

THE BANKRUPTCY POWER AND THE MEANING OF INSOLVENCY

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[working paper]

In 2017, Bestwall LLC filed for bankruptcy even though a generous funding agreement from its parent, Georgia-Pacific, meant it could pay “any conceivable liabilities now and in the foreseeable future.” Surprisingly, the Bankruptcy Code does not require voluntary debtors in chapter 11 to demonstrate or even allege insolvency. Does the Bankruptcy Power in the U.S. Constitution require debtors to be insolvent, and if so, what type of insolvent: cashflow, balance-sheet, or having unreasonably small assets?

An age of refinancing transactions and liability-management exercises has forced the issue. Restructuring attorneys across the country have used Texas’s divisional merger statute to create entities synthetically designed for bankruptcy, loaded up with debt and armed with funding commitments from their corporate parents. But when those funding commitments are uncapped or overly generous, debtors have arrived in bankruptcy court arguably solvent in every sense of the term.

Bestwall and other cases are deepening a circuit split over bankruptcy’s most important outer limit: insolvency. Unless Congress pulls back from the brink, the question whether the Bankruptcy Power carries an insolvency limit seems destined for the Supreme Court. If the Court takes up the question, it would be

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arguably the most important bankruptcy case since the Court approved of the business reorganization in 1935.

This Article tackles the Bestwall problem head-on, and it does so through an exhaustive investigation of insolvency provisions in American bankruptcy law, over roughly three hundred fifty years of history, from the earliest poor man's oaths in the colonies to the 1978 Code revisions that set up the conundrum we see today.

This Article makes at least two novel contributions to the literature. First, unlike prior treatments that focus on whether the prevailing statute required insolvency or not, this Article provides a historical analysis of American bankruptcy law that focuses not only on express insolvency provisions but also on how they relate to bankruptcy procedure and remedies. Second, it proposes a framework for approaching the question of which sort of insolvency the Constitution requires, a framework that courts and attorneys need in a world of refinancings and liability management exercises.

The Bankruptcy Power requires that the debtor be either fraudulent, insolvent, or nonpaying, what this Article calls the "FIN" requirement. As for what kind of insolvency, the Article argues that cashflow insolvency is both the historic and economic touchstone of involuntary bankruptcy. Congress could not, I conclude, pass a statute under the Bankruptcy Power that allowed creditors to start involuntary proceedings against any debtor that was balance-sheet or USA insolvent. However, Congress may allow debtors that are balance-sheet or USA insolvent to file for bankruptcy on a voluntary basis, using much the same logic that allows contract parties to repudiate their obligations in anticipation of breach or that allows parties to seek a declaratory judgment in anticipation of being sued.

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INTRODUCTION: THE *BESTWALL* PROBLEM

All happy families are alike; each unhappy family is unhappy in its own way.¹

On November 2, 2017, Bestwall LLC filed for bankruptcy in the Western District of North Carolina. A subsidiary of Georgia-Pacific, a pulp and paper company based in Atlanta, Bestwall had been loaded up with mass tort debt from asbestos liability and sent into bankruptcy, much like the scapegoat of Levitical law.² The problem was that Bestwall had also been granted an uncapped funding agreement from its parent, Georgia-Pacific. The funding agreement required Georgia-Pacific to pay all of Bestwall's expenses if Bestwall lacked the cash to do so, including inside bankruptcy.³ Georgia-Pacific was easily solvent and so, it seemed, was Bestwall.

Not everyone agreed that Bestwall should be in bankruptcy. The official committee of asbestos claimants (the "Asbestos Committee") sought to have the bankruptcy dismissed, and while the bankruptcy court noted that Bestwall appeared "able to pay any conceivable liabilities now and in the foreseeable future," it refused to dismiss the case.⁴ "[F]iling for Chapter 11, especially in the context of an asbestos or mass tort case," said the bankruptcy court, "need not be due to insolvency."⁵ Later in the case, the court rejected the Committee's argument, rooted in the same facts, that it lacked subject-matter jurisdiction over Bestwall.⁶ On appeal, the Fourth Circuit affirmed, and the Supreme Court declined to get involved.⁷

¹ LEO TOLSTOY, *ANNA KARENINA* 1 (1877) ("Все счастливые семьи похожи друг на друга, каждая несчастливая семья несчастлива по-своему.").

² See *Leviticus* 16:22.

³ See First Day Declaration, at ¶ 20, *In re Bestwall LLC* (No. 17-31795 (Bankr. W.D.N.C. Nov. 2, 2017), ECF No. 2).

⁴ *In re Bestwall LLC*, 658 B.R. 348, 373 (W.D.N.C. Feb. 21, 2024).

⁵ *In re Bestwall LLC*, 605 B.R. 43, 49 (Bankr. W.D.N.C. 2019).

⁶ See *In re Bestwall LLC*, 658 B.R. 348 (Bankr. W.D.N.C. 2024).

⁷ See *Bestwall LLC v. Official Committee of Asbestos Claimants*, 148 F.4th 233 (4th Cir. 2025), *cert denied*, 2026 WL 1513280 (mem.). The case has languished in chapter 11, with a second amended plan of reorganization filed in late 2024 and no end in sight. See Amended Chapter 11 Plan, *Bestwall LLC*, (Oct. 9, 2024), ECF No. 3520.

There are three definitions of insolvency currently operative in American law. The oldest is *equitable* or *cashflow insolvency*, the inability to pay one's debts as they come due. The next is *balance-sheet insolvency*, a state in which a debtor's liabilities outweigh its assets at a fair valuation. The youngest, which burst onto the scene in the 1918 Uniform Fraudulent Conveyance Act, is *unreasonably small assets insolvency*, when a debtor is left with unreasonably small assets ("USA") to continue in its business. Properly speaking, such a debtor is not cashflow or balance-sheet insolvent, but financial distress is unavoidable absent a miracle or stroke of luck.

One might imagine that the Bankruptcy Code would require a debtor seeking bankruptcy relief to demonstrate, or at least plead, some type of insolvency. But it does not, and that presses the question whether the Bankruptcy Power⁸ requires some sort of insolvency and, if so, what kind of insolvency.

Bestwall is not the only case pressing this question. An age of refinancing transactions and liability-management exercises ("LMEs") has forced the issue. Restructuring attorneys across the country have used Texas's divisional merger statute to create entities synthetically designed for bankruptcy, a maneuver colloquially known as the "Texas Two-Step."⁹ The resulting, bankruptcy-ready entities are loaded up with debt and armed with funding commitments from their corporate parents. But when those funding commitments are uncapped or overly generous, debtors have arrived in bankruptcy court arguably solvent in every sense of the term.¹⁰

⁸ U.S. CONST. art. I, sec. 8, cl. 4.

⁹ See, e.g., Michael A. Francus, *Texas Two-Stepping Out of Bankruptcy*, 120 U. MICH. L. REV. ONLINE 38 (2023).

¹⁰ The problem arose first in *LTL Management* and has continued apace with *Aearo Technologies* and *DBMP*. Because the Texas Two-Step means the official case name does not identify the solvent parent company, I use a parenthetical with the Latin "*divisus ex*" to denote the solvent parent. See *In re LTL Management, LLC (divisus ex Johnson & Johnson)*, 64 F.4th 84, 102 (3d Cir. 2023) (holding that financial distress must be "apparent" and "immediate enough to justify a filing"); *In re Aearo Technologies LLC (divisus ex 3M)*, No. 22-02890, 2023 WL 3938436, at *7, 15 (Bankr. S.D. Ina. June 9, 2023) (noting, in dismissing bankruptcy cases, that "[c]ourts have consistently dismissed Chapter 11 petitions filed by financially health companies with no need to reorganize under the protection of Chapter 11" and observing that "Aearo is solvent using a balance sheet analysis and a cash flow analysis"); *Herlihy v.*

Although the Supreme Court denied certiorari in the latest round of *Bestwall*, the matter seems destined for higher review. The circuit courts have fashioned a dizzying array of tests for assessing financial distress at the beginning of a bankruptcy case,¹¹ and they have done so in the context of a statute that requires no showing of insolvency at all. Bankruptcy scholars are divided as well, with one camp underscoring the statutory text and the inefficiency of early-stage insolvency litigation,¹² and another camp underscoring the constitutional problems of allowing solvent debtors to file for bankruptcy.¹³

The puzzle is not confined to business bankruptcy cases. Under state law, self-settled trusts and uncapped homestead exemptions allow debtors to shield millions of dollars from their creditors. Since 1898, federal bankruptcy law has incorporated those provisions into its treatment of individual debtors. Under this regime, then, individuals whose assets outweigh their liabilities can file for bankruptcy and receive a discharge of their debt.

DBMP, LLC (divisus ex CertainTeed), 167 F.4th 142 (4th Cir. 2026) (affirming the bankruptcy court’s decision not to lift the stay and observing that the “statutory authority for a company to pursue a § 524(g) plan in a Chapter 11 reorganization does not require a showing of ‘insolvency’ . . . which is in contrast to other provisions of the Bankruptcy Code”) (citations omitted); *see also Herlihy*, 167 F.4th at 160 (King, J., dissenting) (arguing that the debtor “is not — and never has been — in financial distress”).

¹¹ In the Third Circuit, “financial distress” plays “a central role” in the section 1112 good faith inquiry, but the financial distress must be “apparent” and “immediate enough to justify a filing.” *In re LTL Mgmt., LLC*, 64 F.4th 84, 103 (3d Cir. 2023); *see also In re Integrated Telecom*, 384 F.3d 108, 122 (3d Cir. 2004). The Fourth Circuit requires both “objective futility” of the reorganization and the debtor’s “subjective bad faith.” *Carolin Corp. v. Miller*, 886 F.2d 693, 700–01 (4th Cir. 1989). *See In re Roman Catholic Church of Archdiocese of New Orleans*, 632 B.R. 593, 601 (Bankr. E.D. La. 2021) (using solvency as “one of several factors that a court may consider in determining whether a debtor is experiencing financial distress”).

¹² *See, e.g., Br. of Professors Anthony J. Casey, Brook E. Gotberg, and Joshua C. Macey as Amici Curiae Supporting Appellee and Affirmance, Bestwall LLC v. Official Committee of Asbestos Claimants*, 148 F.4th 233 (4th Cir. 2025), ECF No. 51-1, *cert denied*, 2026 WL 1513280 (mem. op.).

¹³ *See, e.g., Br. of Amici Curiae on Behalf of a Group of Bankruptcy Law Professors In Support of the Petition for a Writ of Certiorari, Official Committee of Asbestos Claimants of Bestwall LLC v. Bestwall LLC*, No. 23-1013, 2026 WL 1513280 (June 1, 2026) (mem. op.); *Br. of Amici Curiae Bankruptcy and Legal History Professors in Support of Granting the Petition for a Writ of Certiorari on the Historical Scope of the Bankruptcy Power*, *id.*

This Article tackles the *Bestwall* problem head-on, and it does so through an exhaustive investigation of insolvency provisions in American bankruptcy law, over roughly three hundred fifty years of history, from the earliest poor man's oaths in the colonies to the 1978 Code revisions that set up the conundrum we see today.

The historical analysis requires nuance and a keen appreciation for the ins and outs of bankruptcy practice. The *right* to file bankruptcy is intertwined with the *remedies* on offer in bankruptcy court. For example, from 1898 to 1978, federal bankruptcy law took a "light touch" in liquidation cases, requiring debtors to affirm that they were cashflow insolvent but largely taking them at their word. Commentators justified this approach in light of the consequences of a liquidation: If a solvent debtor wanted to sell everything and give the proceeds to creditors, why should anyone care? Using insolvency as the gateway to bankruptcy relief took on new importance when reorganization cases entered federal law in 1933.

The scholarly literature contains numerous excellent treatments of bankruptcy history that abut on the question of insolvency,¹⁴ as well as several analyses that address whether the

¹⁴ To list any bankruptcy histories at all is to risk offense to the authors of many worthy treatments not on the list. The state of bankruptcy history is better now than it has ever been, including numerous excellent works in both business and consumer bankruptcy. The seminal work in bankruptcy history remains CHARLES WARREN, *BANKRUPTCY IN UNITED STATES HISTORY* (Da Capo Press 1972) (1935), but David Skeel's book has earned a permanent place in the firmament. DAVID A. SKEEL, *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* (2001). Skeel has recently written a new epilogue highlighting changes in the last quarter century. See David A. Skeel, *Debt's Dominion: A New Epilogue*, 51 *BYU L. REV.* 903 (2026). Professor Stephen J. Lubben has an excellent treatment of how external forces shaped the development of bankruptcy law, Stephen J. Lubben, *A New Understanding of the Bankruptcy Clause*, 64 *CASE W. RES. L. REV.* 319, 337–38 (2013), and his recent book builds on new insights from archival research into railroad insolvencies, STEPHEN J. LUBBEN, *TO PROTECT THEIR INTERESTS: THE INVENTION AND EXPLOITATION OF CORPORATE BANKRUPTCY* (2026).

Many of the comprehensive histories gave short shrift to one of America's most compelling abolitionist movements, the movement to abolish debtors' prisons, perhaps because the reform efforts ended up codified in state constitutions long before the country had a permanent bankruptcy statute. Professor Bruce Mann and Peter Coleman remain leading sources covering this movement. See BRUCE H. MANN, *REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE* (2003); PETER J. COLEMAN, *DEBTORS AND CREDITORS IN AMERICA: INSOLVENCY, IMPRISONMENT FOR DEBT, AND*

debtor's insolvency represents a constitutional limit on bankruptcy.¹⁵

Professor Thomas Plank has the most developed treatment in the literature to date. Plank has persuasively argued that the debtor's insolvency is both a constitutional and jurisdictional limit

BANKRUPTCY, 1607–1900 (1974). Mann, though, covered imprisonment for debt only up to the nation's first bankruptcy statute in 1800, thus excluding from his narrative much of the story of the final push for abolition in Kentucky and other states, which I have documented in my own work. See Christopher D. Hampson, *Harsh Creditor Remedies and the Role of the Redeemer*, 92 FORDHAM L. REV. 935, 975–77 (2023); Christopher D. Hampson, *The New American Debtors' Prisons*, 44 AM. J. CRIM. L. 1 (2017); Christopher D. Hampson, Note, *State Bans on Debtors' Prisons and Criminal Justice Debt*, 129 HARV. L. REV. 1024 (2016); Christopher D. Hampson, *State Bans on Debtors' Prisons and Criminal Justice Debt — Appendix*, 129 HARV. L. REV. FORUM 153 (2016) (listing forty-one state constitutional texts banning imprisonment for debt);

Other historians have advanced our understanding of specific moments in bankruptcy history far beyond the prior state of scholarship. Professor Rafael Pardo has excavated the ways that the institutions of bankruptcy and slavery have interacted and has challenged bankruptcy historians to look beyond statutory text and federal court decisions when drawing conclusions. See, e.g., Rafael I. Pardo, *Rethinking Antebellum Bankruptcy*, 95 U. COLO. L. REV. 995 (2024). Edward Balleisen's book focuses on the 1841 Bankruptcy Act through a study of 1820–1860. EDWARD J. BALLEISEN, NAVIGATING FAILURE (2001).

For excellent analyses focused on consumer bankruptcy, see LOUIS R. HYMAN, DEBTOR NATION: THE HISTORY OF AMERICA IN RED INK (2011) and EMILY ZACKIN & CHLOE N. THURSTON, THE POLITICAL DEVELOPMENT OF AMERICAN DEBT RELIEF (2024).

¹⁵ Professor Jonathan C. Lipson has an excellent treatment that focuses on the role of bankruptcy in a federalist democracy, but does not dig into insolvency requirements. See Jonathan C. Lipson, *Debt and Democracy: Towards a Constitutional Theory of Bankruptcy*, 83 NOTRE DAME L. REV. 605, 617–24 (2008). Professor Charles Jordan Tabb has a decent history but does not delve into the significance of changes in insolvency definitions. See Charles Jordan Tabb, *The History of the Bankruptcy Laws in the United States*, 3 ABI L. REV. 5, 26 (1995) (noting the change in definition but without exploring its significance). Professor John C. McCoid II provides extensive coverage of the history of involuntary bankruptcies, but he does not explore voluntary petitions or make a case for the scope of the congressional grant beyond what economic theory would suggest. See John C. McCoid II, *The Occasion for Involuntary Bankruptcy*, 61 AM. BANKR. L.J. 195, 214–15 (1987) (describing bankruptcy as “a device for mandatory party joinder” occasioned by balance-sheet insolvency). The analysis here diverges from McCoid's analysis by upholding cashflow insolvency, not balance-sheet insolvency, as the “touchstone” of bankruptcy law. See *infra* Part IV.

on the Bankruptcy Power.¹⁶ Plank argues that the debtor must be *either* cashflow *or* balance-sheet insolvent¹⁷ and suggests that the insolvency limit should not operate differently between voluntary and involuntary petitions.¹⁸ Professor Ralph Brubaker draws a wider sweep for the Power, arguing that the test is “risk of nonpayment of creditors, through either inability or unwillingness to pay.”¹⁹ This Article agrees directionally with both scholars, but with an important twist: the scope for voluntary petitions is broader than the scope for involuntary ones.²⁰

¹⁶ Thomas E. Plank, *The Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 499–545 (1996).

¹⁷ See Plank, *supra* note 16, at 492 (“Insolvency means either balance sheet insolvency, that is, the debtor’s liabilities exceed her assets, or cash flow insolvency, that is, she is unable generally to pay current debts as they become due.”); see also Thomas E. Plank, *Bankruptcy and Federalism*, 71 FORDHAM L. REV. 1063, 1076–89, 1093–95 (2002) (unpacking Plank’s “Debtor-Insolvency Principle”).

