risk and complexity, often leading to a less-desirable result when compared to chapter 11”); Harner, supra note 8, at 8 (“Moreover, from the creditors’ perspective, receiverships and ABCs vary, sometimes greatly, from state to state. Even SMEs have multi-state operations, and state law remedies may prove inefficient in such situations.”); see also infra Part III.

10. See infra Part II.A.

11. See infra notes 276-77 and accompanying text.

12. See infra note 24 and accompanying text.

13. As described below, chapter 11 debtors no longer reorganize solely through a plan of reorganization, but also effect change of control reorganizations through going-concern sales under section 363 of the Bankruptcy Code. The latter reorganization strategy also may now be accomplished under certain enhanced state debtor-creditor laws. See infra Part II.

14. See infra note 203 and accompanying text.
Under Supreme Court decisions considering preemption issues in the bankruptcy context, a guiding consideration is whether the state law at issue provides the debtor with a discharge and frees “future acquired property from the obligation of existing debts.” An approach focused only on a statutory “discharge” ignores fundamental policies underlying the Bankruptcy Clause and arguably would validate the state law in our hypothetical scenario—a state law that has the effect of a discharge without being so labeled. That state law also may provide parties with different rights and remedies than federal bankruptcy law. State law rights and processes that differ from, and conflict with, the Bankruptcy Code raise challenging practical issues for creditors and important constitutional issues for all.

It is time for policymakers and courts to question this overlap between a federal bankruptcy scheme whose purpose is to reorganize a debtor’s business assets and free those assets from creditors’ claims and state debtor-creditor laws. These state laws should focus on the collection and liquidation of a debtor’s assets for the payment of creditors’ claims.

The appropriate allocation of debtor and creditor rights and remedies between federal and state statutory schemes requires a delicate balancing of the interests at stake. There unquestionably is a federal interest in, among other things, protecting both debtors and creditors from discrimination, unfair or different standards for satisfying debts, and any undue burdens in invoking the protections afforded by federal bankruptcy laws. These concerns affect not

16. Although this Article focuses on state receivership law, at least two states have included assignment for the benefit of creditors within their revised receivership acts. In these states, assignees generally have the same expanded rights and powers as receivers with respect to the debtor’s assets. See Minn. Stat. § 577.18 (2016) (“Except as otherwise provided in this chapter, an assignee shall be treated as a general receiver, the assignment property shall be treated as receivership property, and all proceedings following the filing of the assignment shall be governed by sections 576.21 to 576.53.”); Wash. Rev. Code § 7.08.030 (2017) (“By making this assignment, the assignor consents to the appointment of the assignee as a general receiver with respect to the assignee’s property in accordance with chapter 7.60 RCW.”). Accordingly, this Article’s discussion of potential issues with expanded rights and powers for state law receivers applies equally to state law assignees.
17. See infra Part III.
18. See, e.g., 2 Joseph Story, Commentaries on the Constitution of the United States §§ 1106-1107 (2d ed. 1851) (discussing the importance of the equal treatment of creditors and fresh starts for debtors under the Bankruptcy Clause and also explaining that
only interstate, but also international, trade, and business relations. States have an interest in protecting their residents and providing effective means for them to pay creditors when assets otherwise prove insufficient. At some point, the interests of Congress and the states collide. Such federalism concerns are not new or novel in the bankruptcy context.

As explained more fully in Part I, the history of the federal bankruptcy laws is replete with examples of tension between federal and state concerns. Indeed, remnants of these struggles remain in the Bankruptcy Code, as the Code references state law or allows for the application of state law (as in the case of exemptions with respect to individual debtors) in several places. The balance struck in the Bankruptcy Code is not, however, determinative for federal preemption purposes. Moreover, the Supreme Court has not considered the federal preemption issue as it relates to general state debtor-creditor laws in any meaningful way for over eighty years. Federal and state laws and the structure of business bankruptcy have changed significantly during that time.

Congress has a strong interest in “preserving harmony, promoting justice, and securing equality of rights and remedies among the citizens of all the states. It is obvious, that if the power is exclusively vested in the states, each one will be at liberty to frame such a system of legislation upon the subject of bankruptcy and insolvency, as best suits its own local interests and pursuits.”

19. See id. § 1107 (“D)iversities of almost infinite variety and object may be introduced into the local system, which may work gross injustice and inequality, and nourish feuds and discontents in neighboring states.”).

20. See, e.g., 11 U.S.C. § 522(b)(3)(A) (2012) (stating that exempt property in an individual bankruptcy case includes “any property that is exempt under Federal law, other than subsection (d) of this section, or State or local law that is applicable on the date of the filing of the petition”); Charles Jordan Tabb, The History of the Bankruptcy Laws in the United States, 3 AM. BANKR. INST. L. REV. 5, 24 (1995) (“The exemption question, so divisive under the 1867 Act, was resolved in favor of allowing the debtor to claim only state exemptions. No separate federal exemptions were permitted.”).

21. See infra Parts I.D, III.A.

22. The Supreme Court’s last opinion directly addressing the preemption of a state’s assignment for the benefit of creditors or receivership law by federal bankruptcy law was Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518, 521 (1933). As discussed in Part I.D, the Court has since considered other preemption issues relating to the Bankruptcy Act and the Bankruptcy Code. See also, e.g., Marine Harbor Props., Inc. v. Mfrs. Tr. Co., 317 U.S. 78, 82-86 (1942) (considering whether the debtor filed its petition under Chapter X of the Bankruptcy Act in good faith given a pending state law receivership proceeding); Faitoute Iron & Steel Co. v. City of Asbury Park, 316 U.S. 502, 503 (1942) (analyzing a New Jersey statute governing the adjustment of a municipality’s debt).

23. See infra Part I.B.
This Article suggests rethinking the scope of the Bankruptcy Clause and enforcing appropriate parameters for federal preemption in the bankruptcy context. State law does and should provide remedies for creditors against a defaulting party. Those remedies should include the traditional tools of foreclosing against the collateral securing the debt, obtaining a judgment lien to facilitate a foreclosure, or seeking the assistance of a receiver or assignee to collect and liquidate the debtor's assets for the payment of debts. The latter remedy should not, however, include the power to reorganize the debtor's business through a going-concern sale.

As used in this Article, a going-concern “reorganization” sale includes the orderly administration of a debtor's business by, for example, implementing an automatic stay, selling all or substantially all of the debtor's assets free from existing or successor liabilities, transferring contracts and leases without counterparty consent, and allowing the business to continue as an operating entity after the closing of the sale. A state law scheme that facilitates a going-concern reorganization sale presents at least two issues. First, it uses powers traditionally reserved to a bankruptcy trustee or debtor in possession to facilitate a fresh start for a debtor's

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24. For a general discussion of creditors’ general state law remedies, see 1 William H. Brown, The Law of Debtors and Creditors § 7:75 (2017); and Edward J. Janger, The Logic and Limits of Liens, 2015 U. Ill. L. Rev. 589, 595-605. For a general discussion of receiverships and assignments for the benefit of creditors, see infra Parts II.B, III.B.

25. See infra Part I.B.

26. This Article references “counterparty consent” in the context of sales where parties have negotiated contract terms that require the counterparty’s consent to certain transactions or assignments of the contract, or that provide the counterparty with certain rights upon events such as a change of control or insolvency. Not every contract may include these provisions, but the phrase is intended to capture those that do.

27. State law receivers and assignees may be able to sell all or substantially all of a company's assets in the context of liquidating the company under state law. See infra Part II.B. These sales also may be free of some liens, provided that proper notice is given and procedures are followed. See infra Parts II.B, III.B. State laws have not, however, historically granted receivers or assignees powers beyond those necessary to accomplish the liquidation of the assets—in other words, powers reserved to bankruptcy trustees and debtors in possession under the Bankruptcy Code. See infra Part III.B. Likewise, the package of expanded rights and powers for receivers and assignees discussed in this Article exceed the traditional powers of corporate directors to sell the company’s assets. Even in the context of asset sales (as opposed to stock sales), corporations cannot override change of control, anti-assignment, and similar contractual provisions, and the assets may remain subject to successor liability in certain cases.
business. Second, it may provide creditors with rights or distributions that are different from, and conflict with, the Bankruptcy Code. Accordingly, such state law schemes raise both field and conflict preemption issues under the Bankruptcy Clause, and also may separately violate the Contract Clause.

Part I of this Article examines the origins of the Bankruptcy Code and the Supreme Court’s historical approach to the Bankruptcy Clause and federal preemption, and the Contract Clause, in the bankruptcy context. This Part explains the nuances of federal preemption law, specifically considering field and conflict preemption. It also reviews how state and lower federal courts have addressed preemption under the Bankruptcy Code, given that Supreme Court precedent exists primarily under the Bankruptcy Act of 1898 and prior federal bankruptcy laws. Part II then considers the increasing similarities between federal bankruptcy law and state debtor-creditor laws and the potential implications of this trend. Part III focuses on the content and scope of the Bankruptcy Code and states’ debtor-creditor laws to consider whether the two bodies of law can coexist, or whether instead certain aspects of state laws are, or should be, preempted by the Code. This Article concludes by rethinking the appropriate approach to federal preemption in bankruptcy to promote the efficient and effective administration of

28. See, e.g., HAROLD REMINGTON, A TREATISE ON THE BANKRUPTCY LAW OF THE UNITED STATES § 13 (2d ed. 1915) (“The subject of ‘bankruptcies’ [within Congress’s power] includes the power to discharge the debtor from his contracts and legal liabilities as well as to distribute his property. The grant to Congress involves the power to impair the obligation of contracts, and this the States were forbidden to do.”); see also infra Part II.

29. See infra Part III.A.2.

30. As explained in Part III.A, preemption under the Supremacy Clause generally falls into the following three categories: express, implied field, and implied conflict preemption. Express preemption occurs when Congress articulates the supremacy of the federal law in the statute itself. See, e.g., Richardson v. Schafer (In re Schafer), 689 F.3d 601, 613-14 (6th Cir. 2012) (citing R.R. Ventures, Inc. v. Surface Transp. Bd., 299 F.3d 523, 561 (6th Cir. 2002)). Field preemption is regulation that “is so pervasive or the federal interest is so dominant that an intent can be inferred for federal law to occupy the field exclusively.” Id. at 614 (quoting R.R. Ventures, Inc., 299 F.3d at 561). Finally, implied conflict preemption involves laws that potentially conflict “such that it is impossible for a party to comply with both laws simultaneously, or where the enforcement of the state law would hinder or frustrate the full purposes and objectives of the federal law.” Id. (citing R.R. Ventures, Inc., 299 F.3d at 561).

31. See infra Part I.D.

32. See infra Part I.D.2.
distressed businesses under the Bankruptcy Code. Business debtors and their creditors need the certainty and protections of a uniform federal bankruptcy law when a proposed resolution will continue the business while impairing the rights of, and obligations and distributions to, creditors and contract parties. That is the essence of reorganization.

I. HISTORICAL BOUNDARIES: CONSTITUTIONAL AND PREEMPTION ISSUES IN BANKRUPTCY

The U.S. Constitution strikes a delicate balance between federal and state powers. That balance and the resulting potential tension are evident in both the Bankruptcy Clause and the Contract Clause. Although this Article focuses primarily on the Bankruptcy Clause, the Contract Clause informs the analysis in several meaningful ways. For example, most courts and commentators agree that Congress is authorized to establish uniform bankruptcy laws, but they also acknowledge some continuing role for state laws governing debtor-creditor relationships. One notable difference between federal and state laws in this context, however, is the ability of Congress to impair contractual relationships, which states for the most part cannot do—at least retroactively and with respect to contracts not subject to that state’s laws—under the Contract Clause. Indeed, this difference has helped courts define certain parameters of preemption in the bankruptcy field, which tend to limit preemption to state laws affecting a discharge of a debtor’s obligations.

This Article challenges such an artificial and static preemption analysis. The materials in this Part provide the background necessary to understand fully the justifications for a broader preemption doctrine. Specifically, this Part analyzes prior and existing approaches to preemption in bankruptcy matters. Subsequent Parts then discuss existing practices in business bankruptcies and significant changes in state laws that warrant reconsideration of the doctrine. They also identify key factors for policymakers and courts

33. See infra Parts III.C-D.
34. See infra Part III.C.
35. For discussions of the Contract Clause, see infra Parts I.C and III.A.3.
to consider in evaluating the constitutionality of state laws in the face of the Bankruptcy Clause, the Contract Clause, and the Bankruptcy Code.\textsuperscript{37}

\subsection*{A. The Origins of the Bankruptcy Clause}

At the time of the Constitutional Convention, the states determined whether, and to what extent, bankruptcy laws would exist. The Articles of Confederation did not address bankruptcy laws on a federal level,\textsuperscript{38} and, as with other commerce matters, the states retained exclusive control over bankruptcy.\textsuperscript{39} This independent approach to bankruptcy produced variances in state laws, with some states following the British template for bankruptcy and insolvency laws, and other states adopting a more progressive approach.\textsuperscript{40}

Despite different approaches, state bankruptcy laws before the Constitution’s adoption were generally characterized as pro-debtor, favoring the states’ respective residents, and therefore disadvantageous to out-of-state creditors.\textsuperscript{41} The potential for discrimination

\textsuperscript{37}See infra Part III.

\textsuperscript{38}See, e.g., Stephen J. Lubben, A New Understanding of the Bankruptcy Clause, 64 CASE W. RES. L. REV. 319, 340 (2013) (“While some merchants apparently hoped for a national bankruptcy law, the Articles of Confederation never provided one.”).

\textsuperscript{39}See CHARLES WARREN, BANKRUPTCY IN UNITED STATES HISTORY 4-5 (W.S. Hein 1994).

\textsuperscript{40}See id. at 6-7 (explaining that Pennsylvania embraced a system akin to the English bankruptcy system, which was limited to insolvent merchants, but that Rhode Island, New York, and other states took different approaches); Samuel Williston, The Effect of a National Bankruptcy Law upon State Laws, 22 HARV. L. REV. 547, 548-49 (1909) (“But though many states have on their statute books laws dealing with the subject of bankruptcy, it would be hard to find two states whose laws are identical with one another, and no state has a law identical with the national act.”).

\textsuperscript{41}As Chief Justice Charles Evans Hughes explained in \textit{Home Building \& Loan Ass’n v. Blaisdell}:

\begin{quote}
The widespread distress following the revolutionary period and the plight of debtors, had called forth in the States an ignoble array of legislative schemes for the defeat of creditors and the invasion of contractual obligations. Legislative interferences had been so numerous and extreme that the confidence essential to prosperous trade had been undermined and the utter destruction of credit was threatened. “The sober people of America” were convinced that some “thorough reform” was needed which would “inspire a general prudence and industry, and give a regular course to the business of society.”
\end{quote}

290 U.S. 398, 427 (1934) (quoting \textit{The Federalist No. 44} (James Madison)); see also \textit{Warren, supra} note 39, at 6-7; Tabb, \textit{supra} note 20, at 12-13 (discussing the pro-debtor nature of state law and noting, “A bankruptcy law was apparently believed to be a necessary subject of federal legislation because of the problems that varying and discriminatory state
against out-of-state parties and disruptions to interstate commerce reportedly led the Framers to consider and adopt the Bankruptcy Clause. Those in favor of a national economy voiced similar concerns to support the adoption of the Contract Clause, which provides that “[n]o State shall ... pass any ... Law impairing the Obligation of Contracts.” As James Madison explained, the Contract Clause was necessary to “banish speculations on public measures, inspire a general prudence and industry, and give a regular course to the business of society.”

The Framers adopted the Bankruptcy Clause with little debate or fanfare. The Bankruptcy Clause was originally proposed as an addition to the Full Faith and Credit Clause of Article IV. That placement could suggest greater focus on the enforceability of state laws rather than the need for, and uniformity of, a national bankruptcy law. Most commentators, however, connect the Bankruptcy Clause directly to the Commerce Clause. This position finds support in the final placement of the Bankruptcy Clause in Article I, Section 8 of the Constitution and the language of the clause itself, which

laws caused for nonresident creditors and interstate commerce in general”); Williston, supra note 40, at 549.

