THE BANKRUPTCY CLAUSE, THE FIFTH AMENDMENT, AND THE LIMITED RIGHTS OF SECURED CREDITORS IN BANKRUPTCY

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It is a commonly held belief that the Fifth Amendment's Takings Clause limits the Bankruptcy Clause and that secured creditors have a constitutional right to receive the full value of their collateral when a debtor declares bankruptcy. This Article rejects this received wisdom: the Fifth Amendment does not—and should not—constrain Congress's ability to define the contours of the Bankruptcy Clause. As revealed by a close examination of the historical evolution of bankruptcy jurisprudence, the Fifth Amendment is not even helpful or relevant in considering the constitutional rights of secured creditors in bankruptcy. As such, the only meaningful limitation on Congress is the Bankruptcy Clause itself. This Article deconstructs this established paradigm and offers a nuanced account of Congress's capacity for reform through its broad authority to modify secured creditors' rights.

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I. INTRODUCTION

It is an article of faith, part of the received wisdom in bankruptcy jurisprudence, that the Fifth Amendment Takings Clause independently limits the exercise of the bankruptcy power under the Bankruptcy Clause. In particular, it is taken as gospel truth that secured creditors in bankruptcy have a constitutional right to receive the full value of their collateral in the bankruptcy case.[1]

My thesis is that the received wisdom is wrong. I argue that the Takings Clause of the Fifth Amendment does not, and should not, constrain the powers of Congress to modify the substantive rights of secured creditors under the Bankruptcy Clause. Instead, the only meaningful limits on the modification of substantive rights of stakeholders pursuant to the bankruptcy power are those that inhere in the Bankruptcy Clause itself. While the Due Process Clause does limit *procedurally* the means by which substantive rights of a lienholder may be affected, that is rarely a problem, and is not the concern of this Article. Frankly, it is not difficult to provide secured creditors with constitutionally required notice and opportunity to be heard. As far as *substantive* due process may apply, the bar is so low as to be hardly a concern, unless the Supreme Court were to decide bizarrely to resurrect the spirit of *Lochner*.[2] Surely almost any congressional legislation in the bankruptcy arena would pass the extremely deferential rational basis test.[3]

That conclusion leaves only the Bankruptcy Clause as a meaningful limitation on what Congress can do to the security rights of lienholders. I argue that the scope of congressional power here is exceedingly broad.

1. *See, e.g.*, Patrick A. Murphy, *Use of Collateral in Business Rehabilitations: A Suggested Redrafting of Section 7-203 of the Bankruptcy Reform Act*, 63 CALIF. L. REV. 1483, 1491 (1975).

2. Lochner v. New York, 198 U.S. 45 (1905). This is an infamous Supreme Court decision striking down a state law regulating the hours of bakeries on substantive due process grounds, and is generally considered the poster child of an era of stringent Supreme Court review of economic regulations under substantive due process. The tide turned in *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937), and since then substantive due process has become essentially a dead letter where the standard of review is rational basis.

3. *See, e.g.*, Usery v. Turner Elkhorn Mining Co., 428 U.S. 1, 15 (1976) ("It is by now well established that legislative Acts adjusting the burdens and benefits of economic life come to the Court with a presumption of constitutionality, and that the burden is on one complaining of a due process violation to establish that the legislature has acted in an arbitrary and irrational way."); United States v. Carolene Prods. Co., 304 U.S. 144, 152 (1938) ("[R]egulatory legislation affecting ordinary commercial transactions is not to be pronounced unconstitutional unless in the light of the facts made known or generally assumed it is of such a character as to preclude the assumption that it rests upon some rational basis within the knowledge and experience of the legislators.").

Two limits appear in the Clause: that the law be "uniform," and that it be "on the subject of Bankruptcies."[4] The first should never be a problem, especially given the very generous interpretation the Court has given to uniformity.[5] Congress could not pass a law that said "only secured creditors in Detroit lose out," but that is about all it is limited from doing. On the "subject of Bankruptcies," the Court has uniformly upheld every law challenged on that basis, with the only requirement being that the law deal with the relations between a debtor and its creditors, when the debtor is having difficulty paying its debts.[6] It is hard to imagine a supposed "bankruptcy" law that Congress might pass that modified the rights of secured creditors that was not predicated on precisely such a scenario.

My thesis has critical implications for prospective reforms of corporate reorganizations. It opens up the possibility of new ways to realign the balance of power between competing stakeholders. Because of the Supreme Court's incoherent waffling,[7] Congress has labored under an unfortunate mistaken belief that its hands are largely tied in being able to pursue significant reform. If we can cut the Gordian knot and (to embrace yet a second metaphor) cast away the shackles of the received wisdom, and return to the correct and original understanding that, for all intents and purposes the Bankruptcy Clause alone dictates the constitutionally permissible bounds of the treatment of the substantive rights of secured creditors in bankruptcy, we can thoughtfully consider meaningful and necessary revisions of our bankruptcy reorganization law. Otherwise, we remain largely enslaved to secured creditor domination of reorganization proceedings.

In Part II, I explain why it matters whether we continue to subscribe to the received wisdom that the Takings Clause limits what can be done to secured creditors in bankruptcy. In Part III, as a means of introduction, I briefly note five curiosities about bankruptcy law as it has developed. Then, in Part IV, I examine in considerable detail the historical evolution of bankruptcy jurisprudence in this area. First, I consider the development of and interpretation of the constitutional grant to Congress to legislate on "the subject of Bankruptcies" in the Bankruptcy Clause, and then move to an examination of the somewhat baffling and bizarre history of the Court's view on the application of the Takings Clause to secured creditors in bankruptcy. In Part V, I assess how we might best strike a prudential and meaningful constitutional balance. A brief conclusion follows.

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4. U.S. CONST. art. I, § 8, cl. 4.

5. *See, e.g.*, Dan J. Schulman, *The Constitution, Interest Groups, and the Requirements of Uniformity: The United States Trustee and the Bankruptcy Administrator Programs*, 74 NEB. L. REV. 91, 105–06 (1995).

6. *See* Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 538–44 (1996).

7. *See infra* Part IV.

II. WHY IT MATTERS

One of the most notable developments in Chapter 11 reorganization practice in this millennium is the dramatic expansion in the power exercised by secured creditors.[8] Financing has experienced a sea change, and today many firms enter Chapter 11 with their assets fully (or almost fully) encumbered.[9] The reality then is that the entire reorganization is dependent on the good graces of the prebankruptcy controlling secured lender. That means that important stakeholders—bondholders, trade creditors, tort victims, employees, and shareholders, to name but a few—are excluded from any recovery but for the whims of the controlling secured creditor.[10]

Indeed, it is even worse than that. Controlling secured lenders often use Chapter 11 as a vehicle to foreclose on their assets. Traditional corporate reorganizations quickly are becoming a *rara avis*; the strongly emerging norm is for debtors to be liquidated in speedy "§ 363 sales," the reference being to the Bankruptcy Code section authorizing sales.[11] This practice has become so prevalent that a coauthor and I have spoken of the "new 'Chapter 3' reorganization."[12]

We should care, first, because this new norm means that all of the value in a firm often goes solely to the secured lender. One might counter that such an outcome is not objectionable if that creditor had a blanket lien on all assets anyway. But it is not so simple. A longstanding premise of reorganizations is that a successful reorganization might produce a going concern value over and above liquidation value.[13] Indeed, the Chapter 11 process is designed in large part to facilitate the ability to capture that going concern surplus. In short, Chapter 11 historically has been predicated on the concept of capturing a going concern (or reorganization) surplus.[14] That surplus then can be allocated among various stakeholders. But with the new norm, *all* value in the enterprise, *including* any reorganization surplus, is captured by the controlling secured lender. The Third Circuit has asserted that such an entitlement necessarily—indeed, *definitionally*—follows from the lender's blanket security position: "Because the Lenders had a valid security interest in essentially all the assets sold, by definition they were entitled to the satis-

8. Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 511–12 (2009).

9. *See, e.g.*, Charles J. Tabb, *Credit Bidding, Security, and the Obsolescence of Chapter 11*, 2013 U. ILL. L. REV. 103, 104–05 & n.6.

10. *See, e.g.*, Lucian Arye Bebchuk & Jesse M. Fried, *The Uneasy Case for the Priority of Secured Claims in Bankruptcy*, 105 YALE L.J. 857, 868–70 (1996).

11. 11 U.S.C. § 363 (2012).

12. CHARLES J. TABB & RALPH BRUBAKER, BANKRUPTCY LAW: PRINCIPLES, POLICIES, AND PRACTICE 719 (3d ed. 2010).

13. *See* CHARLES JORDAN TABB, THE LAW OF BANKRUPTCY § 11.1, at 1023–24 (3d ed. 2013); *see also* Omer Tene, *Revisiting the Creditors' Bargain: The Entitlement to the Going-Concern Surplus in Corporate Bankruptcy Reorganizations*, 19 BANKR. DEV. J. 287, 295 (2003).

14. *See* Douglas G. Baird & Robert K. Rasmussen, *Chapter 11 at Twilight*, 56 STAN. L. REV. 673, 685 (2003).

faction of their claims from available proceeds of any sale of those underlying assets."[15] But why? It is far from evident why this should be the case. Outside of bankruptcy, the secured lender may have considerable difficulty capturing anything above liquidation value. If the bankruptcy process itself allows the recovery of more value, why should all of that bankruptcy-enabled excess go to the secured lender?[16]

Consider a hypothetical example. Debtor owes $25 million to Old Bank, which has a lien on all assets of Debtor, and owes $3 million to a variety of unsecured creditors; including unpaid workers, pension claims, trade debt, warranty claims, and tort claims. Debtor's assets have a liquidation value of $20 million and a going concern value of $22 million. Old Bank forces Debtor into Chapter 11 and moves for a speedy § 363 sale. All the value in Debtor—including the going concern surplus—will be captured by Old Bank, unless it consents to share with other claimants. Absent the consent of Old Bank, no other creditors will recover a dime: not the workers, the retirees, the tort victims, the warranty claimants, or the trade creditors. Why? No one else would bid over $22 million for the Debtor's assets, the highest estimated going concern value. Old Bank, though, can "credit bid" (that is, bid its own debt) up to $25 million,[17] and

15. Cohen v. KB Mezzanine Fund II, LP (*In re* Submicron Sys. Corp.), 432 F.3d 448, 461 (3d Cir. 2006). As Professor Brubaker points out, though, another Third Circuit decision, *In re Phila. Newspapers, LLC*, 599 F.3d 298 (3d Cir. 2010), could stand for limiting the secured creditor's take to a judicially established valuation, under the "cause" limitation on credit bidding in § 363(k). *See* Ralph Brubaker, *Credit Bidding and the Secured Creditor's Baseline Distributional Entitlement in Chapter 11*, BANKR. L. LETTER, July 2012, at 12.

16. For an insightful article analyzing the tension between the secured creditor's rights in floating liens and the policy favoring the debtor's ability to reorganize, see Steven L. Schwarcz & Janet Malloy Link, *Protecting Rights, Preventing Windfalls: A Model for Harmonizing State and Federal Laws on Floating Liens*, 75 N.C. L. REV. 403 (1997). Schwarcz and Link proposed that the secured creditor receive only the liquidation value—even if the debtor were to reorganize:

> Creditors that are secured by after-acquired property should receive in bankruptcy, on account of their floating lien, what they would receive if their lien continued but the debtor were liquidated. This result would obtain irrespective of whether the debtor actually liquidates or reorganizes. It effectively limits the security interest in after-acquired collateral to assets that would become part of the debtor's estate in a liquidation.

Id. at 411.

17. The Third Circuit made it clear in *Submicron Systems* that a secured creditor may credit bid the full face value of its entire claim, irrespective of the value of the underlying collateral. 432 F.3d at 459–60. One might argue that the Delaware court's 2014 decision in the *Fisker Automotive* case raises the specter of capping a credit bid, since the bankruptcy court there capped a credit bid at $25 million (the amount the claims purchaser paid for the claim), rather than allowing a credit bid of the entire purchased claim of $168 million. *In re* Fisker Auto. Holdings, Inc., 510 B.R. 55, 61 (Bankr. D. Del. 2014). The court did so by invoking the "cause" exception in § 363(k), due to a number of factors, including fostering a more competitive bidding environment, an unfair process, and uncertainty as to the secured status of the claim to be credit bid. In denying the disappointed bidder's leave to appeal, the district court concluded that nothing in *Submicron* was inconsistent with the Third Circuit's prior precedent in *In re Philadelphia Newspapers, LLC*, 599 F.3d at 315, which had concluded that the statute plainly allowed a credit bid to be denied or limited for "cause." *See In re* Fisker Auto. Holdings, Inc., 510 B.R. at 58. The big question, of course, then will be whether the "cause" exception in § 363(k) permits allocating some of the going-concern surplus to other stakeholders, by means of a judicial valuation of the secured claim. One could read some aspects of the *Philadelphia Newspapers* decision that way. *See* Brubaker, *supra* note 15, at 12. Regardless, even if some creative courts can find a way in unusual cases to divert some value away from controlling lenders, the overriding norm is to the contrary.

thus at its option is certain to be the successful buyer.[18] The likelihood is that no one else will bid (knowing that to do so would be futile), and thus Old Bank can bid less than the going concern value of $22 million. Either way, Old Bank gets all of Debtor's assets, and for no new money paid (i.e., it just submits a credit bid). If it wishes, Old Bank might then be able to turn around and sell Debtor as a going concern to a third party for up to the going concern value of $22 million. Effectively, Old Bank has taken the entire $2 million going concern surplus for itself. There is no mechanism under the Bankruptcy Code by which the other stakeholders can recover any of that extra $2 million, unless, perhaps, they can persuade the court that part of the sale price was attributable to assets not subject to Old Bank's blanket lien.[19]

Or, if Debtor can somehow avoid the death trap of a § 363 sale, and is able to effect an ongoing reorganization in place, retaining possession and control of its business, Old Bank *still* would get the entire $22 million going concern value. Why? Old Bank could threaten to vote against the plan and insist thereby on being paid what it would be entitled to in a "cram down" plan, which here would be the allowed amount of its secured claim.[20] The amount of the secured claim depends on the collateral value;[21] and the Supreme Court has told us that when a debtor retains and uses collateral, that collateral should be valued at the higher going concern value, not at liquidation value.[22]

While the same result would occur *outside* of bankruptcy, when Old Bank forecloses on its collateral, that observation does not satisfactorily explain why we cannot or should not have a different result *in* bankruptcy. Furthermore, as noted above, outside of bankruptcy Old Bank may well get only liquidation value. Indeed, the bankruptcy process itself may well facilitate Old Bank's ability to capture the extra $2 million, and yet Old Bank gets to keep it all. Bankruptcy proceedings are inherently premised on solving a collective action problem, and are predicated on maximizing the benefits obtainable for the *entire* body of creditors, *inter se*.

