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The Ethics of Using Chapter XI as a Management Strategy

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ABSTRACT. In the past decade, the use of the Chapter XI has soared to the detriment of many creditors, workers, and consumers. A good number of cases were not based on imminent insolvency, but on firms attempts to avoid litigation claims against them, to terminate labor or other contractual obligations, or to gain new financing.

These filings for Chapter XI highlight the use of bankruptcy as a strategic option used by management in running a viable organization. This usage is even advised by some academics and management consultants.

While such uses may not be illegal, this paper questions the seeming ease with which a firm may use bankruptcy to escape contractual obligations to customers, suppliers, and other stakeholders. It also questions the "ethics" of the academics and management consultants who recommend such usage. Finally, the paper calls for a change in the law in order to minimize the opportunity for the unethical abuse of the bankruptcy law.

Introduction

Bankruptcy laws were enacted to protect debtors from destitution, or worse, and also to assist creditors in the collection of funds owed them. American bankruptcy laws evolved from early British laws which were themselves rather harsh, including penalties such as imprisonment for debtors, but provided greater leniency for the bankrupt. Incorporated into the Constitution, several amendments over its history have further made bankruptcy a more rehabilitative process for debtors by affording greater protection of their assets from creditors and an opportunity to make a "fresh start".

Specifically, these provisions are incorporated into the Bankruptcy Code: Chapter 13 for personal bankruptcy, and Chapter 11 for businesses. The important aspect of both of these chapters is that debtors are allowed to retain possession of their assets, unlike Chapter 7 in which assets are liquidated under a trustee's guardianship, while the immediate repayment of debt obligations is temporarily suspended. The underlying idea is that individuals can maintain a basic standard of living and corporations an ongoing entity, while the temporary respite provides an opportunity for the debtors to reorganize and to take corrective action that will allow them to regain financial stability and ultimately repay their debts.

In the past decade, due partly to unfavourable economic conditions, the number of bankruptcies (both personal and corporate) has soared to the detriment of many creditors in the wake of unsuccessful reorganizations. Creditors frequently lose status as secured, senior creditors as their claims become secondary to those of the newly reorganized firm created under Chapter 11. Similarly, the long, drawn-out bankruptcy process experienced in most instances means no remuneration to creditors during that period, while they incur legal and other professional expenses in order to maintain representation in the proceedings. An even greater loss results when some firms eventually liquidate and the revenue from assets sales are unable to cover all claims. Consequently, creditors have begun to question the bankruptcy process, which is felt to be tilted too far in favour of debtors at the creditors' expense. This

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concern has been heightened further by recent corporate filings in which not only creditors, but also consumers and workers have seemingly borne the brunt of bankruptcy losses.

A number of these cases were not based on imminent insolvency, but rather firms were attempting to avoid litigation claims against them, to terminate labor or other contractual obligations or to gain new financing. Such filings highlight the use of bankruptcy as but one of a number of strategic options to be used by management in running a viable organization.

While such uses of bankruptcy may not be illegal, in fact their availability may make it mandatory that managers take advantage of these options because they do exist, this paper questions the "morality" of such usage. It questions the seeming ease with which a firm and its management may use bankruptcy to escape contractual obligations to customers, suppliers, and other stakeholders. There is the implication that a firm's management is no longer held accountable for the consequences of decisions/actions that lead to a petitioning firm's predicament – is this ethical?

What of the debts owed to suppliers, lenders, and other holders of equity – Is it fair that these creditors are forced to absorb significant losses on defaulted debt while the firm in Chapter 11 is allowed to continue revenue-generating operations, and even access new funding while former debts remain unpaid?

A more general question is whether the current bankruptcy law is part of the problem. The broad scope of allowable reasons for bankruptcy filings – immediate insolvency is no longer a requirement – and cases demonstrating greater leniency towards recent debtors seem to be contributory to increasing and innovative bankruptcy applications. This is not a question we will attempt to answer here, but we do bring it up as a subject worthy of consideration.

While these and other questions were addressed in much popular and occasional academic writing, there is only one known, full blown book length treatment of these issues: Kevin J. Delaney's *Strategic Bankruptcy: How Corporations and Creditors Use Chapter 11 to their advantage* (1992).

The focus of this study however, is to illustrate "questionable" applications through the use of selected cases which provide the basis for a discussion on some serious ethical concerns.