42. See, e.g., Ry. Labor Execs.’ Ass’n v. Gibbons, 455 U.S. 457, 471-72 (1982) (discussing the abusive practices in various states’ bankruptcy laws at the time of the Constitutional Convention, examining the history of the Bankruptcy Clause (including its original discussion in the context of the Full Faith and Credit Clause) against this backdrop, and observing that “[t]he Framers sought to provide Congress with the power to enact uniform laws on the subject [of bankruptcies] enforceable among the States”); The Federalist No. 42, at 278 (James Madison) (Isaac Kramnick ed., 1987) (observing the close relation between a uniform national bankruptcy law and interstate commerce).

43. U.S. Const. art. I, § 10, cl. 1; see, e.g., In re Klein, 14 F. Cas. 716, 718 (C.C.D. Mo. 1843) (No. 7,865) (discussing the Bankruptcy Clause, and observing, “The great object was to deprive the states of the dangerous power to abolish debts. Few provisions in the constitution have had more beneficial consequences than this, and the kindred inhibition on the states that they should pass no law impairing the obligation of contracts.”).

44. The Federalist No. 44, supra note 42, at 288 (James Madison).

45. See, e.g., Warren, supra note 39, at 4-5 (observing that the Bankruptcy Clause was not offered until late in the convention and that “[o]n September 3, 1787, this clause was adopted with practically no debate”).

46. See id.

47. Although, as explained herein, many commentators relate the Bankruptcy Clause directly to the Commerce Clause, a counter-narrative exists that posits the Bankruptcy Clause was intended solely to ensure comity among the states with respect to state bankruptcy laws. See Lubben, supra note 38, at 340-41 (explaining that the late Kurt Nadelmann and others have argued that the Bankruptcy Clause is more closely tied to the Full Faith and Credit Clause rather than the Commerce Clause).
provides, “The Congress shall have Power To ... establish ... uniform Laws on the subject of Bankruptcies throughout the United States.”48 The writings of James Madison and Justice Joseph Story also adhere to this view.49 Indeed, Madison observed that

[t]he power of establishing uniform laws of bankruptcy is so intimately connected with the regulation of commerce, and will prevent so many frauds where the parties or their property may lie or be removed into different States, that the expediency of it seems not likely to be drawn into question.50

Several early cases provoked questions concerning the scope of the Bankruptcy Clause and whether it includes bankruptcy and insolvency laws, laws governing distressed (but not insolvent) debtors, and voluntary bankruptcies.51 English law at the time of the Constitution drew a stark distinction between “bankruptcy” laws that covered insolvent merchants and provided a discharge, in certain instances, and “insolvency laws” that covered other kinds of debtors and offered more limited forms of relief.52 Notably, neither Congress nor the Supreme Court has interpreted the Bankruptcy Clause in such limiting ways.53 As the following Sections explain, both Congress and the Supreme Court have repeatedly looked to context and precedent when invoking and applying the Bankruptcy Clause.

49. See, e.g., The Federalist No. 10, supra note 42, at 124-25 (James Madison); id. No. 42, at 278 (James Madison); Story, supra note 18, §§ 1105, 1107-1110.
50. The Federalist No. 42, supra note 42, at 278.
51. Traditional English bankruptcy was involuntary in nature, meaning that creditors could charge a debtor with bankruptcy, but a debtor could not voluntarily seek bankruptcy relief. See, e.g., Tabb, supra note 20, at 16-17 (examining the tension in the promulgation of early federal bankruptcy laws and the assertion by some that voluntary bankruptcies were unconstitutional); see also Thomas E. Plank, The Constitutional Limits of Bankruptcy, 63 Tenn. L. Rev. 487, 527-38 (1996) (providing a thoughtful overview of, and historical perspective on, the Bankruptcy Clause); id. at 491-92 (positing that “[u]nder the Bankruptcy Clause, Congress may only enact legislation that regulates the relationship between an insolvent debtor and her creditors”).
52. See Tabb, supra note 20, at 12.
53. See infra Parts I.B-D.
B. Early Bankruptcy Laws in the United States

Congress did not invoke the Bankruptcy Clause immediately or with any permanency until 1898. Nevertheless, the early and short-lived federal bankruptcy laws demonstrate an evolution in bankruptcy legislation at both the federal and state levels. Congress passed the early federal bankruptcy laws in response to financial crises, and it repealed those laws because of dissatisfaction with the schemes and the availability of state laws to fill the gaps. Congress gradually recognized the inability of state laws to remedy financial distress on a national scale. As the country grew, so did the importance of an effective national bankruptcy scheme.

The Bankruptcy Act of 1898 was the first significant piece of federal bankruptcy legislation to address the country’s financial stability in a proactive manner. The 1898 Act authorized both voluntary and involuntary bankruptcies and permitted compositions to facilitate the payment of debts over time. It did not require insolvency as a prerequisite to invocation of the statute, other than in the involuntary context, and it used a “balance sheet” approach to gauge solvency. The 1898 Act’s application to corporations was refined in 1934 in response to the Great Depression. The business provisions were changed once again in 1938 under the Chandler Act. Both the 1934 and 1938 amendments were premised on a similar “rescue and rehabilitate” principle.

54. See, e.g., Tabb, supra note 20, at 13-14.
56. See, e.g., Lubben, supra note 38, at 384; Tabb, supra note 20, at 23.
57. See, e.g., Lubben, supra note 38, at 383-84.
58. See Tabb, supra note 20, at 24-26. It should be noted that the 1867 Bankruptcy Act also permitted voluntary bankruptcies and corporate filings, so it was closer to the 1898 Act than perhaps the prior two pieces of bankruptcy legislation. See id. at 19.
59. See id. at 25-26.
60. See id.
61. See, e.g., id. at 28.
62. See id. at 29-30.
63. “One of the primary purposes of the bankruptcy act is to ‘relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes.’” Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (quoting Williams v. U.S. Fid. & Guar. Co., 236 U.S. 549, 554-
The Chandler Act offered three options for distressed businesses: Chapter X focused on larger public corporations; Chapter XI addressed smaller business plans of arrangement; and Chapter XII facilitated real estate plans of arrangement. This structure governed business reorganizations for the next forty years, though time and experience would expose inefficiencies. These and other developments led to a congressional study of federal bankruptcy laws, and the enactment of the 1978 Bankruptcy Code, which continues to govern federal bankruptcies.

With respect to business bankruptcy, the Bankruptcy Code essentially combined Chapters X, XI, and XII of the Chandler Act and established a scheme to foster the rehabilitation of distressed businesses. As discussed in Part II, chapter 11 of the Bankruptcy Code offers a distressed company several options for reorganizing its business operations. The debtor can achieve this goal through a plan or a going-concern reorganization sale, and in both instances, the business receives the coveted bankruptcy “fresh start.” But this statutory evolution is only part of the story. The Supreme Court’s approach to the Bankruptcy Clause is the other important

55 (1915)); see Jason J. Kilborn, Bankruptcy, in 1 GOVERNING AMERICA: MAJOR DECISIONS OF FEDERAL, STATE, AND LOCAL GOVERNMENTS FROM 1789 TO THE PRESENT 42-43 (Paul J. Quirk & William Cunion eds., 2011) (“With the rise of private business corporations in the mid- to late 1800s, the rescue- and rehabilitation-oriented bankruptcy policy was extended to take into account the ‘big business’ entities.”); see also David S. Kennedy & R. Spencer Clift, III, An Historical Analysis of Insolvency Laws and Their Impact on the Role, Power, and Jurisdiction of Today’s United States Bankruptcy Court and Its Judicial Officers, 9 J. BANKR. L. & PRAC. 165, 176 (2000) (“The Chandler Act was the Congressional response to the depression and was modeled after the emergency legislation of the early 1930’s. Since 1938, there has existed in America a Congressional policy favoring reorganization over liquidation, where possible.”).


65. See Tabb, supra note 20, at 30-32.


67. President Carter signed the Bankruptcy Code into law in November 1978. See Tabb, supra note 20, at 34.

68. See id. at 35.

69. See infra Part II.A.

70. See infra Part II.A.
piece of this Article’s analysis. Both components are necessary to understand the appropriate parameters of federal preemption in the current legal and economic environment. The Supreme Court’s key decisions are discussed below.

C. The Supreme Court’s Approach to the Bankruptcy Clause

One of the earliest cases to address the scope of the Bankruptcy Clause was *Sturges v. Crowninshield*. This case involved a New York law that both released the debtor from prison and granted a discharge upon the relinquishment of the debtor’s assets for the payment of creditors’ claims. The case arose during a time in which no federal bankruptcy law was in force. Consequently, the Court’s decision, authored by Chief Justice John Marshall, speaks primarily to the powers retained by the states in light of both the Bankruptcy Clause and the Contract Clause.

As a general matter, Chief Justice Marshall explained,

> [S]ince the adoption of the constitution of the United States, a State has authority to pass a bankrupt law, provided such law does not impair the obligation of contracts, within the meaning of the constitution, and provided there be no act of Congress in force to establish a uniform system of bankruptcy, conflicting with such law.

Chief Justice Marshall provided a thoughtful review of the kinds of insolvency and bankruptcy laws in effect at the time, and noted the difficulty in drawing such distinctions. He then determined that the states retained the authority to enact such laws, regardless of the labels used to characterize them, provided that the laws were consistent with the Constitution—in other words, they did not vio-
late either the Bankruptcy Clause or the Contract Clause. Because no federal bankruptcy law was in force, the Contract Clause was the key issue in the case.

Chief Justice Marshall described a contract as “an agreement in which a party undertakes to do, or not to do, a particular thing.” The Framers arguably intended the Contract Clause to cover debt instruments like the promissory notes at issue in Sturges, but Chief Justice Marshall’s description illustrated the breadth of the Clause as reaching most kinds of contracts. He further explained, “The law binds him to perform his undertaking, and this is, of course, the obligation of his contract.... Any law which releases a part of this obligation, must, in the literal sense of the word, impair it.” The Court then struck down the New York law as impairing the obligation of contracts.

The Court’s next major decision on state bankruptcy laws, Ogden v. Saunders, again involved a New York debtor-creditor law that grants the debtor a discharge of her debts upon the consent of at least two-thirds of her creditors. The Court, this time with Chief Justice Marshall dissenting, restated several of the key themes from the Sturges opinion, but clarified that its holding in Sturges applied primarily with respect to contracts in existence at the time of the enactment of the state bankruptcy law and subject to the laws of that state. Contracts entered into after such time necessarily incorporated the limitations of the new law, according to the majority in Ogden. Thus, under the Court’s reasoning, a state bankruptcy

79. Id. at 196-97.
80. See id.
81. See id. at 197.
82. See id.
83. Id.
84. See id. at 208.
86. Chief Justice Marshall, Justice Gabriel Duvall, and Justice Story dissented, primarily on the ground that the Contract Clause should apply to all state laws impairing the obligation of contract, whether such law applied retroactively or prospectively. Id. at 354 (Marshall, C.J., dissenting) (“That the words of the clause in the constitution which we are considering, taken in their natural and obvious sense, admit of a prospective, as well as of a retrospective, operation.”).
87. See id. at 273 (Johnson, J.).
88. Id. at 301-04 (Thompson, J.). For a discussion of the Supreme Court’s later precedent on the Contract Clause, see infra notes 321-28 and accompanying text.
law that applied only prospectively likely could withstand a challenge brought under the Contract Clause.89

1. Cases Under Early Federal Bankruptcy Laws

Following Ogden, lower courts had the opportunity to consider the constitutionality of the Bankruptcy Acts of 1841 and 1867. In these decisions, relying on the Court’s description of the Bankruptcy Clause in Sturges and Ogden, courts determined that Congress could enact both bankruptcy and insolvency laws,90 that such laws could apply to debtors other than merchants (including corporations),91 and that they could facilitate a composition of creditors.92 These cases demonstrate the potential breadth of the Bankruptcy Clause and suggest that the term “bankruptcies” means something more than a law granting a discharge to debtors.93

The Supreme Court also had occasion to evaluate certain state laws in light of the Bankruptcy Act of 1867. In Boese v. King and Mayer v. Hellman, the Court upheld state laws facilitating or permitting the assignment of a debtor’s assets for the payment of creditors’ claims.94 Both cases recognized that state laws conflicting with the federal law, including the discharge provision of the New Jersey statute at issue in Boese, were suspended so long as the federal law remained in force.95 They also, however, upheld the assignments in

89. See Ogden, 25 U.S. (12 Wheat.) at 301-04.
90. See In re Klein, 14 F. Cas. 716, 718-19 (C.C.D. Mo. 1843) (No. 7,865) (upholding the 1841 Act and noting, “In considering the question before me, I have not pretended to give a definition, but purposely avoided any attempt to define the mere word ‘bankruptcy.’ It is employed in the constitution in the plural and as part of an expression—‘the subject of bankruptcies.’ The ideas attached to the word in this connection are numerous and complicated.”).
91. See In re Reiman, 20 F. Cas. 490, 494-95 (S.D.N.Y. 1874) (No. 11,673) (citing In re Silverman, 22 F. Cas. 135 (D. Or. 1870) (No. 12,855)).
92. See id. at 497 (“In view of all these considerations, how can it be said that these provisions for composition do not relate to the ‘subject of bankruptcies?’ They relate to the subject of debts owing by a debtor to creditors, and to the relation of the debtor to his creditors, in view of his assets and of such debts.”).
93. See id. at 496 (“What is the subject of bankruptcies? It is not, properly, anything less than the subject of the relations between an insolvent or non-paying or fraudulent debtor, and his creditors, extending to his and their relief.”).
95. Boese, 108 U.S. at 385-86; Mayer, 91 U.S. at 502-03.
each case, finding no conflict between those state law provisions not granting a discharge and the federal bankruptcy law. 96

Notably, the assignments at issue in Boese and Mayer were akin to traditional assignments for the benefit of creditors that were well recognized under states’ common and statutory laws. 97 These schemes generally permitted the debtor to transfer her property to an assignee or trustee, who would then distribute such property pro rata among the debtor’s creditors. 98 Such assignments generally were voluntary, were subject to bankruptcy cases commenced within six months of the assignment under the 1867 Act, and did not provide a discharge of any kind. 99 These basic attributes of traditional assignments are central to the Court’s decisions upholding state debtor-creditor laws during this period. 100

2. Cases Under the 1898 and 1978 Federal Bankruptcy Laws

The Court’s next significant opinion considered the scope of the Bankruptcy Clause and its impact on state laws related to the Bankruptcy Act of 1898, and the Court continued the trend of upholding state debtor-creditor laws akin to assignments. Specifically, in Stellwagen v. Clum, the Court analyzed two aspects of Ohio’s receivership law. 101 One aspect of the law continued Ohio’s practice of allowing creditors to challenge and avoid fraudulent transfers. 102 The other aspect of the law, which was new at the time, authorized the appointment of a receiver to take charge of, and distribute, the debtor’s assets and pursue creditors’ fraudulent transfer claims. 103 The Court considered whether the state law impeded creditors’ rights or otherwise conflicted with the policies of the Bankruptcy Code. 104 Answering those questions in the negative, the Court observed, “It is only state laws which conflict with the

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96. Boese, 108 U.S. at 387; Mayer, 91 U.S. at 502-03.
98. See, e.g., Boese, 108 U.S. at 384; Mayer, 91 U.S. at 500.
99. See, e.g., Mayer, 91 U.S. at 500-01.
100. See, e.g., Boese, 108 U.S. at 385-87; Mayer, 91 U.S. at 502-03.
101. 245 U.S. 605, 609 & n.1 (1918).
102. Id.
103. Id.
104. Id. at 611-12.
bankruptcy laws of Congress that are suspended; those which are in aid of the Bankruptcy Act can stand.”

Not long after Stellwagen, the Court had an opportunity to consider a fact pattern that directly tested the Court’s correlation between bankruptcy and discharge. In International Shoe Co. v. Pinkus, the Court reviewed an Arkansas law, similar to the New Jersey statute at issue in Boese, which permitted the assignment of a debtor’s assets and conditioned distributions to creditors upon their consent to a discharge of the debtor. The Court started from the basic premise that “[a] State is without power to make or enforce any law governing bankruptcies that impairs the obligation of contracts or extends to persons or property outside its jurisdiction or conflicts with the national bankruptcy laws.” It then scrutinized the Arkansas law at issue, noting that it was more than a mere assignment for the benefit of creditors in that “the property was not handed over simply for the purpose of the payment of debts as far as it would go.”