The scope of congressional power under the Bankruptcy Clause[23] (to be discussed below) surely would support a regime wherein (at the very least), full going concern value of $22 million for Debtor would be

18. The Supreme Court recently confirmed the essential inviolability of the secured creditor's right to credit bid, except on a showing of "cause." RadLAX Gateway Hotel, LLC v. Amalgamated Bank, 132 S.Ct. 2065, 2073 (2012); s*ee also* Tabb, *supra* note 9. Professor Edward J. Janger has taken issue with credit bidding, arguing that the correct approach is to evaluate the realizable value of the secured creditors' collateral rather than the claim. Edward J. Janger, *The Logic and Limits of Liens*, 2015 U. ILL. L. REV. 589.

19. *See, e.g.*, Official Comm. of Unsecured Creditors v. UMB Bank, N.A. *In re* Residential Capital, LLC, 501 B.R. 549, 610–12 (Bankr. S.D.N.Y. 2013); Michelle Morgan Harner, *The Value of Soft Assets in Corporate Reorganizations*, 2015 U. ILL. L. REV. 509.

20. 11 U.S.C. § 1129(b)(2)(A)(i) (2012).

21. *Id.* § 506(a).

22. Assocs. Commercial Corp. v. Rash, 520 U.S. 953, 955–56 (1997).

23. U.S. CONST. art. I, § 8, cl. 4.

realized, Old Bank would be paid \$20 million, and the remaining \$2 million could be distributed to other claimants.[24]

One problem with doing so, though, is the Fifth Amendment concern that Old Bank has a *constitutional right* to receive the full value of its collateral, unconstrained by the Bankruptcy Clause, and that its collateral value, by definition, must be whatever the Debtor's assets are valued at on a going-concern basis or are sold for, up to Old Bank's total debt. I argue that this view is a dangerous and unwarranted—but unfortunately generally assumed to be true—canard.

Furthermore, with secured creditors driving potentially viable debtors into liquidation, motivated by the understandable and yet solely self-interested impetus to recover on their own claims, the going concern surplus may be lost entirely. An agency problem exists. In the foregoing example, whether the going concern surplus is realized at all, by anyone, is dependent entirely on the whim of Old Bank. If Old Bank is content for Debtor to be liquidated and to go out of business, then, as a practical matter, no one can stop it. As explained, Old Bank can use its debt in a credit bid to out-bid anyone.

But, if Old Bank exercises its de facto veto power and kills off a firm at liquidation value, thereby destroying a going concern surplus, the economy as a whole suffers. Most obviously, there is a dead-weight loss of \$2 million in value. Furthermore, firms are not isolated stand-alone economic islands. If a firm closes its doors; jobs are lost, suppliers lose a customer, and competition in the market is weakened. I am not saying that every firm should be salvaged, no matter what. I am saying that the decision whether to do so should not be controlled by an entity that systematically will never take larger implications and externalities into account but will focus solely on its own interests, which might well be at odds with the greater good.

There is a cure for this agency problem. An impartial, neutral arbiter is available—we call her a "bankruptcy judge"; the forum in which she can make decisions as to the fate of a firm with an assessment of the greater good and the interests of all stakeholders is called the "bankruptcy court"; and the law pursuant to which she can make those decisions is the "Bankruptcy Code." That federal bankruptcy law was passed by Congress pursuant to the power granted in Article I, § 8, clause 4 of the Constitution to "make uniform laws on the subject of Bankruptcies," *viz*, the "Bankruptcy Clause."[25] So all is well, right? No. The operation of that bankruptcy law has been hijacked by controlling secured creditors for their own interests.[26]

24. Indeed, I would argue that the Bankruptcy Clause power would support a result that paid even less than \$20 million to Old Bank, but such is not a necessary part of my argument.

25. U.S. CONST. art. I, § 8, cl. 4.

26. *See* Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 844–52 (2004).

There is a major problem with any attempts to reform the bankruptcy system to counter this über-control by secured lenders. Indeed, it is (at least perceived to be) an almost impassable roadblock. As noted above, that imposing hurdle is the Fifth Amendment. Ever since the Supreme Court broke with precedent and settled understandings of our constitutional system in its 1935 decision in *Louisville Joint Stock Land Bank v. Radford*,[27] and for the first time raised the specter of an independent Fifth Amendment takings constraint on the Bankruptcy Clause to limit what could be done to modify secured creditor claims in bankruptcy, we have been hamstrung. Looming large over the bankruptcy landscape is the perceived constitutional imperative that the collateral position of a secured creditor is inviolate, no matter what the costs and no matter what benefits might otherwise be possible through a prudential invocation of the Bankruptcy Clause.

My position is that the supposed roadblock is, in fact, ephemeral and nothing more than a chimera. Properly understood, the *only* limitation on the scope of congressional power under the Bankruptcy Clause inheres in the Bankruptcy Clause itself. In other words, the Fifth Amendment Takings Clause does not and should not constrain the exercise of congressional powers under the Bankruptcy Clause. Thus, if a proper application of the Bankruptcy Clause would permit the modification of a secured creditor's collateral position (and I believe it does), nothing in the Fifth Amendment Takings Clause should stand in the way.

III. PREVIEW: FIVE CURIOSITIES

Five curiosities (at least) present themselves. The first curiosity is that for a very long time in our nation's history, it was well understood that the only restraint on the bankruptcy power was that found in the Bankruptcy Clause itself.[28] In short, my thesis reflects this original and long-standing understanding. And yet, this history eventually was largely forgotten. I suspect that if you could go back in time and ask Joseph Story—author of the leading early nineteenth century commentary on the Constitution[29] and also architect of the historic Bankruptcy Act of 1841[30]—whether the Fifth Amendment Takings Clause limited the Bankruptcy Clause, he likely would have wrinkled his brow and given you a puzzled stare and asked you why on earth you came up with such an odd idea. Too bad he could not have had a brief chat with Justice Brandeis a century later (explanation to follow). The unbroken line of case authority throughout the nineteenth century and up to and even into the Great

27. 295 U.S. 555, 601–02 (1935).

28. *See* James Steven Rogers, *The Impairment of Secured Creditors' Rights in Reorganization: A Study of the Relationship Between the Fifth Amendment and the Bankruptcy Clause*, 96 HARV. L. REV. 973, 975, 1031 (1983). *But see* Julia Patterson Forrester, *Bankruptcy Takings*, 51 FLA. L. REV. 851, 854 (1999).

29. JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES (1833).

30. The Bankruptcy Act of 1841, ch. 9, § 1, 5 Stat. 440 (repealed 1843).

Depression on the scope of the Bankruptcy Clause all proceeded on the universally shared assumption that the scope of the bankruptcy power was to be divined only by reference to the parameters of the Bankruptcy Clause itself.

We lost our way—briefly, it seemed—in a cryptic case that came out of the Supreme Court's epic depression-era battles with FDR over much of the New Deal legislation. In 1935, the Supreme Court, in an opinion authored by Justice Brandeis, struck down a farm bankruptcy relief act that had been passed the year before. In *Louisville Joint Stock Land Bank v. Radford*,[31] the Court held that the Frazier-Lemke Act took away too many of the collective rights of a farm mortgagee and therefore was invalid under the Fifth Amendment.[32] *Radford* was an unprecedented decision; never before had such a possibility even been considered by the Court.

The second curiosity is that the very same Supreme Court, in the very same year, decided a foundationally important case on the scope of the Bankruptcy Clause, and that case never seriously entertained the idea that the Fifth Amendment might pose some hurdle, even though the contention was raised. Instead, in *Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Railway Co.*,[33] the Supreme Court upheld the new railroad reorganization act as being a permissible exercise of congressional power within the scope of the Bankruptcy Clause.[34] Even though that new law directly impacted and restrained secured creditors, and indeed posed a risk (which, in fact, was realized in the case) that the creditor's collateral might be impaired, the Court gave short shrift to the proffered Fifth Amendment complaint (which focused on due process rather than takings), finding it subservient to the overarching power of the Bankruptcy Clause.[35]

Consistent with the approach it took in the *Rock Island* case, the Court soon effectively recanted its unprecedented decision in *Radford*. After *Radford* was decided, Congress almost immediately passed a very slightly amended version of the Frazier-Lemke Act,[36] modestly tweaking some of the supposedly unconstitutional infringements that had haunted the original Frazier-Lemke Act. The Supreme Court then upheld the "new and improved" act against a variety of constitutional challenges in a pair of cases: *Wright v. Vinton Branch of Mountain Trust Bank*[37] and *Wright v. Union Central Life Insurance Co.*[38] After the *Wright* duo,

31. 295 U.S. at 555.

32. *Id.* at 601–02. Just as curiously, it was not entirely clear whether the invalidity was under the Due Process or the Takings Clause—although the latter seems a more plausible reading.

33. 294 U.S. 648 (1935).

34. *Id.* at 685.

35. *Id.* at 680.

36. Act of Aug. 28, 1935, ch. 792, 49 Stat. 942 (amending 11 U.S.C. § 203(s) (1935)).

37. 300 U.S. 440 (1937).

38. 311 U.S. 273 (1940).

Radford, by common consensus, was dead and gone, apparently one of those momentary lapses that even the Supreme Court can make.[39]

The third curiosity comes from the second *Wright* case.[40] The enduring—indeed, almost canonical—embodiment today of the thesis that the Fifth Amendment constrains the exercise of the bankruptcy power as applied to secured creditors is found in that second *Wright* decision, the *Union Central* case.[41] The *Wright* cases, as just noted, and as will be explained in more detail below, for all intents and purposes said, "We goofed in *Radford*. Forget what we said there. Our bad." The *Union Central* Court *held* that it was perfectly fine for James Wright to be allowed to purchase his farm at its appraised value without allowing the secured creditor a chance to bid against him.[42] In a nutshell, the case stands squarely for sticking it to the secured creditor in order to make things better for the debtor. Making light of the secured creditor's constitutional protestations, and ignoring what Justice Brandeis had written in *Radford*, Justice Douglas (who likely knew more about bankruptcy than any justice in United States history, except possibly Justice Story) in *Union Central* observed wryly that the secured creditor could hardly complain because it had been paid "the value of the property"—and here is the canonical statement—and "there is no constitutional claim of the creditor to more than that."[43] This third curiosity, then, is that the Court's action in dramatically *restricting* the rights of secured creditors has come to be embraced, almost on the level of holy writ, as the credo for *upholding* the constitutional rights of secured creditors.[44]

The fourth curiosity is that almost half a century after *Radford's* apparent demise, the Supreme Court inexplicably resurrected it à la Lazarus in *United States v. Security Industrial Bank*.[45] *Security Industrial Bank* was a 1982 decision in which the Court construed a lien avoidance provision in the 1978 Bankruptcy Reform Act[46] in such a way as to avoid the constitutional problem that otherwise would have arisen due to the destruction of the secured creditor's lien.[47] Chief Justice Rehnquist, writing for the Court, plainly signaled that such a retroactive lien destruction was constitutionally verböten under the mandate of *Radford*,[48] which until then had been discredited and largely forgotten.

39. *See* Helvering v. Griffiths, 318 U.S. 371, 401 & n.52 (1943).
40. 311 U.S. at 273.
41. *Id.*
42. *Id.* at 281–82.
43. *Id.* at 278.
44. Thus, for example, Patrick Murphy reads this passage to establish that "the secured creditor has a distinct property interest entitled to constitutional protection throughout the proceeding, but that property interest is limited to the value of the collateral and should be distinguished from the secured creditor's procedural remedies, which can be impaired or even abrogated." Murphy, *supra* note 1, at 1491.
45. 459 U.S. 70, 75 (1982).
46. Bankruptcy Reform Act of 1978, 11 U.S.C. § 522(f) (2012).
47. *Sec. Indus. Bank*, 459 U.S. at 82.
48. *Id.* at 75.

Curiosity number five is that all of the cases, from *Radford* on, that have weighed in on the constitutional issue, have done so in the specific context of *retroactive* legislation that would upset previously existing rights. Yet, and here is the curiosity, those cases have unthinkingly been taken to be equally applicable to impose strict Fifth Amendment limits on what can be done to secured creditors under the bankruptcy power, even with respect to *prospective* legislation. But, indisputably, the constitutional case is radically different depending on whether prospective or retroactive application is on the table. As to the former, it is hard to come up with an even plausibly defensible basis for finding a Fifth Amendment takings constraint.

IV. A MAGICAL HISTORY TOUR

A. The Original Understanding: The Scope and Preeminence of the Bankruptcy Clause

When the Framers included the Bankruptcy Clause in the Article I powers of Congress in the Constitution, granting Congress the power to pass "uniform laws on the subject of Bankruptcies,"[49] it was well understood what that grant meant. And what it meant was—a law just like what bonnie old England had for a quarter of a millennium, the current iteration being the Statute of George of 1732.[50] So, a "bankruptcy" law was a form of collective proceeding that could be brought only against merchant debtors, only involuntarily against the debtor by aggrieved creditors, upon the commission of an act of bankruptcy, which would result in the designation of a bankruptcy commissioner to administer the estate; if the debtor cooperated in the case, perhaps he might be granted a discharge of debts.[51] "Insolvency" laws, by contrast, offered a form of relief (from debts or, more commonly, from imprisonment) on the petition of a distressed individual debtor, whether merchant or not.[52] The only real opposition at the Constitutional Convention to including a bankruptcy power was the worry posed by Roger Sherman of Connecticut that the death penalty for fraudulent bankruptcy might apply, as it then still did in England.[53] But with little fanfare the bankruptcy power was included.

James Madison commented on the wisdom of including such a power in No. 42 of the Federalist Papers:

> The 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

49. U.S. CONST. art. I, § 8, cl. 4.
50. 5 Geo. 2, c. 30 (1732) (Eng.).
51. *See* TABB, *supra* note 13, § 1.6.a., at 37–38.
52. *Id.* § 1.1, at 2.
53. BRUCE H. MANN, REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE 169 (2009).

> removed into different States, that the expediency of it seems not likely to be drawn into question.[54]

In a similar vein, Joseph Story, in his 1833 *Commentaries on the Constitution of the United States*, emphasized the necessity for a *federal* law of bankruptcy, because if the power to enact bankruptcy laws were left to the individual states, relief would be greatly restricted and compromised.[55] States could neither impair the obligation of contracts[56] nor provide efficacious relief beyond their borders.[57] Indeed, experience in the colonial period and under the Articles of Confederation underscored the severe limitations on the effectiveness of state bankruptcy laws.