¹⁸ See, e.g., Plank, *supra* note 16, at 496 (suggesting that the difference between voluntary and involuntary cases is frequently overstated); *id.* at 548 n.345 (noting the irony that involuntary petitions are insolvency gated but not voluntary ones); see also Max Radin, *The Nature of Bankruptcy*, 89 U. PA. L. REV. 1, 7 (1940) (same).

¹⁹ See Ralph Brubaker, *Assessing the Legitimacy of the “Texas Two-Step” Mass-Tort Bankruptcy (Part III): The Constitutional Limits of the Bankruptcy Power*, 44 BANKR. L. LETTER No. 10, at 2–3 (2024). Brubaker may have been the first to raise the question that this would become a live issue, commenting in 1999 that we may have to figure out “when ... it is appropriate to resort to federal bankruptcy proceedings as a means of managing massive litigation — even for what we would normally regard as an eminently ‘solvent’ debtor.” Ralph Brubaker, *One Hundred Years of Federal Bankruptcy Law and Still Clinging to an In Rem Model of Bankruptcy Jurisdiction*, 15 EMORY BANKR. DEV. L. 261, 261–62 (1999).

²⁰ Any discussion of insolvency thresholds for accessing bankruptcy must account for who commences the case. In both England and the United States, bankruptcy cases began as involuntary proceedings in the beginning; that is, a group of creditors banded together to hale the debtor into bankruptcy court, along with any other creditors. The debtor might then defend and seek dismissal of the proceeding by insisting that he was solvent. Insolvency proceedings were brought by individuals within debtors’ prisons, seeking to be released. The insolvency petition may have been the forebear to today’s voluntary petition, but since the petitioner filed from inside a prison, it was voluntary only in the same sense that a habeas petition is voluntary. In 1841, when Congress created voluntary bankruptcy, filed from inside or outside prison, it provoked constitutional concerns and changed the dynamic of insolvency in bankruptcy law.

More recently, Professor Anthony Casey has argued that good-faith fights at the outset of bankruptcy create costly litigation that sucks value out of the estate.²¹ Casey proposes hewing closely to the statutory text and only dismissing the bankruptcy of a solvent debtor when it becomes clear that a plan is objectively futile.²² For reasons explained below, I conclude that an objective futility cannot adequately police the constitutional boundary unless limits are placed on the sorts of plans Congress could endorse.

This Article makes at least three novel contributions to the literature. First, unlike prior historical treatments that describe whether the prevailing statute required insolvency or not, this Article uncovers how those insolvency tests relate to bankruptcy procedure and remedies. Second, this Article proposes a framework for approaching the question of which sort of insolvency the Constitution requires, a framework that courts and attorneys need in a world of refinancings and liability management exercises. Third, the Article disagrees in important ways with scholars' prior conclusions, as discussed below.

The Article proceeds in five parts. Parts I–IV examine the lessons of history, lessons relevant not only to originalists (those prior to 1789 and shortly thereafter),²³ but also pragmatists,²⁴ living constitutionalists,²⁵ and others who locate constitutional meaning in the long annals of application after a constitutional

²¹ See Anthony J. Casey, *Good-Faith Filing in Chapter 11* (unpublished manuscript at 12–18) (on file with author).

²² See *id.* For a thoughtful view along the same lines as Casey's, see Brook Gotberg, *The Burden of Financial Distress* (unpublished manuscript).

²³ See, e.g., *Vidal v. Elster*, 602 U.S. 286, 738 (Barrett, J., concurring) (“[F]or an originalist, the history that matters most is the history surrounding the ratification of the text; that backdrop illuminates the meaning of the enacted law. History (or tradition) that long postdates ratification does not serve that function.”).

²⁴ *Hively v. Ivy Tech Community College of Indiana*, 853 F.3d 339, 352–53 (7th Cir. 2017) (Posner, J., concurring) (“[I]nterpretation can mean giving a fresh meaning to a statement ... that infuses the statement with vitality and significance today. . . . “[S]tatutory and constitutional provisions frequently are interpreted on the basis of present need and understanding rather than original meaning.”).

²⁵ See, e.g., *Houston Community College System v. Wilson*, 595 U.S. 468, 474 (2022) (noting that “[l]ong settled and established practice” can “illuminate” and “liquidate” open-ended constitutional provisions).

provision is ratified.²⁶ Part I begins with the antecedents to American bankruptcy law in Roman, English, and colonial law and shows that the first type of insolvency to enter American bankruptcy law was cashflow insolvency, erected originally as a gateway to voluntary relief in 1841.²⁷ Part II describes how balance-sheet insolvency entered bankruptcy law in 1898 to protect farmers and other heartland workers from being thrust into involuntary bankruptcy prematurely.²⁸ Part III recounts the rise of the business reorganization, drawing from its roots in the equity receivership, and demonstrates how balance-sheet insolvency crossed over from involuntary petitions to serve a gateway function to voluntary reorganizations.²⁹ Part IV discusses the Bankruptcy Reform Act of 1978, which largely scrubbed solvency tests from the commencement of voluntary chapter 11 cases, as well as subsequent statutory amendments designed to make it less desirable for solvent individuals to file for bankruptcy relief.³⁰ Part V is the theoretical payoff of the Article and brings the historical analysis to bear on the *Bestwall* problem.³¹

Like other scholarly treatments, this Article concludes that the Bankruptcy Power requires that the debtor be either fraudulent, insolvent, or nonpaying, what this Article calls the “FIN” requirement.³² Unlike other scholarly treatments, the Article argues that cashflow insolvency is both the historic and economic touchstone of involuntary bankruptcy. Congress could not, I conclude, pass a statute under the Bankruptcy Power that allowed creditors to start involuntary proceedings against any debtor that was balance-sheet or USA insolvent. However, Congress may allow

²⁶ See, e.g., *Hively v. Ivy Tech Community College of Indiana*, 853 F.3d 339, 345 (7th Cir. 2017) (Wood, J.) (“[E]xperience with the law has led the Supreme Court to recognize that each of these examples is a covered form of sex discrimination.”).

²⁷ See *infra* Part I.

²⁸ See *infra* Part II.

²⁹ See *infra* Part III.

³⁰ See *infra* Part IV.

³¹ See *infra* Part V.

³² This conclusion has strong authority in the opinion of Justice Blatchford, who said when he sat on the Southern District of New York, that the Bankruptcy Power in the U.S. Constitution encompasses “the relations between an insolvent or nonpaying or fraudulent debtor and his creditors.” *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502 (1938) (quoting *In re Reiman*, 20 F. Cas. 490 (No. 11,673) (S.D.N.Y. 1874)).

debtors that are balance-sheet or USA insolvent to file for bankruptcy on a voluntary basis, using much the same logic that allows contract parties to repudiate their obligations in anticipation of breach or that allows parties to seek a declaratory judgment in anticipation of being sued. That said, Congress can no longer take debtors “at their word.” That deference made the most sense in a liquidation-only world, but today uncontested declarations would violate the Due Process Clause under *Chrysafis v. Marks*.³³

Many jurists have resisted sketching out any outer limits to the Bankruptcy Power. After all, Congress needs the flexibility to address financial distress, writ large and small. The Supreme Court said in 1938 that “[t]he subject of bankruptcies is incapable of final definition.”³⁴ If that assertion is true, it is true only in the sense that the subject of bankruptcies, as Mandelbrot said of the coastline of England, has infinite internal complexity.³⁵ Like a fractal, the subject of bankruptcies has finite outer limits, and one of them is insolvency.

I. CASHFLOW INSOLVENCY AS THE GATEWAY TO VOLUNTARY RELIEF

A. *Acts of Bankruptcy and the Poor Man’s Oath*

American bankruptcy law has antecedents in Roman, English, and colonial law, but insolvency was not typically used as the gating mechanism to commence legal proceedings. Creditors could take legal action against debtors who failed to pay or absconded with assets. Each of these legal actions had trigger conditions, but those conditions were nonpayment or fraud, not insolvency as such.³⁶ Debtors could respond by repaying in cash, turning over their assets to their creditors, or taking an oath that they were unable to repay.

³³ 594 U.S. ___, 141 S. Ct. 2482 (2021); *see infra* notes 238–239 and accompanying text.

³⁴ *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502, 513–14 (1938). The Court quoted this language approvingly as recently as 2022, in *Siegel v. Fitzgerald*, 596 U.S. 464, 473 (2022).

³⁵ Benoit Mandelbrot, *How Long Is the Coast of Britain? Statistical Self-Similarity and Fractional Dimension*, 156 SCIENCE 636 (1967).

³⁶ Judge Greene C. Bronson expressed this older view in his 1843 dissent in

Under Roman law, for example, creditors could threaten harsh debt collection tools, including imprisonment or enslavement,³⁷ but debtors could avoid those consequences by surrendering their assets through a voluntary procedure called the *cessio bonorum*, something similar to an assignment for the benefit of creditors in contemporary American law.³⁸ After the proceeding, the debtor would be released with a modicum of personal property,³⁹ an allowance that American attorneys would recognize today as exemption law.⁴⁰ The debtor would not receive a discharge at the end of the case, so creditors were free to continue debt collection efforts against after-acquired property.⁴¹

Sackett v. Andros: “Mere insolvency never makes one a bankrupt without the concurrence of some act tending to the injury of his creditors; and when there has been such an act, the man may be declared a bankruptcy, however able he may be to pay his debts.” 5 Hill 327, 344 (N.Y. 1843) (Bronson, J., dissenting).

³⁷ Many commentators claim that Roman creditors could divide up the body of their debtor in proportion to what they were owed, a gruesome notion that is a matter of some debate. The *Lex Duodecim Tabularum*, or Law of the Twelve Tables (449 BCE), allowed creditors to arrest and imprison their debtors, and if no one paid or provided surety within three days, authorized them to “cut parts” (*partis secanto*). See A. CORNELIUS GELLIUS, *NOCTES ATTICAE* (Rolfe trans.) (Loeb 1927) (vol. 2). Whether this phrase means pieces of flesh or shares of the debtor’s estate is unclear. But the bloodier interpretation goes back at least to the second-century author Aulus Gellius, who in Book XX of his *Noctes Atticae* criticizes dissection for debt as too harsh to justify and surmises that perhaps it was used only to terrify debtors into repayment. See D.T. Oliver, *Roman Law in Aulus Gellius*, 5 CAMBRIDGE L.J. 46, 52–53 (1993) (describing the debate in Gellius’s account). Social anthropologist David Graeber observed that the evidence for mutilation of debtors in the ancient world is “nonexistent” and pins the harsher practices to the modern world. See DAVID GRAEBER, *DEBT: THE FIRST 5,000 YEARS* 77 & nn.9–10 (Tenth Anniversary ed. 2021) (criticizing Nietzsche for relying too much on Shakespeare’s *Merchant of Venice*). Imposing the death penalty on debtors is impracticable in most circumstances: dead men may tell no tales, but they also repay no debts.

³⁸ See, e.g., FRANK O. LOVELAND, *A TREATISE ON THE LAW AND PROCEEDINGS IN BANKRUPTCY* 2 (1912).

³⁹ *Id.*

⁴⁰ Exemption law has ancient roots, including in the Hebrew Bible. See *Exodus* 22:26 (providing that a creditor who has taken his neighbor’s cloak as collateral must return it by sunset).

⁴¹ Roman law also had an involuntary proceeding called the *cessio emtio*, which a debtor could contest by taking an oath of solvency. This oath of solvency is captured in the Heracleian Tablets. See George Long, *Bonorum Cessio*, in WILLIAM SMITH, *A DICTIONARY OF GREEK AND ROMAN ANTIQUITIES* (John Murray ed. 1875).

In mid-sixteenth century England, the 1542 Statute of Bankruptcy⁴² built on procedures from civil law jurisdictions in mainland Europe, taking the name *banque route* (French) or *banca rotta* (Italian) from the continent as well.⁴³ English law developed along two separate but related tracks: a *bankruptcy* proceeding was an involuntary case against traders who had committed one of enumerated “acts of bankruptcy,” such as fleeing one’s creditors, avoiding service of process, failing to repay debts, or hiding assets; while an *insolvency* proceeding was a voluntary mechanism for individual debtors to seek release from debtors’ prison.⁴⁴

⁴² An Act Against Such Persons as Do Make Bankrupt, 34 & 35 Henry VIII, ch. 4 (Eng. 1542).

⁴³ Samuel Johnson’s *Dictionary of the English Language* (1755) has both etymologies and defined the term “bankrupt” as “In debt beyond the power of payment.” Most commentators seem to think the English “bankrupt” comes from the Italian, for the broken bench of an insolvent money changer. See Loveland, *supra* note 3838, at 4. Others (including Lord Coke, Blackstone, and Story) suggested an alternative etymology in the French phrase *qui font banque route*, referring to ruined merchants who drag their table away from the market, leaving behind a track. *Id.* (citing 2 BLACKSTONE’S COM. 472 N.); see also Joseph STORY, 3 COMMENTARIES ON THE CONSTITUTION § 1107 (citing Lord Coke on the same etymological debate). That phrase seems to be translated into the English in the first bankruptcy statute in England in 1542: “against such persons, as do make bankrupt.” Professor Max Radin, by contrast, calls that etymology “untenable” and “fantastic.” See Max Radin, *The Nature of Bankruptcy*, 89 U. PA. L. REV. 1, 1 n.1 (1940).

⁴⁴ See, e.g., 13. Eliz., c. 7. (1570) (Eng.) (“An Act Touching Orders for Bankruptcy”) (dealing only with commercial insolvency of traders); 4 Anne, c. 17, §§ 1, 18 (1705) (Eng.) (allowing individuals to obtain a certificate of discharge). Whether English bankruptcy law was limited to involuntary proceedings against merchants took on a constitutional dimension after the framers gave Congress the power “to establish uniform laws ... on the subject of Bankruptcies” in the 1789 Constitution. U.S. CONST. art I, § 8, cl. 4. Several bankruptcy historians, though, have pointed out that the distinction between a *bankruptcy* law and an *insolvency* law had already started to erode in England at the time of the American Constitutional conventions. See Kurt H. Nadelmann, *On the Origin of the Bankruptcy Clause*, 1 Am. J. Legal Hist. 215, 227 (calling the distinction “obsolescent” in England and noting that only some American states had adopted it at the time of the Constitutional Convention); Tabb, *supra* note 15, at 10. In 1783, an English bankruptcy commissioner and member of Lincoln’s Inn published a 400-page analysis of the insolvency system, arguing that the distinction between “Debtors Bankrupt and Not Bankrupt” had been “exploded” and the distinction between traders and non-traders should be “extinguished.” JAMES BLAND BURGESS, CONSIDERATIONS ON THE LAW OF

Under American colonial law, debtors could seek release from prison by taking an oath that they had no assets sufficient to repay the creditor or creditors who had imprisoned them.⁴⁵ Massachusetts enacted such an oath in 1672, by which debtors would swear that their estate was worth less than £5.⁴⁶ A federal version of the oath, passed in 1792, had debtors swear that their estate was less than \$20 and insufficient to repay the debt for which they were imprisoned.⁴⁷ In some places, debtors who owed too much were ineligible to take the oath (£500 to any single creditor under Massachusetts law in 1698).⁴⁸

Under any of these colonial regimes, as Professors Richard Hynes and Nathaniel Pattison point out, the oath functioned as a burden-shifting mechanism, since creditors could challenge the veracity of the debtor's assertions.⁴⁹ Yet even these disputes over the oaths are not, properly speaking, solvency determinations, since they turned either on net worth or the ability of the debtor to repay the debt of the complaining creditor — not creditors generally.

Thus, when the 1789 Constitution entrusted the Bankruptcy Power to Congress, insolvency did not stand at the threshold of bankruptcy court in the cases that existed at the time. Creditors of traders could commence involuntary proceedings against their debtors for fraud or nonpayment, and creditors of individuals could seek to throw them into debtors' prison. For their part, debtors

INSOLVENCY WITH A PROPOSAL FOR REFORM 348–49 (T. Cadell 1783); *see also* David Graham, *A Dark and Neglected Subject: Landmarks in the Reform of English Insolvency Law*, 11 INT'L INSOLVENCY REV. 97, 111 (2002) (discussing Burges's analysis in the context of reform proposals in English law). Contrary to what many commentators repeat, the U.S. Supreme Court actually dodged the issue in *Sturges v. Crowninshield*, 17 U.S. 122 (1819), noting the difficulty of figuring out whether the Bankruptcy Power might encompass the subject matter of both "bankruptcy" and "insolvency" proceedings in the way that English law had previously used the terms, *id.* at 194, but handing down a Contracts Clause opinion that "renders it totally unnecessary to consider the question whether the law of New York is, or is not, a bankrupt law," *id.*

⁴⁵ *See* Richard M. Hynes & Nathaniel Pattison, *A Modern Poor Debtor's Oath*, 108 VA. L. REV. 915, 919 (2022).

⁴⁶ *See* BRUCE H. MANN, *REPUBLIC OF DEBTORS: BANKRUPTCY IN THE AGE OF AMERICAN INDEPENDENCE* 40–41, 50 (2002); Hynes & Patterson, *supra* note 45, at 926–27.

⁴⁷ Act of May 5, 1792, ch. 29, § 2, 1 Stat. 265, 266.

⁴⁸ Hynes & Patterson, *supra* note 45, at 928.

⁴⁹ *Id.* at 927–28.

could raise solvency to resist an involuntary petition or take an oath to get out of debtors' prison, but in either case, the dispute was already lodged in the court system.