The Court found the discharge aspect of the Arkansas law fatal, rendering the state law unconstitutional in light of the federal Bankruptcy Act. Although the holding focused on discharge, the Court’s description of the field occupied by the federal Bankruptcy Act was much broader. For example, the Court observed,

It is clear that the provisions of the Arkansas law governing the distribution of property of insolvents for the payment of their debts and providing for their discharge, or that otherwise relate to the subject of bankruptcies, are within the field entered by Congress when it passed the Bankruptcy Act, and therefore such provisions must be held to have been superseded.

105. Id. at 615.
106. 278 U.S. 261, 266 (1929).
107. Id. at 263-64.
108. Id. at 266.
109. Id. at 268.
110. Id. at 265-66.
111. Id. at 266.
Subsequent opinions have noted the potential breadth of this language, but have generally required the discharge concept to support preemption.\textsuperscript{112}

For example, in \textit{Pobreslo v. Joseph M. Boyd Co.}, the Court upheld a Wisconsin law that facilitated an assignment for the benefit of creditors that was severable from the discharge provisions in the state law.\textsuperscript{113} In \textit{Pobreslo}, the Court quoted the Wisconsin Supreme Court’s explanation of the Wisconsin law,

\begin{quote}
In the matter of \textit{Voluntary Assignment of Tarnowski} ... it was held that the right to make a voluntary assignment for the benefit of creditors is a personal right inherent in the ownership of property, and existed at common law independent of the statute; that, while the discharge of a bankrupt from his debts constitutes the very essence of the Bankruptcy Law, the discharge of a debtor is no part of an assignment law.\textsuperscript{114}
\end{quote}

The Court also distinguished \textit{International Shoe} as involving a state law that “not only governed discharge of the bankrupt debtor but imposed conditions which trammeled and made against equal distribution of his property.”\textsuperscript{115} Consequently, state laws that allow debtors to assign their assets to a third party (for example, assignee, trustee, or receiver) for pro rata distribution to their creditors

\textsuperscript{112} Indeed, even in decisions prior to \textit{International Shoe}, the Court focused on discharge, but would not rule out a broader application of field preemption under the Bankruptcy Clause. For example, in \textit{Stellwagen}, the Court explained,

\begin{quote}
And while it is not necessary to decide that there may not be state insolvent laws which are suspended although not providing for a discharge of indebtedness, all the cases lay stress upon the fact that one of the principal requisites of a true bankruptcy law is for the benefit of the debtor in that it discharges his future acquired property from the obligation of existing debts.
\end{quote}

245 U.S. 605, 616 (1918). For an interesting discussion of whether a “discharge” provision is necessary to invalidate state law governing debtor-creditor relations, see Moskowitz v. Prentice (\textit{In re Wis. Builders Supply Co.}), 239 F.2d 649, 652 (7th Cir. 1956) (opining that a discharge provision is not necessary to suspend a state law preempted by a national bankruptcy act and collecting lower court decisions on the issue).

\textsuperscript{113} 287 U.S. 518, 525-26 (1933).

\textsuperscript{114} \textit{Id.} at 524 (omission in original) (quoting Hazelwood v. Olinger Bldg., Dep’t Stores Inc., 236 N.W. 591, 592 (Wis. 1931)).

\textsuperscript{115} \textit{Id.} at 525; \textit{see also} Johnson v. Star, 287 U.S. 527, 530 (1933) (relying on \textit{Pobreslo} in context of analyzing a Texas statute), \textit{But see Int’l Shoe Co.}, 278 U.S. at 266 (suggesting that preemption extends beyond the concept of discharge); \textit{In re Wis. Builders}, 239 F.2d at 652 (same).
generally are permissible and have withstood Supreme Court scrutiny. As the U.S. Court of Appeals for the Seventh Circuit has explained:

[Supreme Court precedent on the Bankruptcy Clause] implies a recognition of possible alternatives to bankruptcy and that the creditors have a choice of administration, i.e., either the assignee or receiver selected by the debtor or one selected and supervised under the provisions of the Bankruptcy Act. The question is not whether states may legislate at all, but rather how far may they go.\(^{116}\)

During this period, the Court also considered the permissible breadth of federal laws enacted under the Bankruptcy Clause. As discussed above, the 1898 Act included reorganization provisions for railroads and other business entities.\(^{117}\) It also allowed debtors—whether truly insolvent—to invoke these reorganization laws and the provisions of the Act generally.\(^{118}\) The Court in these and other instances upheld the constitutionality of the 1898 Act.\(^{119}\) As the Court explained in *Wright v. Union Central Life Insurance Co.*:

The right of the Congress to legislate on the subject of bankruptcies is granted by the Constitution in general terms.... The subject of bankruptcies is incapable of final definition. The concept changes. It has been recognized that it is not limited to the connotation of the phrase in England or the States, at the time of the formulation of the Constitution. An adjudication in bankruptcy is not essential to the jurisdiction. The subject of bankruptcies is nothing less than “the subject of the relations between an insolvent or nonpaying or fraudulent debtor and his creditors, extending to his and their relief.”\(^{120}\)

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116. *In re Wis. Builders*, 239 F.2d at 653-54 (striking down the involuntary proceeding provisions of the Wisconsin statute, finding that “[t]here is no doubt that Section 128.06 is suspended because it is in conflict with the subject matter covered by the federal law”; notably, the court did not invalidate the entire statute).

117. See supra Part I.C.1.

118. See supra Part I.C.1.


120. *Wright*, 304 U.S. at 513-14 (footnote omitted) (quoting *In re Reiman*, 20 F. Cas. 490, 496 (S.D.N.Y. 1874) (No. 11,673)).
A though the Court developed a rich body of case law analyzing the 1898 Act against the backdrop of the Bankruptcy Clause, the Court has not addressed many similar issues in the context of the 1978 Bankruptcy Code. Much of the Court’s jurisprudence on the Bankruptcy Code has related to jurisdictional issues or strict statutory interpretation and application issues. As a result, the lower federal courts and state courts have attempted to engraft the Court’s older precedent on newer issues arising under the Bankruptcy Code. The following Section summarizes this case law.

D. The Preemption Doctrine, Bankruptcy, and State Debtor-Creditor Laws

State debtor-creditor laws and federal bankruptcy laws have coexisted in one form or another since Congress enacted the first Bankruptcy Act in 1800. Nevertheless, both federal bankruptcy and state debtor-creditor laws have evolved since the Court’s last opinions addressing their coexistence in the 1930s. This changing landscape has created new potential preemption issues, particularly in the context of field and conflict preemption, doctrines under which preemption is implied rather than set out in the language of a federal statute.

In bankruptcy, as in other disciplines, field preemption speaks to federal law that is sufficiently comprehensive “to make reasonable the inference that Congress left no room for” supplementary state regulation. Conflict preemption, on the other hand, applies “when ‘compliance with both federal and state regulations is a physical impossibility,’ or when state law ‘stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.’” The following Sections first discuss recent Supreme

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121. See infra Part I.D.
122. See infra Part I.D.
123. See infra Part I.D.
124. See infra Part II.
125. See, e.g., Pobreslo v. Joseph M. Boyd Co., 287 U.S. 518 (1933); see also infra Part II.
126. See infra Part III.A.
127. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947). The Court also has explained that field preemption applies where “the federal interest is so dominant that the federal system will be assumed to preclude enforcement of state laws on the same subject.” Id.
Court precedent on the preemption doctrine involving disciplines other than bankruptcy and then turn to lower courts’ application of the preemption doctrine in the bankruptcy context.

1. The Supreme Court and the Preemption Doctrine

The Supreme Court’s jurisprudence on the federal preemption doctrine is extensive, not always consistent, and the subject of much commentary. This Section focuses on the Court’s discussions of implied preemption—specifically, field and conflict preemption—given the limited nature of any statutory preemption language in the Bankruptcy Code. That said, the Bankruptcy Clause itself authorizes Congress to occupy the field of bankruptcy, which should inform any analysis of congressional intent as to the scope, purposes, and objectives of the Bankruptcy Code.

The Court’s decision in Arizona v. United States is a good example of the often-overlapping inquiry of implied field and conflict preemption. The case involved certain laws passed by Arizona in an attempt to unilaterally address the issue of illegal immigration. (first quoting Fla. Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963); and then quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).

129. The Court’s case-by-case analysis of preemption questions often leads to different approaches and results in preemption cases. See, e.g., Lawrence O. Gostin, The FDA, Preemption, and Public Safety, HASTINGS CTR. REP., Sept.-Oct. 2011, at 11, 11 (criticizing Court’s preemption jurisprudence as “maddeningly inconsistent”); Alan Untereiner, The Defense of Preemption: A View from the Trenches, 84 TUL. L. REV. 1257, 1257 (2010) (finding that federal preemption “law is a muddle”). That said, the Court’s preemption precedent covers a wide array of industries, statutes, and considerations that may not readily lend itself to a cohesive approach. See Ernest A. Young, The Ordinary Diet of the Law: The Presumption Against Preemption in the Roberts Court, 2011 SUP. CT. REV. 253, 255 (positing that preemption cases “reflect, instead, the fact that any overarching framework of preemption principles must be applied to interpret a range of quite diverse statutory regimes, including many in which courts must share interpretive duties with federal agencies”).


131. See P.R. Dep’t of Consumer Affairs v. Isla Petroleum Corp., 485 U.S. 495, 503 (1988) (“There is no federal pre-emption in vacuo, without a constitutional text or a federal statute to assert it.”).

132. 132 S. Ct. 2492, 2500-02 (2012); see also id. at 2519-20 (Scalia, J., concurring in part and dissenting in part) (discussing overlap of field and conflict preemption analysis).
tion. The Court considered four provisions of the Arizona statute, finding three of the provisions preempted and one constitutional. Similar to the Bankruptcy Clause, Congress’s authority to enact federal immigration legislation also stems, in part, from Article I, Section 8, of the U.S. Constitution, which provides that Congress has the power “[t]o establish an uniform Rule of Naturalization.”

Also akin to the purpose of the Bankruptcy Clause, the Naturalization Clause was meant to protect commerce. As the Court in Arizona explained, “The federal power to determine immigration policy is well settled. Immigration policy can affect trade, investment, tourism, and diplomatic relations for the entire Nation.”

One of the provisions at issue in Arizona involved additional penalties imposed by the state for violations of the federal law. The Court considered the federal statutory scheme for the registration of aliens, and it determined that the scheme was comprehensive and addressed all aspects of alien registration, including the consequences of noncompliance. According to the Court, the scheme “was designed as a ‘harmonious whole.’” The Court observed, “Where Congress occupies an entire field, as it has in the field of alien registration, even complementary state regulation is impermissible.” In doing so, the Court rejected the State’s argument that its penalty provisions were simply in aid of the federal law.

The two other provisions of the Arizona statute struck down in the case attempted to criminalize conduct that was not addressed by

133. See id. at 2497-98.
134. See id. at 2510.
137. Id. at 2501-02.
138. Id. at 2502.
139. Id. (quoting Hines v. Davidowitz, 312 U.S. 52, 72 (1941)).
141. See Arizona, 132 S. Ct. at 2502.
the federal statute and to supplement the authority of state police officers with respect to the removability of aliens under the federal statute, respectively. In both instances, the Court held that the state law created “an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.” In reaching this conclusion, the Court analyzed and relied on the “text, structure, and history” of the federal legislation.

Not all of the members of the Supreme Court support a broad implied preemption doctrine. For example, in his dissent in Arizona and his concurrence in Wyeth v. Levine, Justice Clarence Thomas posited that preemption analysis should be based solely on the language of the applicable statutes. He explained that it “should not be ‘[a] freewheeling judicial inquiry into whether a state statute is in tension with federal objectives, but an inquiry into whether the ordinary meanings of state and federal law conflict.’” Nevertheless, the Court has continued to invoke the field preemption doctrine and a somewhat expansive consideration of the purposes and objectives of the federal statute at issue. Notably, however, the Court’s willingness to engage in a purposive analysis does not always result in federal preemption of the state law at issue.

The Court’s preemption analysis—whether or not solely textual—is guided by two long-standing preemption principles. “First, ‘the purpose of Congress is the ultimate touchstone in every preemption case.’” The Court frequently analyzes the history and

142. See id. at 2505.
143. Id. (quoting Hines, 312 U.S. at 67); see also Geier v. Am. Honda Motor Co., 529 U.S. 861, 883-86 (2000) (holding that the state law at issue was preempted because it conflicted with Congress’s and the Department of Transportation’s purpose in enacting federal regulation).
144. See Arizona, 132 S. Ct. at 2505.
145. See id. at 2522 (Thomas, J., concurring in part and dissenting in part).
147. Id. (alteration in original) (quoting Bates v. Dow Agrosciences LLC, 544 U.S. 431, 459 (2005) (Thomas, J., concurring in part and dissenting in part)).
148. See Meltzer, supra note 130, at 10-14.
149. See, e.g., Williamson v. Mazda Motor of Am., Inc., 562 U.S. 323, 336 (2011) (considering Congress’s and the Department of Transportation’s purpose underlying the regulation at issue and determining that the regulation did not preempt a state tort action on the same subject matter).
150. See Wyeth, 555 U.S. at 565 (quoting Medtronic, Inc. v. Lohr, 518 U.S. 470, 485 (1996)).
context of the federal legislation at issue in making this determination.  

Second, “[i]n all pre-emption cases, and particularly in those in which Congress has ‘legislated ... in a field which the States have traditionally occupied,’ ... we ’start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.”

At least one court of appeals has suggested that such a presumption is weaker in cases involving the Bankruptcy Clause and the regulation of creditors’ rights, which “has ‘a history of significant federal presence.’”

Despite its rich preemption precedent, the Supreme Court has not directly confronted preemption issues with respect to state debtor-creditor laws and business bankruptcies under chapter 11 of the Bankruptcy Code. In fact, the only recent Supreme Court case discussing preemption, general debtor-creditor laws, and the Bankruptcy Code in any meaningful way is *Puerto Rico v. Franklin California Tax-Free Trust*. In that case, creditors argued that chapter

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151. See supra notes 143-44 and accompanying text.

152. See *Wyeth*, 555 U.S. at 565 (alteration and omission in original) (quoting *Medtronic, Inc.*, 518 U.S. at 485). Many commentators have explored the extent of the presumption against preemption, with most acknowledging its continued role in Supreme Court decisions. See, e.g., Mary J. Davis, *The “New” Presumption Against Preemption*, 61 HASTINGS L.J. 1217, 1229 (2010) (concluding that the Court continues to apply the presumption, but with greater frequency in express preemption cases); *Young*, supra note 129, at 277-78.

153. *In re Tribune Co. Fraudulent Conveyance Litig.*, 818 F.3d 98, 111 (2d Cir. 2016) (quoting United States v. *Locke*, 529 U.S. 89, 90 (2000)), petition for cert. filed, No. 16-317 (U.S. Sept. 9, 2016). The Second Circuit also explained that, because “Congress's power to enact bankruptcy laws was made explicit in the Constitution as originally enacted ... and detailed, preemptive federal regulation of creditors' rights has, therefore, existed for over two centuries.” Id. at 111 (citations omitted); see also *Locke*, 529 U.S. at 108 (explaining that the presumption against preemption “is not triggered when the State regulates in an area where there has been a history of significant federal presence,” such as in the field of international shipping) (citing *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947)).

9 of the Bankruptcy Code (relating to municipal bankruptcies) preempted a restructuring law passed by Puerto Rico in 2014 in response to the island’s financial crisis. Although the parties raised implied preemption issues, the Court decided the case based solely on express preemption and the language of section 903 of the Bankruptcy Code. Lower courts thus are left to transfer principles from the Court’s very old Bankruptcy Act preemption cases and its general preemption jurisprudence to often complicated cases under chapter 11 of the Bankruptcy Code that raise nuanced issues not previously considered by the Court.

2. Lower Courts’ Application of the Preemption Doctrine in the Bankruptcy Context

Many courts confronted with a bankruptcy preemption issue under the Bankruptcy Code have upheld the particular state debtor-creditor law at issue. In fact, only one appellate court has

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155. See Franklin Cal. Tax-Free Tr., 136 S. Ct. at 1942-43. Puerto Rico enacted the 2014 Public Corporations Debt Enforcement and Recovery Act to help it address approximately $20 billion of its much larger overall debt obligations. See id. Puerto Rico’s bondholders challenged the legislation, and the Supreme Court ultimately held that the Bankruptcy Code preempted the law. See id. at 1943-44.