Throughout the next century, the battle over the scope of the bankruptcy power focused on whether that power was limited to the sort of proceeding in force in England in 1789, and if not, what innovations were permitted. *Sturges v. Crowninshield*,[58] decided in 1819, dealt with a New York state law that discharged debts, passed at a time when there was no extant federal bankruptcy legislation. Chief Justice Marshall noted in dictum that the extent of the constitutional grant was not necessarily restricted to the technical English understanding of "bankruptcy."[59] What might have been understood to be an "insolvency" law, rather than a bankruptcy law, nevertheless might fall within the constitutional grant.[60] Justice Story agreed in his 1833 *Commentaries*.[61] Over the next century, this view that the scope of the Bankruptcy Clause was not confined to English bankruptcy law as of 1789 was embraced on multiple occasions by the Supreme Court.[62]

Story discussed the bankruptcy power extensively. He first broadly defined a bankruptcy law by reference to its core functions of distributing property and discharging debts:

> [T]he general object of all bankrupt and insolvent laws is, on the one hand, to secure to creditors an appropriation of the property of their debtors *pro tanto* to the discharge of their debts, whenever the latter are unable to discharge the whole amount; and on the other hand, to relieve unfortunate and honest debtors from perpetual bondage to their creditors, either in the shape of unlimited impris-

54. THE FEDERALIST NO. 42, at 217 (James Madison) (Max Beloff ed. 1948).

55. JOSEPH STORY, COMMENTARIES ON THE CONSTITUTION OF THE UNITED STATES §§ 1107–09 (Little Brown 3d ed. 1858).

56. Sturges v. Crowninshield, 17 U.S. (4 Wheat.) 122, 206 (1819).

57. Ogden v. Saunders, 25 U.S. (12 Wheat.) 213, 313 (1827).

58. 17 U.S. at 122.

59. *See id.* at 144–45.

60. The Court went on, though, to say that New York law was not preempted simply because of the existence of the possibly conflicting constitutional grant. It was only the exercise of the power by Congress that would preempt state power. *Id.* at 127–28.

61. STORY, *supra* note 55, at § 1111. Story's position was quoted at length with approval by the Supreme Court in *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 185 (1902).

62. *See, e.g.*, Cont'l Ill. Nat'l Bank & Trust Co. v. Chi., R.I. & P. Ry. Co., 294 U.S. 648, 668 (1935); *Moyses*, 186 U.S. at 185.

> onment to coerce payment of their debts, or of an absolute right to appropriate and monopolize all their future earnings.[63]

He then concluded that:

> Perhaps as satisfactory a description of a bankrupt law, as can be framed, is, that it is a law for the benefit and relief of creditors and their debtors, in cases, in which the latter are unable, or unwilling to pay their debts. And a law on the subject of bankruptcies, in the sense of the constitution, is a law making provisions for cases of persons failing to pay their debts.[64]

For our present purposes, under Story's view, it would appear that a law modifying the rights of secured creditors of a financially distressed debtor would plainly fall within the constitutional power. Both core functions of a bankruptcy law, *viz.*, of dealing with and making distribution of the debtor's property to creditors, and discharging debts thereafter, are at the very core of such a law.

Of more interest and relevance to my central thesis is this: in all of Story's quite extended and detailed discussion of the bankruptcy power, wherein he examines its nature, history, function, and application, he never even intimates that lurking as a brake on what Congress can do is the Fifth Amendment Takings Clause. While I recognize that nothing conclusive can be inferred from such silence, at the same time one of the central, core issues constantly under discussion by Story is what can be done with the debtor's property in bankruptcy, and how and in what manner it should be distributed to creditors. If there were any Fifth Amendment Takings restraint on how a bankruptcy law could deal with a debtor's property that also happens to be subject to a lien, it is most surprising and a seemingly glaring omission for Story to have forgotten to mention it. But his approach typified that of nineteenth century lawyers, judges, and scholars in their assessment of the extent of the bankruptcy power, which was to focus solely on the Bankruptcy Clause itself.[65] I have found no discussions in that era suggesting anything else.

In the first four decades of the nineteenth century, following the 1803 repeal of the Bankruptcy Act of 1801,[66] the big debate was whether a law that allowed a nonmerchant debtor to voluntarily commence a bankruptcy case and discharge his debts fell within the scope of the "subject of Bankruptcies."[67] While some (especially John Calhoun and Thomas Benton) argued that it did not,[68] the prevailing view, championed especially by Joseph Story (architect of the Bankruptcy Act of 1841) and Daniel Webster, was that such a law was a bankruptcy law within the constitutional grant, even though it went beyond the English

63. STORY, *supra* note 55, at § 1106.
64. *See id.* at § 1108 n.25.
65. *See generally* Stephen J. Lubben, *A New Understanding of the Bankruptcy Clause*, 64 CASE W. RES. L. REV. 319 (2013).
66. Bankruptcy Act of 1803, ch. 6, 2 Stat. 248.
67. *See* Plank, *supra* note 6, at 508 n.107.
68. *See* CONG. GLOBE, 26th Cong., 1st Sess. 345, 433 (1840).

practice at the time of the Constitution.[69] Indeed, Story had argued that voluntary bankruptcy by nonmerchants fell within the constitutional grant in his 1833 *Commentaries*.[70] Just such a law was then passed in the Bankruptcy Act of 1841.[71]

The constitutionality of the 1841 Act was never passed on directly by the Supreme Court. Justice Catron, sitting on circuit, however, upheld the constitutionality of the 1841 Act in the case of *In re Klein* in 1843.[72] Justice Catron's extraordinarily broad definition of the scope of congressional power under the Bankruptcy Clause has been quoted in numerous cases with approval by the Supreme Court:

> I hold, it [the bankruptcy power] extends to all cases where the law causes to be distributed the property of the debtor among his creditors; this is its least limit. Its greatest, is a discharge of the debtor from his contracts. And all intermediate legislation, affecting substance and form, but tending to further the great end of the subject—distribution and discharge—are in the competency and discretion of Congress.[73]

Under this expansive definition, there is little doubt that a law modifying the rights of secured creditors in their collateral would be covered. Clearly, "distribution and discharge" are comprehended by such a law. The collateral would be "distributed" and the secured creditor's further rights to collect from the debtor as a personal obligation would be "discharged." Now to be sure, nothing in the 1841 Act purported to so affect a secured creditor's rights, so we cannot take anything from Justice Catron's observation that speaks to the *relationship* between the Takings Clause of the Fifth Amendment and the Bankruptcy Clause. But the constitutional power of the Bankruptcy Clause seemingly would be covered.

The next major development with regard to the scope of the Bankruptcy Clause concerned the addition of a provision for composition agreements in the 1874 amendment[74] to the Bankruptcy Act of 1867. The 1874 composition law was the first important step on the road to a reorganization law. That law did not provide for the modification of secured debts, but only of unsecured debts.[75] The composition agreement, if accepted by the specified percentage of creditors, allowed the debtor to retain his property and discharge his debts—importantly, even as to creditors who voted against the composition—if he paid the amounts provided for in the composition agreement.[76] Again, the Supreme Court never directly passed on the constitutionality of the composition provision. The

69. *See, e.g.*, STORY, *supra* note 55, at § 1106.
70. *Id.* at § 1111.
71. *See* Uniform System of Bankruptcy Act of 1841, ch. 9, 5 Stat. 441 (1841) (repealed 1843); *see* John C. McCoid, II, *The Origins of Voluntary Bankruptcy*, 5 BANKR. DEV. J. 361, 361 (1988).
72. *See In re* Klein, 42 U.S. (1 How.) 277.
73. *Id.* at 281.
74. Composition with Creditors Act, ch. 390, § 17, 18 Stat. 182–84 (1875) (repealed 1878).
75. *Id.*
76. *Id.*

lower courts, however, found that it was constitutional.[77] In an 1881 case, the Supreme Court did recognize that the composition provision was a proceeding "in bankruptcy," and thus had to be applied consistently with the other provisions of the bankruptcy law.[78]

An oft-quoted and influential lower court opinion upholding the 1874 composition law was *In re Reiman*, in which Judge Blatchford explored in depth the history and nature of bankruptcy legislation.[79] He first agreed with the prevailing view that the "subject of Bankruptcies" was not limited to the scope of English practice in 1789:

> [T]he power to establish laws on 'the subject of Bankruptcies' gives an authority over the subject, that is not restricted by the limitation found in the English statutes in force when the constitution was adopted. The power given must, indeed, be held to be general, unlimited and unrestricted over the subject.[80]

That left the question, though: "what is the subject?"[81] Judge Blatchford answered, in a passage often cited or quoted approvingly by the Supreme Court[82] and lower courts: "The subject is 'the subject of Bankruptcies.' 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."[83]

Elaborating, he explained that the essence of a bankruptcy law was to deal with the property of a distressed debtor, and to appropriate and distribute that property amongst the debtor's creditors, with, perhaps, a discharge of debts following that distribution.[84] That analysis again suggests strongly that a law that purported to deal with a debtor's property, even though subject to a lien, would surely fall within the constitutional grant. Again, since the 1874 law did not purport to modify secured claims, there was no need to opine on the question, and thus nothing dispositive can be inferred. The reasoning followed there, however, foreshadowed that used by the Supreme Court in the Great Depression in upholding a reorganization law that *did* affect the claims of secured creditors.[85] Indeed, the Court in 1935 in the landmark *Rock Island* case concluded that the reasoning of *Reiman* in upholding the 1874 composition law directly supported a holding in favor of the constitutionality of the 1933 railroad reorganization act which, as noted, seriously restricted the rights of secured creditors.[86]

77. *See, e.g.*, *In re* Reiman, 20 F. Cas. 490 (S.D.N.Y. 1874) (No. 11,673).

78. *See* Wilmot v. Mudge, 103 U.S. (13 Otto) 217 (1880). The Court held that a debt based on fraud could not be discharged in a composition when the defrauded creditor did not assent.

79. *See Reiman*, 20 F. Cas. at 492.

80. *Id.* at 496.

81. *Id.*

82. *See, e.g.*, Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 187 (1902).

83. *Reiman*, 20 F. Cas. at 496.

84. *Id.* at 493.

85. *See* Cont'l Ill. Nat'l Bank & Trust Co. v. Chi., R.I. & P. Ry. Co., 294 U.S. 648, 663 (1935).

86. *See id.* at 672–73.

A case decided by the Supreme Court in 1886 sheds some light on the rights of secured creditors in bankruptcy cases.[87] Francis Long and his wife Betsy had borrowed money from Daniel Bullard and granted him a mortgage on their homestead to secure repayment.[88] Francis Long subsequently was adjudicated a bankrupt, but Bullard declined to prove his claim or otherwise participate in the bankruptcy case; Long received a discharge.[89] A few years later, Bullard sought to foreclose his mortgage, and Long objected that the discharge in bankruptcy had cut off Bullard's rights.[90] In *Long v. Bullard*, the Supreme Court held for Bullard, the secured creditor.[91] According to the Court, the bankruptcy discharge only eliminated the bankrupt's *personal* liability for discharged debts; the creditor's right to its collateral survived.[92] Notably, though, the Court's decision was not based upon any view of a constitutional right to the collateral, but apparently only on an interpretation of the intended scope of the discharge provisions of the Bankruptcy Act of 1867. The Court in *Radford* a half century later, however, cited *Long* for the proposition that a mortgagee's mortgage is "not disturbed by bankruptcy proceedings" unless the mortgagee chooses to participate and prove his claim,[93] the point being relevant to the *Radford* Court's view that a mortgage is constitutionally inviolable unless the debt is paid in full or the mortgaged property relinquished.[94] Drawing a *constitutional* imperative from *Long*, though was unwarranted.

The onset of the cataclysmic Great Depression raised the stakes and focused the issue of the relative rights of debtors and creditors, especially creditors holding security, such as a mortgage. With debtors ubiquitously in default, and with property values plummeting, the specter of rampant foreclosures appeared.[95] Both state and federal legislatures feared that debtors would lose their property for a song. In response, Congress passed a series of relief acts in 1933 and 1934, including a wide variety of laws providing for compositions and reorganizations.[96] States, too, passed moratorium laws delaying foreclosures.[97]

In a landmark nonbankruptcy decision in early 1934, the Supreme Court upheld Minnesota's mortgage moratorium law against a challenge

87. Long v. Bullard, 117 U.S. 617 (1886).
88. *Id.* at 618.
89. *Id.*
90. *Id.*
91. *Id.* at 621.
92. *Id.*
93. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 582–83 (1935).
94. *Id.* at 579 n.7.
95. *See* Aleatra P. Williams, *Foreclosing Foreclosure: Escaping the Yawning Abyss of the Deep Mortgage and Housing Crisis*, 7 NW J. L. & SOC. POL'Y 454, 497 (2012) ("During the Great Depression, a record number of homeowners faced foreclosure. It was reported that foreclosures swelled from 134,900 to 252,400 from 1929 through 1933.").
96. *See, e.g.*, Michael St. Patrick Baxter, *The Application of § 502(b)(6) to Nontermination Lease Damages: To Cap or Not to Cap?*, 83 AM. BANKR. L.J. 111, 130–37 (2009).
97. Geoff Walsh, *The Finger in the Dike: State and Local Laws Combat the Foreclosure Tide*, 44 SUFFOLK U. L. REV. 139, 139–44 (2011).

that it violated the constitutional prohibition against states passing laws impairing the obligation of contracts.[98] In *Home Building & Loan Association v. Blaisdell*, the Court concluded that in response to a dire economic emergency, states constitutionally may invoke their police powers to grant a moratorium against foreclosures.[99] Delay alone is not enough to contravene the Contracts Clause, if it still appears that the law "preserve[s] substantially the right of the mortgagee to obtain, through application of the security, payment of the indebtedness."[100] That holding would seem to suggest that Congress, which in the Bankruptcy Clause has the express power to legislate upon the subject of bankruptcies—a power which almost inevitably does impair the obligation of contracts, at least as much as if not more so than had been true of the legislation at issue in *Blaisdell*—accordingly may exercise its bankruptcy power to pass laws that would delay the realization by a mortgagee upon its collateral. Nor would doing so appear to trigger any takings problems. After *Blaisdell*, though, the Court went the other way on other state moratorium laws, when the legislation at issue more substantially abridged the lienholder's substantive right to realize on its collateral.[101]

Most pertinent was the Supreme Court's decision on April 1, 1935—just eight weeks before the Court decided *Radford*—in *Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Railway Co.*,[102] upholding the provisions of § 77,[103] permitting railroad reorganizations. The Court concluded that the new reorganization law, passed in 1933, was within the scope of the Bankruptcy Clause,[104] and did not violate any other constitutional provision, most specifically the Due Process Clause of the Fifth Amendment.[105] Importantly, this law *did* affect the rights of secured creditors; indeed, a substantial amount of the debt held against the Rock Island railroad was secured.[106] The specific question that went up to the Court was whether the injunction restraining the sale of the collateral was valid.[107] The new law only required that a railroad debtor's plan for reorganization provide "adequate protection" for the lienholder's collateral position.[108]

98. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 447–48 (1934).