Federal bankruptcy law amendments

Prior to the amendment of the bankruptcy code in 1978, generally, only insolvent firms were allowed to file bankruptcy petitions (Sherman, 1991, p. 123). The definition of insolvency meant an excess of liabilities over assets as measured by current market value, or an inability to make debt payments (Cifelli, 1983, p. 69). Among the provisions of bankruptcy law at the time was the replacement of existing management with a court appointed trustee charged with overseeing a firm's reorganization and the payment of creditors. Firms faced almost certain liquidation. Aside from the firm's declining financial status, the stigma associated with bankruptcy also extended to its executives who stood to lose jobs and status, and to customers and suppliers wary of continuing business relations with firms that might be expected to go under in the near future. Not surprisingly, firms in financial distress were reluctant to file bankruptcy, and those that did frequently waited until there was no alternative but to do so. At that point the firms usually were no longer viable entities leaving liquidation of assets as the only remedy to reimburse creditors.

In 1978, Congress passed the Bankruptcy Reform Act (which became effective in 1979) designed to make it easier for corporations and individuals to file bankruptcy. It was believed that the more liberal laws would encourage debtors in distress to seek remedial action sooner, thus reducing the need for liquidations. An important aspect of the new provisions was that a firm did not have to be insolvent at filing, but needed only to demonstrate to the court that it faced imminent insolvency if operations were continued without the reliefs offered by bankruptcy protection (Cifelli, 1983 and Kaplan, 1987, and others).

Firms were relieved of interest and principal payments on debt once a bankruptcy petition was accepted as were payments to creditors suspended while a reorganization plan, including agreements scheduling debt payments, was formulated. Typically, firms have 120 days once the filing is initiated

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to present a reorganization plan to the courts and another 60 days thereafter to get confirmation of the plan from its creditors. In other words, existing creditors can expect to wait at least six months before receiving their first payments after a bankruptcy filing, though experience has shown that the waiting period can extend to years as creditors and a firm's management haggle over a mutual agreeable reorganization plan.

However, the Act also provided that any goods and services provided after the filing were to be paid for as per normal business procedure thus offering assurances to current and future suppliers regarding prospects for payment. The new amendment also allowed firms to retain their current management team who were themselves charged with carrying out the reorganization plans within a court specified time frame. These provisions serve to allay customer and supplier fears that a firm might be in immediate danger of liquidation, thus enabling a firm to continue business as usual.

Another provision of the 1978 Act allowed bankruptcy lawyers to charge prevailing market rates, whereas prior to the law's modification, fees were restricted (Johnson *et al.*, 1986 and Sherman, 1991). This was to allow firms to engage experienced counsel and other consultants to maximize the prospects for successful reorganization. However, these professional fees have proved to be exorbitant, and because they must be paid as incurred, the drain on a distressed firm's resources is significant. An extended litigation further reduces the funds available to reimburse creditors and litigants. The Manville Asbestos Company is a case in point. By 1987 legal and professional fees paid amounted to $100 million since its bankruptcy filing in 1982, while none of its claimants had yet been paid (Sharplin, 1987, p. 282). Similarly, in just six months after its filing, Carter Hawley Hale Department Stores had accumulated professional fees and expenses in excess of $18 million (Singletary, 1992).

The reforms did make it easier and more feasible for firms to seek reorganization with the result that the volume of bankruptcy filings escalated during the 1980s, though this is also partially explained by the business excesses during that decade. It may be argued that the more liberal laws allowed managers to take greater strategic risks: take on extensive debt, as opposed to equity financing (e.g. leveraged buyouts); over-expand operations; make riskier investments . . . etc.

The suggestion arises that the Bankruptcy Reform Act may inadvertently have defeated the original intent of bankruptcy laws as recent Chapter 11 filings indicate that petitioners have stretched their interpretation of what constitutes "near insolvency" and the bankruptcy courts willingness to accommodate them has led the way for more filings of the same (Engel, 1984; Glaberson, 1983; Martin, 1983; Sherman, 1991).

The strategic use of bankruptcy

Firms have filed for reorganization to avoid litigation, to get out of constricting contractual obligations, or to gain new financing, claiming that without bankruptcy protection from these "onerous" burdens their operations would be forced to go under. Though the debtors' actions are legal, how ethical are their motvations?