This basic settlement lasted through the Bankruptcy Act of 1800, the nation's first (and short-lived) bankruptcy statute. Under the 1800 Act, a bankruptcy case was an involuntary proceeding, brought by creditors against a merchant⁵⁰ who had committed an act of bankruptcy, like fleeing the jurisdiction, absconding with assets, or making fraudulent transfers.⁵¹ Creditors did not need to allege insolvency, and debtors could resist the petition by showing that they did not in fact commit the alleged acts.⁵² Insolvency did not feature in the analysis of bankruptcy cases under the 1800 Act.

To be sure, a constitutional crisis over bankruptcy did boil over in the first fifty years of the fledgling republic, but it was about which level of government in the new federalist system could abolish debtors' prisons. As I have detailed in prior work,⁵³ imprisonment for debt became increasingly unpopular as the young country went through several financial panics. In 1800, the nation's first prison newspaper, *Forlorn Hope*, began to denounce the practice from inside the walls. But the federal government hesitated to pass bankruptcy legislation, and Kentucky spearheaded the abolitionist movement, led by Colonel Richard Mentor Johnson. By the end of the crisis, the courts had made clear that the states could abolish debtors' prisons within their jurisdiction.⁵⁴

⁵⁰ Bankruptcy Act of 1800, § 1 (restricting bankruptcy cases to debtors who were merchants or any "other person ... actually using the trade of merchandise, by buying and selling in gross, or by retail, or dealing in exchange, or as a banker, broker, factor, underwriter, or marine insurer").

⁵¹ *Id.*

⁵² *Id.* at § 3 (allowing a debtor to demand that a jury be impaneled to decide whether the debtor had committed any of the alleged acts of bankruptcy).

⁵³ See sources cited *supra* note 14.

⁵⁴ The Supreme Court arrived at this settlement through a series of rulings. First, the Contracts Clause, which prevents states from impairing the obligation of contracts, prevents the states from discharging debt but allows them to make remedial interventions within their own borders, such as abolishing debtors' prisons by refusing to allow creditors to seize the person of their debtors. See *Ogden v. Saunders*, 25 U.S. 213 (1827); *Mason v. Haile*, 25 U.S. 370, 378 (1827). Second, in the absence of congressional action, the states could continue passing their own bankruptcy statutes. See *Sturges v. Crowninshield*, 17 U.S. 122, 199

Once that matter had been resolved, the next constitutional crisis was whether Congress could pass a voluntary statute. This time, the crisis was provoked not by congressional inaction, but by congressional action.

B. Insolvency in Voluntary Liquidations

In 1841, Congress passed its second bankruptcy act, drafted in large measure by Justice Joseph Story.⁵⁵ The Bankruptcy Act of 1841 kept much of the 1800 Act's involuntary regime for merchant debtors⁵⁶ and added a controversial voluntary regime for individuals.⁵⁷ Along with the voluntary regime came an important threshold determination of cashflow or "equitable" insolvency: individuals had to verify by oath or affirmation that they were "unable to meet their debts and engagements."⁵⁸ Cashflow insolvency had entered federal bankruptcy law for the first time, as the gateway to voluntary liquidations.⁵⁹

Using cashflow insolvency as a gating mechanism was not controversial. What was controversial was whether Congress could

(1819). Third, the Bankruptcy Power encompasses not only merchant cases under the old English sense of the word "bankruptcy," but also individual cases, empowering Congress to pass a uniform bankruptcy law and empty the debtors' prisons through federal bankruptcy procedure. *See* *Hanover Nat. Bank v. Moyses*, 186 U.S. 181, 187 (1902); *see also* STORY, *supra* note 44, at § 1101 (criticizing imprisonment for debt as "a refinement in cruelty, and an indulgence of private passions, which could hardly find apology in an enlightened despotism; and are utterly at war with all the rights and duties of free governments" and arguing that "[a] national government, which did not possess this power of legislation, would be little worth of the exalted functions of guarding the happiness, and supporting the rights of a free people").

⁵⁵ *See* WARREN, *supra* note 14, at 56–79; Morris Weisman, *Story and Webster—And the Bankruptcy Act of 1841*, 46 COM. L.J. 4, 4–6 (1941).

⁵⁶ Creditors could commence involuntary cases against merchants and other similar debtors who owed more than \$2000 in the aggregate, so long as they had committed an Act of Bankruptcy and one or more of the petitioning creditors was owed more than \$500.

⁵⁷ Voluntary bankruptcies were not part of English practice but had some precedent in the colonies. *See* Lubben, *supra* note 14, at 361–62.

⁵⁸ *See* Bankruptcy Act of 1841, Chap. IX(a).

⁵⁹ Under the 1841 Act, partnerships could file if partners all "became insolvent." *Id.*

pass a voluntary regime at all and extend it to non-merchants.⁶⁰ To be fair, the notion was not without precedent; after all, the Roman *cessio bonorum* was a voluntary proceeding. But several lawmakers and jurists felt that the federal government's authority extended only to what the English would have recognized as a "bankruptcy" case.⁶¹ The most famous challengers of the 1841 Act were John Calhoun and Thomas Benton, while its most famous defenders were Daniel Webster and Joseph Story.⁶²

But narrow and overly technical readings are not always correct, and the expansive reading had much to recommend it. As a practical matter, the old English distinctions were hard to maintain and indeed were already eroding away when the U.S. Constitution was ratified.⁶³

As Professor Stephen Lubben points out, the limitation to traders or merchants was more of a liability than a benefit in the context of an involuntary proceeding. It meant that creditors had an additional debt collection tool against merchants that they did not have against other people.⁶⁴ But merchants stood on the leading edge of a shift in attitude toward debt: from a sinful broken promise to an unfortunate roll of the dice. Sometimes ships don't make it home, and the vagaries of the sea cannot be laid at the feet of mortals. Two novels from the 1840s, Alexandre Dumas's *The Count of Monte Cristo* (1846),⁶⁵ and Charles Dickens's *Dombey and*

⁶⁰ See Pardo, *supra* note 14, at 995; see also *Adams v. Storey*, 1 F. Cas. 141, 142 (C.C.D.N.Y. 1817) (Livingston, J.) (questioning whether a bankruptcy law allowing anyone to file would "comport with the spirit of the powers vested in [Congress]").

⁶¹ See, e.g., *Sacket v. Andros*, 5 Hill 327 (N.Y.) ("The argument in support of the law is, and must be, that bankrupt and insolvent — bankruptcy and insolvency — are synonymous terms, and that when the convention spoke of 'bankruptcies,' they intended to cover the whole field of insolvency, or inability to pay debts. To my mind nothing can be more clear than that this position cannot be maintained by any fair course of reasoning.").

⁶² See, e.g., Weisman, *supra* note 55.

⁶³ See sources cited *supra* note 44; see also Michael S. Schreiber, *Original Intent and the Bankruptcy Power*, 2 DEPAUL BUS. & COM. L.J. 165, 168–76 (2003).

⁶⁴ See Lubben, *supra* note 14, at 330–331, 337.

⁶⁵ ALEXANDRE DUMAS, *THE COUNT OF MONTE CRISTO* (Robin Buss trans. 1996) (1846). *N.b.*: SPOILER ALERT. In Dumas's classic novel, a businessman and shipowner named Pierre Morrel faces bankruptcy after losing five ships in two years. Morrel ends up owing 287,500 francs to his creditors with only 15,257

Son (1848),⁶⁶ each feature a main character contemplating suicide over financial ruin tied to ships lost at sea. Both authors see suicide over debt as imaginable, even relatable, to their audiences, while simultaneously tragic and worthy of a major plot twist. Dumas and Dickens thus demonstrate the transformation in attitude toward debt that took place during the mid-nineteenth century.

Lost ships, though, affect not only merchants but also their associated professionals, like bankers, brokers, and insurers, and lawmakers widened the circle of debtors to include those professionals.⁶⁷ From there, the conceptual leap to farmers is quite easy to make — the weather is mercurial over both land and sea — and the other crafts and trades soon follow.

As for whether laws “on the subject of Bankruptcies” could be limited only to involuntary proceedings, such a limit runs into both conceptual and practical problems:

Conceptually, it is hard to see why Congress’s authority to legislate on a given subject matter should be constrained by which party commences a judicial proceeding that otherwise meets the Article III requirements. Indeed, a similar question would be presented to the Supreme Court almost one hundred years later, in the form of Tennessee’s Declaratory Judgments Act.⁶⁸ In a

francs to his name. A series of extensions has run out, and he contemplates ending his life to save his honor. “If I live,” he tells his son, “I am only a man who has broken his word, failed in his engagements—in fact, only a bankrupt. If, on the contrary, I die, remember, Maximilian, my corpse is that of an honest but unfortunate man.” As M. Morrel prepares to pull the trigger, his daughter bursts in holding a massive diamond labeled “Julie’s dowry,” and his daughter’s fiancé announces that Morrel’s flagship, the *Pharaon* — feared lost at sea — is pulling into harbor. Edmond Dantès is, of course, behind both turns in fortune. Immediately after saving Morrel, Dantès begins his course of vengeance: “I have been Heaven’s substitute to recompense the good — now the god of vengeance yields to me his power to punish the wicked!”

⁶⁶ CHARLES DICKENS, *DOMBEY & SON* (Andrew Sanders ed., 2002) (1848). *N.b.*: SPOILER ALERT. In one of Dickens’s lesser known works, Mr. Dombey, a proud shipping firm owner, contemplates suicide after financial ruin brings him to bankruptcy. *Id.* at 909 (“He might yet give up what his creditors had spared him (that they had not spared him more, was his own act), and only sever the tie between him and the ruined house, by severing that other link.”).

⁶⁷ See *supra* note 56.

⁶⁸ See *Nashville, Chattanooga & St. Louis Railway Co. v. Wallace*, 288 U.S. 249 (1933). The High Court concluded that “[w]hile the ordinary course of judicial procedure results in a judgment requiring an award of process or

declaratory judgment suit, the party that would normally be the defendant commences the proceeding as the nominal plaintiff. A similar role reversal happens in voluntary bankruptcy, where a debtor files for bankruptcy before the creditors force him there (or rip apart his estate under state law).

Practically, a debtor who wishes to file for bankruptcy can usually find some creditors who agree that a collective proceeding is better than the alternative — even if they disagree with the debtor on everything else. And if a debtor cannot find such a creditor, they can readily obtain one by borrowing money from a relative or friend. Debtors have long been known to partner with sympathetic creditors, who can then file an “involuntary” case against them.⁶⁹ This sort of conduct is almost impossible for courts to police.

The Supreme Court eventually agreed with Daniel Webster and Joseph Story.⁷⁰ For a time, bankruptcy historians pegged the date of resolution of this constitutional controversy as much later than it really was, since the Bankruptcy Act of 1841 was repealed only two years after it was enacted. But bankruptcy litigation under the 1841 Act was preserved by a savings clause, and enough courts had ruled on the matter (including Supreme Court justices riding circuit⁷¹), that the Supreme Court of Arkansas declared it a settled matter by 1845.⁷² Voluntary liquidation was constitutional, even if Congress was not committed to permanent bankruptcy legislation as a policy matter.

execution to carry it into effect, such relief is not an indispensable adjunct to the exercise of the judicial function.” *Id.* at 263.

⁶⁹ See, e.g., MANN, *supra* note 14, at 228–39. This playbook was particularly prominent during the rise of the railroad reorganization through the equity receivership. Such receiverships could only be commenced by creditors, but railroad reorganization counsel pioneered using a friendly creditor to commence an equity receivership against the company.

⁷⁰ See *Hanover Nat. Bank v. Moyses*, 186 U.S. 181, 187 (1902) (observing that the conclusion that Congress could pass voluntary bankruptcy for non-traders “is really not open to discussion”).

⁷¹ See, e.g., *In re Klein*, 14 F. Cas. 716, 717 (C.C.D. Mo. 1843) (holding that the bankruptcy power extends “to all cases where the law causes to be distributed the property of the debtor among his creditors” and to “a discharge of the debtor from his contracts”).

⁷² *State Bank v. Wilborn & Phillips*, 1845 WL 364 (Ark. 1845). For good historical treatments of this constitutional debate, see Pardo, *supra* note 14; LUBBEN, *supra* note 14.

C. The Definitional Fight Begins

A quarter-century and a civil war later, Congress passed the Bankruptcy Act of 1867. The 1867 Act borrowed heavily from Massachusetts's statute,⁷³ and it featured both voluntary and involuntary bankruptcy proceedings, now with both partnerships and corporations. As under the 1841 Act, a voluntary debtor could swear or affirm "inability to pay all his debts in full," as well as "his willingness to surrender all his estate and effects for the benefit of his creditors."⁷⁴ Doing so comprised an "Act of Bankruptcy" under the statute and allowed the court to adjudicate the debtor a bankrupt.⁷⁵

For the first time, though, *insolvency* was used as an element of some of the acts of bankruptcy. Creditors who alleged fraudulent or preferential transfers had to show that the transfers were made while the debtor was "insolvent" or "in contemplation of insolvency."⁷⁶ Now, this restriction makes good sense. Moving assets around to frustrate a creditor seems most wrong when the debtor cannot otherwise pay or be forced to pay. Similarly, preferring one creditor to another seems wrong only when the debtor cannot pay all its creditors.

But equitable or cashflow insolvency was not the only thing that "insolvency" could mean at the time. Balance-sheet insolvency — owing more than the fair market value of one's assets — was so prominent in the public mind that the courts had to ask which sort of insolvency Congress meant in the 1867 Code. According to Professor McCoid, between 1867 and 1871, over a dozen federal courts reached the question and most of them agreed that Congress meant *insolvency* in the older, equitable sense of inability to pay debts as they came due.⁷⁷

⁷³ McCoid, *supra* note 15, at 199–200.

⁷⁴ Bankruptcy Act of 1867, § 11. Courts seemed to take the oath at face value, particularly since the relief offered in the 1867 Act was liquidation, something a solvent debtor would be unlikely to want. *See, e.g., In re Fowler*, 9 F. Cas. 614 (D. Mass. 1867) ("[T]he law takes him at his word.").

⁷⁵ Bankruptcy Act of 1867, § 11.

⁷⁶ *Id.* § 35.

⁷⁷ McCoid, *supra* note 15, at 197. Several bankruptcy treatises in the 1850s and 1860s agreed with this view. *See id.* at 198 n.15 (collecting sources).

In 1871, in *Toof v. Martin*,⁷⁸ the Supreme Court resolved the matter, noting that while the “general and popular meaning” of *insolvency* is the “insufficiency of the entire property and assets of an individual to pay his debts,” Congress meant to incorporate equitable or cashflow insolvency into the Code.⁷⁹ The decision was rooted in standard interpretive principles: without greater specificity in the statute, Congress likely meant to use the meaning of insolvency that had long governed both bankruptcy and equitable receivership cases in England⁸⁰ and several states, most notably Massachusetts.⁸¹

⁷⁸ 80 U.S. 40 (1871).

⁷⁹ Some states took the other route. For example, the Supreme Court of South Carolina noted that the U.S. Supreme Court had adopted cashflow insolvency but noted that South Carolina law used balance-sheet insolvency. See *Miller v. Southern Land & Lumber Co.*, 53 S.C. 364 (S.C. 1898); *Mitchell v. Mitchell*, 20 S.E. 405 (S.C. 1894); *Akers v. Rowan*, 12 S.E.165 (S.C. 1890).

⁸⁰ Two leading English cases built the foundation for the *Toof* decision. In *Bayly v. Schofield*, 1 M. & S. 338, 105 Eng. Rep. 127 (1813), three separate judges wrote to affirm their understanding of insolvency as equitable. Chief Justice Ellenborough wrote that “[b]y insolvent circumstances is meant that a person is not in a condition to pay his debts in the ordinary course, as persons carrying on trade usually do.” *Id.* at 131. Justice Le Blanc defined it as “not in a situation to make his payments as usual” and clarified that “it does not follow that he is not insolvent, because he may ultimately have a surplus upon the winding up of his affairs.” *Id.* at 133. Justice Bayley agreed: “insolvency means that a trader is not able to keep his general days of payment; and that he is not to be considered as solvent because possibly his affairs may come round.” *Id.* In *Shone v. Lucas*, 3 D. & R. 218 (Eng. 1823), the King’s Bench reaffirmed that *insolvency* “does not mean an inability to pay twenty shillings in the pound when the affairs of the bankrupt shall be ultimately wound up, but that a man is in insolvent circumstances ‘when he is not in a condition to pay his debts in the ordinary course, as persons carrying on trade usually do.’” *Id.* (quoting *Bayly v. Schofield*).

⁸¹ The Massachusetts Supreme Judicial Court had adopted the rule of *Bayly v. Schofield* for its own insolvency statute — which as noted above was the source for the 1867 Act. See *Thompson v. Thompson*, 58 Mass. 127 (Mass. 1849) (“By the term ‘insolvency,’ however, as used in these statutes, we do not understand an absolute inability to pay one’s debts at some future time, upon a settlement and winding up of all a trader’s concerns; but a trader may be said to be in insolvent circumstances, when he is not in a condition to pay his debts in the ordinary course, as persons carrying on trade usually do.”); see also *Lee v. Kilburn*, 69 Mass. 594 (1855) (clarifying that balance-sheet insolvency was not the test under Massachusetts law). Other states followed the same rule prior to *Toof*. See *Daniels v. Palmer*, 29 N.W. 162 (Minn. 1886) (noting that while the common meaning of insolvency was balance-sheet insolvency, Minnesota law

The 1867 Act was widely considered a failure, particularly in the post-Confederate South, where it was seen as facilitating carpetbagging by Yankee financiers.⁸² Although the 1867 Act was repealed shortly after *Toof v. Martin*, the ruling ignited a debate about the definition of insolvency that would dramatically change the approach in the nation's first permanent bankruptcy statute.