99. *Id.* at 436.

100. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 581 (1935).

101. *See, e.g.*, W. B. Worthen Co. v. Kavanaugh, 295 U.S. 56, 63 (1935); W. B. Worthen Co. v. Thomas, 292 U.S. 426, 434 (1934).

102. 294 U.S. 648 (1935).

103. *Id.* at 672; *see also* Act of Mar. 3, 1933, ch. 204, 47 Stat. 1467, 1474 (repealed 1978).

104. *Cont'l Ill. Nat'l Bank*, 294 U.S. at 675.

105. *Id.* at 680.

106. *Id.* at 657.

107. *Id.*

108. Unless a class voted in favor of the plan, 77(g)(6) required:

> adequate protection for the realization by them of the value of their securities, liens, and claims, either (a) by the sale of such property subject to their liens, if any, or (b) by the sale free of such liens at not less than a fair upset price, and the transfer of such liens to the proceeds of such sale, or (c) by appraisal and payment in cash of either the value of such liens and claims or, at the objecting creditors' election, the value of the securities allotted to such liens and claims under the plan.

The Court first had to decide if the new law fell within the "subject of Bankruptcies."[109] It began with the recognition that, as noted above, the scope of the bankruptcy power had never been understood to be limited only to English practice as of 1789.[110] Instead, it noted that "[f]rom the beginning, the tendency of legislation and of judicial interpretation has been uniformly in the direction of progressive liberalization in respect of the operation of the bankruptcy power."[111] Yet, Justice Sutherland for the unanimous Court further observed: "But, while it is true that the power of Congress under the bankruptcy clause is not to be limited by the English or Colonial law in force when the Constitution was adopted, it does not follow that the power has no limitations. Those limitations have never been explicitly defined . . . ."[112] Taking a close look at the historical evolution of the bankruptcy acts in the United Sates, the Court concluded:

> The fundamental and radically progressive nature of these extensions becomes apparent upon their mere statement; but all have been judicially approved or accepted as falling within the power conferred by the bankruptcy clause of the Constitution. Taken altogether, they demonstrate in a very striking way the capacity of the bankruptcy clause to meet new conditions as they have been disclosed as a result of the tremendous growth of business and development of human activities from 1800 to the present day. And these acts, far-reaching though they be, have not gone beyond the limit of congressional power; but rather have constituted extensions into a field whose boundaries may not yet be fully revealed.[113]

With respect, then, to the new railroad reorganization law, the Court then observed: "Section 77 advances another step in the direction of liberalizing the law on the subject of bankruptcies. . . . Obviously, Section 77 does no more than follow the line of historical and progressive development projected by previous acts."[114] The Court found precedent for approval of the fundamental nature of the relief offered by Section 77 as being within the bankruptcy power in prior decisions upholding composition laws. First was the Court's *Gebhard* decision,[115] which had upheld on comity grounds the legislation of the Canadian Parliament allowing for restructuring of the debts, secured and unsecured, of a Canadian railway. Such a law deserved comity, the Court opined, as it was within "the spirit of bankrupt laws."[116] So too did the *Rock Island* Court cite ap-

Id. at 663 n.4.

109. *Id.* at 668.
110. *Id.* at 669.
111. *Id.* at 668.
112. *Id.* at 669.
113. *Id.* at 671.
114. *Id.* at 671–72.
115. Canada S. Ry. Co. v. Gebhard, 109 U.S. 527 (1883).
116. *Id.* at 539.

provingly the lower court cases, such as *Reiman*, which had approved the 1874 composition law,[117] emphasizing that:

> The constitutionality of the old provision for a composition is not open to doubt. . . . The same view sustains the validity of section 77. Both contemplate an adjustment of a failing debtor's obligations; and although actual bankruptcy may not supervene in either, they are none the less laws on the subject of bankruptcies.[118]

The Court thus concluded: "It follows, from what has now been said, that section 77, in its general scope and aim, is within the power conferred by the bankruptcy clause of the Constitution; and we so hold."[119]

But that holding only disposed of the contention that Section 77 fell outside of the scope of congressional powers. Even if that enactment came within congressional powers under the Bankruptcy Clause, were the specific provisions of the railroad reorganization law affecting secured creditors, and the manner in which they were implemented via injunction restraining the sale of the collateral, nevertheless in contravention of the Fifth Amendment? The Court thought not, and indeed did not even appear to think it a close question.[120]

Notably, the Court acknowledged the possibility that the value of the collateral might decline during the period the injunction against sale was in force.[121] Indeed, the petitioner's brief pointed out that the value of the collateral *already* had declined by over forty percent from the time the petition for an injunction was filed, and that the petitioner had gone from being over-secured to being substantially underwater.[122] Nevertheless, the *Rock Island* court did not believe that to be problematic or to pose any constitutional difficulty; the same possibility existed in regular proceedings in bankruptcy, and that had never been thought to pose a constitutional problem.[123] Indeed, the Court did not even intimate, nor did the aggrieved lienholders argue, that such a collateral decline might raise an issue under the Takings Clause.

117. *Cont'l Ill. Nat'l Bank*, 294 U.S. at 672.
118. *Id.* at 672–73.
119. *Id.* at 675.
120. *Id.* at 680–81.
121. *Id.* at 677.
122. In their Brief before the Supreme Court, the Petitioners argued that:

> When the Debtor's petition for an injunction was filed (September 26, 1933) the collateral held by petitioners had a market value (based on past prior sales on the New York Stock Exchange) of $4,153,355, an amount substantially in excess of the $3,866,923.34 principal amount of indebtedness then owing to petitioners. On October 15, 1934, when the petition for certiorari was prepared, the market value of the collateral (on the same basis) was $2,614,755. On January 12, 1935, as this brief is being prepared, the market value of the collateral (on the same basis) is $2,389,980. It is apparent, therefore, that *any* postponement of the sale of collateral of the character in question may cause substantial damage to the pledgees—as indeed the injunction in these cases has already damaged petitioners.

Brief for Petitioners at 69, Cont'l Ill. Nat'l Bank & Trust Co. v. Chi. R.I. & P. Ry. Co., 294 U.S. 648 (1935) (Nos. 479–88).
123. *Cont'l Ill. Nat'l Bank*, 294 U.S. at 677.

Rather, the specific constitutional objection the *Rock Island* Court entertained was a due process challenge.[124] The objecting lienholders argued that since they were empowered by the terms of their security to sell their collateral at a time of their own choosing, the injunction entered in the present case under Section 77 "deprives them of their property—that is to say, impairs or destroys their contractual rights—without due process of law."[125] The Supreme Court previously had held that due process limits the operation of the bankruptcy power, stating in *Hanover National Bank v. Moyses* that "Congress may prescribe any regulations concerning discharge in bankruptcy that are not so grossly unreasonable as to be incompatible with fundamental law."[126] The secured creditors in *Rock Island* argued that the delay preventing them from foreclosing indefinitely, while their collateral was declining in value, was arbitrary and unreasonable.[127]

The Court, however, had little trouble in rejecting that claim: "We find no substance in the contention of the petitioning banks that section 77, as applied by the court below to permit an injunction restraining the sale of the collateral, violates the Fifth Amendment."[128] The Court's reasoning rested first on the structure of the Constitution and the necessary and evident purpose and function of the clauses read in harmony:

> [U]nder the express power to pass uniform laws on the subject of bankruptcies, the legislation is valid though drawn with the direct aim and effect of relieving insolvent persons in whole or in part from the payment of their debts. So much necessarily results from the nature of the power, and this must have been within the contemplation of the framers of the Constitution when the power was granted.[129]

That argument, though, simply said that under the Bankruptcy Clause, Congress can pass an act the effect of which is to impair the obligation of contracts, without necessarily violating due process. The objecting banks did not entirely dispute that point; rather, their primary argument was that in the instant case the means of doing so—an indefinite injunction against foreclosure while the value of the collateral dropped by almost half—was in fact arbitrary and unreasonable.[130] The Court's response was conclusory: "The injunction here goes no further than to delay the enforcement of the contract. It affects only the remedy."[131] The Court also pointed out that it had already held, in *Straton v. New*, that a court sitting as a court of bankruptcy had the constitutional power to de-

124. *Id.* at 667.
125. *Id.* at 680.
126. Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 192 (1902).
127. *See Cont'l Ill. Nat'l Bank*, 294 U.S. at 684–85.
128. *Id.* at 680.
129. *Id.* at 680–81 (internal citation omitted).
130. *Id.*
131. *Id.* at 681.

lay the enforcement of a real estate mortgage.[132] The situation in *Rock Island*, the Court thought, was "strictly analogous in character."[133]

Taken together, the substance of what the Court *did* in *Rock Island* as well as what it *said* would grant considerable deference to Congress to pass a bankruptcy law that affected the rights of secured creditors to their collateral, with no meaningful hindrance posed by the Fifth Amendment. For all intents and purposes, as long as the law enacted fell within the extremely expansive and ever-expanding scope of the Bankruptcy Clause, which basically any law that dealt with debtors and creditors would, it would pass muster. Due process would be violated only if the provisions of the act were "so grossly unreasonable as to be incompatible with fundamental law,"[134] and no mention of an issue under the Takings Clause was even discussed. And yet, if the facts posited by the petitioning banks in that case were as alleged, the secured creditors already had seen over forty percent of the value of their collateral evaporate, and had gone from being oversecured to undersecured. In such a world, secured creditors apparently were almost entirely at the mercy and whim of Congress.

B. Radford*: Birth, Death, and Resurrection*

The case that at first blush changed everything was *Louisville Joint Stock Land Bank v. Radford*[135]—decided, as noted earlier, a mere eight weeks after *Rock Island*. Inexplicably, even though the substance of what was being done to the mortgagees in the two cases was hardly distinguishable (in both, the gravamen was that foreclosure was delayed) the Court made an about turn and, in direct contrast to *Rock Island*'s permissive and deferential approach, struck down the law at issue in *Radford* as a violation of the Fifth Amendment (apparently as a taking, rather than as a denial of due process).[136] Ironically, on the facts, a compelling argument could be made that the mortgagees in *Rock Island* were more negatively affected than the mortgagee in *Radford*, having already lost over forty percent of their collateral value (and going from oversecured to underwater) and were still hamstrung by an injunction of indefinite term.[137] In *Radford*, it was hard to believe that the farm could fall much more in value than it already had. The primary difference in the two acts, though, was the purchase option given to the debtor by the act at issue there. As Justice Brandeis observed in *Radford*, "This right of the mortgagee to insist upon full payment before giving up his security has been deemed of the essence of a mortgage."[138]

132. *Id.* at 677 (citing Straton v. New, 283 U.S. 318, 321 (1931)).
133. *Id.* at 682.
134. Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 192 (1902).
135. 295 U.S. 555 (1935).
136. *Id.* at 601–02.
137. *Cont'l Ill. Nat'l Bank*, 294 U.S. at 684–85; Brief for Petitioners, *supra* note 122.
138. *Radford*, 295 U.S. at 580.

Part of the New Deal legislation was a farm relief act, the Frazier-Lemke Act ("FLA").[139] The original relief act for farmers was passed in March of 1933 as part of President Franklin Roosevelt's "100 days" legislative packet, and added a new § 75 to the Bankruptcy Act.[140] But even that law proved ineffectual in affording relief, so Congress amended § 75 with the FLA in the dreary summer of 1934.[141] The amendment provided a mechanism by which a farmer could keep his farm, even if he was underwater on the mortgage.[142] The core of the Act allowed the farmer to retain possession of the farm and then exercise an exclusive option to purchase that farm at its appraised value over a period of up to five years.[143] Consent of the mortgagee was not required.[144] By its terms the Act applied only to mortgages entered into *before* the Act was passed.[145]

William W. Radford, Sr., owned a 170-acre farm in Christian County, Kentucky, and had executed mortgages in 1922 and 1924 to the Louisville Joint Stock Land Bank to secure loans of $8000 and $1000.[146] When the Great Depression hit, Radford defaulted on his mortgages and the Bank eventually sued in June of 1933 to foreclose the mortgages.[147] Radford filed a farmer bankruptcy petition under § 75 of the Bankruptcy Act[148] in February 1934 and sought a composition, but his creditors did not approve.[149] But when Congress added subsection (s) to § 75 in the Frazier-Lemke Act on June 28, 1934, Radford had new hope. The state court had ordered foreclosure on June 30, 1934, but on August 6, Radford amended his petition in bankruptcy to include a prayer for relief under the new Frazier-Lemke Act, which would let him retain possession for up to five years upon payment of an annual rent (fixed at $325 for Radford) and then to purchase the farm at its appraised value (initially $4445, although the mortgagee could request reappraisal at the time of debtor's proposed purchase), even if the mortgagee did not consent.[150] The bank did not consent, and offered to pay $9209 for the property, which the referee in bankruptcy refused.[151] Instead, Radford retained

139. Frazier-Lemke Farm Bankruptcy (Agricultural Debt Relief) Act, ch. 869, Pub. L. No. 73-486, 48 Stat. 1289 (1934) (codified at 11 U.S.C. § 203(s) (1934)).

140. Agricultural Adjustment Act of 1933, ch. 25, Pub. L. No. 73-10, 48 Stat. 31; *see generally* Harold F. Briemyer, *Agricultural Philosophies and Policies in the New Deal*, 68 MINN. L. REV. 333 (1983) (analyzing the events leading to the New Deal's agricultural legislation).

141. Frazier-Lemke Farm Bankruptcy Act, 48 Stat. at 1289.

142. *Id.*

143. *Id.* at 1291.

144. *Id.*; *see* Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 575–76 (1935).

145. Frazier-Lemke Farm Bankruptcy Act, 48 Stat. at 1291.

146. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 573 n.3 (1935).

147. *Id.* at 574.

148. *Id.* at 574–75. The farmer bankruptcy provisions were added to the Bankruptcy Act in § 75 by the Act of Mar. 3, 1933, ch. 204, 47 Stat. 1470 (repealed 1978).

149. *Radford*, 295 U.S. at 574.

150. *Id.* at 576–77.