The spirit of the bankruptcy law intended to help the debtor that had unpredictably suffered a financial setback, by offering temporary protection, sufficient relief and the means to start again without undue punishment. Current Chapter 11 suits suggest that the original intent of the law may no longer be the primary consideration of those who are using it. The superseding goal now seems to be preserving a going enterprise at all costs. But what does this mean to the creditors and other stakeholders left to bear these costs? The cases that are discussed here highlight some of the ethical issues raised by recent, varied, and apparently not purely financially, motivated filings.

To avoid (delay) litigation

Manville Corporation's Chapter 11 filing in August 1982 was notable because the firm was emphatic that financial insolvency was not its motivation. In fact, at the time of its action the company had a net worth in excess of $1 million (Marbach *et al.*, 1982, p. 54). As the firm's then CEO and president John McKinney stated: "This is not a financial failure,"

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(Marbach *et al.*, 1982 and Maxwell *et al.*, 1982). The action was taken because the company feared the outcome of *potential* product liability lawsuits filed against it by asbestos victims, most of whom were former employees.

A study carried out by an independent research firm hired by Manville predicted that the firm faced over 50,000 claims which expected to cost the company over $2 billion. This would have wiped out the company's entire net worth (Sharplin, 1991; Marbach *et al.*, 1982). Claims were averaging $40,000 per claim, while some settlements had been as high as $1 million. Contributing to the situation was the refusal of its insurance companies to pay the claims. The litigation between Manville and its insurers, and the probability of paying the victims damaging itself seemingly left the firm's directors no choice but to declare bankruptcy.

The filing in effect put a halt to any new claims against the company, while current ones were placed on hold for five years, ostensibly to give the firm breathing room to reorganize its operations and deal with its insurers. What effect did this have on the asbestos litigants? While Manville continued to earn revenue from ongoing operations, incoming receivables liability payments were frozen as were those on claims to asbestos litigants. By 1988 when asbestos claim payments were expected to begin, many of the victims had died, and new ones were still emerging (Sharplin, 1991).

Despite the financial statistics, what is more troubling about this case is that there is evidence that, as early as the 1930s, Manville was aware of the possible health risks of asbestos use. Additionally, most of the firm's senior executives had been with the firm for over 25 years and its directors over ten years, yet though well aware of emerging findings on asbestos related diseases, continued to sell asbestos products (though by 1964 the firm had begun placing warning labels on its products (Sharplin, 1991; Dubashi, 1989).[1] This evidence questions the ethics of the firm's management to continue operations, and its later decision to pursue bankruptcy when faced with mounting lawsuits.

Legally, Manville's motion for bankruptcy was correct and allowable – the firm was able to demonstrate convincingly that it was approaching serious financial distress. However, in light of its continued production and sales of asbestos products – knowing of its inherent dangers – if that resulted in terrible financial burdens, should Chapter 11 come to the rescue? Is that its proper or intended use? Should the company shirk its own accountability by hiding behind Chapter 11? Should the firm's management not have been held accountable for its actions, even if it might mean the firm's demise? Admittedly, the government also shares part of the responsibility (Sharplin, 1991; Marbach *et al.*, 1982; Johnson *et al.*, 1986)[2] but Manville's management and its directors had a clear moral obligation to its workers and its customers to either stop production/and or inform them of the dangers of asbestos once the company became aware of it. Since the firm did neither, it then should have faced its obligations to pay reparation to victims hurt by its products, rather than trying to avoid them through the protection available under Chapter 11. Ultimately, Manville's creditors and suppliers are the ones paying the asbestos claims through the firm's accumulation of cash generated by the suspension of its liability payments (Rotbart, 1982).

The precedent set by Manville's actions can set off serious repercussions for the community at large if firms that manufacture or exude harmful products or substances are simply allowed to walk away from their responsibilities in a similar manner. What is to prevent a manufacturer that caused serious environmental damage, because of toxic waste by-products, from declaring Chapter 11 rather than pay the costs for clean-up and damages? The resulting burden would of course fall to the general community – the taxpayers, and the affected victims. The firm may be able to achieve a turnaround in due time and become a more environmentally responsible entity, but should that be at the cost of exemption from its former liabilities?