II. THE HEARTLAND FIGHTS FOR BALANCE-SHEET INSOLVENCY

At the turn of the century, as Congress weighed up a permanent bankruptcy statute, the test for insolvency featured prominently in its discussions. The debate centered on whether Congress should use cashflow insolvency, as *Toof v. Martin* had suggested was the default,⁸³ or balance-sheet insolvency.

This fight over insolvency definitions was a new battlefield for American bankruptcy law. As recounted in Part I,⁸⁴ ancient, medieval, and early modern bankruptcy proceedings were almost all involuntary proceedings brought against debtors who had committed an act of bankruptcy.⁸⁵ Cashflow insolvency had entered federal bankruptcy law when Congress created the voluntary petition in 1841 and became an element of the acts of bankruptcy under the 1867 Act. The notion that voluntary debtors would have to swear (or affirm) that they were cashflow insolvent was not particularly controversial at the time. The affirmation was superficial, but since the relief was liquidation, policymakers expressed little concern over the prospect of abuse.⁸⁶

The more pressing concern was that using cashflow insolvency as an element of acts of bankruptcy would expose certain Americans to involuntary filings, Americans who might struggle to

followed that of Massachusetts and England); *Levan's Appeal*, 3 A. 804 (Penn. 1886) ("A man, to avoid insolvency, is not expected to be able at once to put his hand in his pocket, and pay every debt he owes; but he must be able to pay or to provide for all his debts as they fall due in the usual course of business"). Still others adopted the idea after *Toof*. See, e.g., *State v. Cadwell*, 44 N.W. 700 (Iowa 1890) (citing *Toof* and using equitable insolvency for purposes of Iowa law).

⁸² See Tabb, *supra* note 15, at 19.

⁸³ *Toof v. Martin*, 80 U.S. 40, 47–48 (1871).

⁸⁴ See *supra* Part I.

⁸⁵ Again, the *cessio bonorum* is the notable exception.

⁸⁶ "[T]he law takes him at his word," said a federal judge in 1867. *In re Fowler*, 9 F. Cas. 614 (D. Mass. 1867).

make payments on time even though they anticipated future revenue: farmers.

A. Cashflow Versus Balance-Sheet Insolvency

Justice Bronson, sitting on New York’s highest court,⁸⁷ had anticipated the problem fifty years earlier in a scathing dissent that attacked the 1841 Act from multiple angles. Cashflow insolvency attracted his ire. “Our farmers, planters and mechanics, to say nothing of many other classes which are not engaged in trade, are not always very exact in paying their debts at the day, although they may be solvent,” pointed out Bronson, “and if a commission could be sued out against such persons, it could hardly fail to prove ruinous to them, and that too without benefiting the creditor.”⁸⁸

So when Congress began to consider permanent bankruptcy legislation in the early 1880s, it was no surprise that the first proposal out of committee, called the Equity Bill or the Ingalls Bill, chose a balance-sheet approach for its definition of insolvency.⁸⁹ Balance-sheet insolvency was not a new concept; indeed, contemporaneous court cases suggest that it was actually what the public understood by “insolvency.”

⁸⁷ See Historical Soc’y of the N.Y. Cts., *Court for the Trial of Impeachments and Correction of Errors, 1777–1846*, <https://history.nycourts.gov/court/court-impeachments-errors/> (last visited July 22, 2026).

⁸⁸ *Sacket v. Andros*, 5 Hill 327, 351 (N.Y. 1843) (Bronson, J., dissenting). As Professor McCoid points out, President Ulysses S. Grant made the same argument in 1873 when he urged Congress to repeal the 1867 Act. As Grant put it: “Careful and prudent men very often become involved in debt in the transaction of their business, and though they may possess ample property, if it could be made available for the extraordinary scarcity of money they may be unable to meet their pecuniary obligations as they become due, in consequence of which they are liable to be frustrated in their business by proceedings in bankruptcy at the instance of unrelenting creditors.” Quoted, Cong. Rec., 54th Cong., 2d Sess. 4615; see also Warren, *supra* note 14; SOLICITOR GENERAL THACHER’S REPORT TO THE PRESIDENT ON THE BANKRUPTCY ACT AND ITS ADMINISTRATION IN THE COURTS OF THE UNITED STATES (1932); McCoid, *supra* note 15, at 202.

⁸⁹ S. 1382, Cong. Rec., 47th Cong., 1st Sess. 1629. The proposal read: “Insolvency under this act shall be deemed to exist only when the debtor’s liability exceed in amount the value of his property liable to execution and the available debts due him.” Cong. Rec., 47th Cong., 2d Sess. 81; see also McCoid, *supra* note 15, at 204 n.44.

Senator Garland of Arkansas defended the approach,⁹⁰ pointing out that agricultural communities in the South, Southwest, and West frequently struggled to repay their debts even though the coming harvest meant they were balance-sheet solvent. “[W]ith our annual return of crops, at the maturing of them, with the coming on of the red leaves of autumn and the gathering of them with the frosts of the winter, is the only time when we have capital upon which to pay our debts,” the Senator from the Natural State told Congress (waxing poetic about insolvency definitions). “They are not like Eastern States, which turn out every day their manufactures and turn out everything that can bring money.”⁹¹ Other lawmakers from agricultural states underscored the same point.⁹²

Senator Hoar of Massachusetts attacked the approach, favoring a substitute called the Lowell Bill, named for Judge John Lowell of the Bay State, who had drafted it.⁹³ The balance-sheet test was unworkable as a jurisdictional threshold, argued Senator Hoar:

You require at the threshold of every application in bankruptcy that the court shall go into an investigation of the value of every debt, bad debt or good debt, the value of every interest, contingent or absolute, in property, the value of all expectations of every sort which are the property of the debtor ...⁹⁴

⁹⁰ Senator Garland’s role was unsurprising, McCoid points out, since Garland had litigated *Toof v. Martin* to the Supreme Court and lost. Passing a bankruptcy statute with a balance-sheet test was a way of overriding the Supreme Court’s decision. See McCoid, *supra* note 15, at 204.

⁹¹ Cong. Rec., 47th Cong., 2d Sess 79–80; see also WARREN, *supra* note 14, at 113–14 (“To the ordinary man [*insolvency*] denoted lack of assets of value sufficient to pay debts; but the Court held it to mean inability to pay debts as they become due in ordinary course of business. This definition, while possibly suited to commercial men in the cities, was utterly out of line with the usual business methods of the farmers, planters, and country merchants.”).

⁹² See, e.g., WARREN, *supra* note 14, at 104 (quoting Dalbert E. Paine of Wisconsin as saying that “forc[ing] farmers and mechanics into compulsory bankruptcy is ‘a preposterous and revolting this.’”); *id.* at 116 (quoting Charles A. Eldredge of Wisconsin as attacking the 1867 Act as a “scheme” with the effect of “encourage[ing] speculation and recklessness in the transaction of business”).

⁹³ See McCoid, *supra* note 15, at 203.

⁹⁴ *Id.* (quoting CONG. REC., 47th Cong., 21 Sess. 146).

Cashflow insolvency was, to Senator Hoar, the only definition that was practical and that had “provided itself to the experience of mankind.”⁹⁵

The fight over the shape of the country’s first permanent bankruptcy bill carried on in Congress for years,⁹⁶ and ultimately Congress passed a third bill, the Torrey Bill, named for Jay L. Torrey of St. Louis, who had drafted the legislation as chair of a national commercial organization that met in St. Louis and Minneapolis in 1889.⁹⁷ Torrey “borrowed liberally” from Judge Lowell’s proposal, so the Torrey Bill in its initial form did not define insolvency and thus adopted the cashflow meaning from *Toof v. Martin*.⁹⁸

The Torrey Bill passed the House in 1890 and ricocheted around Congress for almost a decade.⁹⁹ When the federal government came under unified Republican control in 1897 under President McKinley,¹⁰⁰ the Torrey Bill emerged as the consensus bill. To get Southern lawmakers on board, it used a balance-sheet definition of bankruptcy that supporters defended as a pro-debtor approach.¹⁰¹

⁹⁵ CONG. REC., 47th Cong., 2d Sess. 146.

⁹⁶ McCoid has a good history of the tortious pathways the various bills went through on the way to the 1898 Act, following Warren and the Thacher Report. See McCoid, *supra* note 15, at 205–06. One of the major points of debate was whether the federal bankruptcy law could or should incorporate state exemption laws. The Nelson Act incorporated state exemption laws into its regime, and this framework was immediately challenged as insufficiently “uniform” to pass constitutional muster. In a landmark bankruptcy case, the Supreme Court upheld this approach. See *Hanover Nat’l Bank v. Moyses*, 186 U.S. 181, 187 (1902).

⁹⁷ See David A. Warfield, *The Three Giants of Bankruptcy Law in St. Louis*, 55 J.L. & POL’Y 87, 88–89 (2017); McCoid, *supra* note 15, at 206 & n.48; WARREN, *supra* note 83, at 134.

⁹⁸ See McCoid, *supra* note 15, at 206.

⁹⁹ The chief source of opposition came from Southern lawmakers, who focused on the involuntary bankruptcy provisions and suspected that demand for bankruptcy “comes only from rich and powerful commercial corporations, wholesale dealers and boards of trade and associated jobbers.” WARREN, *supra* note 83, at 134 (quoting Cong. Rec., 51st Cong., 1st Sess. 7569 (July 22, 1890)). Charles A. Culbertson of Texas proposed a much shorter bill that would have only voluntary bankruptcy. *Id.* at 134.

¹⁰⁰ See WARREN, *supra* note 14, at 134; Warfield, *supra* note 97, at 90–92.

¹⁰¹ *Id.* at 92; McCoid, *supra* note 15, at 206. William C. Oates of Alabama said: “This bill is intended not as a machine for the speedy collection of debts, but as an instrumentality on the one hand to relieve poor debtors from the

[A] person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed or removed, with intent to defraud, hinder or delay his creditors, shall not, at a fair valuation, be sufficient in amount to pay his debts.¹⁰²

Finally, in the 55th Congress, the Torrey Bill passed the House and a substitute bill, introduced by Senator Knute Nelson of Minnesota, passed the Senate. Ultimately, the legislation would become known as the Nelson Act. The heartland states had won not only a favorable definition of insolvency, but also a prohibition on involuntary petitions against “a wage-earner or a person engaged chiefly in farming or the tillage of the soil” — double protection for their constituents.¹⁰³

Importantly, though, the Nelson Act used balance-sheet insolvency only as an element of some of the acts of bankruptcy, specifically preferential transfers.¹⁰⁴ The balance-sheet test thus entered federal bankruptcy law not to broaden access for debtors in voluntary cases, but to narrow access to creditors in involuntary cases.¹⁰⁵

burdens that would otherwise weigh them down, and on the other hand to furnish to creditors the means of reaching the property of the debtor and making an equitable distribution among honest creditors, in cases where the debtor is a rascal and is undertaking to conceal his property . . . or where the debtor is in fact insolvent. The definition of insolvency in this bill now differs from that of the Court.” Warren, *supra* note 14, at 137–38 (quoting Cong. Rec., 53d Cong., 1st Sess. 2780 (October 23, 1893)).

¹⁰² Act of July 1, 1898, 30 Stat. 544, ch. 541, § 1.

¹⁰³ *Id.*, 30 Stat. 547, ch. 541, § 4(b); see also *The National Bankruptcy Act*, 12 HARV. L. REV. 272 (1898) (characterizing this provision as the “most objectionable feature of the law” as “creat[ing] privileges in special classes”).

¹⁰⁴ Act of 1898, ch. III, § 3.

¹⁰⁵ This effect was moderated somewhat by the Supreme Court’s decision in *George M West Co. v. Lea*, 174 U.S. 590 (1899). One reading of the Nelson Act suggested that insolvency was a freestanding element of an involuntary petition, apart from the specific acts of bankruptcy of which it was an element. If that were right, debtors could defend against involuntary petitions by proving that they were balance-sheet solvent, even though two of the acts of bankruptcy, intentional fraudulent transfers and making a general assignment for the benefit of creditors, did not require the debtor to be insolvent. Officials Forms 3, 6, and 7 seemed to support that reading. But in *George M West Co. v. Lea*, the Supreme Court took a nuanced view of the statute and determined that

For voluntary cases, cashflow insolvency was still the gateway to bankruptcy relief under the Nelson Act. Confusingly, the Act appeared to remove the requirement that a voluntary debtor swear an inability to meet debts as they came due, a requirement that had featured prominently in the 1841 and 1867 Acts.¹⁰⁶ In its eligibility provision, it said, simply, that “Any person who owes debts, except a corporation, shall be entitled to the benefits of this Act as a voluntary bankrupt.”¹⁰⁷ William Collier, in the third edition of his *Collier on Bankruptcy*, said this:

The present act does not in express terms require that the person shall be insolvent, or unable to pay all his debts in full, as did the act of 1867; and there seems to be no reason why, if a solvent person cares to have his property distributed among his creditors in bankruptcy, he should not be allowed to do so. It will not be necessary to allege insolvency in the petition, nor to prove it, to procure an adjudication.¹⁰⁸

Collier’s analysis was more aspirational than technically correct. The Nelson Act still required a judge to hear a voluntary petition and “make the adjudication or dismiss the petition,”¹⁰⁹ and the fifth and final Act of Bankruptcy under the Act was when a person had “admitted in writing his inability to pay his debts and his willingness to be adjudged a bankrupt on that ground.”¹¹⁰ Put together, those two provisions preserved the requirement of cashflow insolvency for voluntary relief, and the Supreme Court implemented that requirement in the Official Forms.¹¹¹

insolvency was not a defense to involuntary petitions based upon intentional fraudulent transfers or general assignments. *Id.* at 599. In doing so, the Court also affirmed a longstanding principle that even its own official forms cannot override the text of the law. *Id.* at 599 (“These rules were but intended to execute the act, and not to add to its provisions by making that which the statute treats in some cases as immaterial a material fact in every case”).

¹⁰⁶ See *supra* Part III.B. and III.C.

¹⁰⁷ Act of 1898, Sec. 4(a).

¹⁰⁸ WILLIAM COLLIER, COLLIER ON BANKRUPTCY 46 (3d ed.) (quoted in *In re Chapell*, 133 F. 545 (E.D. Va. 1901).

¹⁰⁹ Act of 1898, ch. IV, § 18(g).

¹¹⁰ Act of 1898, ch. III, § 3(a)(5).

¹¹¹ The official form of the voluntary petition included an averment that the debtor “owes debts which he is unable to pay in full.” Form Nos. 1 and 2, General Orders and Forms in Bankruptcy, Adopted and Established by the Supreme

Still, American bankruptcy law was shifting slowly away from its roots in acts of bankruptcy and cashflow insolvency. Despite persistent evidentiary challenges with the test,¹¹² balance-sheet insolvency had entered bankruptcy law to stay.

B. Unreasonably Small Assets Enters the Scene

Balance-sheet insolvency was not the only such innovation of this era. During the mid-nineteenth to the early twentieth century, a third definition of insolvency began to emerge, not in federal bankruptcy law but in the state law of voidable transfers: the unreasonably small capital or unreasonably small assets (“USA”) test.

Under either label, the USA test signifies “financial difficulties which are short of equitable or bankruptcy insolvency.”¹¹³ This definition allowed creditors to unwind transactions made on unfair terms when the transactions left a debtor with unreasonably small assets to pursue their go-forward business. *Carpenter v. Roe*,¹¹⁴

Court of the United States (Nov. 28, 1898). Plank averts to the official forms as maintaining the cashflow insolvency requirement, as did a few courts at the time. See Plank, *supra* note 16, at 546–47; *In re Carleton*, 115 F. 246, 249–50 (D. Mass. 1902). But the stronger form of the argument is not that the Supreme Court maintained an insolvency test through the official forms alone. After all, the Supreme Court had just ruled in *George M West Co v. Lea* that official forms could not contravene the plain language of the statute. Instead, the statutory text does that work, and the official forms confirm it. This argument also outlasts the Supreme Court’s quiet deletion of the insolvency requirement from the official forms in 1939.

¹¹² Professor McCoid recounts some of these challenges in his survey on involuntary bankruptcy. See McCoid, *supra* note 15, at 209. The Committee on Commercial Law of the American Bar Association thought the test was “practically embarrassing in matter of proof” and too debtor-friendly to boot. See 31 AMERICAN BAR ASSOCIATION REPORTS 601–02 (1907). Professors Bonbright and Pickett pilloried the test in a law review article that focused on both conceptual and evidentiary problems. See James C. Bonbright & Charles Pickett, *Valuation to Determine Solvency under the Bankruptcy Act*, 29 COLUM. L. REV. 582, 621–22 (1929).

¹¹³ James F. Queenan Jr., *The Collapsed Leveraged Buyout and the Trustee in Bankruptcy*, 11 CARDOZO L. REV. 1, 18 (1989).

¹¹⁴ 11 N.Y. 227, 232 (N.Y. 1851) (“To avoid the conveyance and trust to and in favor of his wife, it was not necessary that the debtor should be insolvent, or believe himself to be so ... It was sufficient that he was indebted, and that insolvency would be the inevitable or probable result of want of success in the business in which he was engaged.”).

Potter v. McDowell,¹¹⁵ and *Kehr v. Smith*¹¹⁶ were early USA cases in the mid-nineteenth century,¹¹⁷ but the idea took the national stage in 1918 when the Uniform Fraudulent Conveyance Act (the “UFCA”) adopted it alongside cashflow and balance-sheet insolvency as an element of voidable transactions.¹¹⁸

Using USA as the test for insolvency is the most forward-looking of the three tests. A business might be left with unreasonably small assets long before it became balance-sheet insolvent and long before it became unable to pay its debts as they came due. Courts, both then and now, struggle with the time horizon of USA bankruptcy. If balance-sheet insolvency created evidentiary issues, USA bankruptcy was arguably even worse, requiring courts to size up the sufficiency of a business’s assets several years into the future. Cashflow insolvency asked if the debtor was currently paying its debts as they came due; balance-sheet insolvency asked whether liabilities outweighed assets, at a fair valuation and discounted to present value. USA insolvency asked whether the debtor could carry on its business with the assets it had, and courts wondered how far into the future they should look, with most courts landing between one to three years.