151. *Id.* at 577.

possession upon payment of the first year's rental of $325.[152] The district court approved the referee's orders, and the bank appealed.[153]

The Sixth Circuit upheld the constitutionality of the Frazier-Lemke Act,[154] as did the Fourth Circuit in a similar case soon thereafter.[155] Both the Sixth and Fourth Circuits found the Frazier-Lemke Act to fall squarely within the scope of the "subject of Bankruptcies" under the Bankruptcy Clause.[156] They also rejected constitutional attacks under the Fifth Amendment, finding no due process violation, but instead concluded that the FLA was eminently fair and reasonable, and easily satisfied the test announced by the Supreme Court in *Moyses*, that the act need only be "not so grossly unreasonable as to be incompatible with fundamental law."[157] Indeed, to the contrary, under the FLA, the mortgagee would get the value of what it bargained for, *viz*., the value of the mortgaged farm. On the heels of the *Blaisdell* case decided just the year before, which upheld state mortgage foreclosure moratorium laws against a challenge under the Contracts Clause,[158] the circuit courts found the even greater power to affect debtor-creditor relations inherent in the Bankruptcy Clause to be easily more than sufficient to withstand a constitutional Fifth Amendment challenge. Neither circuit court gave serious consideration to the Act as posing a Fifth Amendment takings problem, given that the mortgagee did receive the appraised value of its collateral, with even a right of reappraisal before purchase. Finally, both the Sixth and Fourth Circuits found little difference in the farm act than in the corporate reorganization law (§ 77), which had been widely upheld by the lower courts and would soon be upheld by the Supreme Court in the *Rock Island* case, as discussed above.

Shockingly, the Supreme Court not only granted certiorari, notwithstanding any circuit split, but then reversed and held the Frazier-Lemke Act unconstitutional under the Fifth Amendment.[159] At different places in the opinion Justice Brandeis seems to suggest a due process problem and in others a takings issue,[160] but it appears that the fairest reading of the Court's actual holding was that the FLA violated the Takings Clause, as the Court concluded that the FLA took "from the [mortgagee] without compensation, and [gave] to Radford, rights in specific property which are of substantial value . . . without just compensation," in violation of the Fifth Amendment.[161] Notwithstanding this apparently clear

152. Louisville Joint Stock Land Bank v. Radford, 74 F.2d 576, 578 (6th Cir. 1935), *rev'd*, 295 U.S. 555 (1935).

153. *Id.*

154. *Id.* at 583.

155. Bradford v. Fahey, 76 F.2d 628, 638 (4th Cir. 1935).

156. *Id.* at 635; *Radford*, 74 F.2d at 580.

157. Hanover Nat'l Bank v. Moyses, 186 U.S. 181, 192 (1902).

158. Home Bldg. & Loan Ass'n v. Blaisdell, 290 U.S. 398, 447 (1934).

159. *Radford*, 295 U.S. at 601–02.

160. Indeed, the Court itself has read *Radford* as both a Due Process case, *Wright v. Vinton Branch of Mountain Trust Bank*, 300 U.S. 440, 457 (1937)), and as a takings case, *United States v. Sec. Indus. Bank*, 459 U.S. 70, 75–76 (1982).

161. *Radford*, 295 U.S. at 601–02.

takings holding, however, the Supreme Court itself later interpreted *Radford* as having been based on due process.[162]

Note that the Court expressed no opinion as to the constitutionality under the Bankruptcy Clause and the Fifth Amendment of applying the FLA against *subsequent* mortgages (i.e., mortgages granted after the legislative enactment).[163] The FLA by its terms only applied to prior mortgages.[164] The constitutional case would be much different for postenactment mortgages, as the *Radford* Court acknowledged.[165]

Nor did the Court decide whether the FLA exceeded congressional authority under the Bankruptcy Clause, notwithstanding the bank's strenuous argument that the FLA was not a law on the "subject of Bankruptcies" at all.[166] The Court noted and reiterated what it had said previously, that the outer limits of the bankruptcy power had not yet been fully elucidated, had been expanded beyond the English practice as of 1789, were not necessarily limited to what had been exercised to date, and potentially could continue to be expanded.[167] But such a decision on the scope of the Bankruptcy Clause ultimately was unnecessary in the case before it, Justice Brandeis stated, since the FLA contravened another constitutional provision.[168]

Instead, the Court held the FLA unconstitutional under the Fifth Amendment, as applied against preexisting mortgages.[169] Regarding the important threshold question of the constitutional interrelationship between the Fifth Amendment and the Bankruptcy Clause, Brandeis appeared to embrace the following premises. First, to the extent that the bankruptcy law did nothing more than impair the obligation of prior contracts, and discharge the debtor's *personal* obligation, the Bankruptcy Clause would control,[170] because it is necessarily inherent in any bankruptcy law that contract debts be compromised and scaled back *pari passu* to the extent of the debtor's insolvency, and accordingly the Framers must have so intended.[171] Stated otherwise, if a bankruptcy law could *not* compromise contract debts when the debtor's assets were insufficient to pay all debts in full, it would be a pretty worthless bankruptcy law. By contrast, though, and this is the critical move, if the bankruptcy law involved the "taking of substantive rights in specific property acquired by the bank prior to the act,"[172] then the conclusive effect accorded to the Bankruptcy Clause no longer obtained. Instead, the taking of *property*

162. *Wright*, 300 U.S. at 457.
163. *Radford*, 295 U.S. at 589.
164. Frazier-Lemke Farm Bankruptcy (Agricultural Debt Relief) Act, ch. 869, Pub. L. No. 73-486, 48 Stat. 1289 (1934) (codified at 11 U.S.C. § 203(s) (1934)).
165. *Radford*, 295 U.S. at 589.
166. *Id.* at 586.
167. *Id.* at 586–89.
168. *Id.* at 589.
169. *Id.* at 601–02.
170. *Id.* at 589.
171. *Id.* at 594.
172. *Id.* at 590.

triggered Fifth Amendment scrutiny. While I argue below that the Court's contract/property distinction has serious flaws, it formed the heart of the *Radford* analysis.

Having stated that a taking of "property" pursuant to the bankruptcy law in question triggered Fifth Amendment scrutiny, and precluded giving total deference to legislative discretion exercised under the Bankruptcy Clause, the *Radford* Court then proceeded to (1) identify all of the rights in property that a mortgagee had as to the mortgaged property under state law and then (2) see which of those rights were taken away, and to what extent, by the FLA.[173] After making that comparison, the Court then would weigh the deprivation in the balance and see whether that cumulative deprivation amounted to a Fifth Amendment violation.[174] It did so in view of the act's "avowed object . . . to take from the mortgagee rights in the specific property held as security; and to that end 'to scale down the indebtedness' to the present value of the property."[175]

The *Radford* Court then found that the FLA took from the mortgagee the following five rights in property:

> (1) The right to retain the lien until the indebtedness thereby secured is paid[;]
> (2) The right to realize upon the security by a judicial public sale[;]
> (3) The right to determine when such sale shall be held, subject only to the discretion of the court[;]
> (4) The right to protect its interest in the property by bidding at such sale whenever held, and thus to assure having the mortgaged property devoted primarily to the satisfaction of the debt, either through receipt of the proceeds of a fair competitive sale or by taking the property itself[; and]
> (5) The right to control meanwhile the property during the period of default, subject only to the discretion of the court, and to have the rents and profits collected by a receiver for the satisfaction of the debt.[176]

The Debtor argued, nevertheless, "that the changes in the mortgagee's rights in the property, even if substantial, are not arbitrary and unreasonable, because they were made for a permissible public purpose."[177] That argument, of course, purported to address the issue of whether the FLA violated the Due Process Clause. The Court, though, declined to weigh that balance, finding such to be a legislative assessment.[178] But it did not matter whether the Act was reasonably justified or not. Brandeis said that "[t]he province of the Court is limited to deciding whether the Frazier-Lemke Act . . . has taken from the bank without compensation,

173. *Id.* at 590–94.
174. *Id.* at 578–90.
175. *Id.* at 594.
176. *Id.* at 594–95.
177. *Id.* at 598.
178. *Id.* at 601.

and given to Radford, rights in specific property which are of substantial value,"[179] and held:

> As we conclude that the act as applied has done so, we must hold it void; for the Fifth Amendment commands that, however great the nation's need, private property shall not be thus taken even for a wholly public use without just compensation. If the public interest requires, and permits, the taking of property of individual mortgagees in order to relieve the necessities of individual mortgagors, resort must be had to proceedings by eminent domain; so that, through taxation, the burden of the relief afforded in the public interest may be borne by the public.[180]

Thus, for the first time in our nation's history, the Supreme Court limited the operation of congressional power under the Bankruptcy Clause by finding a Fifth Amendment violation of the Takings Clause.[181] In taking that tack, I believe that the Court made an error. Rather, the only constitutionally relevant questions should have been: first, was the FLA an act "upon the subject of Bankruptcies" (i.e., within congressional power under the Bankruptcy Clause?—and the answer clearly was "yes"); and second, even if so, were "the changes in the mortgagee's rights in the property, even if substantial . . . arbitrary and unreasonable" (i.e., did the FLA violate due process?—and here the answer, I believe, is indisputably "no"). Putting "takings" on the table, and requiring the parsing of what rights in "property" were taken, which the Court distinguished from its recognition that Congress has the paramount authority under the Bankruptcy Clause to compromise claims on "contracts," was untenable, illogical, and unworkable.

Events that soon followed the *Radford* decision appeared to indicate that both Congress and the Supreme Court agreed with the conclusion in the preceding paragraph that *Radford* had been ill-advised, both in its analysis and its conclusion. The *Radford* holding perhaps can be understood in its historical context as part of the Supreme Court's little war with President Roosevelt over the legitimacy of his New Deal legislative agenda, and the subsequent cases apparently recanting *Radford* as part of the Court's apologetic response to FDR's Court-packing plan.[182] If so, that suggests even more strongly that *Radford* should be ignored today.

Undeterred by the Court's rejection of the original FLA in *Radford*, Congress went back to the drawing board and less than one hundred days later passed a very slightly modified version in a new Frazier-Lemke Act.[183] A prominent commentator has described the new law as little

179. *Id.*
180. *Id.* at 601–02.
181. *Id.*
182. *See generally* Barry Cushman, *Rethinking the New Deal Court*, 80 VA. L. REV. 201 (1994).
183. Act of Aug. 28, 1935, ch. 792, 49 Stat. 942 (amending 11 U.S.C. § 203(s) (1935)).

more than making "a few superficial changes."[184] While much lip service was paid in the legislative process to responding to the objections made by the *Radford* Court—much, frankly, via obfuscation—the reality is that the only truly significant difference in the two Acts was a reduction in the stay period from five years to three.[185] It is hard to imagine how that could be constitutionally significant. In both Acts, the debtor had the ability to impose a stay, retain possession in exchange for payment of only a reasonable rental, and to purchase the property at an appraised price.[186] On the latter point, the new law did provide for the mortgagee to have the right to request and then to bid at a public sale, but it was unclear whether that right was absolute or not, if the debtor also sought to purchase at the appraised price.[187]

Robert Wright, a Virginia farmer, was one of many farmers who sought to take advantage of the new FLA and keep his farm.[188] Much like the unfortunate William Radford, Wright had unsuccessfully attempted to obtain the approval of his creditors to a composition under § 75.[189] A month later, though, the "new" FLA was enacted, and Wright amended his petition soon thereafter seeking relief under the newly revised law.[190] Unsurprisingly, the mortgagee, the Vinton Branch of the Mountain Trust Bank of Roanoke, Virginia, objected, claiming that the new law was unconstitutional for exactly the same reasons as the first one.[191] *Radford* seemed obviously to dictate such a result, and the lower courts had little trouble agreeing with the bank's constitutional challenge squarely on the basis of the *Radford* decision.[192] What, really, was different, at least from a constitutional perspective? In both laws, the mortgagee was stayed from realizing on its security for many years, while the defaulting mortgagor retained possession on payment of a modest rental fee, with the debtor potentially being able to purchase the property notwithstanding the mortgage at an appraised price.

The debtor appealed to the Supreme Court. Shockingly (except as perhaps explained by the Court's own reaction to FDR's Court-packing plan), in *Wright v. Vinton Branch*, decided in 1937, the Court unanimously upheld the constitutionality of this revised FLA, with Justice Brandeis, the author of *Radford*, again writing for the Court.[193] In *Vinton Branch*, the Court read *Radford* as a due process decision, not a takings case, notwithstanding the clear takings language in the *Radford* holding, and

184. Abner J. Mikva & Jeff Bleich, *When Congress Overrules the Court*, 79 CALIF. L. REV. 729, 737 (1991).

185. Act of Aug. 28, 1935, 49 Stat. at 944.

186. *See id.*

187. *Id.*

188. Wright v. Vinton Branch of Mountain Trust Bank, 300 U.S. 440, 454–55 (1937).

189. *Id.* at 455.

190. *Id.*

191. *Id.*

192. *See In re* Sherman, 12 F. Supp. 297, 301 (W.D. Va. 1935), *aff'd sub. nom.* Wright v. Vinton Branch of Mountain Trust Bank, 85 F.2d 973, 976 (4th Cir. 1936).

193. *Vinton Branch*, 300 U.S. at 470 (1937).

in its analysis addressed the constitutional question only as whether the mortgagee's due process rights had been violated.[194] The Court noted that the key issue was "whether the legislation modifies the secured creditor's rights, remedial or substantive, to such an extent as to deny the due process of law guaranteed by the Fifth Amendment."[195] Takings never even came up; whether the Court was simply being disingenuous, or whether it recognized (correctly) that the only relevant constitutional issues should be whether the law fell within the "subject of Bankruptcies" (which was no longer even seriously contested) and whether it violated due process, the end result is that takings was now apparently off the table.

The due process issue, as I argued earlier, is a fairly easy one to resolve. The Court agreed, holding that "the provisions of subsection(s) make no unreasonable modification of the mortgagee's rights; and hence are valid."[196] The second version of the FLA, the Court believed, preserved the substance of three of the mortgagees' five rights that had troubled the *Radford* Court,[197] and only modified to some extent two other rights.[198] According to the *Vinton Branch* Court, no single right of the mortgagee is necessarily constitutionally inviolate; the question is whether the totality of the modification of all rights satisfies the test of reasonableness.[199] The takeaway from *Vinton Branch*, then, is that a "reasonable modification" of the mortgagee's security is constitutionally permissible. Furthermore, that modification might encompass the debtor's purchase of the collateral at an appraised price, and at a time chosen by the debtor. There was some language in the Court's opinion, however, that might suggest that the mortgagee retained a constitutional right to ask for and then to bid at a public sale,[200] although the Court soon would abandon that view in another decision again upholding the second version of the FLA.[201]

Another debtor named Wright (this one James) would find his way into Supreme Court annals (indeed, on multiple occasions).[202] The facts were fairly convoluted, but the essence of the dispute in the case (on its

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194. The Court noted that in *Radford*:

> the original Frazier-Lemke Act was there held invalid solely on the ground that the bankruptcy power of Congress, like its other great powers, is subject to the Fifth Amendment; and that, as applied to mortgages given before its enactment, the statute violated that Amendment, since it effected a substantial impairment of the mortgagee's security.

Id. at 456–57. Further, the Court observed that "[i]t was not held that the deprivation of any one of these rights would have rendered the Act invalid, but that the effect of the statute in its entirety was to deprive the mortgagee of his property without due process of law." *Id.* at 457.