156. See id. at 1946. Under section 109(c) of the Bankruptcy Code, a municipality may only be a debtor under chapter 9 if authorized by the state. 11 U.S.C. § 109(c) (2012). Section 101(52) includes Puerto Rico and the District of Columbia in the definition of “State” as used in the Bankruptcy Code, “except for the purpose of defining who may be a debtor under chapter 9.” Id. § 101(52). The language of section 903, in turn, addresses what a state may do with respect to its municipalities given Congress’s decision to enact chapter 9 of the Bankruptcy Code. See id. § 903. The section specifically allows a state to continue to exercise control over its municipalities, including the municipalities’ financial affairs, other than the following: “[A] State law prescribing a method of composition of indebtedness of such municipality may not bind any creditor that does not consent to such composition; and ... a judgment entered under such a law may not bind a creditor that does not consent to such composition.” Id. The Court determined that section 903 applied to Puerto Rico and preempted its 2014 Recovery Act. Franklin Cal. Tax-Free Tr., 136 S. Ct. at 1947.

157. See, e.g., Ready Fixtures Co. v. Steven Cabinets, 488 F. Supp. 2d 787, 792 (W.D. Wis. 2007); In re Newport Offshore Ltd., 219 B.R. 341, 355 (Bankr. D.R.I. 1998); Cambio v. G-7 Corp., No. 96-0705, 1998 WL 1472896, at *6 (R.I. Super. Ct. Feb. 11, 1998). In addition, several courts have considered the validity of state laws that are bankruptcy-specific, such as state law exemptions that are only applicable if the debtor has filed a bankruptcy case. See, e.g., Richardson v. Schafer (In re Schafer), 689 F.3d 601, 614-16 (6th Cir. 2012) (upholding Michigan bankruptcy-specific exemptions as being contemplated by an opt-out provision in section 522 of the Bankruptcy Code and consistent with the fresh start objectives of the
preempted such a law since the enactment of the Bankruptcy Code.\(^{158}\) This trend is perhaps understandable given the Supreme Court precedent discussed above\(^{159}\) and the general presumption in favor of state laws when challenged on federal preemption grounds.\(^{160}\) Nevertheless, even a cursory review of these cases illustrates the need to rethink the relevance of a bankruptcy discharge to preemption, as well as the import of the Bankruptcy Clause’s reference to “subject of Bankruptcies.”\(^{161}\)

Bankruptcy Code). These cases generally invoke federal preemption analysis. See, e.g., id. at 614. Moreover, in 1994, the Supreme Court addressed the interplay of state foreclosure law and the Bankruptcy Code, holding that the price received through a properly conducted state foreclosure proceeding was reasonably equivalent value for purposes of section 548 of the Bankruptcy Code. See Resolution Tr. Corp., 511 U.S. at 545.

158. See Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1206 (9th Cir. 2005). Outside of state debtor-creditor laws, some lower courts have preempted various provisions of state law. See, e.g., In re Tribune, 818 F.3d at 123 (holding that creditors’ state law fraudulent conveyance claims were barred by section 546(e) of the Bankruptcy Code); Miles v. Okun (In re Miles), 430 F.3d 1083, 1091-92 (9th Cir. 2005) (holding that the doctrine of complete preemption barred the state law damages claim in light of section 303(i) of the Bankruptcy Code and relying on the Supreme Court’s decision finding preemption under the National Banking Act in Beneficial National Bank v. Anderson, 539 U.S. 1 (2003)); In re Bratt, 527 B.R. 303, 305 (Bankr. M.D. Tenn. 2015) (holding that the state law that set the interest rate on tax claims was preempted as being in conflict with, and frustrating the purposes of, the Bankruptcy Code), aff’d on other grounds, 549 B.R. 462 (B.A.P. 6th Cir. 2016), aff’d sub nom. In re Corrin, 849 F.3d 653 (6th Cir. 2017); In re Am. Suzuki Motor Corp., 494 B.R. 466, 477 (Bankr. C.D. Cal. 2013) (finding state law governing automobile dealerships preempted by section 365 of the Bankruptcy Code); In re Old Carco, LLC, 406 B.R. 180, 212 (Bankr. S.D.N.Y. 2009) (same result as In re American Suzuki Motor Corp.). But see Rosenberg v. DVI Receivables XVII, LLC, 835 F.3d 411, 421 (3d Cir. 2016) (disagreeing with the Ninth Circuit’s decision in Miles); PAH Litig. Tr. v. Water St. Healthcare Partners L.P. (In re Physiotherapy Holdings, Inc.), No. 13-12965(KG), 2016 WL 3611831, at *7 (Bankr. D. Del. June 20, 2016) (disagreeing with Second Circuit’s preemption holding in Tribune). The Third Circuit in Rosenberg distinguished the Miles decision because, in that case, the Ninth Circuit relied on “complete preemption,” which is different from the doctrine of field (or ordinary) preemption. Rosenberg, 835 F.3d at 421 n.4 (explaining the two doctrines). The Third Circuit explained complete preemption as preemption that “operates to confer original federal subject matter jurisdiction notwithstanding the absence of a federal cause of action on the face of the complaint.” Id. (quoting In re U.S. Healthcare, Inc., 193 F.3d 151, 160 (3d Cir. 1999)).

159. See supra Parts I.C-D.1.

160. See Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947) (“So we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress.” (first citing Napier v. Atl. Coast Line R.R. Co, 272 U.S. 605, 611 (1926); and then citing Allen-Bradley Local v. Wis. Emp’t Bd., 315 U.S. 740, 749 (1942)));

A good example of preemption analysis concerning state receivership laws and the Bankruptcy Code is the case of *In re Newport Offshore Ltd.*\(^{162}\) In *Newport Offshore*, the debtor was placed into state law receivership after emerging from an earlier chapter 11 bankruptcy case.\(^{163}\) The state law at issue authorized the appointment of receivers in an action by a creditor upon a showing of the company’s insolvency or potential waste of assets.\(^{164}\) The receivers were then empowered to liquidate the assets of the company, including through an asset sale free of interests.\(^{165}\) The law did not grant the debtor a discharge, but creditor collections outside of the receivership were highly unlikely because the debtor—an entity in this case—had no remaining assets.\(^{166}\)

The court in *Newport Offshore* started with the premise that Rhode Island had historically offered state law receiverships to its residents.\(^{167}\) It then considered whether Congress had evidenced intent to preempt this kind of receivership law through the adoption of the Bankruptcy Code and the exercise of its powers under the Bankruptcy Clause.\(^{168}\) The court determined that no such intent existed, pointing to the Supreme Court’s holding in *Pobreslo* and the absence of any discharge provision in the Rhode Island law.\(^{169}\) In so holding, the court observed, “Receivership or similar liquidation processes, available against (or invoked by) insolvent debtors are plainly preempted if they refuse to yield to, or interfere with, federal bankruptcy proceedings, but if they may be administered in harmony with the federal bankruptcy laws, they are not.”\(^{170}\)

Courts also have considered the constitutionality of state laws tangentially related to receiverships or assignments for the benefit

\(^{162}\) 219 B.R. 341 (Bankr. D.R.I. 1998). Notably, the receivership statute at issue in *Newport Offshore* was repealed, but the case is still an accurate representation of how some courts approach the issues. See 7 R.I. GEN. LAWS §§ 7-1.1-90 to -98 (1958), repealed by 2004 R.I. Pub. Laws 819.

\(^{163}\) 219 B.R. at 342-43.

\(^{164}\) See id. at 347.

\(^{165}\) See id. at 348; see also John T. Callahan & Sons, Inc. v. Dykeman Elec. Co., 266 F. Supp. 2d 208, 219 (D. Mass. 2003) (discussing the breadth of Rhode Island receivership law based on *Newport Offshore*).

\(^{166}\) See *In re Newport Offshore*, 219 B.R. at 343.

\(^{167}\) See id. at 346-47.

\(^{168}\) See id. at 349.

\(^{169}\) See id. at 355.

\(^{170}\) Id. at 353-54 (citations omitted).
of creditors (ABC), such as laws allowing an assignee or receiver to pursue fraudulent transfer or preference claims against the debtor’s transferees. Some courts have found that these laws align with the powers historically exercised by the states and are consistent with the Bankruptcy Code. The U.S. Court of Appeals for the Ninth Circuit disagreed, however, with respect to California’s preference statute that applied in the context of ABCs.171

In Sherwood Partners, Inc. v. Lycos, Inc., the Ninth Circuit struck down California’s preference statute, finding that “[t]he exercise of the preference avoidance power by Sherwood under the authority of [the preference statute] is inconsistent with the enactment and operation of the federal bankruptcy system and is therefore pre-empted.”172 The Ninth Circuit recognized the Supreme Court’s precedent in favor of voluntary assignments for the benefit of creditors.173 It was concerned, however, by the scope of California’s preference statute, which according to the Ninth Circuit created a new right in the assignee that would not have been available to individual creditors.174 This new right had the potential, in the court’s view, to conflict directly with the rights and remedies available to creditors under the Bankruptcy Code.175 It also could discriminate against out-of-state creditors who might benefit from a bankruptcy case.176 The Ninth Circuit concluded, “We believe that statutes that give state assignees or trustees avoidance powers beyond those that may be exercised by individual creditors trench too close upon the exercise of the federal bankruptcy power.”177

Both the dissent in Sherwood Partners and subsequent decisions outside of the Ninth Circuit have criticized the Sherwood Partners holding.178 The primary criticism suggests that the California law is

171. Sherwood Partners, Inc. v. Lycos Inc., 394 F.3d 1198, 1206 (9th Cir. 2005).
172. Id.
173. See id. at 1205.
174. See id.
175. See id.
176. See id. at 1204.
177. Id. at 1205.
no different than other aspects of involuntary assignment laws that have been upheld by courts, including the Supreme Court.\textsuperscript{179} As the dissent explained, “[I]t is well established that there is a common-law right to make an assignment ... for the benefit of creditors. It is thus illogical that state laws that provide a forum for the equitable distribution of that property should be preempted by federal bankruptcy law.”\textsuperscript{180}

As a general proposition, the dissent's position in \textit{Sherwood Partners} has some appeal, in that it appears consistent with the Supreme Court's precedent on preemption in the bankruptcy context.\textsuperscript{181} But the devil may be in the details. For example, does it suggest that any state law enacted as part of the state's receivership or ABC law is valid so long as it does not grant the debtor a discharge? Although such a law may garner a presumption of validity, the remainder of this Article suggests a more robust and in-depth analysis of state laws purporting to facilitate and govern the collection and distribution of the assets of a business debtor. In that analysis, a central consideration, discussed below, is that state laws facilitating business reorganizations are not within the historical police powers of the state, but rather are one of the core features of federal bankruptcy law.

\section*{II. BLURRING BOUNDARIES BETWEEN FEDERAL AND STATE BANKRUPTCY LAWS}

As evidenced by the history of federal bankruptcy laws, a strong and predictable business bankruptcy scheme is critical to economic growth, market stability, and job creation and preservation.\textsuperscript{182} The United States has been an innovator and leader in business

\begin{footnotesize}
\textsuperscript{179} See \textit{Sherwood Partners}, 394 F.3d at 1206-08 (Nelson, J., dissenting).
\textsuperscript{180} Id. at 1207.
\textsuperscript{181} See id. at 1206-08.
\end{footnotesize}
bankruptcy, particularly since the promulgation of the 1978 Bankruptcy Code. The Code introduced a “debtor in possession” concept that allows a company’s management to stay in control of the debtor’s business and reorganization efforts throughout the chapter 11 case.

Chapter 11 arguably occupies the field of business reorganizations. Congress and the Supreme Court nonetheless have recognized the important role that state laws play in debtor-creditor matters involving businesses. These state laws include ABCs and receiverships, and they primarily focus on the collection and distribution of a debtor’s assets. A few states have amended their laws, however, to mimic key aspects of the Bankruptcy Code, including those integral to facilitating reorganizations. This Section compares certain state debtor-creditor laws with the Bankruptcy Code and lays the groundwork for an analysis of the constitutionality of such state laws.

A. Chapter 11 of the Bankruptcy Code

Chapter 11 of the Bankruptcy Code fosters the reorganization of financially distressed companies. Congress enacted chapter 11 as part of its overhaul of federal bankruptcy law in 1978. As a conceptual matter, chapter 11 draws on the strengths of the prior business reorganization chapters—in particular, Chapters X, XI, and XII of the 1898 Bankruptcy Act—and strives to rehabilitate distressed businesses while maximizing creditor recoveries. Both the legislative history of chapter 11 and Supreme Court cases applying chapter 11 emphasize the importance of the rehabilitation

183. See Martin, supra note 182, at 2-7.
185. For a general discussion of state law receiverships and ABCs, see 12 BUSINESS ORGANIZATIONS WITH TAX PLANNING §§ 155.01, 156.03 (Matthew Bender & Co., Inc. ed., 2017); see also infra notes 332-34 and accompanying text. See generally THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (1986) (explaining and comparing the individual creditor rights under state law with the collective remedy provided by federal bankruptcy law).
186. See infra notes 239-44 and accompanying text.
188. See Tabb, supra note 20, at 35.
189. For a detailed explanation of each chapter under the Bankruptcy Act, see id. at 35-38.
goal.\textsuperscript{190} For example, the House report explains, “The purpose of a business reorganization case, unlike a liquidation case, is to restructure a business’s finances so that it may continue to operate, provide its employees with jobs, pay its creditors, and produce a return for its stockholders.”\textsuperscript{191}

A company commences a chapter 11 case by filing a petition with the bankruptcy court.\textsuperscript{192} It does not have to be insolvent to do so.\textsuperscript{193} The filing triggers the protection of the court and the automatic stay of section 362 of the Bankruptcy Code.\textsuperscript{194} The automatic stay, as its name implies, immediately halts any litigation and collection actions against the debtor to the extent those matters relate to pre-petition activities.\textsuperscript{195} It often is critical to the debtor’s reorganization efforts, as it allows the debtor to catch its financial breath and evaluate its reorganization alternatives.\textsuperscript{196} It also often provides any creditors’ committee appointed in the case an opportunity to review the financial affairs of the debtor in possession and to better monitor the debtor’s conduct during the case.\textsuperscript{197}

\textsuperscript{190.} See, e.g., NLRB v. Bildisco & Bildisco, 465 U.S. 513, 528 (1984) (“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.” (citing the 1978 House report referenced infra note 191)).


\textsuperscript{192.} 11 U.S.C. § 301 (2012) (“A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter.”). In certain situations, creditors also may file an involuntary petition for bankruptcy against a debtor under either chapter 7 (providing for a straight liquidation of the debtor’s assets) or chapter 11 of the Bankruptcy Code. Id. § 303.

\textsuperscript{193.} See, e.g., In re Marshall, 300 B.R. 507, 510 (Bankr. C.D. Cal. 2003) (“As a statutory matter, it is clear that the bankruptcy law does not require that a bankruptcy debtor be insolvent, either in the balance sheet sense (more liabilities than assets) or in the liquidity sense (unable to pay the debtor’s debts as they come due), to file a chapter 11 case or proceed to the confirmation of a plan of reorganization.”), aff’d, 403 B.R. 668 (C.D. Cal. 2009), aff’d, 721 F.3d 1032 (9th Cir. 2013).

\textsuperscript{194.} 11 U.S.C. § 362(a)(1) (defining scope of automatic stay and explaining, among other things, that a bankruptcy petition “operates as a stay ... of ... the commencement or continuation ... of a judicial, administrative, or other action or proceeding against the debtor that was or could have been commenced before the commencement of the case under this title”).

\textsuperscript{195.} See id.

\textsuperscript{196.} See A. Mechele Dickerson, The Many Faces of Chapter 11: A Reply to Professor Baird, 12 AM. BANKR. INST. L. REV. 109, 119 (2004) (“One primary benefit of filing for bankruptcy is that it gives debtors the protection of the automatic stay, which prevents creditors from seizing the debtors’ assets and also prevents landlords from immediately removing debtors from leased premises (something that is especially beneficial for small businesses.”).