¹¹⁵ *Potter v. McDowell*, 31 Mo. 62, 72–73 (Mo. 1860) (“If a debtor is in embarrassed circumstances, and makes a voluntary conveyance, and is afterwards unable to meet his debts owing at the time of the assignment in the ordinary course prescribed by law for their collection, or is reduced to that situation that an execution against him would be unavailing, such conveyance is void as to those debts, and the property conveyed is subject to their payment. We do not deem it necessary to define insolvency.”) (enslaved person at issue); see also Justin L. Simard, *Citing Slavery*, 72 STAN. L. REV. 79 (2020).

¹¹⁶ *Kehr v. Smith*, 87 U.S. 31 (1873) (“Nor can [the transfer] be supported on the theory that the whole estate was worth a few thousand dollars more. Suppose it was, there would still be that extent of embarrassment, which would have a direct tendency to impair the rights of creditors.”).

¹¹⁷ Lee B. Shepard, Note, *Beyond Moody: A Re-Examination of Unreasonably Small Capital*, 57 U.C. L.J. 891, 899–901 (2006).

¹¹⁸ *Id.* at 898–99 & n.51. The UFCA used a balance-sheet definition of insolvency. See UFCA § 2 (“A person is insolvent when the present fair salable value of his assets is less than the amount that will be required to pay his probable liability on his existing debts as they become absolute and matured.”). But it also deemed transactions without fair consideration to be fraudulent if they left the debtor USA insolvent. See UFCA § 5 (“Every conveyance made without fair consideration when the person making it is engaged or is about to engage in a business or transaction for which the property remaining in his hands after the conveyance is an unreasonably small capital, is fraudulent.”).

American commercial lawyers had decided that the long-term stability of businesses was important enough to empower creditors to unwind fraudulent or preferential transfers that left a debtor not just cashflow insolvent or balance-sheet insolvent, but USA insolvent. It triggered early warning systems when the corporate treasury began to tip past the point of no return. USA insolvency was not part of federal bankruptcy law. That came later.

III. THE AMERICANS INVENT BUSINESS REORGANIZATION

We have seen that it was the new, voluntary form of bankruptcy that carried cashflow insolvency into federal law,¹¹⁹ and it was heartland concerns over involuntary bankruptcy that provoked Congress to bring balance-sheet insolvency into the nation's first permanent bankruptcy statute to protect farmers from involuntary petitions.¹²⁰ The battlefield for the third development in insolvency definitions was a new, and distinctly American innovation: business reorganization.

In a liquidation case, the debtor surrenders all its assets to its creditors. This kept the pressure off solvency fights in bankruptcy court. True, debtors had to swear that they were cashflow insolvent, but “the law takes him at his word,” as a federal judge said in 1867.¹²¹ William Collier went further, arguing that the Nelson Act did not require debtors to allege insolvency at all.¹²² As

¹¹⁹ *See supra* Part I.

¹²⁰ *See supra* Part II.

¹²¹ *In re Fowler*, 9 F. Cas. 614 (D. Mass. 1867); *see also Ex parte Hull*, 12 F. Cas. 853, 856 (S.D.N.Y. 1842) (observing that “the court has no authority to institute or entertain an inquiry into the fact of insolvency, for it is compelled to declare a petitioner bankrupt on his own sworn representation of his inability to pay his debts, or on that of his creditors if he has done any act indicated by the statutes, and owes \$2,000, whatever may be his real wealth and responsibility”); *Hanover Nat. Bank v. Moyses*, 186 U.S. 181, 190–91 (1902) (noting that the filing of a sworn petition “establishes those facts so far as a decree of bankruptcy is concerned” and that “[t]hese are not issuable facts, and notice is unnecessary, unless dismissal is sought, when notice is required”); *In re Patterson*, 18 F. Cas. 1315, 1318 (S.D.N.Y. 1867) (noting that the filing of the petition is an act of bankruptcy and that the debtor “has a right to be adjudged a bankrupt immediately upon the filing of the petition”).

¹²² COLLIER, *supra* note 108 (quoted in *In re Chapell*, 133 F. 545 (E.D. Va. 1901).

noted above,¹²³ Collier was incorrect on this point, but he was on to a deeper, more pragmatic truth.¹²⁴ Under the Nelson Act, the only voluntary cases were individual liquidations, and if an individual wanted to turn all their assets over to creditors, why would creditors want to stand in the way? That premise eroded when reorganization entered the scene, and it did so first with railroads.

To be fair, the reorganization had some precedent in the composition. A composition was a collective agreement at common law, between a debtor and multiple creditors, to settle a debt for less than the nominal amount.¹²⁵ Composition entered federal bankruptcy law in 1874, when Congress amended the 1867 Act to allow a judge to enforce a composition accepted by a majority in number and three-fourths in value of the creditors.¹²⁶ The composition could therefore impose a cents-on-the-dollar resolution and bind holdouts, but because a court only had jurisdiction to enforce the composition when a bankruptcy case was pending, the procedure was regulated by the same acts of bankruptcy and insolvency provisions that served as the gateway to bankruptcy court under the 1867 Act. Since 1910, business corporations could access bankruptcy law for liquidations and compositions.¹²⁷

¹²³ See *supra* notes 109–111 and accompanying text.

¹²⁴ Collier had his pulse on the practical realities behind bankruptcy law: he was a New York lawyer who would go on to serve as an attorney in the Department of Commerce and Labor, President of George Washington University, and U.S. ambassador to Spain and Chile.

¹²⁵ See, e.g., ELIZABETH LEE THOMPSON, *THE RECONSTRUCTION OF SOUTHERN DEBTORS: BANKRUPTCY AFTER THE CIVIL WAR* 102–03 & 127–28 (2004).

¹²⁶ See 43 Cong. Ch. 390, June 22, 1874, 18 Stat. 178, § 17. Whether the composition fit within the Bankruptcy Power was first addressed by Justice Samuel Blatchford of New York, an expert on admiralty and patent law, in *In re Reiman*, 20 F. Cas. 490, 496, 497 (S.D.N.Y. 1874), when he sat on the Southern District of New York. Justice Blatchford's opinion was cited favorably, after his death, by Chief Justice Melville Fuller, who had served with Blatchford for a decade on the Court. See *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 187 (1902)). By 1935, the Court said, "[t]he constitutionality of the old provision for a composition is not open to doubt." *Continental Ill. Nat. Bank & Tr. Co. v. Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648, 672 (1935).

¹²⁷ Act of June 25, 1910, 36 Stat. 839, § 4 (1910).

A. Railroad Reorganizations

As numerous bankruptcy historians have recounted,¹²⁸ the American railroad industry provided a natural context for the development of reorganization bankruptcies. Once track had been laid, the railway had go-forward value, no matter how much unpaid debt was hanging over the company. Ripping up the track and selling it for scrap metal made much less sense than finding some procedural mechanism to gather the creditors together and reach a plan that repaid the creditors from the go-forward value of the company.

The equitable receivership had long provided such a mechanism.¹²⁹ Creditors could ask a court to appoint a receiver over a company that was failing to pay its debts, and the receiver did not need to liquidate the company. Instead, the receiver could sell the company as a going concern (usually to a syndicate composed of some of the old lenders), using the proceeds to pay off the debt for cents on the dollar. During the process, the receiver would be protected since suits could not be brought against receivers without the approval of the appointing court.¹³⁰ Technically, only creditors could ask a court to appoint a receiver over a company,¹³¹ but clever commercial lawyers realized that the debtor could solicit a friendly creditor or two to bring the case on its behalf.¹³² The debtor would decline to object to the motion, and the case would be lodged in court.¹³³

The appointment of a receiver — an equitable remedy — had long required the petitioners to allege serious misconduct or financial distress. For involuntary receivership cases, both cashflow and balance-sheet insolvency came to serve as gateway mechanisms,¹³⁴ just as the acts of bankruptcy did in federal court.

¹²⁸ See, e.g., David Skeel, *Railroad Receivership and the Elite Reorganization Bar*, in DAVID A. SKEEL, *DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA* 48-70 (2001); Steven J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 CORNELL L. REV. 1420 (2004).

¹²⁹ Lubben places the beginning of railroad receiverships before the Civil War. See Lubben, *supra* note 14, at 379 (citing cases).

¹³⁰ *Id.* at 381; *Davis v. Gray*, 83 U.S. (16 Wall.) 203, 218 (1872).

¹³¹ See, e.g., Skeel, *supra* note 14.

¹³² *Id.*

¹³³ *Id.*

¹³⁴ McCoid, *supra* note 15, at 210.

For example, in the 1931 case of the National Radiator Corporation, a federal district court appointed receivers and approved a plan selling the company. A subset of the creditors protested, arguing that the company had not been insolvent when it filed, but the district court and the Third Circuit approved of the plan. Three years later, in *First National Bank of Cincinnati v. Flershem*,¹³⁵ the Supreme Court rebuked the lower courts for allowing a solvent company to seek relief, in an opinion written by Justice Brandeis:

Insolvency was not present or imminent. The debentures were not to mature until 1947. Insolvency even in the remote future was not certain. This company defaulted when it was both solvent and liquid. It defaulted, although it had cash in bank equal to three and a half times its total current liabilities, including [the interest owing on the debentures]. It defaulted, although the amount of the cash on hand was so large that, even if the interest had been paid, the surplus of cash remaining would have been more than was then required for working capital.¹³⁶

“[T]he suit is clearly without equity,” concluded Brandeis. “The court’s power was invoked for a purpose for which it may not be exercised.”¹³⁷

Nor did the company’s later insolvency fix the threshold problem.¹³⁸ After all, companies placed into receivership tend to drop in value merely by virtue of the proceeding. What mattered was whether the company was facing sufficient financial distress at the commencement of the case.¹³⁹ In the reverse situation, when a company was insolvent at the commencement of the case and then became solvent afterward, courts were not required to dismiss

¹³⁵ 290 U.S. 504 (1934).

¹³⁶ *Id.* at 516–17, 519.

¹³⁷ *Id.* at 515.

¹³⁸ *Id.* at 519 (“The lack of equity in the bill when filed is not cured by the insolvency later occurring” [*sic*]).

¹³⁹ That said, the remedy for an error here was complicated. In *Flershem*, it would have been impossible to unwind the plan and put all the creditors back in the *status quo ante*. The Supreme Court did not direct the lower court to vacate the order confirming the plan and dismiss the receivership case. Instead, it concluded that the creditors who raised the equity argument should be repaid in full, while others who complained about the sale price should be repaid the pro rata amount that they would have received had the receiver conducted the sale properly. *See id.* at 520–30.

the case immediately but could maintain oversight of the receivership until equity had been done.¹⁴⁰ That idea was the basis for what came to be known as the “solvent debtor exception” or the “solvent debtor rule,” a series of equitable adjustments that ensured creditors were treated fairly when the debtor became solvent during the case.¹⁴¹

B. Reorganization Bankruptcies

In 1933, the day before Franklin Delano Roosevelt was sworn in, Congress passed and Herbert Hoover signed the Railroad Reorganization Act (the “RRA”).¹⁴² The RRA amended the Nelson Act to allow individuals, farmers, and railroads to pursue compositions, extensions, and reorganizations in bankruptcy court. In each case, the RRA required the debtor to claim cashflow or balance-sheet insolvency.¹⁴³ The statute also required the court to ensure that the case had been filed in good faith.¹⁴⁴

The New Dealers tried to create a way for municipalities to file

¹⁴⁰ See, e.g., *Bailey v. Proctor*, 160 F.2d 78 (1st Cir. 1947).

¹⁴¹ For a discussion of the solvent debtor exception, see Christopher D. Hampson, *Bankruptcy Abstention*, B.U. L. REV. (forthcoming 2026) (manuscript at 15); *Ultra Petroleum Corp. v. Ad Hoc Comm. of Opco Unsecured Creditors (In re Ultra Petroleum Corp.)* 51 F.4th 138, 150–52 (5th Cir. 2022) (concluding that Congress legislated against the backdrop of the solvent debtor exception).

¹⁴² Railroad Reorganization Act, Mar. 3, 1933, ch. 204, 47 Stat. 1470; see also Josiah M. Daniel III, *Determining the Historiographical Problem of Municipal Bankruptcy: Enactment and Amendment of Chapter IX, 1933–1979* (manuscript at 30). Congress would continue to amend the RRA throughout the 1930s (and beyond), in ways that do not impinge upon the subject of this Article. See, e.g., Act of Aug. 27, 1935, ch. 774, 49 Stat. 911 (amending the 1898 Act); Act of June 26, 1936, ch. 833, 49 Stat. 1969 (amending the 1898 Act).

¹⁴³ Under Section 74, eligible persons wishing the bankruptcy court to approve a common law composition or extension needed to file a petition or answer “stating that he is insolvent or unable to meet his debts as they mature, and that he desires to effect a composition or an extension of time to pay his debts.” Chapter VIII, § 74. Under Section 75, farmers could seek a composition or extension so long as they filed a petition stating that “the farmer is insolvent or unable to meet his debts as they mature.” Chapter VIII, § 76. Similarly, railroad corporations under section 77(a) had to “file a petition stating that the railroad corporation is insolvent or unable to meet its debts as they mature and that it desires to effect a plan of reorganization.” Chapter VIII, § 77(a).

¹⁴⁴ §§ 74(a); 75(i); 77(a).

for bankruptcy too, in the Municipal Bankruptcy Act of 1934,¹⁴⁵ but the Supreme Court — led by the “Four Horsemen” — struck it down in 1936 as violating state sovereignty.¹⁴⁶ Alongside other Supreme Court decisions, *Ashton* provoked Roosevelt’s court-packing threat in 1937.¹⁴⁷ The New Dealers tried again in 1937,¹⁴⁸ having made minor to *de minimis* changes,¹⁴⁹ and this time the

¹⁴⁵ Act of May 24, 1934, ch. 345, 49 Stat. 798. Congress amended the Municipal Bankruptcy Act in 1937 to add compositions. *See* Act of Aug. 16, 1937, ch. 657, 50 Stat. 653.

¹⁴⁶ *Ashton v. Cameron Cnty Water Imp. Dist. No. 1*, 298 U.S. 513 (1936). The constitutional dispute had nothing to do with insolvency, although whether the water district was insolvent or not was hotly litigated. *See id.* at 523–24 (noting that the water district claimed to be both cashflow and balance-sheet insolvent and that a minority of the bondholders argued that it wasn’t insolvent at all). Instead, the question was whether the Bankruptcy Power authorized Congress to impede on state sovereignty without its consent. Justice Cardozo, in dissent, underscored the challenges faced by thousands of public corporations across the country during the Great Depression, pointing out that the mix of public and private debt left many municipalities and taxing districts without any practical solution. “The plight of the debtors was bad enough,” said Cardozo, “that of the creditors was even worse.” *Id.* at 534 (Cardozo, J., dissenting). When municipalities defaulted on their bonds, courts could not order execution against public property, and writs of mandamus ordering municipal officers to “tax and tax again,” *id.*, were remedies on shaky legal ground. *See, e.g.,* *Rees v. City of Watertown*, 86 U.S. 107, 120 (1873) (affirming dismissal of a writ of mandamus that sought execution against property disallowed by the debtor’s charter); *Meriwether v. Garrett*, 102 U.S. 472 (1880) (reversing with instructions to dismiss writs of mandamus on similar rationale); *see also* Jeff. B. Fordham, *Methods of Enforcing Satisfaction of Obligations of Public Corporations*, 33 COLUM. L. REV. 28, 29 (1933) (“[P]roperty of a public corporation presently devoted to a public use and appropriate to that end is free from execution.”).

¹⁴⁷ *See* Daniel, *supra* note 142 (manuscript at 20). Texas Congressman Sumners responded to the rejection of his municipal bankruptcy bill by proposing and passing two laws, one that would incentivize voluntary retirements and a second that would give the government standing to defend laws against challenges to their constitutionality in federal court. *Id.*; *see also* Josiah M. Daniel, III, “*What I Said Was ‘Here Is Where I Cash In’*”: the Instrumental Role of Congressman Hatton Sumners in the Resolution of the 1937 Court-Packing Crisis, 54 UIC J. MARSHALL L. REV. 379, 384–93 (2021).

¹⁴⁸ Act of Aug. 24, 1937, ch. 74, 50 Stat. 751, then codified at 11 U.S.C. § 401 *et seq.* The second attempt was filed just days after *West Coast Hotel v. Parrish*, 300 U.S. 379 (1937). For a fulsome discussion of the history of municipal bankruptcy, including the role of Texas Congressman Hatton W. Sumners, *see* Daniel, *supra* note 142 (manuscript at 5–6).

¹⁴⁹ *See, e.g.,* KENNETH N. KLEE, BANKRUPTCY AT THE SUPREME COURT 152

Supreme Court allowed it.¹⁵⁰ Under both of these attempts, the statute required a municipality or political subdivision to claim either cashflow or balance-sheet insolvency.¹⁵¹

Notice the shift from the 1898 Act. The statutory definition of balance-sheet insolvency, prior to 1933, had been used only as an element of acts of bankruptcy. To access bankruptcy court, voluntary debtors still had to admit, in writing, cashflow insolvency. Now, for the first time, debtors could claim balance-sheet insolvency to enter bankruptcy court — and not only to seek liquidation relief. They could claim balance-sheet insolvency to seek reorganization relief.