195. *Id.* at 470.

196. *Id.*

197. *Id.* at 458–59. Those were the rights to retain the lien, to realize upon the collateral at a public sale, and to bid at that public sale.

198. *Id.* at 460–61, 465–68. The impaired rights were to determine the time of sale and to control the property during the period of default.

199. *Id.* at 457.

200. *Id.* at 458–59.

201. *See* Wright v. Union Cent. Life Ins. Co., 311 U.S. 273, 281 (1940).

202. *See id.* at 275; *see also* Wright v. Union Cent. Life Ins. Co., 304 U.S. 502, 504–05 (1938).

second trip to the high Court) was that James had a 200-acre farm, which he wanted to purchase at its appraised price of $6000 (even though the debt was close to $16,000), but which the mortgagee wanted to bid on at a public sale.[203] The district court had ordered a public sale, at which the mortgagee could bid, and the debtor appealed.[204] Thus, the ambiguity elided in *Vinton Branch* was now squarely presented. Under the new FLA, which provision controlled: the mortgagee's request to bid at a public sale, or the debtor's petition to redeem at the appraised value? And if the latter, was that constitutional, or did denial of the mortgagee's right to bid at a public sale violate the Fifth Amendment? As noted above, a plausible reading of *Vinton Branch* was that the Court there had upheld the new FLA in part because that law preserved to the mortgagee the rights to realize upon its collateral at a public sale and to bid at that sale; indeed, those were two of the three "preserved" rights that the Court cited as a basis for distinguishing *Radford*.[205] If the debtor could trump those two rights by insisting on purchasing the farm at the appraised price, virtually nothing would be left of *Radford*. Realizing this, the lower courts denied the debtor's attempt and held for the bank.[206]

The Supreme Court reversed and held for the debtor James Wright. Construing the apparently conflicting statutory terms in the debtor's favor, Justice Douglas for the Court first held that "the denial of an opportunity for the debtor to redeem at the value fixed by the court before ordering a public sale was error."[207] To interpret the Act otherwise would defeat its purpose of aiding distressed farmers, the Court thought, as the mortgagee could always trump the debtor by insisting on a public sale, at which it undoubtedly would prevail and take the debtor's farm if it wished, by submitting a credit bid in excess of the property's current market value.[208] But was such a reading of the statute constitutional? *Vinton Branch* could be read to have suggested that the mortgagee's apparent right to insist on and to bid at a public sale was central to distinguishing *Radford* and upholding the new FLA against a Fifth Amendment due process challenge; takings, apparently, had been discarded as a basis for challenging what was done to secured creditors.

The *Union Central* Court, though, found no constitutional problem.[209] Notably, as was true also in *Vinton Branch*, nothing in *Union Central* indicates that the Takings Clause is even to be considered as a possible basis for invalidation. Even if the debtor were allowed to redeem at an appraised price, with the mortgagee accordingly denied the right to insist upon a public sale at which it could bid, the Court found no

203. *Union Cent. Life Ins. Co.*, 311 U.S. at 275–76.
204. *Id.* at 276–77.
205. *Vinton Branch*, 300 U.S. at 458–59.
206. Wright v. Union Cent. Life Ins. Co. (*In re* Wright), 108 F.2d 361, 363 (7th Cir. 1939), *rev'd*, 311 U.S. 273, 281 (1940).
207. *Union Cent. Life Ins. Co.*, 311 U.S. at 277.
208. *Id.* at 278.
209. *Id.* at 277.

constitutionally viable complaint, since it would still be the case that "the creditor will not be deprived of the assurance that the value of the property will be devoted to the payment of its claim . . . [for] if the debtor did redeem pursuant to that procedure, he would not get the property at less than its actual value."[210] That is, the right to bid at a public sale would be "denied the creditor only in case he is paid the full amount of what he can constitutionally claim."[211]

In so concluding, Justice Douglas announced the now-iconic and oft-repeated justification: "Safeguards were provided to protect the rights of secured creditors, throughout the proceedings, to the extent of the value of the property. There is no constitutional claim of the creditor to more than that."[212]

Parsing that language carefully, in the context in which it was made, reveals two possible ways of reading it: (1) as an affirmative imposition of a definite constitutional requirement for the protection of secured creditors, or (2) as a refutation of any possible constitutional argument based on the modification of the secured creditor's rights, by saying that *at most* this would be what secured creditors could insist on, without necessarily deciding that they do in fact enjoy such an absolute protection. The latter reading seems much more plausible. As James Rogers argued:

> Although Justice Douglas' comments are consistent with the proposition that a secured creditor is constitutionally entitled to have the liquidation value of the collateral preserved, there is little reason to suppose that Justice Douglas had such a proposition in mind. His comments concerning the safeguards provided to protect the mortgage were made in the course of ruling, as a matter of statutory interpretation, that even a debtor who failed to pay rent required by order of the court was entitled to the opportunity to buy the property at its appraised value. Thus, the most plausible interpretation of his comments in *Union Central* is that Justice Douglas was not addressing the notion that preservation of the value of collateral is a constitutional requirement, but instead was rejecting the suggestion in *Radford* and *Vinton Branch* that the mortgagee is constitutionally entitled to the opportunity of obtaining title to the property itself by bidding in the amount of his debt at a foreclosure sale.[213]

Reading these cases together, in a prior article dealing with the rights of secured creditors in bankruptcy, I concluded:

> Under *Union Central* and *Vinton Branch*, then, a secured creditor does not have a constitutional right to decide if or when the collateral will be sold, to control the collateral pending the sale, or to counter the redemption of the collateral at a judicially appraised price by insisting on submitting a competing bid at a public sale. . . . Stated otherwise, then, the debtor constitutionally may pick the

210. *Id.* at 279.
211. *Id.*
212. *Id.* at 278 (internal citations omitted).
213. Rogers, *supra* note 28, at 983–84.

time when it wants to either redeem or sell the collateral, and may redeem or sell without competition from the secured creditor, at a price set by the court or at auction.[214]

In short, almost everything the *Radford* Court had found to constitute an unconstitutional taking had been refuted by subsequent decisions of the Court in the next five years; although the Court did not expressly overrule *Radford*, after the two *Wright* cases, nothing was left but an empty edifice. Indeed, the Court itself soon recognized this. In *Helvering v. Griffiths*,[215] a 1943 tax case, the Court cited *Vinton Branch* and *Radford* as a pairing of cases illustrative of the following point:

> There is no reason to doubt that this Court may fall into error as may other branches of the Government. Nothing in the history or attitude of this Court should give rise to legislative embarrassment if in the performance of its duty a legislative body feels impelled to enact laws which may require the Court to re-examine its previous judgments or doctrine.[216]

Numerous cases and commentators in ensuing years assumed that *Radford* was dead.[217]

Dead, that is, until a 1982 Supreme Court decision in *United States v. Security Industrial Bank*[218] mysteriously resurrected it.[219] The *Security Industrial Bank* case arose because the Bankruptcy Reform Act of 1978[220] created a new provision (11 U.S.C. §522(f)(2)) that permitted the avoidance of certain liens that impaired a debtor's exemptions; no such rule had existed under the prior Bankruptcy Act. It was not clear whether the new provision applied to preexisting liens. The court of appeals had held that the 1978 Act was intended to apply retrospectively and that doing so violated the Fifth Amendment.[221] Defenders of the provision's constitutionality, including the United States, argued "that the enactment is a 'rational' exercise of Congress' bankruptcy power, that for 'bankruptcy purposes' property interests are all but indistinguishable from contractual interests, that these particular interests were 'insubstantial' and therefore their destruction does not amount to a 'taking' of property requiring compensation."[222] In short, they argued for the position advocated in this Article.

The Supreme Court rejected that permissive view. Although the Court did not hold the statute to be unconstitutional, it explored the constitutional issue in sufficient detail to find a significant constitutional

214. Tabb, *supra* note 9, at 116–17.
215. 318 U.S. 371 (1943).
216. *Id.* at 400–01 & n.52.
217. *See, e.g.*, John D. Ayer, *Rethinking Absolute Priority After* Ahlers, 87 MICH. L. REV. 963, 979–84 (1989).
218. 459 U.S. 70 (1982).
219. Ayer, *supra* note 217, at 986–88.
220. Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (1978).
221. Rodrock v. Sec. Indus. Bank, 642 F.2d 1193, 1198 (10th Cir. 1981), *aff'd sub nom.* United States v. Sec. Indus. Bank, 459 U.S. 70 (1982).
222. *Sec. Indus. Bank*, 459 U.S. at 74.

problem, and then invoked the interpretive canon of constitutional avoidance to conclude that the new law applied only prospectively.[223] The majority stated that it would "consider the statutory question because of the cardinal principle that this Court will first ascertain whether a construction of the statute is fairly possible by which the constitutional question may be avoided."[224] The majority concluded that:

> [I]n the absence of a clear expression of Congress' intent to apply §522(f)(2) to property rights established before the enactment date, we decline to construe the Act in a manner that would in turn call upon the Court to resolve difficult and sensitive questions arising out of the guarantees of the Takings Clause.[225]

The approach and analysis of the *Security Industrial Bank* Court is summarized in the following passage:

> It may be readily agreed that § 522(f)(2) is a rational exercise of Congress' authority under Article I, Section 8, Clause 4, and that this authority has been regularly construed to authorize the retrospective impairment of contractual obligations. Such agreement does not, however, obviate the additional difficulty that arises when that power is sought to be used to defeat traditional property interests. The bankruptcy power is subject to the Fifth Amendment's prohibition against taking private property without compensation. Thus, however "rational" the exercise of the bankruptcy power may be, that inquiry is quite separate from the question whether the enactment takes property within the prohibition of the Fifth Amendment.[226]

The Court found that a secured creditor has a *property* interest in its collateral that is constitutionally distinguishable from its purely *contractual* rights, and that the property interest is protected by the Takings Clause.[227] It then noted that the lien avoidance statute in question would result in a "complete destruction" of the secured creditor's property interest.[228] Accordingly, the Court believed that there was "substantial doubt" about whether retroactive application of the lien avoidance statute to preexisting liens would comport with the takings limitation.[229]

If the Court had been writing the quoted passages in 1936, prior to the post-*Radford* decisions in *Vinton Branch* and *Union Central* (or the 1943 *Helvering* case that assumed that the two *Wright cases* effectively had overruled *Radford*), it might have been understandable and defensible. Curiously, though, the Court made no mention whatsoever of any of those subsequent *Radford* decisions. How could the Court ignore those

223. *Id.* at 81–82.
224. *Id.* at 78 (internal quotation marks omitted).
225. *Id.* at 82 (internal quotation marks omitted).
226. *Id.* at 74–75 (internal citations omitted).
227. *Id.* at 75 (observing that "the contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral").
228. *Id.* at 75.
229. *Id.* at 78.

cases, which had taken a due process approach, and not a takings approach, to assessing the constitutionality of bankruptcy legislation modifying secured creditors' rights?

The only Supreme Court cases in the almost-half-century following the *Wright* cases that even intimated a possible takings limitation on the exercise of the bankruptcy power were a couple of railroad cases decided in the early 1970s, and in those cases any such limitation was very narrow and circumscribed.[230] Even if a takings limit can be found in those 1970s railroad cases, it is so easily satisfied as to be hardly meaningful—no violation was found even though the bondholders had suffered substantial erosion in their collateral value during the pendency of the bankruptcy proceedings.[231] Even those cases were ignored by the *Security Industrial Bank* Court (perhaps wisely so, since in the *New Haven* case the Court had stated that "[t]he rights of the bondholders are not absolute."[232]). In short, the Court's reembrace of *Radford* and its takings analysis seemingly came out of left field, with no explanation or justification.

V. IN SEARCH OF A PROPER CONSTITUTIONAL BALANCE

One of the fundamental functions of a bankruptcy law is to act on the claims of a multiplicity of competing creditors. In the typical bankruptcy case, the debtor has a limited pool of assets, and a horde of creditors clamoring for their share of the insufficient pie. No one questions the constitutionality of a congressional act under the Bankruptcy Clause discharging the claims of creditors—unsecured *or* secured—to the extent

230. The first case was the *New Haven Inclusion Cases*, 399 U.S. 392 (1970). Penn Central was taking over the New Haven road. The Supreme Court had to resolve the question of how much Penn Central had to pay for New Haven's assets. *Id.* at 399. Justice Stewart concluded that under New Haven's reorganization plan, by which Penn Central would acquire New Haven's assets at liquidation value, secured creditors did not suffer a taking of their property without just compensation. *Id.* at 493. The Court held that the Commission's valuation (liquidation value) should not be second-guessed. *Id.* at 499–501. Importantly, the Court so held even though the time that had passed in these proceedings had imposed a substantial loss. *Id.* at 491. In a crucial passage, the Court noted that "[t]he rights of the bondholders are not absolute." *Id.* Furthermore, it held that "[t]he public interest is not merely a pawn to be sacrificed for the strategic purposes or protection of a class of security holders." *Id.* at 492. Next was the Penn Central case. In the early 1970s, many major railroads were in financial crisis, with eight entering reorganization proceedings. Blanchette v. Conn. Gen. Ins. Corps., 419 U.S. 102, 108 (1974). The largest of the railroads, Penn Central, entered reorganization proceedings under § 77 of the Bankruptcy Act. *Id.* at 117; *see also* 11 U.S.C. § 205. Even this was not enough to save the railroad, so Congress passed the Regional Rail Reorganization Act (45 U.S.C. § 701 (2012)). Plaintiffs contested the RRRA, claiming that it "effect[ed] a taking of rail properties of Penn Central without payment of just compensation. . . ." *Blanchette*, 419 U.S. at 118.

The primary takings problem arose from the fact that the compelled continuation of rail operations of the Penn Central, notwithstanding mounting losses and the creation of claims with priority, coupled with the unlikelihood that successful reorganization would be possible, would constitute an "erosion taking." *Id.* at 118, 122–25. The critical point of the opinion, for our purposes, is that the Court did acknowledge the possibility that an unconstitutional taking could occur. *Id.* at 123–25. If so, there then had to be an adequate remedy provided. The Supreme Court accepted the government's argument that the Tucker Act provided adequate remedies so that plaintiffs would receive just compensation if indeed there were an erosion taking. *Id.* This case, then, indicates that there can be a line beyond which the erosion of the creditor's property interest will constitute an unconstitutional taking.