\textsuperscript{197.} Section 1102(a)(1) of the Bankruptcy Code provides, subject to certain exceptions,
Traditionally, companies sought to reorganize under chapter 11 by negotiating and confirming chapter 11 plans of reorganizations. The chapter 11 plans represent a new contract between the debtor and its creditors. Most plans restructure the debtor’s balance sheet and streamline business operations by, for example, distributing the value of the business to prepetition creditors through new debt and equity issuances, rejecting burdensome contracts and leases, and selling noncore assets. The debtor’s prepetition equity interests often are extinguished through this process, with some creditors receiving all or a portion of the reorganized debtor’s equity in satisfaction of their prepetition debt. Upon confirmation of the plan, the debtor’s business continues with a new debt and equity structure, and the debtor may receive a discharge from its prepetition obligations.

More recently, distressed companies have been “reorganizing” under chapter 11 by selling their businesses as going concerns free of the debtor’s obligations. This strategy, similar to a traditional
plan of reorganization under chapter 11, permits the business to continue to operate after the bankruptcy case, free of legacy costs and other prepetition obligations. Under both a plan and a going-concern reorganization sale, prepetition equity holders or new equity holders may own the post-bankruptcy business, with the latter (a change of control) occurring in most cases. Although the “debtor” does not receive a statutory “discharge” in the sale context, the Bankruptcy Code and the court’s order authorizing the sale cleanse the business of prepetition obligations in a manner mirroring the statutory discharge.

Although several aspects of the Bankruptcy Code facilitate a debtor’s reorganization under chapter 11, a few specific provisions merit special mention. For example, the following provisions give a debtor the time and the ability to finance and streamline its business operations: section 362 automatically stays most kinds of prepetition litigation and collection actions against the debtor; Notably, many courts interpret section 363 of the Bankruptcy Code to release all claims and interests, including successor liability and environmental claims, against the debtor’s assets. See, e.g., Robert G. Sable et al., When the 363 Sale Is the Best Route, 15 J. BANKR. L. & PRAC. 121, 123 (2006) (explaining the scope and advantages of free and clear sale). This result is akin to that obtained under section 1141(c) (effect of confirmation of a plan), which provides, “[T]he property dealt with by the plan is free and clear of all claims and interests of creditors.”

Notably, many courts interpret section 363 of the Bankruptcy Code to release all claims and interests, including successor liability and environmental claims, against the debtor’s assets. See, e.g., Robert G. Sable et al., When the 363 Sale Is the Best Route, 15 J. BANKR. L. & PRAC. 121, 123 (2006) (explaining the scope and advantages of free and clear sale). This result is akin to that obtained under section 1141(c) (effect of confirmation of a plan), which provides, “[T]he property dealt with by the plan is free and clear of all claims and interests of creditors.”

Additionally, section 363(f) may be even broader than a plan discharge. Moreover, the protection provided to the purchaser of the debtor’s assets under section 363(f) is akin to the “discharge” of the debtor provided by section 1141(d) upon confirmation of a plan. In both instances, the debtor’s assets and the owner of those assets are freed from prepetition claims; prepetition creditors are forced to look solely to the sale proceeds or to the recoveries provided by the plan. In each scenario, prepetition creditors also may have access to the proceeds of avoidance or other actions pursued by the estate or post-confirmation trust, but again the limited nature of recourse is similar. There effectively remains no entity against which prepetition creditors can assert their claims. See also Dickerson, supra note 196, at 119-20 (explaining breadth of free and clear sales); Melissa B. Jacoby & Edward J. Janger, Ice Cube Bonds: Allocating the Price of Process in Chapter 11 Bankruptcy, 123 YALE L.J. 862, 875-89 (2014) (noting that 363 sales have become the preferred method of selling distressed companies because of the ability to sell assets free and clear and also discussing potential issues posed by the increasing use of quick going-concern sales in bankruptcy).
section 364 allows a debtor in possession to obtain postpetition financing on terms that it could not otherwise obtain outside of bankruptcy without the consent of pre-existing lenders—for example, new credit backed by a pari passu or senior lien on the debtor’s collateral; section 365 authorizes the debtor in possession to assume, assume and assign, or reject prepetition executory contracts and unexpired leases; and section 363 provides the debtor in possession defined rights to sell, use, and lease its assets. The debtor in possession can use these provisions to sell noncore assets and, together with the rejection of contracts and leases under section 365, create efficiencies in its business operations during its bankruptcy case.

In addition, as explained above, one of the primary goals of chapter 11 is the rehabilitation of the debtor’s business. Chapter 11 fosters this goal by allowing the debtor in possession to confirm a plan of reorganization under section 1129 of the Bankruptcy Code with, or, under certain circumstances, without the support of all creditors. Section 1129 contemplates a debtor selling its business through the plan process. A court will typically also permit the debtor in possession to sell its business as a going concern under section 363.

207. Id. § 364.
208. This provision allows the debtor to make this decision in its business judgment for most kinds of contracts and leases without the consent of the nondebtor counterparty. Id. § 365.
209. The debtor in possession also can sell all or substantially all of its assets under section 363, facilitating a going-concern reorganization sale of the business. The debtor in possession can pursue both one-off asset sales and going-concern reorganization sales “free and clear” of all liens and encumbrances under section 363(f). Id. § 363.
210. Id. § 365.
211. See supra notes 189-91 and accompanying text; see also H.R. REP. No. 95-595, at 220 (1977), as reprinted in 1978 U.S.C.C.A.N. 5963, 6179 (“The premise of a business reorganization is that assets that are used for production in the industry for which they were designed are more valuable than those same assets sold for scrap.”).
213. See id. §§ 1123(a)(5), 1129(b)(2)(A)(i)(ii) (discussing sale in cramdown context); 7 COLLIER ON BANKRUPTCY, supra note 198, ¶ 1129.04[2][b][i] (“The plan must anticipate a sale, either contained in the plan itself, or postconfirmation. Inclusion of the sale in the plan is not troublesome as section 1123 expressly anticipates that a sale of all or some assets can be a means to implement the plan.”).
If the debtor in possession confirms a plan of reorganization, the reorganized debtor—in other words, the business that continues operating after confirmation and the effective date of the plan—receives the benefit of a discharge under section 1141. A business that liquidates under chapter 11 is not eligible to receive a discharge under that section. Nevertheless, an order authorizing a going-concern reorganization sale of the debtor’s business free of liens and encumbrances has essentially the same effect as a confirmed plan, in that the debtor’s business continues after the bankruptcy and the business is free of the debtor’s prepetition obligations.

In contrast to chapter 11, chapter 7 of the Bankruptcy Code offers a process to liquidate a debtor’s assets to pay creditors. A trustee replaces the debtor’s management upon or shortly after the filing of the chapter 7 petition, and the trustee’s primary objective is to identify, collect, and liquidate the debtor’s assets for the benefit of creditors. Although the court may authorize the chapter 7 trustee to continue the debtor’s business and even seek a going-concern sale under section 363, those sales much more frequently occur in chapter 11 under the direction of the company’s management. A business debtor does not receive a discharge in a chapter 7 case.

B. State Debtor-Creditor Laws

A variety of state laws affect the debtor-creditor relationship. State law has traditionally governed the formation and enforcement

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216. See id. § 1141(d)(3)(A).
217. See Jacoby & Janger, supra note 205, at 893 (“At least in theory, these sales can preserve going-concern value and transfer clear title to complex assets—from software licenses to whole companies, solving fragmentation and assemblage problems, and addressing issues of successor liability in relatively short order.”); see also supra note 205.
218. See 6 Collier on Bankruptcy, supra note 198, ¶ 700.01 (explaining basic elements of chapter 7 bankruptcy). State debtor-creditor law and chapter 7 of the Bankruptcy Code have historically overlapped to the extent that both seek to liquidate a debtor's assets to pay creditors' claims. See infra Part II.B. This Article focuses primarily on the increasing overlap between state debtor-creditor law and chapter 11 of the Bankruptcy Code because the reorganization objective is reserved to chapter 11 of the Bankruptcy Code. In addition, that overlap more vividly illustrates the potential and significant conflicts between state law and the provisions and purposes of the Bankruptcy Code.
219. See 6 Collier on Bankruptcy, supra note 198, ¶ 721.02.
220. See id. ¶ 700.05 (explaining the scope of discharge in chapter 7).
of contracts underlying the relationship, as well as creditors’ basic rights and remedies upon a default by the debtor.\textsuperscript{221} Aspects of state property law, commercial law, and business law, among others, may be relevant to any given business debtor’s obligations to creditors. That debtor’s default may trigger a state law foreclosure action, collection action, or fraudulent transfer action.\textsuperscript{222} It also may result in an assignment for the benefit of creditors or a receivership, in which the receiver is charged with the preservation and perhaps liquidation of the debtor’s assets.\textsuperscript{223}

In general, state debtor-creditor laws focus on creditors’ remedies.\textsuperscript{224} For example, a plaintiff in litigation may seek the appointment of a receiver to preserve the defendant’s assets pending resolution of the litigation.\textsuperscript{225} This use of a receiver helps to ensure that the defendant has assets to pay any damages award.\textsuperscript{226} A court may also appoint a receiver upon the dissolution of a company or upon the request of a company, its shareholders, or its creditors to facilitate the liquidation of the company’s assets and the payment of creditors’ claims from the proceeds.\textsuperscript{227} Such a receiver may receive general authority over all of the company’s assets or limited authority over certain assets subject to a particular creditor’s liens.\textsuperscript{228} A distressed company also may use an ABC to achieve similar

\textsuperscript{221} See supra note 27 (discussing creditors’ remedies under state law); see also Butner v. United States, 440 U.S. 48, 55 (1979) (“Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding.”).

\textsuperscript{222} See Comm. on Bankr. & Corp. Reorganization, N.Y.C. Bar Ass’n, Non-Bankruptcy Alternatives to Restructurings and Asset Sales, 1, 3-4 (2010).

\textsuperscript{223} See 12 Business Organizations with Tax Planning, supra note 191, §§ 155.01, 156.03.

\textsuperscript{224} See, e.g., Steve H. Nickles, Radical Reductionism in Debtor-Creditor Law, 39 Cath. U. L. Rev. 765, 765 (1990) (explaining that state debtor-creditor laws “serve two main purposes. It describes when and how property of a debtor is forcibly taken and applied to satisfaction of debt. Equally important, debtor-creditor law also determines the order of paying the debtor’s creditors from the property.”).


\textsuperscript{226} See id.

\textsuperscript{227} See, e.g., N.C. Gen. Stat. § 1-507.1 (2016) (providing for the appointment of a receiver “[w]hen a corporation becomes insolvent or suspends its ordinary business for want of funds, or is in imminent danger of insolvency”).

\textsuperscript{228} See id. § 1-507.2.
results. In an ABC, the debtor assigns all of its assets to a trustee or assignee, who then liquidates those assets to pay creditors’ claims.

State receivership and ABC law may be governed by statute or developed under the common law. Consequently, state law varies on these kinds of creditor remedies. Most states authorize the appointment of a receiver if the debtor is insolvent or in danger of becoming insolvent, wasting assets, or dissolving. The scope of the receiver’s duties and powers may include preserving the assets, liquidating the assets, and paying creditors. The receiver also may have the authority to pursue claims and causes of action on behalf of the debtor and to object to creditors’ claims. In these contexts, the receiver has traditionally been viewed as a neutral fiduciary appointed by the court to facilitate the payment of creditors.

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230. See id. at 1456-57.

231. See 12 Business Organizations with Tax Planning, supra note 185, § 156.03 (noting that “an assignment for the benefit of creditors is based on trust law, sometimes supplemented or modified by a specific state statute”). For a discussion of equity receiverships under common law, see infra Part III.B.

232. See Geoffrey L. Berman, General Assignments for the Benefit of Creditors 3 (David Gould ed., 3d ed. 2015) (noting that the law governing ABCs “varies from state to state”); Morrison, supra note 7, at 258 n.4 (observing variance in state law and noting, “An ABC, for example, is regulated by statute and overseen by courts in New York; it is unregulated and requires no court involvement in Illinois”).

233. See 12 Business Organizations with Tax Planning, supra note 185, § 155.01.

234. See id. § 155.04.

235. For example, in the context of insolvent corporations, the Delaware General Corporate Law provides:

Whenever a corporation shall be insolvent, the Court of Chancery, on the application of any creditor or stockholder thereof, may, at any time, appoint 1 or more persons to be receivers of and for the corporation, to take charge of its assets, estate, effects, business and affairs, and to collect the outstanding debts, claims, and property due and belonging to the corporation, with power to prosecute and defend, in the name of the corporation or otherwise, all claims or suits, to appoint an agent or agents under them, and to do all other acts which might be done by the corporation and which may be necessary or proper. The powers of the receivers shall be such and shall continue so long as the Court shall deem necessary.

Del. Code Ann. tit. 8, § 291 (2017); see also id. § 279 (providing a similar right to pursue claims for trustees and receivers of dissolved corporations).

236. See Jonathan P. Friedland, Strategic Alternatives for and Against Distressed Businesses § 1:6 (Robert Hammke & Elizabeth B. Vandespeeg eds., 2017) (“A receiver is a fiduciary charged with the preservation or operation of assets pending some other
Over time, states have amended their receivership and ABC statutes to enlarge the role and powers of the receiver or assignee and the purpose of the receivership or ABC in the distressed company context.\(^\text{237}\) For example, state receivership laws may authorize the receiver to pursue not only claims and causes of action held by the debtor, which constitute part of the debtor’s assets, but also individual creditor remedies such as fraudulent transfer and preference actions.\(^\text{238}\) Moreover, some states have modified and expanded their receivership statutes (and, in at least two states, extended these powers to assignees in ABCs) to look like mini Bankruptcy Codes.\(^\text{239}\) These enhanced statutes include, for example, the imposition of an automatic stay, the unilateral treatment of contracts and leases, and the sale of the business as an operating entity (or going concern) free of the debtor’s obligations.\(^\text{240}\) Several of these changes in particular raise questions concerning the Bankruptcy Clause and federal preemption and potential violations of the Contract Clause.

The State of Washington’s Receivership Act is a good example of the various changes being incorporated into an integrated scheme of receivership that mimics the Bankruptcy Code. As one summary of the statute explains, “The 2004 amendments greatly improved


\(^{238}\) See, e.g., Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1205-06 (9th Cir. 2005) (holding a California state preference law preempted by the Bankruptcy Code); Ready Fixtures Co. v. Stevens Cabinets, 488 F. Supp. 2d 787, 790-92 (W.D. Wis. 2007) (upholding a receiver’s right under Wisconsin state law to recover alleged preferential transfers and disagreeing with the Ninth Circuit’s conclusion in Sherwood Partners).

\(^{239}\) See Minn. Stat. § 577.18 (2016) (providing that an assignment for the benefit of creditors is governed generally by Minn. Stat. §§ 576.21-.53); Wash. Rev. Code § 7.08.030(1) (providing that the debtor must consent to have the assignment for the benefit of creditors governed generally by Wash. Rev. Code ch. 7.60).

the Act, and were largely aimed at making it function more like the Bankruptcy Code.241 The Washington statute authorizes a court to appoint both general and custodial receivers.242 The statute further explains, “A receiver must be a general receiver if the receiver is appointed to take possession and control of all or substantially all of a person’s property with authority to liquidate that property and, in the case of a business over which the receiver is appointed, wind up affairs.”243 Both the court and the receiver (which includes an assignee in an ABC) have broad powers under the Receivership Act.244

In addition, the amendments to the Receivership Act adopted in 2004 introduced, among other things, an automatic stay, the ability to sell assets free of liens and encumbrances, and the assumption or rejection of executory contracts and unexpired leases. Each of these provisions generally tracks the language of the Bankruptcy Code, but as noted here and below, there are important differences throughout the statute. For example, the Receivership Act implements a stay of litigation and collection actions against the debtor and its property for a period of sixty days, which may be extended by the court.245 This stay does not, however, extend to pending litigation initiated by a creditor who sought the receivership.246

The Receivership Act also authorizes the “receiver [to] assume or reject any executory contract or unexpired lease of the person over whose property the receiver is appointed upon order of the court.