In 1935, the Supreme Court upheld plans of reorganizations as consistent with the Bankruptcy Power in *Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island & Pacific Railway Company*.¹⁵² The change in the gating mechanism for voluntary bankruptcy barely attracted its notice.¹⁵³ “Obviously,” Justice Sutherland opined for the Court, “section 77 does no more than follow the line of historical and progressive development projected by previous acts.”¹⁵⁴

In 1938, Congress replaced the Nelson Act with the Chandler Act.¹⁵⁵ The chief thrust of the legislation was not insolvency

(2008); David A. Skeel, Jr., *States of Bankruptcy*, 79 U. CHI. L. REV. 677, 788 (2012).

¹⁵⁰ *United States v. Bekins*, 304 U.S. 27, 51 (1938) (“The statute is carefully drawn so as not to impinge upon the sovereignty of the State. The State retains control of its fiscal affairs. The bankruptcy power is exercised in relation to a matter normally within its province and only in a case where the action of the taxing authority in carrying out a plan of composition approved by the bankruptcy court is authorized by state law.”). Here, too, the “petition alleged insolvency.” *Id.* at 46.

¹⁵¹ May 24, 1934, ch. 345, 49 Stat. 798, chapter IX, § 80 (requiring such entities, referred to as “taxing districts” to “file a petition stating that the taxing district is insolvent or unable to meet its debts as they mature”).

¹⁵² *Continental Illinois Nat. Bank & Trust Co. v. Chicago, R.I. & P. Ry. Co.*, 294 U.S. 648 (1935) [hereinafter *Continental Illinois*].

¹⁵³ *Id.* at 672 (noting that Congress wanted section 77 to “extend to cases where the corporation is ‘unable to meet its debts as they mature’ and noting that balance-sheet insolvency “may be construed to include a debtor who, although unable to pay promptly, may be able to pay if time to do so be sufficiently extended”).

¹⁵⁴ *Id.*

¹⁵⁵ In designing the Chandler Act, Congress was advised by a loose group of

definitions; it was the concern that corrupt “bankruptcy rings” had taken over the restructuring process. The New Dealers created an assertive role for the relatively new Securities and Exchange Commission (“SEC”), which would form protective and reorganization committees that would actively monitor the case.

As for insolvency, the Chandler Act kept the balance-sheet definition from the Nelson Act, with only minor adjustments.¹⁵⁶ The last act of bankruptcy was, as in the Nelson Act, “admitting in writing his inability to pay his debts and his willingness to be adjudged a bankrupt.”¹⁵⁷ As in the Nelson Act, debtors who wanted to challenge an involuntary case had the right to a jury trial on the question of his insolvency or any alleged act of bankruptcy.¹⁵⁸

The Act also introduced a structure familiar to today’s bankruptcy practitioners: several initial chapters governing definitions, courts, debtors, procedure, officers, creditors, and the estate, followed by four specific chapters for certain debtors or forms of relief: chapter X for corporate reorganizations, chapter XI for arrangements, chapter XII for real property arrangements, and chapter XIII for wage earners’ plans. Under any of these chapters, a debtor that wished to seek relief needed to declare either cashflow or balance-sheet insolvency.¹⁵⁹

leading bankruptcy scholars and practitioners that would eventually become the National Bankruptcy Conference (“NBC”).

¹⁵⁶ See Chandler Act, ch. 1, § 1(19) (“A person shall be deemed insolvent within the provisions of this Act whenever the aggregate of his property, exclusive of any property which he may have conveyed, transferred, concealed, removed, or permitted to be concealed or removed, with intent to defraud, hinder, or delay his creditors, shall not at a fair valuation be sufficient in amount to pay his debts”).

¹⁵⁷ *Id.*, ch. 3, § 3(a)(5). A partnership could file for bankruptcy with fewer than all of the general partners supporting it, so long as the petition alleged that the partnership was insolvent. *Id.*, ch. 3, § 5(b).

¹⁵⁸ See *id.*, ch. IV, § 19.

¹⁵⁹ See *id.*, § 77(a); ch. X, § 130(1) (“Every petition shall state — (1) that the corporation is insolvent or unable to pay its debts as they mature”; *id.*, ch. XI, § 323 (“A petition filed under this chapter shall state that the debtor is insolvent or unable to pay his debts as they mature, and shall set forth the provisions of the arrangement proposed by him.”); *id.*, ch. XII, § 423 (same as chapter XI); *id.*, ch. XIII, § 623 (“A petition filed under this chapter shall state that the debtor is insolvent or unable to pay his debts as they mature and that he desires to effect a composition or an extension, or both, out of his future earnings or wages.”). Kennedy points out that the procedural rules did not allow for creditors to file

The Chandler Act also brought USA insolvency into the federal regime for the first time — not as a gateway mechanism, but as a fourth way to prove that a prepetition transfer was fraudulent. Under the Chandler Act, transfers and obligations incurred within a year of the filing of the petition were fraudulent if they were made with “actual intent ... to hinder, delay, or defraud either existing or future creditors,”¹⁶⁰ or if they were made “without fair consideration” and left the debtor insolvent, either on a cashflow, balance-sheet, or USA basis.¹⁶¹

After the Chandler Act, then, the basic framework of American bankruptcy law had reached a new equilibrium. Reorganization was a new form of federal relief, greenlit by the Supreme Court in *Continental Illinois*.¹⁶² To pursue such a reorganization, a debtor needed to file a petition declaring either cashflow or balance-sheet insolvency. The New Dealers had successfully pushed the outer boundaries of bankruptcy practice far beyond what Congress — or the Court — would have accepted just forty years earlier. But the Supreme Court gave no indication that it saw a problem.

Bankruptcy is the “subject of the relations between an insolvent or nonpaying or fraudulent debtor and his creditors, extending to his and their relief,” the Court said in *Wright v. Union Central Life Insurance Co.* in 1938, quoting a district court opinion from years earlier.¹⁶³ *Union Central* was the broadest articulation of the Bankruptcy Power that the Court had ever endorsed, and it became the high-water mark for the scope of the clause. Forty years later, Congress tried to expand the scope of federal bankruptcy practice even wider, in the Bankruptcy Reform Act of 1978.

answers to petitions, except under sections 77, 137, and chapter X. See Frank R. Kennedy, *The Commencement of a Case Under the New Bankruptcy Code*, 36 WASH. & LEE L. REV. 977, 982 & n. 30 (1979).

¹⁶⁰ Chandler Act, ch. VII, § 67(5)(d)(2)(d).

¹⁶¹ See *id.*, § 67(5)(d)(2)(a)–(c). Balance-sheet insolvency, for these purposes, had a slightly different definition: “when the present fair salable value of his property is less than the amount required to pay his debts.” *Id.* at §(d)(1)(d).

¹⁶² See *Continental Illinois*, 294 U.S. 648 671 (1935) (noting that Congress had progressively extended the reach of federal bankruptcy law, “demonstrate[ing] 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”).

¹⁶³ *Wright v. Union Cent. Life Ins. Co.*, 304 U.S. 502 (1938) (quoting *In re Reiman*, 20 F. Cas. 490 (No. 11,673) (S.D.N.Y. 1874)).

IV. THE BANKRUPTCY COURTROOM DOORS THROW OPEN

In 1978, after years of sustained study from the Commission on the Bankruptcy Laws of the United States (the “Commission”),¹⁶⁴ Congress passed another comprehensive reworking of federal bankruptcy law, the Bankruptcy Reform Act of 1978.¹⁶⁵ The Reform Act established the Bankruptcy Code (or just “the Code”) and is, as amended, the legal framework still in force today. Among the Reform Act’s innovations were an automatic stay that paused debt collection activities against the debtor immediately upon the filing of the petition,¹⁶⁶ allowing old management to run operations during the case (the debtor-in-possession or “DIP” model),¹⁶⁷ eliminating the role of the SEC in most cases,¹⁶⁸ and creating the new role of bankruptcy judge, an Article I adjudicator that would preside over bankruptcy cases.¹⁶⁹ These innovations, in the aggregate, would give business debtors far greater control over the trajectory of their cases.

The Rehnquist Court paid the most attention to the new bankruptcy judges and issued a series of separation-of-powers cases that required Congress to rethink the statutory design.¹⁷⁰ It

¹⁶⁴ In 1980, Congress established the Commission on the Bankruptcy Laws of the United States, due in significant part to the dramatic increase in the number of bankruptcy filings over the previous twenty years. *See* Act of July 24, 1970 (amended 1973), Pub. L. No. 91-354, 84 Stat. 468; Kennedy, *supra* note 159, at 977–78 & n.1.

¹⁶⁵ Pub. L. 95-598, 92 Stat. 2549.

¹⁶⁶ 11 U.S.C. § 362.

¹⁶⁷ *Id.* § 1107.

¹⁶⁸ *See, e.g.*, David A. Skeel, Jr., *Welcome Back, SEC?*, 18 ABI L. REV. 573 (2010).

¹⁶⁹ *See, e.g.*, Frank R. Kennedy, *The Bankruptcy Court Under the New Bankruptcy Law: Its Structure, Jurisdiction, Venue, and Procedure*, 11 ST. MARY’S L.J. 251 (1979).

¹⁷⁰ In *Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 36 (1989), the Court held that the Seventh Amendment right to a jury trial extends into appropriate proceedings in bankruptcy court. *Stern v. Marshall*, 564 U.S. 462, 478 (2011), required Article III judges to render final judgment on certain common law claims.

did not feel the need to weigh in on changes to the insolvency definitions, but — as we will see — those changes were significant.

A. Insolvency Yields to Good Faith

The Commission believed that business debtors waited too long to file, reducing the value available for distribution to creditors.¹⁷¹ Accordingly, the 1978 Code dramatically changed the way federal law used insolvency to gatekeep bankruptcy cases.

For involuntary cases, Congress abolished the acts of bankruptcy approach, ending a tradition tracing back to 1542.¹⁷² Instead, Congress would use a modified cashflow insolvency test. Unless the debtor acquiesced in the bankruptcy, petitioning creditors in an involuntary case would have to show either that the debtor was “generally not paying such debtor’s debts as such debts become due” or that a receiver or similar custodian had recently been appointed (an event that had been an act of bankruptcy).¹⁷³ Note that the focus of the analysis is on the debtor’s conduct and thus encompasses both failure to pay and inability to pay.¹⁷⁴ If the debtor challenged the involuntary petition, the bankruptcy judge would decide the matter without a jury.¹⁷⁵ But the Commission indicated that focusing on the debtor’s nonpayment would be easier

¹⁷¹ See Kennedy, *supra* note 169, at 979.

¹⁷² See *supra* note 42 and accompanying text. Numerous scholars had called for the abolition of the acts of bankruptcy as a medieval concept ill-suited to a modern statute. See Treiman, *Acts of Bankruptcy: A Medieval Concept in Modern Bankruptcy Law*, 52 HARV. L. REV. 189 (1938); J. MACLACHLAN, *BANKRUPTCY* 56–64 (1956); Herzog, *Bankruptcy Tomorrow*, 45 AM. BANKR. L.J. 57, 59 (1971); Seligson, *Major Problems for Consideration by the Commission on the Bankruptcy Laws of the United States*, 45 AM. BANK. L.J. 73, 98–100 (1971); Note, “*Acts of Bankruptcy*” in *Perspective*, 67 HARV. L. REV. 503 (1954).

¹⁷³ *Id.* (codified at 11 U.S.C. § 303(h)). Congress would later amend this provision to add “unless such debts are the subject of a bona fide dispute as to liability or amount,” largely eviscerating the provision, since a bona fide dispute is, for clever lawyers, easy to find or manufacture. See 11 U.S.C. § 303(h).

¹⁷⁴ See Kennedy, *supra* note 159, at 1009–10.

¹⁷⁵ See *id.* at 979.

to demonstrate than either acts of bankruptcy or balance-sheet insolvency.¹⁷⁶

Insolvency still featured in the Code's fraudulent transfer and preferential transfer provisions,¹⁷⁷ as it did under the Chandler Act, but these voidable transfers were no longer "acts of bankruptcy," just causes of action that the debtor-in-possession, a trustee, or a statutory committee could bring once the case had been commenced. The types of insolvency required under the Code's clawback actions included cashflow insolvency, balance-sheet insolvency, or USA insolvency.¹⁷⁸

For voluntary cases, the Code removed all the provisions (formerly in sections 77(a), 84, 130(1), 323, 423, and 623) that required debtors to affirm that they were cashflow or balance-sheet insolvent to access reorganization relief.¹⁷⁹ "Neither insolvency nor inability to pay debts nor even the fact that the debtor is indebted in any amount is required to be alleged or proved," noted Professor Frank Kennedy.¹⁸⁰ The Code represented a "liberalization of access by individuals, partnerships, and corporations to the bankruptcy

¹⁷⁶ See COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. NO. 137, 93d Cong., 1st Sess, pt. 1, at 188 (1973) [hereinafter COMMISSION REPORT I]; MACLACHLAN, *supra* note 172, at 55 ("The commercial world has little time or inclination to argue about valuations shown on a balance sheet and, in most instances, the sort of evidence that is adduced upon the trial of an issue of insolvency when the debtor resists adjudication in bankruptcy is not available").

¹⁷⁷ Pub. L. 95-598, 92 Stat. 2549 (codified at 11 U.S.C. § 101(26)) (defining *insolvent* to mean "financial condition such that the sum of such entity's debts is greater than all of such entity's property, at a fair valuation, exclusive of — (i) property transferred, concealed, or removed with intent to hinder, delay, or defraud such entity's creditors").

¹⁷⁸ 11 U.S.C. § 548.

¹⁷⁹ See Pub. L. 95-598, 92 Stat. 2549 (codified at 11 U.S.C. § 301 ("A voluntary case under a chapter of this title is commenced by the filing with the bankruptcy court of a petition under such chapter by an entity that may be a debtor under such chapter. The commencement of a voluntary case under a chapter of this title constitutes an order for relief under such chapter."); see also *In re Johns-Manville Corp.*, 36 B.R. 727, 732 (Bankr. S.D.N.Y. 1984) (noting that no provision in the Code "relating to voluntary petitions by companies contains any insolvency requirement"). The removal of those provisions is strong evidence that Congress did not intend for insolvency to be a gating mechanism at the beginning of a bankruptcy case. By comparison, in *Toibb v. Radloff*, 501 U.S. 157 (1991), the Supreme Court ruled that chapter 11 was not restricted to business debtors and individuals in business, since 11 U.S.C. § 109 contains no such restriction. *Id.* at 160–61.

¹⁸⁰ See Kennedy, *supra* note 159, at 983.

court for reorganization and rehabilitation.”¹⁸¹ The only remaining debtors that had to demonstrate insolvency and good faith at the point of entry were municipalities.¹⁸² More tellingly, Congress removed all provision for the adjudication of a voluntary petition and swapped in the phrase “order for relief.”¹⁸³ The Code thus sharply cut down on early-stage litigation over insolvency at the beginning of a bankruptcy case.

The only remaining statutory provisions that could encompass an insolvency test were scattered requirements of “good faith.” Plans under the new chapters 11 and 13 had to be proposed “in good faith.”¹⁸⁴ And a court could dismiss a reorganization case or convert it to a liquidation case for cause, which courts quickly began to interpret as including a lack of good faith.¹⁸⁵ The problem, of course, is that the judicially created doctrines are inconsistent.

B. Congress Adjusts on the Back End

The United States has not undertaken a comprehensive overhaul of its federal bankruptcy legislation since 1978. But Congress has made adjustments that reflect its concerns about

¹⁸¹ *Id.* at 984.

¹⁸² *See id.* (codified at 11 U.S.C. § 109(c) (providing that an entity may only be a debtor under chapter 9 if it “is insolvent or unable to meet such entity’s debts as such debts mature”) 92 Stat. 2623 (codified at 11 U.S.C. § 921(c) (“After an objection to the petition, the court, after notice and a hearing, may dismiss the petition, if the debtor did not file the petition in good faith, or if the petition does not meet the requirement of this title.”)).

¹⁸³ *See* H.R. REP. NO. 595, 95th Cong., 1st Sess. 222, 321, *reprinted in* [1978] U.S. CODE CONG. & AD. NEWS 5963, 6277 [hereinafter, HOUSE REPORT] (noting that Congress had replaced the word *adjudication* with *order for relief* “in light of the clear power of Congress to permit voluntary bankruptcy without the necessity for an adjudication, as under the 1898 Act, which was adopted when voluntary bankruptcy was a concept not thoroughly tested”); Frank R. Kennedy & Gerald K. Smith, *Postconfirmation Issues: The Effects of Confirmation and Postconfirmation Proceedings*, 44 S.C. L. REV. 621, 732–33 & n.409 (1993); Kennedy, *supra* note 159, at 983 nn. 33.

¹⁸⁴ *See id.* §§ 1129(a)(3); 1325(a)(3). Railroad plans, by contrast, had be to “compatible with the public interest.” *See id.* § 1173(a)(4).

¹⁸⁵ *See* 11 U.S.C. § 1112, 1307(c). Alongside many others, Gerald K. Smith and Randolph J. Haines have criticized the speed with which bankruptcy courts re-read in good faith to the Code, despite the legislative history suggesting a deliberate intent to excise it from various places in the 1978 Code. *See* Gerald K. Smith & Randolph J. Haines, 1988 ANN. SURV. BANKR. L. 24 II.

solvent debtors, despite studies indicating that the “can-pay” debtor is largely a myth.¹⁸⁶ In doing so, Congress did not modify the gatekeeping provisions of the Code to address those concerns; instead, it adjusted the relief available in bankruptcy court.