To terminate labour agreements

Continental's Texas Air 1983 filing of Chapter 11 demonstrated its use to terminate labor contracts (Johnson *et al.*, 1986; Stein, 1989). It followed a similar move by Wilson Foods months earlier to cancel its union contract whose terms it claimed put the concern at a competitive disadvantage among other firms in the industry (Glaberson, 1983). Neither company was in immediate financial distress but

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both alleged that high labor costs threatened the viability of continued operations.

Wilson claimed that it was unable to negotiate wage concessions with its unions as had its competitors (Glaberson, 1983), while Continental was struggling against the lower wage rates of its non-union competitors (Engel, 1984). The basis for the acceptance of their petitions by the bankruptcy court stems from the provision in the law that creates a new entity, a debtor-in-possession (DIP), which replaces the troubled petitioner (Glaberson, 1983). The newly formed DIP is released from the obligations of the former company. This allowed Wilson and Continental a release from their labor contracts. Another factor in the decision allowing contract termination was the ability of a firm's management to apply the "business judgment" rule that generally favored the bankrupt (Roukis and Sharnov, 1986).[3] The fact that neither of the unions involved were notified prior to the contracts' cancellation was also allowable under this rule.

The applications here can hardly be considered actions in good faith by management towards its employees who lost jobs, pensions, insurance benefits, without having had the chance to renegotiate their contract terms had there been prior notification (Johnson *et al.*, 1986). Continental, for example, eliminated some two-thirds of its employees, and reduced wages by 50% of those kept on (*The Economist*, March 1989). Another issue of note is the implication that the cost of labor contracts is among the primary reasons that these firms found themselves in financial difficulty. This is too great a burden to place on labor alone when in actuality it may be but one factor of many, including poor managerial judgment or, say, a competitor's better manufacturing process, that in combination lead to a firm's precarious position (Roukis and Charnov, 1986).

Another consideration involves the future of relations between workers and unions and management. An element of distrust and diminished company loyalty is now introduced which cannot be in the best interest of a firm, particularly a troubled one that requires strong cooperation among these parties to achieve a successful turnaround. Wilson had dificulties, including a three-week strike, with its workers for weeks after their contract had been dissolved (Engel, 1984).

As a result of is reorganization filing, Wilson expected to ". . . save . . . some $45 million annually, mostly (due to savings) in labor costs" (Engel, 1984, p. 68). Continental, it is evident today, has emerged a stronger airline. However, the issue raised here is the questionable use of Chapter 11 to bolster firms floundering because of competitive conditions. By allowing firms to use bankruptcy protection as occurred in these cases, a precedent is set for any firms suffering at the hands of their competitors to do the same. Instead of wage rates being too high, the motivation might be that other firms have access to lower supplier prices or better loan rates. Should petitioners also be allowed to use the privileges of Chapter 11 to break contracts in these instances? What is the impetus for managers to strive to make their organizations more competitive if the ability to file for reorganization provides an easier way out of a difficult situation?

To cancel other contractual obligations

It was believed that the retailer HRT Industry, Inc. had similar contract cancellation motives when it declared bankruptcy under Chapter 11 in 1982 (*Business Week*, May 9, 1983). Financial figures just before the filing did not show any immediate problems, in fact its credit line had been recently increased, assets were comfortably in excess of liabilities, and it had just taken possession of merchandise for sale during the approaching Christmas season (*Business Week*, May 9, 1983 and Cifelli, 1983). The most distressing aspect though, was the fact that the motion for reorganization occurred soon after the firm had received its inventory for the holiday sales. In its defense, HRT had experienced an almost doubling of its accounts payable that added to an existing cash flow problem, and the refusal of its lenders to negotiate a loan restructuring may explain management's feeling that no other alternative existed but to seek the protection of Chapter 11 to give it time to turn its financial structure around. But creditors and other business analysts were of the opinion that these problems were not detrimental, certainly not to the extent that bankruptcy was necessitated, therefore, there must have been other motives for the action (*Business Week*, May 9, 1983).

And what of the creditors left unpaid — their

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claims now fell secondary to those of current suppliers, and any expected payments were dependent on the successful emergence of HRT from reorganization – a firm that was undergoing Chapter 11 for the second time in just six years.[4] If management had reasons to doubt the security of its financial position as HRT must have had, it cannot be said that it acted in good faith by accepting the preseason merchandise.