242. WASH. REV. CODE § 7.60.015.
243. Id.
244. The statute, for example, provides,

Exception as otherwise provided for by this chapter, the court in all cases has exclusive authority over the receiver, and the exclusive possession and right of control with respect to all real property and all tangible and intangible personal property with respect to which the receiver is appointed, wherever located, and the exclusive jurisdiction to determine all controversies relating to the collection, preservation, application, and distribution of all the property.

Id. § 7.60.055(1). A receiver can, among other things, operate the debtor’s business and pursue claims not only of the debtor, but also fraudulent transfer claims of the debtor’s creditors. See id. §§ 7.60.060(1), 19.40.071(a)(3)(ii), amended by S. 5085, 65 Leg., Reg. Sess. (Wash. 2017).
245. Id. § 7.60.110(2).
246. See id. § 7.60.110(3)(a). Notably, the automatic stay under the Bankruptcy Code generally does extend to such creditors, placing all creditors on a more level playing field. See 11 U.S.C. § 362(a)(1) (2012).
following notice to the other party to the contract or lease upon notice and a hearing.” This provision overrides ipso facto clauses—allowing the receiver to assume or reject a contract or lease despite a provision terminating the agreement upon certain conditions relating to the debtor's financial condition—and relegates any claims of the counterparty upon rejection to a pre-receivership claim. Moreover, subject to certain limited exceptions, the Receivership Act permits the sale of the debtor’s property “free and clear of liens and of all rights of redemption, whether or not the sale will generate proceeds sufficient to fully satisfy all claims secured by the property.”

A receiver under the Washington Receivership Act is authorized to operate the debtor’s business, obtain receivership financing, pursue the debtor’s claims and causes of action, invoke the rights of individual creditors, and object to claims submitted in the receivership. The statute also limits the rights of utilities upon the commencement of the receivership in a manner similar to section 366 of the Bankruptcy Code, and it bars creditors who fail to submit timely proofs of claim from participating in distributions. The Act purports to bind all creditors, providing that

[c]reditors and parties in interest to whom written notice of the pendency of the receivership is given in accordance with RCW 7.60.210, and creditors or other persons submitting written claims in the receivership or otherwise appearing and participating in the receivership, are bound by the acts of the receiver with

247. WASH. REV. CODE § 7.60.130(1).
248. See id. § 7.60.130(2)-(3). These provisions are among the traditional reorganization powers of a bankruptcy trustee or debtor in possession. See, e.g., 11 U.S.C. § 365(e), (g).
249. WASH. REV. CODE § 7.60.260(2). The statute further provides,
Orders of the court with respect to the treatment of claims and disposition of estate property, including but not limited to orders providing for sales of property free and clear of liens, are effective as to any person having a claim against or interest in the receivership estate and who has actual knowledge of the receivership, whether or not the person receives written notice from the receiver and whether or not the person appears or participates in the receivership.

Id. § 7.60.190(4).
250. Id. §§ 7.60.060(1), 7.60.140(1), 7.60.160(1), 7.60.220(1).
251. Compare id. § 7.60.120, with 11 U.S.C. § 366.
252. WASH. REV. CODE § 7.60.210(1).
regard to management and disposition of estate property whether or not they are formally joined as parties.253

Under the Act, a receiver can sell the debtor’s business as a going concern free of all liens and encumbrances, as well as reject burdensome executory contracts and leases.254 This process allows the distressed business to continue in operation post-receivership while barring pre-receivership creditors from pursuing claims against the business. Yet creditors do not receive the same treatment and protections as under the Bankruptcy Code.

For example, under the Washington statute, a secured creditor’s after-acquired property clause extends to post-receivership property; this treatment differs from the scope of permissible after-acquired property clauses in bankruptcy.255 The priority scheme for distribution purposes varies,256 and contract rights may be terminated without certain protections typically afforded to counterparties by the Bankruptcy Code or the Constitution.257 Creditors are not able to depose, or conduct an inquiry of, the debtor as under Bankruptcy Rule 2004, which often allows individual creditors to determine issues relating to their claims and the location of various assets, wherever located.258 The state law does not provide full “safe harbor” protections for qualified financial contracts (for example, swap agreements, securities contracts, forward contracts, commodities contracts, and repurchase agreements), subjecting these contracts and any payments made thereunder to the powers of the receiver.259

253. Id. § 7.60.190(1).
254. Id. §§ 7.60.260(1), 7.60.130(1).
258. The receiver may have the ability to depose the debtor, see WASH. REV. CODE § 7.60.060(1)(i), but that is different from Bankruptcy Rule 2004, which provides that “[o]n motion of any party in interest, the court may order the examination of any entity.” FED. R. BANKR. P. 2004(a). The term “party in interest,” in turn, is defined broadly, and parties in interest generally have standing to appear and be heard on any matter in a chapter 11 bankruptcy case. See 11 U.S.C. § 1109(b).
259. The Bankruptcy Code generally exempts qualified financial contracts from the automatic stay, preference, and fraudulent conveyance provisions of the Code, as well as permits parties to terminate and close out those contracts (despite provisions in the Code that override ipso facto clauses). See generally 11 U.S.C. §§ 362(b)(27), 546(e)-(g), (j), 555, 556, 559, 560, 561(a), 562. State law may pick up a few of these protections (or none at all), but differences in coverage and application will likely exist. See, e.g., WASH. REV. CODE § 7.60.110(3)(g)
In addition, it is unclear whether state law provides the same robust noticing of creditors or the same level of court oversight as under the Bankruptcy Code; state law certainly does not provide for the appointment of a creditors’ committee or oversight by an independent party, such as the U.S. Trustee or Bankruptcy Administrator, thus limiting protections available for unsecured creditors.

Notably, Washington is not the only state to expand its receivership laws to foster the continuation of distressed businesses through a process that alters the rights of creditors and other stakeholders. Minnesota and Missouri have each enacted receivership statutes that contain some, if not all, of the provisions included in the Washington statute discussed above. Moreover, as noted above,
the Washington and Minnesota statutes grant assignees in ABCs rights and powers akin to receivers under these receivership acts. Commentators readily note the strong resemblance between these amended state statutes and federal bankruptcy law.

C. Potential Implications of Changes to State Debtor-Creditor Laws

States historically have adopted laws to facilitate the liquidation of debtors’ assets. These laws allow states to assist their residents, including business entities, with a timely and cost-effective distribution of a debtor’s assets in satisfaction of creditors’ claims. That kind of basic liquidation mechanism is an important component of debtor-creditor law. But the extension of these laws to include processes that enable a distressed business to continue despite not paying its creditors raises serious preemption questions that are underdeveloped in the existing literature. This is not to say that laws promoting the rehabilitation of distressed businesses are ill-advised. Rather, the critical question is whether federal and state bankruptcy laws that facilitate such relief can coexist in light of the Bankruptcy Clause and other constitutional concerns.

The following Section analyzes these state law developments in light of the Bankruptcy and Contract Clauses, along with the Supreme Court’s jurisprudence on the enforcement of these constitutional provisions. Although Congress could expressly preempt state bankruptcy laws, it has not yet chosen to do so other than in the limited context of chapter 9. Accordingly, the inquiry focuses

264. See supra note 16.
265. See, e.g., John Young, Jr., Missouri Commercial Receivership Act Creates a New Statutory Scheme Which Presents a More Robust Remedy, JDsupra (Aug. 3, 2016), http://www.jdsupra.com/legalnews/misouri-commercial-receivership-act-37797/ [https://perma.cc/KG6R-7SK9] (“Many subjects covered by the MCRA [amended Missouri receivership statute] are similar to federal bankruptcy provisions, such as [the automatic stay, executory contract, and sale provisions].”).
266. See Marine Harbor Props., Inc. v. Mfrs. Tr. Co., 317 U.S. 78, 83 (1942) (“The federal bankruptcy power is, of course, paramount and supreme and may be so exercised by Congress as to exclude every competing or conflicting proceeding in state or federal tribunals.”).
267. 11 U.S.C. § 903 (preempting certain state laws concerning the adjustment of debts for municipal debtors). The preemption issue in the chapter 9 context (and perhaps the state debtor-creditor law context discussed in Part II.B of this Article) raises interesting federalism questions that are subject to much scholarly debate. See, e.g., Melissa B. Jacoby, Federalism
on implied preemption under the field and conflict preemption doctrines. State bankruptcy laws not only conflict with federal bankruptcy law in certain instances, but they also subject creditors to disparate treatment and undermine the uniformity of bankruptcy laws.

III. THE NEED TO RETHINK BOUNDARIES TO ACHIEVE THE OBJECTIVES OF THE BANKRUPTCY CLAUSE

The Bankruptcy Clause gives Congress the authority to establish uniform laws “on the subject of Bankruptcies.” The concept of a “fresh start” that allows a debtor to rehabilitate its financial affairs and remove its future assets from the reach of creditors is the essence of bankruptcy law. As the Supreme Court has explained in the consumer debtor context, “One of the primary purposes of the bankruptcy act is to give debtors ‘a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preëxisting debt.’” Congress adopted this core principle for business debtors as well when it enacted chapter 11 of the Bankruptcy Code. In doing so, it left no room for states to legislate concerning a change of control of distressed businesses that replicates a chapter 11 result. State laws that conflict with, or pose an obstacle to, bankruptcy protections also undermine the purposes of chapter 11. This Section explains the implied preemption issues created by state statutes authorizing going concern sales in an environment akin to chapter 11 and explores the appropriate roles for federal and state laws in the context of distressed businesses.


268. See supra note 30.
270. See Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934).
272. Both the confirmation discharge and a going-concern reorganization sale free of preexisting claims effect a fresh start. See 11 U.S.C. §§ 363(f), 1141; see also supra note 205.
273. See generally Tabb, supra note 20, at 47-49 (explaining preemption in the bankruptcy context).
A. Congress’s Intended Purpose in Enacting Chapter 11

Congress enacted chapter 11 to allow distressed businesses to continue to operate and ultimately reorganize, thereby saving jobs and preserving the business’s role in its industry and community. Chapter 11 also contains protections for creditors, and it seeks to treat all creditors fairly throughout the process and in distributions. State laws that attempt to replicate chapter 11 reorganizations—whether a plan or sale reorganization—directly compete with the federal platform created by Congress and conflict with chapter 11’s core objectives and purposes. State laws that facilitate a transfer of a debtor’s business as an operating entity (or going concern), free of existing obligations and without counterparty consents, compromise the interests of both debtors and creditors, particularly creditors junior in a debtor’s capital structure.

A business that is facing a liquidity crisis or is otherwise unable to pay its debt obligations can liquidate (sell its assets on a piece-meal basis, using the proceeds to pay creditors), or it can try to continue to operate while reorganizing its financial and ownership structure. The latter can be accomplished through a variety of schemes, including a debt-for-equity exchange, a capital infusion for new equity interests, or a going-concern sale. In each of these approaches the business continues, usually under new ownership. If the new owners assume all of the existing debt obligations, or all creditors and contract parties consent to the transaction, then the restructuring can be done by private contract and under applicable

274. See United States v. Whiting Pools, Inc., 462 U.S. 198, 203 (1983) (“In proceedings under the reorganization provisions of the Bankruptcy Code, a troubled enterprise may be restructured to enable it to operate successfully in the future.... By permitting reorganization, Congress anticipated that the business would continue to provide jobs, to satisfy creditors’ claims, and to produce a return for its owners. Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if sold for scrap.” (citations omitted)).

275. For example, the automatic stay protects not only the debtor, but also other creditors from one creditor dismantling the debtor’s assets and keeping the value solely for itself. See 11 U.S.C. § 362(a). In addition, a trustee’s avoidance and turnover powers, which reach all of a debtor’s assets wherever located in accordance with a bankruptcy court’s in rem jurisdiction, protect creditors. See id. §§ 542-559.

nonbankruptcy law. However, if the new owners want to unilaterally strip some (or all) existing obligations from the business, pick and choose contracts necessary to continue to operate the business, and obtain a court order protecting themselves and the business from liability, the transaction must be accomplished through a federal bankruptcy case. That result flows directly from the purpose of chapter 11 and the Supreme Court’s precedent eschewing state laws that free debtors’ assets from the claims of existing creditors.

1. Implied Field Preemption

As discussed above, the Bankruptcy Clause is closely related to the Commerce Clause and, among other things, protects parties from discrimination and unfair treatment in commercial transactions and debtor-creditor relations. Congress was mindful of these issues and of due process concerns in considering a federal bankruptcy law that freed a debtor and its assets from creditors’ claims. The Bankruptcy Code, including chapter 11, incorporates significant protections for creditors in cases that cut off the creditors’ rights against the debtor and its assets. For example, the Code requires that all creditors (not just lienholders) receive notice and an opportunity to be heard, and the Code establishes a process and imposes limitations on unilateral treatment of contracts and leases. The bankruptcy court also has expansive jurisdiction over the debtor’s assets wherever located and offers a national forum to resolve disputes concerning any proposed plan, sale, or discharge.

277. See id.; see also FRIEDLAND, supra note 236, § 1:4 (explaining general attributes of compositions under state law).
278. See supra Part II.A.
279. See supra Part I.C.
280. See supra Part I.A.
283. The district courts’ jurisdiction in bankruptcy matters is addressed by 28 U.S.C.
Consequently, creditors doing business with an entity understand, and have certainty regarding, their rights if the debtor defaults and wants to avoid liability through a nonconsensual transaction in bankruptcy.

Although the Bankruptcy Code does not expressly preempt state law in the context of the reorganization of a business by either a plan or sale, the overall scheme of the Bankruptcy Code, and its history, strongly support a finding of implied field preemption. Congress clearly intended to foster business reorganization under chapter 11 of the Bankruptcy Code. Congress did not define “reorganization” in the Code, but courts have “interpret[ed] ‘reorganization’ to include all types of debt adjustment, including going-concern asset sales.” When a state scheme imposes an automatic stay on creditors’ and other parties’ rights against the debtor, allows a third party to operate and sell the business free of claims, and permits that third party to unilaterally assume or reject contracts or leases, the scheme addresses precisely the same reorganization subject matter as the Bankruptcy Code. The Supreme Court found this kind of parallel regulation impermissible in Arizona v. United States. In that case, the Court explained, “Field preemption reflects a congressional decision to foreclose any state regulation in the area, even if it is parallel to federal standards.”

The Court also has repeatedly described a discharge of a debtor’s financial obligations as one of the hallmarks of a bankruptcy law that is within the exclusive purview of Congress under the Bank-

§ 1334. 28 U.S.C. § 1334 (2012). Section 1334(e) provides the district court with “jurisdiction ... of all of the property, wherever located, of the debtor as of the commencement of such case, and of property of the estate.” Id. § 1334(e). The bankruptcy court’s jurisdiction, a referral of the district court’s jurisdiction, is addressed in 28 U.S.C. § 157. Id. § 157.

284. See supra Part I.D.

285. See supra notes 189-91 and accompanying text.


287. See supra notes 6, 194, and 202 and accompanying text.

288. 132 S. Ct. 2492, 2510 (2012) (finding parallel state immigration laws impermissible); see also supra note 140 and accompanying text.

A “discharge” is commonly defined as an act that liberates, frees, or releases a person or thing. For example, section 1141 of the Bankruptcy Code provides that a plan “discharges the debtor from any debt” and that all “property dealt with by the plan is free and clear of all claims and interests.” This formal discharge falls squarely within the preemption lines drawn by Stellwagen v. Clum, International Shoe Co. v. Pinkus, and Pobreslo v. Joseph M. Boyd Co. Consequently, chapter 11 would preempt any state law that provided a discharge to the debtor, its ongoing business, or its property under a plan or arrangement.

For both practical and doctrinal reasons, however, field preemption can and should extend to features of the Bankruptcy Code beyond the technical “discharge” of a debtor. For example, section 363(f) of the Bankruptcy Code also authorizes the sale of the debtor’s property “free and clear of any interest in such property.” Notably, the language of the statute does not include “claims.” Nevertheless, particularly in the context of going-concern reorganization sales, courts often approve a broad release of all interests, liens, and claims against the property. In these scenarios, from the perspective of the ongoing business and the creditors who can no longer pursue the business’s assets to collect their claims, there is little meaningful difference between the respective practical effects of sections 1141 and 363.