231. For further discussion, see *supra* note 230.

232. *New Haven Inclusion Cases*, 399 U.S. at 491.

the debtor's extant pool of assets at the time of the commencement of the bankruptcy case is insufficient to satisfy all claimants in full. This holds true even with respect to preexisting claims. The Contracts Clause must give way to the Bankruptcy Clause. Nor is there any debate regarding whether Congress has the power under the Bankruptcy Clause to provide for the allocation and distribution of the debtor's assets as between competing creditor claimants. In short, discharge and distribution are the heart and soul of any bankruptcy law. No one seriously disputes that the reach of the congressional bankruptcy power is paramount with regard to those twin functions. While due process does constrain very modestly the manner in which those functions can be implemented, that is a minimal constraint at best, requiring only a sufficient notice and opportunity to be heard on the procedural side, and a rational basis on the substantive side. But what about takings?

An assertion that the Takings Clause independently limits the power of Congress under the Bankruptcy Clause to modify the rights of secured creditors must rest on at least two core assumptions. The first assumption is that secured creditors have a protectable *property* right that constitutionally trumps the bankruptcy power in a way that simple "contract" claims do not. This first assumption really is the crux of the whole debate. The second assumption is that, as a distributional matter, the nonbankruptcy priority of secured creditors over unsecured creditors to repayment out of their collateral is constitutionally mandated. Both assumptions are questionable at best. If they do hold, the positive law as currently implemented in fact departs substantially from a consistent and faithful adherence to them. It is well to be mindful of Frank Michelman's observation about takings jurisprudence that "[t]he results . . . are nonetheless liberally salted with paradox."[233]

First, consider the claim that secured creditors enjoy a "property" right in their collateral that deserves constitutional protection under the Takings Clause notwithstanding a bankruptcy law in a way that unsecured creditors, who have only a general claim to the debtor's entire pool of assets, do not, based on their constitutionally subordinate mere "contract" claims. This premise was the central move made by the *Security Industrial Bank* Court, which stated in conclusory fashion, relying almost entirely on the dubious authority of *Radford*, that "the contractual right of a secured creditor to obtain repayment of his debt may be quite different in legal contemplation from the property right of the same creditor in the collateral."[234] With only the slightest of pushes, that seemingly powerful and meaningful distinction collapses.

The first problem is that the distinction suggests a property/not-property dichotomy for property/"mere contract" claims for Takings Clause purposes. That supposed strict dichotomy, however, is not only

233. Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1170 (1967).
234. *Sec. Indus. Bank*, 459 U.S. at 75.

misleading, it also assumes the answer. The Supreme Court squarely concluded many years ago in *Lynch* that "contract" claims are considered "property" for Fifth Amendment Takings Clause purposes.[235] Nor has the Court ever directly recanted that position. Many economic interests are—and should be—legally protected interests, requiring just compensation when private property is taken for public use,[236] *including* valid contracts.[237]

Even aside from the positive law, normatively this conclusion makes sense. A "contract" can be, and indeed is intended and hoped to be by the parties thereto, a valuable right owned by those parties. As Michelman explains in discussing takings jurisprudence, "[t]he one incontestable case for compensation (short of formal expropriation) seems to occur when the government deliberately brings it about that its agents, or the public at large, 'regularly' use, or 'permanently' occupy, space or a thing which theretofore was understood to be under private ownership."[238] He then points out that:

> [T]he word "thing" signifies any discrete, identifiable (even if incorporeal) vehicle of economic value which one can conceive of as being owned. Patents, easements, *and contract rights* are all examples of "things" as I am here using the term. Such things can be affirmatively expropriated by public authority in a manner analogous to its "taking" of a corporeal thing. Government, for example, might expropriate and continue to operate a going business, exploiting all its appurtenant incorporeal things.[239]

If the government were to so expropriate a business, which after all is really nothing but a nexus of contracts,[240] surely there has been a "taking" of private property for Fifth Amendment purposes.

Some modern authority (especially in the Seventh Circuit) argues that the *Lynch* doctrine has effectively been overruled, and that "contract" claims simply are not "property" for takings purposes.[241] The better view, though, is just that the expectations deserving takings protection are simply weaker in a contract setting than when there is a lien. But "weaker" is not the same as "nonexistent." Notably, much of the genesis of the Seventh Circuit's "not property" view came from the Supreme Court's misguided and unprecedented 1982 decision in *Security Industrial Bank*,[242] discussed above, which in turn simply restated *Radford* as gos-

235. Lynch v. United States, 292 U.S. 571, 579 (1934).
236. United States v. Willow River Power Co., 324 U.S. 499 (1945).
237. *Lynch*, 292 U.S. at 579.
238. Michelman, *supra* note 233, at 1184.
239. *Id.* at 1184 n.37 (emphasis added).
240. Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. Fin. Econ. 305, 311–12 (1976).
241. *See, e.g.*, Pro-Eco, Inc. v. Bd. of Comm'rs, 57 F.3d 505, 510 (7th Cir. 1995), *cert. denied*, 516 U.S. 1028 (1995); Peick v. Pension Benefit Guar. Corp., 724 F.2d 1247, 1275–76 (7th Cir. 1983), *cert. denied*, 467 U.S. 1259 (1984).
242. United States v. Sec. Indus. Bank, 459 U.S. 70, 75–76 (1982); *see Peick*, 724 F.2d at 1276 ("[T]he Court continues to view this constitutional provision as offering no protection for 'contractual rights' as opposed to 'property rights.'").

pel. In short, if *Radford* falls (as I argued above), the whole construct collapses. Other courts of appeal, by contrast, continue to treat *Lynch* as good law.[243] The most that can be said, I submit, is that in contracts takings cases the protection is less absolute and more easily provided under the Court's three-part takings analysis.[244] But that does not take it out of takings protection altogether.

Yet, no one doubts that there is no Fifth Amendment takings problem when a contract-as-property claim is discharged pursuant to a bankruptcy law. Assuming that such is a correct conclusion, and I submit that it is, that then means that a supporter of the position that the Takings Clause limits what can be done to secured creditors in bankruptcy must identify a constitutionally distinguishable basis for treating the two types of "property" differently. I do not believe that case can be made.[245] Just saying so, as the Court did in *Radford* and then in *Security Industrial Bank*, is not satisfactory but question-begging.

To identify a constitutional distinction, we first need to know *why* it is that contract-as-property claims are conceded to be undeserving of takings protection in the face of a bankruptcy law. That answer then might tell us how (if at all) we can distinguish secured-claims-as-property claims.

The possibilities for why there is no takings protection for "mere" contract claims in bankruptcy are: (1) the contract claim is not a protectable property interest at all; (2) the property interest is not "taken"; (3) even if taken, it is not taken for a public use within the meaning of the Fifth Amendment; (4) the property interest is taken for a public use, but receives just compensation; or (5) the legitimate exercise of congressional power under the Bankruptcy Clause trumps any takings problem.

The Supreme Court has never carefully analyzed the bankruptcy discharge of contract claims under a takings paradigm, but appears to proceed on a view either that contract claims are not "property" in the way that rights in collateral are, or under the unstated assumption that there simply is not a takings problem when contract claims are dis-

243. *See, e.g.*, Cienega Gardens v. United States, 331 F.3d 1319, 1329 (Fed. Cir. 2003); Yankee Atomic Elec. Co. v. United States, 112 F.3d 1569, 1582 (Fed. Cir. 1997) (Mayer, J. dissenting), *cert. denied*, 524 U.S. 951 (1998).

244. For example, the Court in *Connolly v. Pension Benefit Guar. Corp.* observed:

> [T]he fact that legislation disregards or destroys existing contractual rights does not always transform the regulation into an illegal taking. This is not to say that contractual rights are never property rights or that the Government may always take them for its own benefit without compensation. . . . This conclusion is not inconsistent with our prior Taking Clause cases. In all of these cases, we have eschewed the development of any set formula for identifying a "taking" forbidden by the Fifth Amendment, and have relied instead on ad hoc, factual inquiries into the circumstances of each particular case. To aid in this determination, however, we have identified three factors which have "particular significance": (1) "the economic impact of the regulation on the claimant"; (2) "the extent to which the regulation has interfered with distinct investment-backed expectations"; and (3) "the character of the governmental action."

475 U.S. 211, 224–25 (1986) (internal citations omitted).

245. *But see* John D. Echeverria, *Public Takings of Private Contracts*, 38 ECOLOGY L.Q. 639, 642–43 (2011) (arguing that contracts are distinct due to their in personam character, while other property have an in rem character, and that this should result in different treatment by courts).

charged in bankruptcy, because that is the essence of what it means to have a bankruptcy law in the first place. That is, if the outcome were otherwise, then the possibility of having an efficacious bankruptcy law would be stillborn, and the Bankruptcy Clause would be, pardon the pun, a bankrupt grant of power. In short, the Court's premise plainly has been to embrace the fifth possibility listed above, *viz*., that the Bankruptcy Clause simply controls, along with (at times)[246] the first option (contract claim is not "property" for takings purposes in this context).

A clear explication of the view favoring the fifth option (Bankruptcy Clause trumps) is found in the *Rock Island* case,[247] albeit in the announced context of considering the tension between the Bankruptcy Clause and the Contract Clause, not the Takings Clause. In addition, the Court considered and rejected a Fifth Amendment challenge—lack of *due process*. No one, not even the affected secured lienholders, apparently even considered that *takings* might be implicated.[248] The Court said:

> Speaking generally, it may be said that Congress, while without power to impair the obligation of contracts by laws acting directly and independently to that end, undeniably, has authority to pass legislation pertinent to any of the powers conferred by the Constitution however it may operate collaterally or incidentally to impair or destroy the obligation of private contracts. And under the express power to pass uniform laws on the subject of bankruptcies, the legislation is valid though drawn with the direct aim and effect of relieving insolvent persons in whole or in part from the payment of their debts. So much necessarily results from the nature of the power, and this must have been within the contemplation of the framers of the Constitution when the power was granted.[249]

What about the first possibility, *viz*., that contract rights are not "property" for Takings Clause purposes? The first problem, of course, is the Court's clear statement that contract rights *are* indeed "property" within the meaning of the Takings Clause,[250] as discussed earlier. Note, though, that the Court on two occasions has used some language that may suggest otherwise in the bankruptcy context. So, for example, in *Radford*, the Court stated:

> Under the bankruptcy power Congress may discharge the debtor's personal obligation, because, unlike the states, it is not prohibited from impairing the obligations of contracts. But the effect of the act here complained of is not the discharge of Radford's personal obligation. It is the taking of substantive rights in specific property acquired by the bank prior to the act.[251]

246. *See, e.g.*, *Sec. Indus. Bank*, 459 U.S. at 75–76.
247. Cont'l Ill. Nat'l Bank & Trust Co. v. Chi., R.I. & P. Ry. Co., 294 U.S. 648 (1935).
248. *See supra* notes 120–34 and accompanying text.
249. *Cont'l Ill. Nat'l Bank*, 294 U.S. at 680–81 (internal citations omitted).
250. Lynch v. United States, 292 U.S. 571, 579 (1934).
251. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 589–90 (1935) (internal citations omitted).

That passage implies that lien rights are "specific property" subject to takings scrutiny, whereas "contract" rights are not. It was this premise from *Radford* that the *Security Industrial Bank* Court resurrected,[252] even though, as discussed in detail in Part IV, immediate post-*Radford* bankruptcy cases soon recanted that position.[253] And, as noted, the Court has held directly that contract rights *are* "property" within the meaning of the Takings Clause,[254] a position from which it has never withdrawn, even if some subsequent cases suggest that the extent of contract-as-property protection under the Fifth Amendment is less robust.[255] The above-quoted passage in *Radford*, if taken literally, would directly contradict that other authority, which held that contract rights are protectable property for purposes of the Takings Clause. The only honest way to harmonize the two is to reason that contract rights are a sort of "property-light" in the specific context of bankruptcy for takings purposes, as compared to lien rights as property. As will be discussed below, though, that approach is fraught with peril. The other option, which is even less satisfying, is simply to ignore *Lynch* and similar authority, as *Radford* and *Security Industrial Bank* did.[256]

On the second question (*viz*., is there a taking at all?), the sort of "taking" that a bankruptcy law would implicate would be a regulatory taking. Determining whether a regulatory taking has occurred is a heavily fact-based endeavor.[257] In 1922, the Supreme Court held that just compensation is due when government regulation "goes too far" in diminishing private property's value.[258] Yet, this standard is vague and the Court has struggled to come up with a test to determine what sort of government regulations go "too far."[259] There is no "set formula" to determine whether a regulation is a taking.[260]

The Court has identified three factors which aid in determining whether a regulatory taking has occurred: "(1) 'the economic impact of the regulation on the claimant'; (2) 'the extent to which the regulation has interfered with distinct investment-backed expectations'; and (3) 'the character of the governmental action.'"[261]

252. *Sec. Indus. Bank*, 459 U.S. at 75.

253. *See supra* Part IV.

254. *Lynch*, 292 U.S. at 579 ("Valid contracts are property, whether the obligor be a private individual, a municipality, a state, or the United States.").

255. *See, e.g.*, Connolly v. Pension Benefit Guar. Corp., 475 U.S. 211, 224–25 (1986).

256. *See Sec. Indus. Bank*, 459 U.S. at 75; Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 589–90 (135).

257. United States v. Cent. Eureka Mining Co., 357 U.S. 155, 168 (1958) ("Traditionally, we have treated the issue as to whether a particular governmental restriction amounted to a constitutional taking as being a question properly turning upon the particular circumstances of each case.").

258. Pa. Coal Co. v. Mahon, 260 U.S. 393, 415–16 (1922).

259. *Id.*

260. Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1071 (1992) (Stevens, J., dissenting) ("We have frequently and consistently recognized that the definition of a taking cannot be reduced to a set formula and that determining whether a regulation is a taking is essentially an ad hoc, factual inquiry." (internal quotation marks omitted)).

261. Connolly v. Pension Benefit Guar. Corp., 475 U.S. 211, 225 (1986).

In a bankruptcy discharge, the economic impact is to eliminate forever any right of the creditor to seek to collect from the debtor, in exchange for the creditor receiving either: (1) in a liquidation case, an aliquot share of any unencumbered, nonexempt property of the debtor, after deduction of expenses of administration and other statutory priority claims, or (2) in a reorganization case, a stream of future payments at least equal in present value to the creditor's expected liquidation entitlement.

While at the exact instant in time of the implementation of the bankruptcy case, the creditor might not have received anything more, what it does have taken away is any chance to pursue recovery against the debtor in the future. For an individual debtor, who has human capital and the ongoing ability to generate leviable assets, that is a meaningful loss, whether in a liquidation or a reorganization case. For a corporate debtor, however, who can simply go out of business and wind up its affairs, the creditor arguably would have no more rights in a liquidation bankruptcy but is losing a meaningful chance to collect in the future from the debtor in a reorganization.