Another issue, regarding its contractual obligations, was also raised by HRT's bankruptcy filing – that of terminating leases, an option that is made easier under Chapter 11. After its filing, HRT did close over 30 stores in its most unprofitable locations (*Business Week*, May 9, 1983). Apparently, this is becoming a common move for retailers (Sherman, 1991), now being evidenced in this year's Chapter 11 filing by R. H. Macy's Department stores that just announced plans to close its chain of I. Magnin stores – a chain which had been unprofitable since its purchase by Macy's, and which the retailer had been trying to sell, unsuccessfully, up to the time of its bankruptcy action.

To secure financing

HRT's bankruptcy action would also enable it to pursue a new loan package. As in the case of Carter Hawley Hale Department Stores, HRT was in a better position to secure credit from new lenders, albeit at higher rates, having disposed of its old debts (Sherman, 1991). The attraction to the lender, in addition to the higher loan rate commanded, is the assurance that debt payments are senior to any former claims and must be paid timely in accordance with the rules of Chapter 11 reorganization.

It was also believed that Braniff International Corp.'s bankruptcy filing in May 1982 was partly motivated by the opportunity provided by reorganization to gain new financing (Schlender *et al.*, 1982). The airline suspended flights and laid off employees claiming cash problems so severe that it was unable to meet its current payroll, much less obligations on over $700 million worth of debt (Schlender, 1982; Schlender *et al.*, 1982). What was unusual about the filing was that the airline, in effect, shut down operations, then filed for Chapter 11. Without the resources to generate revenue through continued services, analysts feared that its attempt at reorganization would be a futile effort (Schlender, 1982; Schlender *et al.*, 1982). However, the provisions of the Bankruptcy Act would make it easier to access funds through new loans and lending arrangements.

In fact, Braniff made an impressive re-emergence from bankruptcy, due in large part to "expansionary financing" that it was able to negotiate during its reorganization (Heuer and Vogel, 1991).

Ethical issues and corporate action

Ethical business conduct by a firm's management involves carrying out operations in a manner morally responsible to customers, suppliers, workers, and the general community. The basic principles including acting in good faith, exercising due care in relationships with others, and being mindful of the responsibilities derived from holding a particular position (Dunfee, 1990, pp. 19–20).[5] The actions highlighted here demonstrated a general negligence in such ethical applications. However, the determination of what constitutes ethical behavior is claimed to be subjective at best, based on varied perceptions among differing relationships.

Managers have a legal and moral responsibility to their owners to exercise good business judgment towards maximizing the performance of their firm. Management also has an obligation to provide products meeting the reasonable expectations of its customers; to honour contractual agreements with its suppliers of labor, goods, and services, and to its debt commitments. Conflicts in meeting these varied obligations are inevitable, particularly when, for whatever reason, a firm is not performing well, and managers are forced to choose which of them will take precedence. Ultimately, management's first priority is to its stockholders – to maintain a viable operation; Chapter 11 allows a firm that option. Despite the fact that their actions may have put the firm in this position, managers feel that they would be remiss in their obligations if they did not elicit the corrective action, reorganization, that is available. However, it is the issue between accountability for their actions and the decision to correct management blunders while preventing the complete disruption of a firm's operations that results in the hazy application of reorganization reliefs.

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In the face of increasing competition and an uncertain economic environment where companies can find themselves in trouble very quickly, certain types of academics promote the use of bankruptcy as an "... early, and thus proactive, strategic choice ..." to cope with these elements if managers believe that their organizations have a chance for survival (Flynn and Farid, 1991). As a risk management tool, bankruptcy provides the means to protect a corporation's assets from liquidation (Power, 1983).[6] Yet, though this is the very basis for the bankruptcy laws, there seems to be no factoring in of manager's responsibility for poor performance. The punitive aspect of bankruptcy seems to have been eliminated. What is most distressing about such writing, however, is that it, under the guises of "survival" and efficiency, legitimizes unethical managerial behavior. It is a slick position that demonstrates absolute obiviousness to its ethical ramifications.