290. See supra Part I.C.
293. 245 U.S. 605, 615 (1918).
294. 278 U.S. 261, 265 (1929).
295. 287 U.S. 518, 526 (1933).
297. See id.
299. Notably, the statutory language of the two sections does differ, but the implementation of this language by courts and parties leads to similar practical results. See also supra note 205. Compare 11 U.S.C. § 1141(c), with id. § 363(f).
In fact, these scenarios correspond with the notion of “discharge” for businesses discussed in the legislative history to the Bankruptcy Code. For example, the Report of the Commission on the Bankruptcy Laws in the United States, reviewed in connection with the enactment of the Bankruptcy Code, explains, “In a reorganization case a corporation in effect obtains a discharge to the extent a reorganization plan binds creditors to satisfaction of less than the full amounts of their claims.” A going-concern reorganization sale in effect “binds” creditors in the same manner. In both instances, debtors and creditors deserve the protections and certainty of the federal bankruptcy laws. Accordingly, chapter 11 should likewise preempt state laws purporting to facilitate going-concern reorganization sales that impair the rights and claims of creditors.

2. Implied Conflict Preemption

In addition, state law schemes of this nature create an actual conflict with the Bankruptcy Code. These schemes essentially give debtors and creditors an option to file a state or federal reorganization case, with each having potentially different results. State law schemes may differ from key aspects of the Bankruptcy Code, such as whether a secured creditor’s after-acquired property clause continues after the proceeding is commenced. A difference in this one small provision may make a state proceeding more favorable for the secured creditor and significantly worse for the unsecured


301. This conclusion is supported not only by the Court’s implied conflict preemption precedent, but also the Supremacy Clause. As Chief Justice Marshall explained in Gibbons v. Ogden,

The appropriate application of that part of the clause which confers the same supremacy on laws and treaties, is to such acts of the State Legislatures as do not transcend their powers, but, though enacted in the execution of acknowledged State powers, interfere with, or are contrary to the laws of Congress, made in pursuance of the constitution, or some treaty made under the authority of the United States.

22 U.S. (9 Wheat.) 1, 211 (1824); see also Dawson, supra note 7 (discussing, among other things, the cost to nonuniformity in creditors’ rights).

302. See supra notes 255-57 and accompanying text.
creditors.\textsuperscript{303} To the extent that an after-acquired property clause is limited in bankruptcy under section 552 of the Bankruptcy Code, the value of the property may flow to the unsecured creditors.\textsuperscript{304} Yet, this value would not be available to unsecured creditors in the state court proceeding.

In addition, the state court may have limited jurisdiction if the business is involved in interstate commerce.\textsuperscript{305} Although, in theory, creditors not subject to the state court’s jurisdiction should not be harmed by its rulings, those creditors would have little recourse in practice. Moreover, state receivership and ABC laws lack many of the protections provided to creditors in federal bankruptcy cases, including extensive noticing provisions;\textsuperscript{306} protections for qualified financial contracts;\textsuperscript{307} protection from the dissipation of the debtor’s assets by creditors (for example, the creditor invoking the receivership) not subject to the stay;\textsuperscript{308} oversight by the U.S. Trustee (or Bankruptcy Administrator);\textsuperscript{309} the right to examine the debtor;\textsuperscript{310} and the potential appointment of a creditors’ committee to monitor the debtor and represent the interests of the debtor’s general unsecured creditors.\textsuperscript{311}

Even these few examples of inconsistencies and nuances between certain state receivership and ABC laws and the Bankruptcy Code show an actual conflict—state laws facilitating going-concern sales of businesses “stan[d] as an obstacle to the accomplishment and

\textsuperscript{303} See supra notes 255-61 and accompanying text.

\textsuperscript{304} 11 U.S.C. § 552(a).

\textsuperscript{305} See, e.g., Friedland, supra note 236, § 11:2 (“State courts have general subject matter jurisdiction, but that jurisdiction is confined to the territorial boundaries of the state.”); see also Baldwin v. Hale, 68 U.S. (1 Wall.) 223, 224 (1863) (“We do not suggest that this or any State law relating to property possesses extra-territorial force: the legislative sovereignty of each State is confined to its limits. Beyond these the laws of some other local jurisdiction prevail.”).


\textsuperscript{307} See supra note 245 and accompanying text.

\textsuperscript{308} See supra notes 223-36 and accompanying text.

\textsuperscript{309} See supra note 281 and accompanying text.


\textsuperscript{311} See, e.g., id. §§ 1102-1103 (setting forth the appointment of committees and the duties of committees, respectively). Junior creditors—specifically general unsecured creditors—are arguably exposed to the greatest level of risk created by deficiencies or variances in state debtor-creditor laws. See also supra Part II.B (discussing potential conflicts between state and federal law).
execution of the full purposes and objectives of Congress.” As discussed above, chapter 11 was designed to help distressed businesses continue in operation while protecting the rights of that business’s creditors to the extent possible and consistent with the rehabilitation goal. Likewise, the Bankruptcy Clause was intended to ensure fair and nondiscriminatory treatment of parties in matters concerning debtor-creditor relations. Notably, this latter concern—fair treatment and certainty for creditors—also encouraged Congress to consolidate the reorganization chapters of the Bankruptcy Act into chapter 11 of the Bankruptcy Code. The legislative history explains, “Under [the Bankruptcy Act], creditors are constantly at the mercy of debtors who may file under two or more reorganization chapters. Each chapter proceeding has different rules and affects creditors in a different way.” This concern increases dramatically if creditors are now subject to different reorganization processes in each of the fifty states.

Although lower courts considering similar preemption issues have viewed state receivership and related laws as “complementary” to the Bankruptcy Code, schemes replicating aspects of the Bankruptcy Code that impair creditors’ rights and affect distributions to creditors go too far and should be treated differently. Allowing a state law receiver to operate a debtor’s business, benefit from an automatic and broad stay, assume or reject contracts unilaterally, and sell the business as a going concern free of all claims, conflicts with the “fresh start” concept and the related protections for creditors, and do so in a manner that may be preempted by federal law.

312. Barnett Bank of Marion Cty., N.A. v. Nelson, 517 U.S. 25, 31 (1996) (alteration in original) (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)); see also BFP v. Resolution Tr. Corp., 511 U.S. 531, 567 (1994) (Souter, J., dissenting) (“[W]hether or not Congress has used any special ‘pre-emptive’ language, state regulation must yield to the extent it actually conflicts with federal law. This is no less true of laws enacted under Congress’s power to ‘establish ... uniform Laws on the subject of Bankruptcies.’” (omission in original) (quoting U.S. CONST. Art. I, § 8, cl. 4)).

313. See supra Part II.A.

314. See supra Part I.A.

315. See supra note 189 and accompanying text.


317. See Dawson, supra note 7 (discussing the concern of nonuniformity and its veritable impact).

318. See, e.g., Ready Fixtures Co. v. Stevens Cabinets, 488 F. Supp. 2d 787, 791 (W.D. Wis. 2007) (holding no preemption of the state receivership statute and noting that the statute simply provided insolvent debtors with a “simpler, less expensive” alternative to filing for bankruptcy).
creditors codified in the Bankruptcy Code. As discussed further below, state legislatures and courts may have the power to grant relief to entities or assets subject to their jurisdiction, but any such power is suspended once Congress chooses to act under the Bankruptcy Clause. Lower court decisions suggesting otherwise ignore the practical effects of these state laws and elevate the artificial label of “discharge” over substance.

3. The Contract Clause

State law schemes that facilitate going-concern reorganization sales also raise issues under the Contract Clause in cases such as *Sturges v. Crowninshield* and *Ogden v. Saunders*. For example, these schemes allow a receiver to alter the parties’ contractual bargain by, among other things, avoiding performance of contractual obligations—including promises to pay in full and to not assign the contract, not be subject to an ABC or receivership, and take (or refrain from taking) other specified actions. These schemes in turn arguably violate the Contract Clause. Admittedly, the Supreme Court has gradually increased deference to state legislatures under the Contract Clause, particularly with respect to the impairment of

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319. See supra Part II.A.
320. See infra Part III.B. Notably, Congress knows how to exclude kinds of bankruptcy from the Bankruptcy Code. For example, Congress chose to remove insurance companies from federal bankruptcy law. 11 U.S.C. § 109(b)(2) (2012) (excluding, among others, domestic insurance companies). Accordingly, states can, and do, regulate the insolvency of insurance companies through their receivership laws.
323. *Hearings Before the Subcomm. on Civil & Constitutional Rights of the Comm. on the Judiciary, House of Representatives, Ninety-Fourth Congress, First Session on H.R. 31 and H.R. 32 Bankruptcy Act Revision, 94th Cong. 188 (1975)* (statement of Professor Frank R. Kennedy, University of Michigan Law School) (“The impairment of obligation of contract clause is a limitation only on State legislatures. There is no question about the power of Congress to provide for a discharge of indebtedness even as to indebtedness incurred before Congress enacts the Bankruptcy Act.”).
obligations under private contracts. This deference is not, however, without limits. As the Court has explained,

Yet private contracts are not subject to unlimited modification under the police power. The Court in Blaisdell recognized that laws intended to regulate existing contractual relationships must serve a legitimate public purpose. A State could not "adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them." A state law that overrides an ipso facto clause, nullifies an anti-assignment clause, or reduces or limits a claim (for example, by deeming claims under rejected contracts to be incurred prior to the receivership) under a private contract falls squarely within this language. As commentators have observed, "State debtor relief legislation, to be sure, was passed during the economically troubled period between the end of the Revolution and the framing of the

324. See, e.g., Home Bldg. & Loan Ass’n v. Blaisdell, 290 U.S. 398, 443-48 (1934). In Blaisdell, the Supreme Court upheld a state law that extended a homeowner’s redemption period with respect to mortgage contracts during an economic emergency in the state. Id. at 447. Although the emergent circumstances were central to the Court’s analysis, subsequent cases placed less emphasis on the existence of an emergency and gave more deference to state laws that were reasonable and appropriate to serve a legitimate public purpose. See Douglas W. Kmiec & John O. McGinnis, The Contract Clause: A Return to the Original Understanding, 14 HASTINGS CONST. L.Q. 525, 540-50 (1987) (discussing the original purpose of the Contract Clause and the Supreme Court’s interpretation of the clause, particularly after Blaisdell). 325. U.S. Tr. Co. of N.Y. v. New Jersey, 431 U.S. 1, 22 (1977) (citation omitted) (quoting Blaisdell, 290 U.S. at 439). 326. Presumably, states could try to articulate a public purpose. For example, a law mitigating the effect of an ipso facto clause may increase borrowers’ access to credit. This kind of justification underlies, in part, amendments to Article 9 of the Uniform Commercial Code that allow certain kinds of collateral to be pledged and, in some instances, transferred despite contractual language to the contrary. See U.C.C. §§ 9-406 to -409 (AM. LAW INST. 2014). These provisions in Article 9 are more limited than a general override of ipso facto clauses—they are a targeted response to an identified concern. It is unclear whether such state laws would withstand scrutiny under a federal preemption analysis. See, e.g., N.Y. U.C.C. LAW § 9-408 (McKinney 2017) (addressing assignability of, among other things, general intangibles); id. at cmt. 9 (“This section does not override federal law to the contrary. However, it does reflect an important policy judgment that should provide a template for future federal law reforms.”). This kind of provision is an important policy judgment, one arguably already made under federal patent and bankruptcy laws. It also is unclear whether this kind of public purpose would be adequate justification in the face of the Supremacy Clause and the Bankruptcy Clause. Indeed, a public purpose of overriding ipso facto clauses to facilitate a receiver’s transfer of an operating business as a going concern directly conflicts with the reservation of this power to Congress under the Bankruptcy Clause.
Constitution. Therefore, there is little doubt that such legislation was one of the major evils that the Clause was designed to eradicate.\footnote{Kmie\c & McGinnis, supra note 324, at 533 (footnote omitted).}

Consequently, even if Congress had not enacted chapter 11 of the Bankruptcy Code, states still could not impair the parties’ obligations under creditors’ contracts in this manner, at least not retroactively. Likewise, a state should not be able to prospectively affect contracts governed by the laws of other states.\footnote{See supra Part I.C; see also, e.g., Denny v. Bennett, 128 U.S. 489, 498 (1888) (finding that a state cannot discharge an “extraterritorial” debt); Cook v. Moffat, 46 U.S. (5 How.) 295, 309 (1847) (holding that a Maryland law could not discharge debtor as to contracts governed by New York law).} The combined principles of the Bankruptcy Clause and the Contract Clause demonstrate the constitutional infirmities with certain state receivership and ABC laws, and the need for a more thoughtful analysis of the appropriate role of such laws in debtor-creditor relations.

\textbf{B. Historical Police Powers of the States and the Bankruptcy Clause}

The other important consideration in federal preemption analysis is whether Congress is legislating in an area historically governed by state law. This factor is more challenging to analyze than it first appears. A simple response would be that states have long possessed authority to address debtor-creditor relations and, in fact, exercised that authority prior to the first federal bankruptcy laws.\footnote{See supra Parts I.B-C.} A more nuanced explanation would consider the nature of traditional state receivership and ABC laws, as well as the significant federal interest in establishing uniform bankruptcy laws under the Bankruptcy Clause.\footnote{See supra Parts I.B-C.}

States undeniably have the power to regulate the debt relations of, and commercial transactions involving, their residents. As discussed in Part I, prior to the adoption of the Constitution, many states had processes in place whereby debtors could relinquish their assets to creditors in order to be released from prison or perhaps even to receive a formal discharge. The permissible scope of these
laws changed, however, in response to the Bankruptcy Clause and the Contract Clause. Thereafter, the options available to debtors and creditors under state law generally were limited to ABCs in which the debtor’s assets were liquidated to pay creditors, receiverships in which a neutral receiver was appointed to preserve or dispose of an asset or wind down a business, or a consensual composition.331

Even as states’ ABC and receivership laws progressed, most state law schemes were structured as a creditor collection mechanism.332 The assignee or receiver would preserve the value of the assets, and then sell those assets, for the benefit of the debtor’s creditors. Most of these sales proceeded as liquidations. In these liquidations, state law may permit the sale free of liens, to the extent lienholders received proper notice and the sale otherwise complied with applicable state law.333 These sales did not necessarily involve the sale of a debtor’s business as an operating entity (or going concern), the unilateral assumption and assignment of contracts, or state court orders that enjoined all parties from pursuing claims, including successor liability claims, against the business assets.334

331. See supra Parts I.C-D.

332. See, e.g., FRIEDLAND, supra note 236, § 11.1 (“In most states, the right to seek the appointment of a receiver is ancillary to, and therefore must arise out of, the primary claims asserted in the lawsuit. In its broadest application, a court may appoint a receiver to take possession of, manage, dissolve and liquidate the entire business and assets of a defendant for distribution to the defendant’s creditors and interest holders.” (footnote omitted)); see also James E. McCarty, Federal Bankruptcy or State Court Receivership, 48 MARQ. L. REV. 340, 342 (1965) (explaining when a state law receivership may be allowed to proceed notwithstanding a federal bankruptcy case, and noting that “bankruptcy does not supersede a state court proceeding for the enforcement of a lien and the appointment of a receiver therein where the institution of the suit created a valid lien or was for the enforcement of a valid existing lien obtained more than four months prior to bankruptcy”).


334. States take different approaches to successor liability in the asset sale context, but have traditionally considered different factors to assess a purchaser’s potential liability. For a concise description of the different approaches to successor liability under state law, see John H. Matheson, Successor Liability, 96 MINN. L. REV. 371, 383-93 (2011) (describing various exceptions to the no liability rule in the asset sale context, including the de facto merger and continuation of business doctrines); see also, e.g., Martin Hilti Family Tr. v. Knoedler Gallery, LLC, 137 F. Supp. 3d 430, 455-58 (S.D.N.Y. 2015) (explaining elements of successor liability under New York and Delaware law). In addition, the fact that some state courts may
The evolution of state receivership and ABC laws to a point where they mimic the Bankruptcy Code and facilitate a fresh start for a debtor’s business assets has been gradual, with some acceleration in the past twenty years. These changes appear to be driven by several factors, including practices in federal equity receiverships and perceived deficiencies in the Bankruptcy Code. The latter factor is discussed more fully in Part III.D.