1. Tightening the Screws on Solvent Students

Consider, for example, a medical school or law school graduate, fresh out of school, asset-poor, and overburdened with student debt. Let us imagine that our budding professional has secured their first job and can service the student loan payments. Such a debtor is cashflow solvent, but balance-sheet insolvent and therefore eligible for voluntary bankruptcy relief under federal bankruptcy law going back to 1938. Could such a debtor file for bankruptcy, obtain a quick discharge of their student loans, and then move back into the workforce, experiencing all the upside benefit of increased earning potential?

That narrative alarmed Congress, although the evidence was scant that medical or law students were in fact running this play in significant numbers.¹⁸⁷ In 1978, the Code had made student loan debt nondischargeable unless the loan had been in repayment for at least five years or requiring repayment after bankruptcy would impose an “undue hardship on the debtor and the debtor’s dependents.”¹⁸⁸ That limited the ability for recent graduates to use bankruptcy court to slough off student loans. But Congress did not think it went far enough. In 1990, Congress increased the waiting period to seven years¹⁸⁹ and in 1998 abolished it completely, leaving only the “undue hardship” provision.¹⁹⁰ In 2005, Congress

¹⁸⁶ See, e.g., PAMELA FOOHEY, ROBERT LAWLESS & DEBORAH THORNE, DEBT’S GRIP: RISK AND CONSUMER BANKRUPTCY (2025) (summarizing results from numerous interviews and statistical surveys); Rafael I. Pardo & Michelle R. Lacey, *Undue Hardship in the Bankruptcy Courts: An Empirical Assessment of the Discharge of Educational Debt*, 74 U. CIN. L. REV. 405 (2005).

¹⁸⁷ See Melissa Jacoby; Rajeev Darolia & Dubravka Ritter, *Strategic Default Among Private Student Loan Debtors: Evidence from Bankruptcy Reform*, 15 EDUC. FIN. & POL’Y 487 (2020) (finding little evidence that student borrowers were abusing chapter 7).

¹⁸⁸ See Act of 1978, 92 Stat. 2591 (then codified at 11 U.S.C. § 523(a)(8)).

¹⁸⁹ See Crime Control Act of 1990, Pub. L. 101-647, 104 Stat. 4789, § 3621 (codified at 11 U.S.C. § 523(a)(8)).

¹⁹⁰ See Higher Education Amendments of 1998, Pub. L. No. 105-244, Title

expanded the set of educational loans subject to the discharge exception. The liberal access policy of 1978 was being cabined, not by adjustments to insolvency definitions on the front end, but by adjustments to the relief available on the back end.

2. Channeling High-Income Workers into Plans

Similarly, in 2005, Congress passed the Bankruptcy Abuse Prevention and Consumer Protection Act (“BAPCPA”). Here, too, Congress was worried about excessive filings.¹⁹¹ In particular, Congress expressed its concern that high-income workers who could service at least a percentage of their debt would file for quick liquidation bankruptcies instead of undertaking repayment plans under chapter 13 of the Code. Almost all such workers are both balance-sheet and cashflow insolvent, but given their stable income, Congress felt the use of bankruptcy for a quick discharge was inappropriate.

Congress passed a “means test” that would force a subset of debtors whose monthly earnings are above the state median from chapter 7 liquidation into five-year, chapter 13 repayment plans. The means test is complicated (and inartful), but the core mechanism is that debtors who can devote more than \$250 per

IX, Part G, § 971, 112 Stat. 1581, 1837 (1998) (codified as amended at 11 U.S.C. § 523(a)(8) (1999)). The seminal *Brunner* test for undue hardship investigates not only the debtors’ present circumstances but also whether those circumstances are “likely to persist for a significant portion of the repayment period of the student loans.” *Brunner v. N.Y. State Higher Education Services*, 831 F.2d 395 (2d Cir. 1987). That inquiry made some sense for student loan borrowers who merely had to wait five (or seven) years to avoid the “undue hardship” inquiry entirely: it makes much less sense when the waiting period has been completely abolished. Numerous commentators have called for the reassessment or amendment of the undue hardship standard after 1998. See, e.g., Scott Pashman, *Discharge of Student Loan Debt Under 11 U.S.C. § 523(a)(8): Reassessing “Undue Hardship” After the Elimination of the Seven-Year Exception*, 44 N.Y.L. SCH. L. REV. 605 (2000).

¹⁹¹ See Kennedy, *supra* note 159, at 978; COMMISSION REPORT I, *supra* note 176, at 9. The 2005 reforms were not the first in this vein. In 1984, Congress allowed courts to dismiss petitions brought by consumers if they felt that granting a discharge would be an abuse of the chapter. As Plank notes, *supra* note 16, at 547 n.340, Congress rejected proposals that would have reintroduced an insolvency test to address that concern. As in 1978, the reform efforts drew on the work of the National Bankruptcy Review Commission (“NBRC”), which delivered a report in 1997.

month to their general unsecured creditors in chapter 13 must do so, and debtors who can devote between \$150 and \$150 per month must do so if the payments represent at least 25 cents on the dollar.

Although the means test mostly regulates insolvent debtors, it would have an impact on solvent debtors as well, blocking them from taking advantage of chapter 7's quick discharge.

3. Cabining Uncapped Exemptions

Congress also cut back on the ability of individual debtors to use uncapped exemptions under state law. The federal Code had incorporated state exemptions since the 1898 Act, and the Supreme Court had upheld the approach as sufficiently uniform to pass constitutional muster in *Hanover National Bank v. Moyses*.¹⁹² The federal exemptions, which debtors can select when their state allowed it, are not particularly generous and may even be too meager in some respects.¹⁹³ But when states like Florida and Texas allowed debtors to create self-settled trusts or to park their money in uncapped homestead exemptions, the federalist approach allows solvent debtors to take advantage of bankruptcy relief while shielding millions of dollars from their creditors.¹⁹⁴

Without disrupting the core mechanism of exemption law in the Code, Congress took a few measures to curb the worst abuses. Debtors could no longer move to a new state to take advantage of its exemption laws without living there for two years.¹⁹⁵ Taking advantage of a generous homestead exemption would take even longer: federal law would impose its own cap on homestead exemptions (currently \$214,000) until the debtor had lived in the state for 1215 days, three years and four months.¹⁹⁶ Value moved into homestead exemptions with the intent to hinder, delay or defraud creditors would not be exempt, no matter where in the

¹⁹² 186 U.S. 181, 189–90 (1902) (“It is quite proper ... to confine its operation to such property as other legal process could reach.”).

¹⁹³ See 11 U.S.C. §§ 722(b); 722(d).

¹⁹⁴ See, e.g., Hynes & Pattison, *supra* note 45, at 921 (noting that the exemption rules allow debtors with significant wealth to seek bankruptcy relief).

¹⁹⁵ See 11 U.S.C. § 722(b)(3)(A). If the debtor did not live in a single state for the two-year period preceding the filing, the analysis switched to the half-year before that.

¹⁹⁶ 11 U.S.C. § 722(p).

country it happened.¹⁹⁷ Debtors cannot claim any homestead exemption at all if they have been convicted of a felony or owe debts arising out of specified bad acts.¹⁹⁸ And the trustee in bankruptcy could recover intentionally fraudulent transfers into a self-settled trust within ten years of the date of the filing of the petition.¹⁹⁹

* * *

Congress has made other minor adjustments since 1978, but they are not central to our discussion of insolvency. Over the last half century, Congress has left in place the basic pillars of the Code’s insolvency regime: modified cashflow insolvency for involuntary petitions, parallel definitions for clawback actions, and no insolvency standard at all for voluntary petitions — only the dubious standard, variably applied, of good faith.

V. THE INSOLVENCY LIMITS OF THE BANKRUPTCY POWER

The history and tradition of American bankruptcy law cannot, by themselves, tell us what kind of insolvency limit cabins the Bankruptcy Power. As Justice Amy Coney Barrett pointed out in *United States v. Rahimi*,²⁰⁰ originalists cannot assume that “founding-era legislatures maximally exercised their power to regulate,” and historical analogues create level-of-generality problems.²⁰¹ Beyond that, the constitutional text here — “uniform laws ... on the subject of Bankruptcies”²⁰² — is remarkably capacious, both in the repeated use of the plural and in the use of the phrase “on the subject of,” a phrase that appears nowhere else in the U.S. Constitution.

Even so, the “subject of Bankruptcies” must have some outer limits. After all, uniformity is a rather weak limit on its own,²⁰³

¹⁹⁷ *Id.* § 522(o).

¹⁹⁸ *Id.* § 522(q).

¹⁹⁹ *See* 11 U.S.C. § 548(e).

²⁰⁰ *United States v. Rahimi*, 602 U.S. 680 (2024) (Barrett, J., concurring).

²⁰¹ *Id.* at 739–40. The Court’s Second Amendment jurisprudence is equal parts terrifying and fascinating, a sort of primordial soup sparked by *New York State Rifle & Pistol Association v. Bruen*, 597 U.S. 1 (2022).

²⁰² U.S. CONST. art. I, sec. 8, cl. 4.

²⁰³ The Supreme Court has only intervened four times on uniformity

and the Bankruptcy Clause would otherwise swallow up the Commerce Clause by allowing Congress to regulate intrastate commerce under the guise of regulating bankruptcies.

McCoid has argued, for example, that a bankruptcy law is a “(1) coercive and (2) collective judicial process the purpose of which is (3) to settle creditors’ claims between each creditor and the debtor and among creditors themselves.”²⁰⁴ That definition suggests that bankruptcy law has some important limits. Plank argues, for example, that bankruptcy law must limit relief to the debtor and its creditors,²⁰⁵ an argument that the Supreme has recently buttressed (albeit on statutory grounds) by holding in *Harrington v. Purdue Pharma L.P.*²⁰⁶ that the Code does not authorize a bankruptcy court to grant nonconsensual, third-party releases.²⁰⁷ Similarly, since 1542, a bankruptcy has been a collective judicial or administrative proceeding, drawing a debtor and all its creditors together. Even the colonial acts of insolvency granted debt relief against the body of creditors as a whole, not against specific creditors on their own. Thus, the Bankruptcy Clause likely does not empower Congress to regulate two-party disputes between a debtor and a single creditor,²⁰⁸ sending Congress to look to other

grounds, and half of those were to uphold the statute against constitutional challenges. The Court upheld the incorporation of state exemption law as sufficiently uniform in *Hanover National Bank v. Moyses*, 186 U.S. 181, 188–89 (1902). In *Regional Rail Reorganization Act Cases*, 419 U.S. 102, 160 (1974), it upheld a statute that only applied to a specific industry in a particular region of the country. In *Railway Labor Executives’ Association v. Gibbons*, 455 U.S. 457, 471 (1982), the Court struck down a bankruptcy act that was aimed at a single railroad. And in *Siegel v. Fitzgerald*, 596 U.S. 464, 479–80 (2022), the Court decided that Congress could not charge different fees in bankruptcy based purely on the geographical location of the debtor.

²⁰⁴ McCoid, *supra* note 15, at 213; *see also* Radin, *supra* note 43, at 4–5.

²⁰⁵ *See* Plank, *supra* note 16, at 492 (“A bankruptcy law may not create direct entitlements or liabilities for parties other than debtors and their creditors.”).

²⁰⁶ 603 U.S. 204.

²⁰⁷ *Id.* at 225–26.

²⁰⁸ *See, e.g.,* Radin, *supra* note 43, at 3–4 (arguing that bankruptcy does not cover debt collection or protection of creditors from debtor fraud); *see also* Ry. Lab. Execs. Ass’n v. Gibbons, 455 U.S. 457, 468 (1982) (“We do not understand either appellant or the United States to argue that Congress may enact bankruptcy laws pursuant to its power under the Commerce Clause.”).

authority to regulate debt collection or voidable transfers — or to leave those areas to the states.²⁰⁹

Second, even across waves of financial crises in the history of the republic, Congress has not invoked the Bankruptcy Power to provide sweeping remission of debt like the biblical Jubilee²¹⁰ or even to support moratoria on debt collection, like the COVID-19 moratoria on foreclosure and eviction.²¹¹ Bankruptcy is a one-at-a-time system.

²⁰⁹ For example, when Congress was considering the Fair Debt Collection Practices Act (codified as amended in 15 U.S.C. §§ 1692 *et seq.*) (the “FDCPA”), a former debt collector testified that he would “call[] parents of alleged debtors and [tell] them that their children would be incarcerated unless the parents paid their debt.” Neil L. Sobol, *Fighting Fines & Fees: Borrowing from Consumer Law to Combat Criminal Justice Debt Abuses*, 88 U. COLO. L. REV. 841, 886–87 (2017); *see also* Hampson, *supra* note 40, at 956 & n.128. But Congress limited the FDCPA’s coverage to “debt collectors,” 15 U.S.C. § 1692c, keeping the statute safely within the bounds of Congress’s lawmaking authority under the Commerce Clause, *see* 11 U.S.C. § 1692(d) (underscoring the relationship between debt collection and interstate commerce); § 1692a(6) (incorporating the use of “any instrumentality of interstate commerce” in the definition of “debt collector”). *But see* Consumer Credit Protection Act, Pub. L. No. 90-321, 82 Stat. 146, 159 (1968) (codified as amended in scattered sections of 15 and 18 U.S.C.) (expressly drawing on the Commerce Clause and the Bankruptcy Clause to pass regulation of extortionate credit transactions).

²¹⁰ For an analysis of the biblical Jubilee and a history of its use in American legal history, *see* Christopher D. Hampson, *The Spirit of Jubilee*, 51 BYU L. REV. 1251 (2026); *see also* Christopher D. Hampson, *Mission Creep or Mission Failure?*, 5 AM. J. LAW & EQUALITY 158, 166 (2025); (distinguishing between bankruptcy and jubilee); Radin, *supra* note 43, at 6 (distinguishing bankruptcy from the Biblical Jubilee, the Athenian *seisachtheia*, and the Roman *tabulae novae*).

²¹¹ In 2020, Congress passed the Coronavirus Aid, Relief, and Economic Security Act (or “CARES Act”), Pub. L. 116–136, 134 Stat. 281, which paused both foreclosures and evictions. But Congress rooted its authority in federal funding, not in the Bankruptcy Power. *See* CARES Act, §§ 4022(c)(2), 4023(d), 4024(b). And when the CARES Act moratorium expired, the Centers for Disease Control (CDC) attempted to extend it under the Public Health Service Act, 58 Stat. 703 (codified as amended in 42 U.S.C. § 264(a)). The Supreme Court struck down the CDC’s moratorium as “intrud[ing] into an area that is the particular domain of state law: the landlord-tenant relationship,” in an opinion that does not mention bankruptcy. *See* Alabama Ass’n of Realtors v. Dep’t of Health and Human Servs., 594 U.S. 758, 763 (2021). This distinction is not new. Radin wrote in 1970 that a general moratorium on debt collection is not a bankruptcy law and would have to be justified under a war power or some other power. *See* Radin, *supra* note 43, at 6–7.

That leaves insolvency. Everyone knows, or rather suspects, that the subject of bankruptcies is the subject of insolvency or financial distress of some kind. “The debtor must be insolvent in some sense,” argues Plank.²¹² But in what sense? And what sort of policing of insolvency does the Constitution require? Can Congress simply adjust the relief available in bankruptcy court to ensure that filing for bankruptcy is simply not attractive for solvent debtors? Can Congress take the debtor at its word or must it allow creditors (or the judge) to dismiss the cases of solvent debtors? If the latter, when must that adjudication happen? This Part attempts to shed some light on these questions.

A. The Fraudulent, Insolvent, or Nonpaying Debtor (FIN)

First, the long arc of bankruptcy history in England and the United States indicates that bankruptcy laws deal not with the creditor-debtor relationship generally, but rather with specific types of debtors: *fraudulent*, *insolvent*, or *nonpaying* debtors. *Union Central* had isolated the core of bankruptcy jurisdiction. This Article will refer to those qualifying debtors as the “FIN” requirement of bankruptcy law, and it is a disjunctive test.

The FIN test has solid textual and originalist footing. Chronologically, the earliest bankruptcy laws in England and the American colonies focused on debtors that were fraudulent or nonpaying: “as do make bankrupt,” as the 1542 Act put it. Cashflow insolvency was a feature of what were then known as insolvency laws, but the Supreme Court early on decided that the Bankruptcy Power encompassed both sorts of English and early American proceedings into one font of constitutional authority.²¹³ The Bankruptcy Power, then, empowers Congress to design uniform, collective proceedings to deal with fraudulent debtors, insolvent debtors, or nonpaying debtors. That conclusion suggests that the Bankruptcy Code can deal with solvent debtors — so long as they are nonpaying or have attempted to hinder, delay, or defraud their creditors.²¹⁴

²¹² Plank, *supra* note 16, at 492.

²¹³ See *Sturges v. Crowninshield*, 177 U.S. 122 (1819).

²¹⁴ McCoid disagrees, saying that fraud on its own does not justify a bankruptcy law. See McCoid, *supra* note 15, at 215–16. He may be right in

B. Three Insolvency Tests, One Touchstone

Second, our discussion of insolvency over the course of American bankruptcy law has yielded three tests for insolvency: equitable or cashflow, balance-sheet, and USA insolvency. Which of the three limit Congress's authority to pass bankruptcy laws?