For instance, while middle management layers may be eliminated, executive level managers who have been the firm's strategic planners and decision makers generally retain their positions. Many are frequently "rewarded" with generous severance packages, or offered financial and other inducements to stay on with the firm during its reorganization.[7] Again, to use Manville as an example its top executives received lucrative termination and compensatory packages during the firm's reorganization, as did several of A. H. Robins' executives (Sharplin, 1987; Glaberson *et al.*, 1986). Drexel Bernham also provides a famous example. The reasoning claimed is that retaining existing management, already experienced with the firm's operations and, hopefully, now more aware of its problems and the corrective procedures necessary for its survival, would be a less riskier proposition than installing an outsider with significantly less familiarity.

Power (1983) discusses the partial shift of financial responsibility for a debtor's liabilities to its creditors through the suspension of some debt obligations under a firm's reorganization plan. Should this be considered a fair procedure for dismissing liabilities actively incurred by the debtor? This would support Manville's action of transferring partial responsibility of its asbestos claim payments to its creditors, and also Texaco's substantially reduced award payment of $3 billion to Pennzoil. Consider that Texaco's management knowingly interfered with Pennzoil's purchase of Getty Oil, and despite an asset balance of $35 billion, the firm filed for bankruptcy protection to avoid paying damages of $10.5 billion awarded to Pennzoil (Stein, 1989). In just six months Texaco emerged from bankruptcy in 1988 with revenues over $40 billion (Ballen, 1991). Such creative maneuvering occurs at the expense of a firm's creditors who seemingly have little recourse in the bankruptcy courts to prevent it.

Bankruptcy can also be used to "... avoid the consequences of bad marketing decisions — or a strategic blunder ..." through the permissible rejection of the executory contracts of the old firm by the newly reorganized firm (Meyerowitz, 1985, pp. 88, 92). Managers have taken advantage of this position to rescind on product liability obligations, e.g., A. H. Robins (Dalkon Shield), UNR Industries and Manville (asbestos). The same pretext has been applied to the cancellation of labor contracts and pension agreements (Bildisco, Continental, and Wilson Foods). Is it right that consumers, employees, and creditors be penalized (in the form of unpaid claims, defaulted payments, lost jobs, and benefits) for the ill-fated strategy of a corporation, while the firm and its management make limited reparation and are provided a clean slate with which to restructure and reorganize? Manville's bankruptcy is particularly troubling, note the volume of articles on the subject, because of the very visible human tragedy involved (Johnson *et al.*, 1986). Today the firm has abandoned its asbestos operations, generating revenue from other concerns (immune from asbestos-claim suits) such as milling and forestry products, however, the trust established to pay asbestos claims is proving to be less than sufficient (Sharplin, 1991; Ballen, 1991).

Claimants displaced by a firm's contractual dissolution do have the right to sue for breach of contract. However, such suits are difficult to win, compounded by the fact that claimants rarely have the legal and financial resources, or influence, to compete with those of the usually larger defendant. As Kaplan (1987, p. 66) noted in his discussion on the use of bankruptcy as a management tool, breach of contract "... is normally not a major problem ..." for the firm being sued. Such "bad faith" proceedings are difficult to prove since bankruptcy filings incorporating contract cancellations are generally supported by the existence of severe financial problems. The motion by Continental's unions to

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have the airlines bankruptcy petition denied as an illegal move to breach its labor contracts was rejected by the courts (Engel, 1984). The courts deferred to management's business judgment in determining actions deemed to be in the airline's best interest.

The bankruptcy courts also have diverse obligations to the petitioning debtor, its creditors, and to the community at large. A major element in the decision on whether to grant a firm Chapter 11 status consists of which action, granting the petition or not, would be of greater service to the public good. Disallowing Chapter 11 and letting the petitioner fall into liquidation forces the scale of assets to satisfy creditor's claims, but it also results in a loss of jobs, perhaps inequitable distribution of assets gained, and the ensuing ripple effect throughout the community. Alternatively, a reorganization would allow the firm to remain operable, ensuring continued employment, earned revenue, and the purchase of goods and services which should benefit a greater economic good. This partly explains the court's leniency in granting questionable Chapter 11 petitions, at the expense of creditors and other stakeholders whose interests rank predominantly lower in the current scheme of priorities.