Parties have used federal equity receiverships with varying frequency since the late 1800s. Federal equity receiverships emerged as a way to help save distressed railroads and offered a template for the early composition schemes incorporated into federal bankruptcy laws. A federal equity receivership generally allows a distressed railroad or business to submit to the jurisdiction of the federal district court, negotiate a plan with certain creditor groups, and receive court approval of that plan, which often extinguished junior claims and, in some cases, equity interests. The railroad or business would continue under completely new, or partially new, ownership after the receivership. Notably, a federal court overseeing a federal equity receivership case does not face the same Contract Clause or federal preemption issues confronting state legislatures and courts.

have permitted state law receivers or assignees to sell assets free of liabilities, terminate existing contracts, or otherwise exercise powers beyond selling the debtor’s assets and distributing the proceeds to creditors does not change the analysis concerning whether those expanded rights and powers are advisable from a practical perspective or permissible from a constitutional perspective. See Ray v. Alad Corp., 560 P.2d 3, 4-5 (Cal. 1977) (California law); Vill. Builders 96, L.P. v. U.S. Labs., Inc., 112 P.3d 1082, 1084 (Nev. 2005) (Nevada law); Ramirez v. Amsted Indus., Inc. 431 A.2d 811, 812 (N.J. 1981) (New Jersey law).

335. See supra Parts II.B-C.


337. See Tabb, supra note 20, at 21-23.

338. See id.


340. See id.

341. Federal law generally governs federal equity receiverships. For example, Rule 66 of the Federal Rules of Civil Procedure explains,

These rules govern an action in which the appointment of a receiver is sought or a receiver sues or is sued. But the practice in administering an estate by a
Any reliance by states on federal equity receiverships to support the scope of their state receivership or ABC laws is misplaced. Although the objectives of the states to provide greater flexibility and options for distressed businesses within their borders are laudable, they must give way to federal bankruptcy laws. The Bankruptcy Clause authorizes Congress to regulate the field of bankruptcy; Congress’s adoption of chapter 11 of the Bankruptcy Code leaves little, if any, room for states to legislate in that space.342

Importantly, this analysis does not suggest that all aspects of state receivership or ABC laws are preempted. State debtor-creditors laws provide important alternatives and protections for parties involved in distressed situations. Creditors should have an efficient and effective means for foreclosing on their collateral.343 Likewise, debtors should have a state law option to liquidate their assets for the benefit of creditors.344 Moreover, sales of a debtor’s assets may be free of liens (and in the context of real property, redemption rights) in the creditors’ collateral to the extent provided by state law.345 That has long been the practice and utility of state debtor-creditors laws.

These traditional and ongoing valuable uses of state debtor-creditors laws are very different from current trends. State receiverships or ABC laws that allow either the debtor or secured creditors to transfer the debtor’s business as an operating entity (or going concern) free of existing obligations and without counterparty consents exceed the traditional bounds of receiverships, and pose

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342. See supra Part I.A.
343. See, e.g., Friedland, supra note 236, § 11:1 (explaining general utility of state law receiverships).
344. See id.
345. See, e.g., id., at Preliminary Materials (“Whether a court can or will approve a receiver sale free and clear of liens and interests remains a highly debated and, in many states, an open issue.”); Baruch Kreiman, Survey of the Rights of Receiverships to Sell Real Property, 8 J. Bus. Entrepreneurship & L. 257, 263 (2014) (examining, among other things, situations in which states permit receiver sales free of redemption rights).
significant risk to junior creditors, contract parties, employees, and other stakeholders. \(^{346}\) Accordingly, although states have an interest in regulating the affairs of debtors and creditors within their borders, those interests must give way to the extent they impede significant federal interests.

**C. Modernizing Preemption Analysis Under the Bankruptcy Clause**

In addition to recognizing the breadth of the term “discharge” under the Supreme Court’s preemption precedent, a strong argument exists to rethink the phrase “subject of Bankruptcies” \(^{347}\) and whether it should be limited to discharge and related concepts. Business and financial markets are significantly different than those in existence when the Supreme Court first considered the scope of the Bankruptcy Clause. Markets are more sophisticated, more global, and even more dependent on the certainty of law. Variances in law—whether expected or unexpected—can cause losses for some and unwarranted windfalls for others. \(^{348}\) They also can increase the cost of doing business in the United States, as contract parties increase rates to compensate for legal changes or variances. \(^{349}\)

The commerce objectives underlying the Bankruptcy Clause should serve as a guidepost to interpreting the phrase “subject of Bankruptcies.” Under this approach, the Supreme Court’s language in *International Shoe* is particularly relevant. \(^{350}\) As discussed above, the Court observed,

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346. *See supra* note 363 and accompanying text.


348. For a general discussion of the costs of legal uncertainty for businesses, see Oliver Budzinski, *Modern Industrial Economics: Open Problems and Possible Limits*, in *COMPETITION POLICY AND THE ECONOMIC APPROACH: FOUNDATIONS AND LIMITATIONS* 111, 127 (Josef Drexl et al. eds., 2011).


It is clear that the provisions of the Arkansas law governing the distribution of property of insolvents for the payment of their debts and providing for their discharge, or that otherwise relate to the subject of bankruptcies, are within the field entered by Congress when it passed the Bankruptcy Act.351

The Court’s language acknowledges at least two fundamental bankruptcy principles covered by the Bankruptcy Clause: equitable distribution of property (key from the creditor perspective) and discharge (key from the debtor perspective).352 It also contemplates additional principles with the reference to “or that otherwise relate to the subject of bankruptcies.”

In Sherwood Partners, the Ninth Circuit suggested that the Court’s language in International Shoe encompassed not only discharges, but also rights and powers given specifically to bankruptcy trustees (or debtors in possession under section 1107) by Congress under the Bankruptcy Code.353 The Ninth Circuit focused its analysis on rights and powers not available to state law assignees or receivers—at least not available at the time of the enactment of the Bankruptcy Code.354 For example, the Bankruptcy Code authorizes a bankruptcy trustee to avoid preferential payments made to certain creditors prior to the bankruptcy filing.355 This is not a creditor-specific right transferred to the trustee once a bankruptcy case is filed. Rather, it is a bankruptcy-specific right created by the Bankruptcy Code.356 A bankruptcy trustee’s powers with respect to, among other things, contracts and leases (including labor contracts), utility obligations, the automatic stay, and broad “free and clear”

351. Id. (emphasis added).
352. Id. The Ninth Circuit also recognized these two fundamental principles in Sherwood Partners, explaining (in the context of chapter 7) that the Bankruptcy Code “embodies two ideals: (1) giving the individual debtor a fresh start, by giving him a discharge of most of his debts; and (2) equitably distributing a debtor’s assets among competing creditors.” Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1203 (9th Cir. 2005) (citing Stellwagen v. Clum, 245 U.S. 605, 617 (1918)) (further observing that “these two goals are separate and operate somewhat independently of each other” (citing 1 COLLIER ON BANKRUPTCY, supra note 198, ¶ 1.03[2][a])).
353. See Sherwood Partners, 394 F.3d at 1204-05.
354. See id.
356. See Sherwood Partners, 394 F.3d at 1204-05.
sales are similarly bankruptcy-specific. An individual creditor could not exercise these powers under state statutory law and, at least prior to recent changes to state receivership laws, neither could a state law assignee or receiver.\textsuperscript{357}

Rights or powers appropriately unique to federal bankruptcy laws should qualify as a federal law “on the subject of Bankruptcies.”\textsuperscript{358} The fact that a state copies or replicates those aspects of the Bankruptcy Code should not change the analysis. Such an approach would allow states to define that constitutional phrase and the resulting federal preemption doctrine. Congress has chosen to exercise its powers under the Bankruptcy Clause, and the Bankruptcy Code should serve as the only source of bankruptcy laws.\textsuperscript{359} There is no meaningful reason to limit the term “subject of Bankruptcies” to formal discharges when doing so undercuts the purpose and utility of the Bankruptcy Clause.\textsuperscript{360} It is time for parties and courts to adopt a more holistic approach to the phrase and find a more appropriate balance between what constitutes federal laws on the subject of bankruptcies and what is a valid state law on debtor-creditor relations.

\textsuperscript{357} See, e.g., id. at 1205 (“We believe that statutes that give state assignees or trustees avoidance powers beyond those that may be exercised by individual creditors trench too close upon the exercise of the federal bankruptcy power.”). Admittedly, some state courts have authorized receivers to exercise powers beyond collecting, preserving, and liquidating a debtor’s assets. Courts typically invoke their equitable powers in such cases, and may not raise exactly the same issues as a state statutory scheme granting such powers. Nonetheless, as discussed supra notes 331-32, state equity receiverships may pose problems as well.

\textsuperscript{358} See U.S. CONST. art. 1, § 8, cl. 4.

\textsuperscript{359} See, e.g., Int’l Shoe Co. v. Pinkus, 278 U.S. 261, 266 (1929); Moskowitz v. Prentice (In re Wis. Builders Supply Co.), 239 F.2d 649, 654 (7th Cir. 1956) (examining the Supreme Court’s language in International Shoe and concluding that state law general assignments were permissible to an extent and striking one aspect of the Wisconsin statute at issue because it was “as broad and comprehensive as Section 3 of the Bankruptcy Act”).

\textsuperscript{360} See, e.g., Sherwood Partners, 394 F.3d at 1203 (“What goes for state discharge provisions also holds true for state statutes that implicate the federal bankruptcy law’s other major goal, namely equitable distribution. Bankruptcy law accomplishes equitable distribution through a distinctive form of collective proceeding. This is a unique contribution of the Bankruptcy Code that makes bankruptcy different from a collection of actions by individual creditors.”).
D. Why the Status Quo Is Unacceptable

Some observers may believe that the suggested constitutional infirmities with certain state receivership and ABC laws are much ado about nothing. If a state law can provide a sale reorganization alternative for business debtors, why should federal law impede that progress? This narrow perspective has several shortcomings.

State receivership or ABC laws that facilitate a transfer of a debtor’s business as a going concern free of existing obligations and without counterparty consent jeopardize the rights of creditors, create variances in business bankruptcy laws, and likely increase the cost of doing business for all companies, regardless of size or financial condition. That said, putting aside the constitutional concerns addressed above, perhaps the benefits to individual state sale reorganization processes outweigh the risks. States do have an interest in providing debt relief to individuals and businesses domiciled in their states. But do they need to provide the extensive relief evidenced by recent amendments to state laws? In most cases, a business could liquidate or sell its assets as a going concern without the provisions that facilitate the kind of bankruptcy fresh start discussed above. Indeed, state commercial laws have long provided for the sale of property free of some liens. To the extent that a purchaser desires greater protection from claimants, the assignment of particular contracts or leases, or a renegotiation of utilities or similar obligations existing at the time of the sale, the purchaser (or

361. See supra Parts III.A-B; see also supra notes 8 (discussing potential issues with state debtor-creditor laws, particularly for unsecured creditors) and 26 (discussing the meaning of counterparty consent in this context).

362. Receivers historically have dissolved businesses and, in some instances, sold them at auction to facilitate the payment of creditors. Likewise, creditors often can obtain similar results under Article 9 of the Uniform Commercial Code. See, e.g., FRIEDLAND, supra note 236, § 1.5 (“It is not uncommon for lenders with blanket liens on all of a borrower’s assets to sell them as a package as a going concern or operating entity. Although these sales are often conducted on an ‘as is, where is’ basis with few, if any, representations and warranties, they have increased in popularity over the last few years.”).

363. For a thoughtful explanation of why state law sales of a going concern may not be a complete “free and clear” sale—at least under traditional state law principles—see Douglas G. Baird & Robert K. Rasmussen, The End of Bankruptcy, 55 STAN. L. REV. 751, 786-87 (2002). But see Gibbons & Grimes, supra note 263, at 51, 78 (asserting that receivers are able to sell property free and clear without the consent of all lienholders, with some caveats, and acknowledging there is case law to the contrary).
the receiver) can negotiate acceptable terms with counterparties. Consensual out-of-court workouts are an important component of business restructurings and should be encouraged.

To the extent a business debtor, receiver, assignee, or purchaser desires more—say a nonconsensual restructuring—the business should invoke the federal bankruptcy laws. If the Bankruptcy Code no longer is providing an effective reorganization option for businesses, Congress should amend the Code. The courts and Congress should not allow states (or the parties) to craft workarounds to any perceived deficiencies in the Code. That kind of ad hoc reform not only exposes parties to uncertainty and unfair treatment, but it also undercuts significantly the value of a national bankruptcy law and the role of the Supremacy Clause, the Bankruptcy Clause, and the Contract Clause.

Notably, prominent figures in the bankruptcy profession have called for the reform of chapter 11. A commission formed by the American Bankruptcy Institute in December 2011 studied the many aspects of chapter 11 for three years, and issued an extensive final report identifying weaknesses in chapter 11 of the Bankruptcy Code and suggesting principles for reform. The commission’s report discussed the changes in chapter 11 cases and the challenges facing distressed businesses that file a chapter 11 case. These challenges include the cost and complexity of chapter 11 and the need for different tools to assist business debtors in their restructuring efforts. The report also noted that the Code continues to work for

364. See supra notes 276-77 and accompanying text.
365. Several commentators suggest that the increasing use of state law receiverships relates to frustrations with, and concerns about, the Bankruptcy Code’s effectiveness, particularly for smaller companies. See, e.g., Lucey, supra note 7, at 12 (“The impression is widespread that federal bankruptcy court has been less effective in recent years as a tool for maximizing net-asset values, particularly when it comes to situations requiring the expeditious sale of a small business as a going concern.”); ABI Commission Report, supra note 182, at 299-303 (explaining that witnesses before the commission testified that the Bankruptcy Code no longer worked for small- and middle-market companies and that, as a result, companies were increasingly turning to state law receiverships and ABCs).
367. See id. at 12-19.
368. See id. at 12-19, 297-312.
369. See id. at 12 (“Moreover, anecdotal evidence suggests that chapter 11 has become too expensive (particularly for small and medium-sized enterprises) and is no longer capable of achieving certain policy objectives such as stimulating economic growth, preserving jobs and tax bases at both the state and federal level, or helping to rehabilitate viable companies that
some businesses, but with appropriate reforms, it could work much better for all businesses.\footnote{370. See id.}

States trying to provide a more effective reorganization option for businesses by amending their receivership or ABC laws miss the mark. Those laws weaken business bankruptcy laws by creating variances and opportunities for parties in control of the debtor (whether the company or senior creditors) to pick and choose, perhaps even manipulate, reorganization laws based on what best suits their particular interests. A strong, uniform federal bankruptcy law is vital to sustaining a robust national economy in a global marketplace.\footnote{371. See supra note 182 and accompanying text.} Policymakers and courts should not permit individual states or parties to undermine that objective.

\section*{Conclusion}

The United States has long been the global leader in business reorganization laws.\footnote{372. See supra Part I.} That status stems, in large part, from the innovative business reorganization laws of chapter 11 that apply nationally. Both foreign and domestic creditors doing business with U.S. companies know the rules of the game, and they rely on these uniform, national rules in negotiating and pricing their commercial transactions with U.S. companies.

The evolution and expanding scope of certain states’ debtor-creditor laws threaten this landscape. State laws that facilitate the transfer of a debtor’s business as an operating entity (or going concern) free of existing obligations, and without counterparty consents, jeopardize the rights of creditors and other stakeholders affected by a distressed business.\footnote{373. See supra Parts III.A-B.} Those laws also directly govern the subject of bankruptcies in violation of the Bankruptcy Clause.\footnote{374. See supra Parts III.A-B.} Policymakers and courts need to rebalance the allocation of powers between Congress and the states with respect to bankruptcy laws. They need to define more clearly the parameters of federal preemption and preserve Congress’s exclusive authority over laws affecting

cannot afford a chapter 11 reorganization.”).
the rights of creditors and other stakeholders in the context of a 
fresh start for business debtors. That said, state debtor-creditor 
laws provide meaningful relief for creditors trying to collect 
defaulted obligations and debtors needing to liquidate assets to pay 
creditors.375 They likewise can form the basis of negotiated, consensual debt resolutions.376 If a creditor vol-
untarily agrees to relinquish or diminish its rights, state law and 
public policy should support that result. State laws should not, 
however, force or compel that result—even if it is not labeled a dis-
charge. Recognizing the appropriate roles of federal and state laws 
in the context of debtor-creditor relations will enhance certainty and 
value for all stakeholders.

375. See supra Part II.B.
376. See supra Part III.D.