Similarly, the discharged creditor is being forced to relinquish "distinct investment-backed expectations."[262] A creditor who enters into a contract with a debtor expects to be able to pursue collection from the debtor's assets in perpetuity, again excepting only as against a corporate debtor who poses the expectable threat of dissolution. Of course, if the bankruptcy law were to operate only prospectively, then the "expectations" of contract creditors would account for the possibility of a less-than-compensatory bankruptcy discharge.

Finally, the character of the government action is to bar absolutely and permanently, via a statutory injunction, any right of the discharged creditor to pursue future collection.[263] Thus, except for the possible case of a liquidating corporate debtor, a bankruptcy discharge appears to "take" a creditor's contract rights within the meaning of the Takings Clause.

So, too, it is quite clear that the taking of that contract claim is for a public use (the third issue identified above in the takings analysis). The Supreme Court in the iconic *Local Loan* case, in which the Court explained most clearly the justification for the bankruptcy discharge, specifically stated that:

> 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." *This purpose of the act has been again and again emphasized by the courts as being of public as well as private interest*, in that it gives to the honest but unfortu-

262. *Id.* at 212.

263. *See* TABB, *supra* note 13, at 282 ("Once the discharge is granted, a permanent statutory injunction against the collection of discharged debts goes into effect."); *see also* 11 U.S.C. § 524 (2012).

> nate debtor who surrenders for distribution the property which he owns at the time of bankruptcy, a new opportunity in life and a clear field for future effort, unhampered by the pressure and discouragement of preexisting debt.[264]

A good argument thus can be made that a contract claim that is discharged in bankruptcy is protectable property and is taken for a public use. But does the discharged creditor receive "just compensation"? The answer is plainly "no"—the government provides no compensation at all! All that the creditor receives in exchange for its discharged debt is whatever distribution is called for in the bankruptcy distribution of the debtor's assets. If that suffices as a taking in the first instance, as discussed above, then the Fifth Amendment takings violation appears evident.

And yet, as already explained, the Court has never even taken seriously the argument that there is a Fifth Amendment takings problem with discharging a contract claim in bankruptcy. The likely reason is, as noted in the *Rock Island* case, that the Bankruptcy Clause simply prevails,[265] assuming the legislation in question is a legitimate bankruptcy law and within the scope of congressional constitutional bankruptcy power. As discussed at length earlier, the scope of the constitutional grant on the "subject of Bankruptcies" has an expansive and elastic reach, and easily would encompass legislation affecting secured and unsecured claims alike. The key point, though, is that for *contract* claims, the *only* question is whether the legislation is within the scope of the Bankruptcy Clause, assuming no due process violations exist. The due process bar, as noted, is quite modest as a substantive matter: as an economic regulation, due process can easily be satisfied if the legislation is not arbitrary, unreasonable, and at odds with fundamental law. The bottom line, then, is that for *unsecured* creditors, there is no takings problem at all.[266]

Why, then, should *secured* creditors be treated any differently for takings purposes? The only realistic possibilities are: (1) that their lien rights are a constitutionally more deserving form of "property" than are simple contract claims; (2) that the "taking" of property that occurs with regard to a lien triggers Fifth Amendment takings scrutiny in a way that discharge of contract rights does not; and (3) that the Bankruptcy Clause does not trump the Takings Clause for the specific category of lien "property" only. None of these explanations are persuasive.

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264. Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (emphasis added) (internal citations omitted).

265. Cont'l Ill. Nat'l Bank & Trust Co. v. Chi., R.I. & P. Ry. Co, 294 U.S. 648, 675 (1935).

266. One could argue that the Takings Clause does (or at least should) apply to contract claims as well in the bankruptcy context. Danielle Spinelli of WilmerHale suggested this point to me at the April 2014 symposium (cosponsored by the University of Illinois and the American Bankruptcy Institute) at which I presented an earlier draft of this Article. Her argument, as I understand it, is that even unsecured creditors have a constitutional right to an aliquot share of the net liquidation value of the debtor's estate. Thus, on this view, it would violate the Fifth Amendment Takings Clause if the bankruptcy law diverted all or part of the net bankruptcy estate away from residual unsecured creditors. The Court has never had to address that question, because the statutory bankruptcy law in effect has always protected at least that basic entitlement.

The only intimations on the point that can be found in the Court's opinions appear to rest on the first possibility, that lien rights are a form of "property" that is entitled to takings protection whereas contract-as-property claims are not. The passage in *Radford*, quoted above (and embraced anew by the Court in *Security Industrial Bank*), suggests as much.[267] The basis for this view is probably an unarticulated but assumed premise that a secured creditor has a right to have its claim paid by resort to a *specific piece of property* (the "collateral") and, claiming thereby a tangible "stick" in the bundle of property rights, indisputably has a protectable property interest that unsecured creditors lack, who instead only have a general claim against the debtor, with no particular, specific items of property answerable for payment of their "mere contract" claim.[268] If my suspicion is correct, that is a simplistic and unsupportable basis for drawing a constitutional line.

Among other problems, it ignores the fact that unsecured creditors, too, may have a "property" interest in the debtor's assets, as, for example, in situations where the "trust fund" doctrine (*viz*., that the assets of an insolvent corporation are held in "trust" for the corporation's creditors) would be triggered.[269] Even if that doctrine is not directly applicable, the practical reality of analogous situations involving unsecured as opposed to secured creditors may undermine the plausibility and wisdom of drawing a constitutional line between them. Furthermore, the "property" mantra obscures the fact that for insolvent debtors, the significance of security lies not in a *property* right but in the *priority* ranking it confers; and yet, it is not thought that protection of priority alone is constitutionally mandated. To ascribe constitutional significance to a semantic difference between "property" and "priority" is, well, absurd.

Furthermore, if the "property" interest of a secured creditor in collateral *is* to be afforded constitutional takings protection, we are left with the conundrum of identifying which sticks in the "property" bundle deserve that constitutional protection. The reality (as the *Radford* Court aptly noted[270]) is that under state law secured creditors enjoy *multiple* "property" rights arising out of their "deal" with the debtor. Which of those rights must be protected from takings under the Fifth Amendment? If fewer than all of the rights deserve protection (as the Supreme Court clearly has held),[271] why and on what conceivable basis can distinc-

267. United States v. Sec. Indus. Bank, 459 U.S. 70, 75 (1982).

268. *See, e.g.*, Lawrence Ponoroff & F. Stephen Knippenberg, *Having One's Property and Eating It Too: When the Article 9 Security Interest Becomes a Nuisance*, 82 NOTRE DAME L. REV. 373, 394–95 (2006).

269. This doctrine is traced to the opinion of Justice Story in *Wood v. Drummer*, 30 F. Cas. 435 (C.C.D. Me. 1824).

270. Louisville Joint Stock Land Bank v. Radford, 295 U.S. 555, 594–95 (1935).

271. *See, e.g.*, United Sav. Ass'n. v. Timbers of Inwood Forest Assocs., Ltd., 484 U.S. 365, 372–73 (1988) (denying undersecured creditor compensation for delay in foreclosure imposed by bankruptcy stay even though state law would allow creditor to proceed with foreclosure); Wright v. Union Cent. Life Ins. Co., 311 U.S. 273, 278 (1940) (finding no constitutionally protected right to control timing of sale or to insist on or bid at public sale).

tions be made between those rights? On this matter, Justice Brandeis surely had it right in *Radford*, that is, they *all* should matter equally and—*if* takings protection applies at all—then *none* can be taken. Yet the Court retreated almost immediately from that absolutist view of the property protection required, principally for the pragmatic reason that to do so would almost completely defang many necessary and justifiable forms of bankruptcy relief.

And that recognition, of course, supports the critical point: as an independent and coequal constitutional rule, the Bankruptcy Clause simply is not, and should not be, constrained by the Takings Clause. Freeing the Bankruptcy Clause from the tethers of takings is necessary for a bankruptcy law to be efficacious in realizing its core functions.

Let us consider three pairs of hypotheticals. Hypos one and two illustrate how it can be problematic to differentiate between secured and unsecured creditors on a "property/not-property" basis for determining whether takings protection does/does-not apply.

A. Hypo # 1

DebtorCo has $15,000 in assets. It has three creditors (A, B, and C), each of whom it owes $10,000 (thus $30,000 total), all on an unsecured basis. There is little question that Congress could pass a bankruptcy law that would discharge the claims of these creditors, without requiring as a constitutional takings matter an aliquot distribution of all of the assets between them.[272] Congress could afford one creditor priority over the others without offending the Takings Clause. It likewise could provide for distribution of less than the entire fifty percent in value. The only limitations would be that the law must be on the "subject of Bankruptcies" (which it indisputably is) and cannot offend due process, which would be satisfied as long as there was a rational basis for the legislation and reasonable notice is given, both of which likely would be quite easy to show. Even though under state law the assets of DebtorCo might well be considered to be held in "trust" for the claims of the three creditors, nevertheless that trust claim is not considered to be the sort of "property" deserving of takings protection in the face of bankruptcy legislation enacted pursuant to the Bankruptcy Clause. And that makes sense as a structural matter; otherwise, the efficacy of possible bankruptcy legislation would be hamstrung by the constraints of takings jurisprudence.

B. Hypo # 2

Same facts as number one, except now assume that creditors A, B, and C each have taken a security interest in all of DebtorCo's assets. Assume for simplicity that the security interests are of equal rank. Thus, the

272. Unless the argument detailed in *supra* note 266 is upheld by the Court. The Court has never suggested such a limit in the bankruptcy context, but then again, the occasion has never arisen, since no such bankruptcy law has been enacted.

"secured claim" of each equals $5000.[273] Assuming that *Radford* and *Security Industrial Bank* are good law and that *Union Central* does in fact *constitutionally require* preservation of the secured creditor's collateral value as of the beginning of the case, Congress is precluded by the Takings Clause from passing a bankruptcy law that would vary or diminish such a recovery, such as would be allowed under Hypo one.

Yet, the two hypos, as a functional matter, are essentially indistinguishable; in both, no value remains for any stakeholder other than creditors A, B, and C, and as between those three creditors, they are of equal priority rank under nonbankruptcy law. Drawing a constitutional line between them makes no sense.

Hypos three and four, presented next, show how a takings analysis can be changed based on unimportant semantic differences in underlying state law. The important question when a debtor is insolvent is determining relative *priorities* as between competing claimants; a "property" label is but one means of expressing that priority. But if a takings analysis is used, the label becomes outcome-determinative.

C. Hypo # 3

Same facts as number one, except that creditor A enjoys a state statutory *priority* over other unsecured creditors. A's priority claim is not entitled to constitutional takings protection. State law priorities are preempted by federal priorities under the bankruptcy law. Under the current bankruptcy law, creditors A, B, and C would take equal shares of DebtorCo's bankruptcy estate. Yet, outside of bankruptcy, A would get paid before creditors B and C. Since A lacks a "property" right, though, Congress has the power to enact legislation on the "subject of Bankruptcies" that would modify A's rights, subject only to very modest due process protection.

D. Hypo # 4

Same facts as number three, except now the state statute characterizes A's preferred standing as a "lien" and not as just a "priority." Now A is a "secured" creditor, for its full $10,000 claim, and is constitutionally entitled to protection against a taking of that $10,000 "property" right. Justifying the extreme difference in constitutional rights that occur as between hypos three and four is difficult, to say the least. Outside of bankruptcy, under the creating state law, there are few if any meaningful differences in the rights accruing to the holder of the entitlement, whether it is *called* a "priority" or a "lien"; for both, the only important point is that the party with the entitlement gets paid first.

273. 11 U.S.C. § 506(a)(1) (2012) ("[A] secured claim to the extent of the value of such creditor's interest in the estate's interest in such property . . . ."). Each creditor has an equal one-third share in the estate's property of $15,000.

Hypos five and six demonstrate how the current constitutional analysis distinguishes between different "property" rights held by secured creditors. Some are protected, while others are not. Such a picking and choosing likewise is difficult to justify constitutionally.

E. Hypo # 5

Same facts as in number one, except now A has a security interest in one of DebtorCo's assets, which collateral has a value of $9000 to secure A's claim of $10,000. That collateral is not depreciating in value. Under state law, A would be entitled to foreclose immediately and realize $9000, and would be able to put that $9000 to work as an investment at a rate of ten percent per annum. DebtorCo files bankruptcy, however, and A is stayed from foreclosing. DebtorCo is in bankruptcy for two years. A thus loses $1800 (ten percent of $9000, for two years) due solely to the interference of the bankruptcy case with its state law foreclosure rights. Yet, the Supreme Court has squarely held that A has no constitutional (or statutory) claim to reimbursement of the lost $1800.[274]

F. Hypo # 6

Same facts as number 5, except now A could only make a five percent return on a reinvestment of the $9000 that it is barred from realizing immediately via foreclosure. Thus over two years A would lose only $900 on lost opportunity costs. Over those two years, however, the collateral would depreciate by $900 rather than remaining constant in value. Now A is entitled to constitutional taking protection (as well as statutory protection[275]) against the decline in collateral value. In both Hypos five and six, A suffers a loss of $1800 due to the bankruptcy deprivation of indisputable state law rights. How much, if any, of that loss is protected by the Takings Clause depends, though, on which of the sticks in the property bundle is being taken away by the bankruptcy law. Why that should be so, as a matter of either policy or constitutional law, is difficult to grasp. I submit that the better result is simply to abandon the notion of an independent takings restraint on the exercise of the bankruptcy power as it affects secured creditor's rights in collateral.

IV. CONCLUSION

In the final analysis, perhaps the clearest way to state the matter is to say that a Fifth Amendment takings analysis simply is not helpful or indeed even applicable when considering the nature and scope of the protection constitutionally due to secured creditors in bankruptcy. Somehow we have arrived at a curious and unprincipled compromise in which a "secured" creditor—but not an unsecured creditor—is accorded

274. *See United Sav. Ass'n.* 484 U.S. at 372–73.
275. 11 U.S.C. § 361.

constitutional takings protection to the preservation of its "property" interest as measured and defined by the market value in collateral of a bankruptcy debtor at the outset of a bankruptcy case, but not to the protection of any other of its state law property rights, and not to any protection if its nonbankruptcy priority rights stem from any source other than what is labeled as "security" and thus "property." It only obfuscates the very real tradeoffs and competing constitutional and policy imperatives to hew to such an odd regime. And it hobbles greatly congressional flexibility to enact meaningful bankruptcy reforms.

If, however, we could move away from an obsessive preoccupation with takings and a secured creditor's "property" interest, and look instead at whether a law fell within the Bankruptcy Clause as a "uniform" law on the "subject of Bankruptcies," and if so, whether that law complied with the fundamental dictates of due process, considerable clarity and freedom of action would be gained. The ability of Congress to realize fully the promise of the Bankruptcy Clause would be enhanced, without unfairly sacrificing the legitimate expectations of stakeholders. The Takings Clause, in short, simply should not be treated as an independent limitation on the operation of congressional power under the Bankruptcy Clause.