Conclusion

There used to be a strong stigma associated with the use of bankruptcy prior to the 1978 Amendments. A company filing for bankruptcy faced almost certain liquidation. Management was removed and replaced with a trustee who was not necessarily a businessperson. Creditors and customers expecting impending liquidation were wary and unwilling to continue to do business with the bankrupt. Former managers were mostly ostracized, few could hope to find positions of similar stature. The 1978 amendments eliminated much of this stigma, and the relaxation of some of the earlier provisions gave firms more leeway in filing for the bankruptcy court's protection.

One of the effects of bankruptcy reform, however, seems to be that the process is more effective for larger firms than for smaller ones (*The Economist*, March 1989). The expense of the process is cited as a leading factor. Unlike most smaller firms, larger firms frequently have in-house counsel and advisors, or else greater resources to hire professional services. Similarly, while big companies have access to revenue generated from other operations, almost all of a smaller firm's income is used for its bankruptcy expenses leaving little available to reinvest for reorganization purposes, or to support an extended litigation. Additionally, the size of the firm is an important element. The bankruptcy courts are disposed to be more lenient towards a larger, more established firm because of the greater number of jobs at stake and the potential economic impact.

These advantages have clearly allowed some of the abuses of bankruptcy law identified here, and the high visibility of the firms involved have raised the public's awareness that the process may be in need of review and modification. Probably the area needing the most attention is in defining when and if a firm is eligible for bankruptcy protection, not only in legal but also in ethical terms. Requirements should include stronger proof of a petitioner's insolvency – maybe verification of financial records by outside auditors, or a performance analysis conducted by independent management consultants. Supporting evidence should be directly related to problems with payments or its creditors, which would further serve to restrict the field of eligibility (Glaberson, 1983).

More attention also needs to be paid to the protection of creditors' claims. Current Chapter 11 pits creditors against a firm's management and shareholders who are trying to protect their own interests at the creditor's expense (*The Economist*, May 1991). Firms should not be allowed to lose sight of the fact that there is a debt incurred and owed. Creditors' claims should have a greater priority than a shareholder's investment, who as owners of a firm, should be prepared to share in its profits as well as its losses.

The structure of the bankruptcy process, as it stands now, is designed to be rehabilitative rather than punitive and the precedents set by current allowable Chapter 11 filings will allow managers to continue to perform ineffectively by affording them the opportunity to simply erase their mistakes, relatively cost-free (to them), and continue as before. Since our earliest recorded history bankruptcy has favored the forgiveness of debtors' debts and the provision of assistance to make a new start (Sutherland, 1988; Tamari, 1990), but until the bankruptcy courts begin to scrutinize not only the reason for a reorganization petition, but also the events that

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culminated in its necessity, and to tender less lenient judgments, pressure from those victimized by the current process may force the law to be so amended that firms honestly in need of rehabilitation may find such resources severely restricted, or unavailable (Glaberson, 1983; Johnson *et al.*, 1986).

Changes in the bankruptcy process will only come about if there is significant public outcry against it (Johnson *et al.*, 1986). The Bankruptcy Code is established under Federal Law and unless Congress is alerted to an urgent and overwhelming pressure for its modification, as the law currently stands petitioners will continue to get away with pushing its limits.

Notes

[1] Dubashi also states that former company president McKinney knew of asbestos concerns as far back as 1951 when he first joined the firm.

[2] The authors discuss the fact that the Navy sanctioned the use of asbestos products for ship manufactures during World War II. Manville was one of the primary suppliers.

[3] The authors discuss Section 1113 of the Bankruptcy Amendments of 1984 that replaced the business judgement rule with the "balancing of equities" standard in response to labor's outcry against the unilateral decision making allowed by the former (based on Bildisco & Bildisco vs. the NLRA). The modification is intended to ensure that the interests of affected parties are weighted by the courts in the determination of whether to allow contract cancellation, and this only after all parties have made reasonable attempts to negotiate new contract terms.

[4] Formerly known as Hartfield-Zody's Inc. the firm first underwent Chapter 11 in 1976.

[5] Adapted from Dunfee's list of eight principles which form the basis of a general set of ethical standards.

[6] The author defines the term, and uses the case of Manville's bankruptcy to demonstrate its strategic application to prevent sales of the firm's assets to pay the claims of its asbestos litigants.

[7] Managers here refer to the top executives who are the decision makers directing the organization's course. Lower level managers fall into the same situation as the rank and file of regular workers.

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