For McCoid, the best theoretical answer is balance-sheet insolvency, because the only justification for bankruptcy's mandatory joinder of all creditors into one collective proceeding is the fact that a limited fund exists.²¹⁵ Equitable insolvency, for McCoid, does not justify a bankruptcy proceeding, unless a stay is needed to stop a creditor destroying go-forward value.²¹⁶ The chief difficulty with McCoid's view is that it suggests that Congress could pass an involuntary bankruptcy statute allowing creditors to force debtors — who are current on their payments — into bankruptcy court simply by virtue of being balance-sheet insolvent. While not dispositive of the constitutional issue, it is instructive that Congress has never taken this approach. The battle in 1898 for a permanent bankruptcy statute used balance-sheet insolvency to provide farmers a powerful defense to allegations that they had committed acts of bankruptcy, and even today's involuntary bankruptcy provision requires creditors to show general nonpayment of debts.

As a matter of economic theory, McCoid is correct that the limited fund is what justifies bankruptcy regulation, but he is wrong about its application. Cashflow insolvency is a more serious form of limited-fund problem than balance-sheet insolvency. A cashflow insolvent debtor has insufficient funds to pay mature obligations. Such a debtor is more likely to commit fraudulent or

theory, and of course Congress does not need to regulate fraudulent debtors, even if it has the constitutional power to do so. But that is a separate question from whether the Constitution authorizes Congress to regulate fraudulent debtors, and it clearly does.

²¹⁵ See McCoid, *supra* note 15, at 214–15; see also Radin, *supra* note 43, at 3–4 (“[W]hatever happens to the debtor, in every case the creditors have been assembled in some formal way, their claims examined and classified, and assigned for satisfaction in definite proportions to an existing or prospective fund.”); see also Ortiz v. Fibreboard Corp., 527 U.S. 815 (1999) (requiring a showing for limited fund theory of class actions).

²¹⁶ *Id.* at 216–17.

preferential transfers, pay a premium for liquidity, or even mortgage away future earnings or unencumbered assets, endangering the potential recovery of future creditors.²¹⁷ The creditors, for their part, are able to begin debt collection actions at state law, ripping the debtor apart in their quest to be repaid before the value dissipates from the debtor's assets. By contrast, balance-sheet or USA insolvent debtors (like many a recent law graduate) have breathing room to turn things around.²¹⁸ And, usually, entering balance-sheet or USA insolvency is not an act of default under all but the most complex credit agreements.

If I am right that cashflow insolvency is the touchstone for the Bankruptcy Power, may Congress pass a statute allowing debtors to file for bankruptcy on a voluntary basis when they are balance-sheet or USA insolvent? To my mind, the answer is *yes*. While creditors cannot force a balance-sheet insolvent or USA insolvent debtor to commit breach of its financial obligations, a debtor can always do so voluntarily. Allowing a debtor to file a voluntary case, without putting it to the trouble of committing breach on purpose, stands on solid, American pragmatic soil, with longstanding precedents in the contracts doctrine of anticipatory repudiation²¹⁹ and the remedies doctrine of declaratory relief.²²⁰

²¹⁷ This is how the U.C.C. defines insolvency as well, a person who “has ceased to pay his debts in the ordinary course of business.” U.C.C. § 1-201(23) (1962). In 2014, the U.C.C. specified that nonpayment as a result of a bona fide dispute did not count. *See* U.C.C. § 1-203(b)(23) (2014).

²¹⁸ For this reason, even though state voidable transfer law might give creditors a cause of action to clawback transactions made for less than reasonably equivalent value when a debtor is balance-sheet or USA insolvent, federal bankruptcy law has never treated balance-sheet or USA insolvency as a triggering mechanism for hauling a debtor into bankruptcy court on an involuntary basis.

²¹⁹ *See, e.g.*, *Truman L. Flatt & Sons Co. v. Schupf*, 649 N.E.2d 990 (1995); *Hornell Brewing Co. v. Spry*, 664 N.Y.S.2d 698 (Sup. Ct. N.Y. Cty. 1997); CHARLES L. KNAPP ET AL., *PROBLEMS IN CONTRACT LAW: CASES AND MATERIALS* 870–88 (Aspen Publishing 10th ed. 2025). The doctrine traces back at least to *Hochster v. De La Tour*, 118 Eng. Rep. 922 (Q.B. 1853), and is not particularly controversial, *see* Restatement (Second) of Contracts § 253(1) and Uniform Commercial Code § 2-610; Keith A. Rowley, *A Brief History of Anticipatory Repudiation in American Contract Law*, 69 U. CIN. L. REV. 565 (2001).

²²⁰ *See, e.g.*, *Nashville, Chattanooga & St. Louis Railway Co. v. Wallace*, 288 U.S. 249 (1933) (confirming that federal courts may hear appeals from Tennessee's declaratory judgment act under Article III's “case or controversy” requirement).

The same principle applies for uncapped exemptions. Even though the Supreme Court has decided that the federal use of state exemptions presents no uniformity issue,²²¹ that approach still presents an insolvency issue. Imagine a debtor, living in Texas or Florida, with an exempt homestead worth \$5 million, a \$1 million mortgage, and a \$1 million debt arising from contract. Such a debtor is balance-sheet solvent (to the tune of \$3 million dollars) but under current law can still file for bankruptcy and obtain a discharge. The statutory approach allows a state to end-run around the Bankruptcy Power's insolvency limit.²²²

C. Insolvency as Ripeness

Back to *Bestwall*. In its latest attack on the proceedings, the Asbestos Committee argued that the bankruptcy court did not have subject-matter jurisdiction over the *Bestwall* bankruptcy, because Bestwall was a can-pay, will-pay debtor. Subject-matter jurisdiction is not the correct framing, of course,²²³ and the Asbestos Committee may have framed it that way simply so that they could raise a jurisdictional issue in the middle of the case.

The statutory grounds for dismissing the *Bestwall* bankruptcy are murky. As Casey has pointed out, the list of actions constituting cause under section 1112 are chiefly post-filing offenses and have nothing to do with the debtor's solvency or motivation in filing the case itself.²²⁴ Section 1112 does not even mention good faith, and the legislative history does not clearly propose adding it. More problematically, Congress scrubbed solvency tests from the gateway to chapter 11, but it left them in place for municipal bankruptcies and involuntary bankruptcies. Recreating such a test through section 1112 has little footing in the statutory text and cuts against Congress's evident intent.

Casey proposes an objective futility test, arguing that a bankruptcy court should dismiss the case of a solvent debtor when

²²¹ See *Hanover Nat'l Bank v. Moyses*, 186 U.S. 181, 190 (1902).

²²² This problem mirrors the challenge of states running around the Takings Clause by passing unfair tax foreclosure statutes. See *Tyler v. Hennepin Cty.*, 598 U.S. 631 (2023); *Pung v. Isabella Cty.*, 609 U.S. __ (2026).

²²³ A federal court has subject-matter jurisdiction to preside over a case brought under title 11. 28 U.S.C. § 1334.

²²⁴ See Casey, *supra* note 21.

it becomes apparent that it cannot propose a confirmable plan.²²⁵ But while it is not ideal to have costly valuation disputes at the beginning of a bankruptcy case, it seems counterproductive to forestall such a dispute until the end of a bankruptcy case, all the while dissenting creditors are held at bay by the automatic stay.

Additionally, futility cannot police the constitutional line because Congress can change the requirements for plan confirmation to make futility easier or harder, while it cannot, by *fiat*, make a debtor more or less insolvent. If futility is to be a real limit on the Bankruptcy Power, then it would have to impose limits on the sorts of plans Congress could endorse, resurrecting all the same doctrinal challenges that the futility model sought to avoid.

The solvent debtor exception (or rule) has a long pedigree, but it cannot provide a satisfying answer to the *Bestwall* problem either. Under the solvent debtor exception, a court need not dismiss a bankruptcy case when a debtor in financial distress finds itself suddenly solvent during the case. The court's jurisdiction was established at the beginning of the case, and a court sitting in equity can ensure that equity is done once its jurisdiction is properly invoked.²²⁶ That does not mean that a solvent debtor can waltz (or two-step) into bankruptcy court and invoke its authority without an appropriate basis.

A court might, of course, abstain from hearing a solvent debtor case under section 305.²²⁷ As I have pointed out in prior work, bankruptcy courts do use abstention to steer away from constitutional trouble, most notably to avoid exercising jurisdiction over two-party disputes that are better handled at state law.²²⁸ But this sort of abstention is discretionary and works best as an equitable way of dodging creative workarounds, not as a way to police a fundamental constitutional limit.

The more accurate way to force the issue is as an as-applied challenge to the Bankruptcy Code, arguing that the Code is unconstitutional as applied to a non-FIN debtor like *Bestwall*. Similarly, since the Bankruptcy Code routes all bankruptcy cases through the Article III courts, from which they are referred to the

²²⁵ *See id.*

²²⁶ *See, e.g.,* *Bailey v. Proctor*, 160 F.2d 78 (1st Cir. 1947).

²²⁷ 11 U.S.C. § 305 (authorizing the bankruptcy court to abstain from hearing any proceeding when in the best interests of creditors and the debtor).

²²⁸ *See* Hampson, *supra* note 163 (manuscript at 23–29).

bankruptcy courts, litigants can argue that voluntary cases brought by non-FIN debtors do not represent a “case or controversy” under Article III for the court’s jurisdiction properly to be invoked.

This is not a demanding test, but it does sketch out an outer bound. Bankruptcy is for debtors in financial distress, or FIN debtors, as this Article has argued. A debtor that is cashflow solvent, balance-sheet solvent, and USA solvent — and who has not committed fraud and is currently paying its obligations — does not present sufficient financial distress to invoke the jurisdiction of the Article III courts. I have referred to this idea elsewhere as “bankruptcy ripeness,”²²⁹ but really it is just ripeness in the context of bankruptcy law. When the Supreme Court approved of the declaratory judgment in 1941, it said that the parties needed to have “adverse legal interests, of sufficient immediacy and reality to warrant the issuance of a declaratory judgment.”²³⁰ That formulation mirrors Judge Ambro’s ruling in *LTL Management*, that a debtor must be in financial distress, and that distress “must not only be apparent, but it must be immediate enough to justify a filing.”²³¹ The Third Circuit offered this formulation as a test for good faith, but it works much more cleanly as a test for ripeness.

Clever litigants might invoke the doctrine of constitutional avoidance. Despite the 1978 legislation’s seeming intent to avoid costly valuation disputes at the beginning of bankruptcy cases, if the as-applied and ripeness challenges discussed above present a serious constitutional concern (as I believe they do), then courts may wish to avoid any constitutional cliffs by interpreting sections 305 and 1112 to include limits on solvent debtor filings.

D. Legislative Action

Finally, the best solution is for Congress to respond, either by specifying the proper procedural moment for solvency gating or by amending the Code to make bankruptcy less attractive to solvent debtors. Congress could, for example, tackle the Texas Two-Step head-on, such as by deeming such transactions to be intentionally

²²⁹ *Id.* at 58.

²³⁰ *Maryland Cas. Co. v. Pac. Coal & Oil Co.*, 312 U.S. 270, 273 (1941) (reaffirmed in *MedImmune, Inc. v. Genentech, Inc.*, 549 U.S. 118, 127 (2007)).

²³¹ *In re LTL Management, LLC*, 64 F.4th 84, 102 (3d Cir. 2023) (Ambro, J.).

fraudulent or extending the lookback period for such transactions. A bipartisan group of lawmakers has already filed legislation to this effect.²³² Similarly, Congress could tackle the problem of mass torts head-on. This Article has not explored the relative advantages and disadvantages of class actions versus bankruptcy versus multi-district litigation, although that very question has provoked a very good and fast-growing literature.²³³ If bankruptcy lawyers have discovered efficiencies in the insolvency context that are worth exploring for solvent, mass tort debtors,²³⁴ then Congress should amend the class action of Rule 23 or the multidistrict litigation provisions in 28 U.S.C. 1407 to incorporate them.

As for exemptions, Congress has already taken some steps to prevent states from allowing solvent individual debtors to file by extending the lookback period on uncapped homestead exemptions and self-settled trusts.²³⁵ But that does not completely solve the problem, because solvent individual debtors can still seek a discharge. Congress could narrow the issue by amending section 522 to impose a flat cap on state homestead exemptions, perhaps something high but not outlandish, such as twice the median home value in the state.²³⁶

²³² See Consumer Protection and Corporate Accountability in Bankruptcy Act of 2026.

²³³ For two recent proposals, see Lindsey Simon, *Mass Tort Designation*, 60 GA. L. REV. (forthcoming 2026) (proposing a new subchapter VI for mass torts); Michael A. Francus, *Designing Designer Bankruptcy*, 102 TEX. L. REV. 1205 (2024) (proposing a new approach to mass tort bankruptcies that allows an operational company to stay outside of bankruptcy).

²³⁴ Casey and Macey argue that the efficiencies of bankruptcy court should be “welcomed” in the mass tort context. See Anthony J. Casey & Joshua C. Macey, *In Defense of Chapter 11 for Mass Torts*, 90 U. CHI. L. REV. 973 (2023). Professor Daniel J. Bussel has made the same argument. See Daniel J. Bussel, *The Mass Tort Claimants’ Bargain*, 97 AM. BANKR. L.J. 684, 691–95 (2023) (arguing that bankruptcy “efficiently and fairly compensates individual claims in a way that harmonizes the treatment of the affected claimants to effect a rough justice for the vast majority”). The debtor in *Aearo* made the same point, arguing that the MDL process was “broken.” *In re Aearo Tech. LLC (divisus ex 3M)*, No. 22-02890, 2023 WL 3938436, at *20 (Bankr. S.D. Ind. June 9, 2023). The bankruptcy court was not impressed, opining that “[t]hese cases were and are a litigation management tactic and not a rehabilitative effort.”

²³⁵ See *supra* Part IV.3.

²³⁶ This approach mirrors that of the National Consumer Law Center (“NCLC”) in its annual report card of state exemption law. See NATIONAL

E. Refutatio of Common Counterarguments

Both in the annals of history and today, the leading counterarguments to an insolvency limit on the Bankruptcy Power have been rooted in pragmatism and efficiency.

As a threshold matter, any insolvency regime today must allow for a contested hearing. The idea that the law today could “take the debtor at his word” is untenable, both because the Bankruptcy Code now offers reorganization, undercutting the premise on which the uncontestable petition once relied,²³⁷ and because such a scheme would violate the Due Process Clause under *Chrysafis v. Marks*,²³⁸ a short Supreme Court case issued at the height of the COVID-19 pandemic, which held that New York could not let tenants receive a moratorium on eviction by certifying financial hardship without letting the landlord respond.²³⁹ So insolvency must be contestable. That means a valuation fight.

Having a valuation fight at the commencement of a case is expensive, draining the estate of funds that could be used to repay

CONSUMER LAW CENTER, NO FRESH START 18–24 (Dec. 2025), *available at* https://www.nclc.org/wp-content/uploads/2026/01/2025.12_Report_No-Fresh-Start.pdf. States that have uncapped homestead exemptions or that protect a median-priced home in the state receive an A, so this federal intervention would allow states to treat the poor fairly without being overly generous to the rich. *Cf. Isaiah* 40:4 (“Every valley shall be exalted, and every mountain and hill shall be made low: and the crooked shall be made straight, and the rough places plain.”) (KJV).

²³⁷ *See supra* Part III.

²³⁸ 594 U.S. ___, 141 S. Ct. 2482 (2021).

²³⁹ In 2020 New York passed an eviction moratorium in response to the COVID-19 pandemic. *See* COVID Emergency Eviction and Foreclosure Prevention Act, 2020 N.Y. Laws. ch. 381 (CEEFFPA). To access relief, a tenant could self-certify financial hardship, after which the landlord was barred from contesting the certification. The Supreme Court enjoined enforcement of that provision, saying that it “violates the Court’s longstanding teaching that ordinarily ‘no man can be a judge in his own case’ consistent with the Due Process Clause.” *Chrysafis v. Marks*, 594 U.S. ___ (2021) (citations omitted). But it allowed New York’s mandate that judges “entertain a COVID-related hardship defense” to go forward. New York’s Tenant Safe Harbor Act, 2020 N.Y. Laws. ch. 127, §§ 1, 2(2)(a) (McKinney). Even the dissent argued only that CEEFFPA might not violate the Due Process Clause because it was only a delay, not a deprivation. *See Chrysafis*, 594 U.S. at ___ (Breyer, J., dissenting) (noting that “the challenged law will expire in less than three weeks” and arguing that the “strict standard” for a preliminary injunction had not been met).

creditors. Parties aware of how costly a valuation fight can become will hesitate to file bankruptcies if they anticipate a struggle, especially if they are unlikely to possess compelling evidence in advance.

This point draws force from contemporary experience with involuntary bankruptcies. In many cases, petitioning creditors struggle to prove that the debtor is generally not paying its debts as they come due.²⁴⁰ Before the case is commenced, any single creditor is unlikely to know that the debtor is generally not paying — unless the debtor's financial distress has become so pronounced that the debtor admits its troubles publicly. Recognizing an insolvency requirement in voluntary cases, enforceable at the beginning of the case, will add similar evidentiary battles precisely when the debtor cannot afford them.

This concern, to my mind, is overstated. The vast majority of debtors who file for bankruptcy are FIN debtors who can demonstrate their financial distress readily.²⁴¹ Any increased litigation is likely to ensnare debtors that are either solvent or on the edge of insolvency, meaning that the legal fees incurred in the solvency fight are not diminishing creditors' recovery. Lastly, creditors are unlikely to contest the debtor's insolvency if they think the ensuing legal battle will undermine their own recovery. In a voluntary case, the incentives align with the evidence: the debtor, the party with the best evidence of its financial condition, decides whether to file the bankruptcy; and the creditors, if they believe that the debtor is cashflow, balance-sheet, and USA solvent, can contest the petition, causing the debtor to expend funds in its defense. The creditors will simply have to decide if the fight is worth it.

A second counterargument is that individuals and businesses in financial distress may need to reorganize quickly, and the Bankruptcy Code cannot impose rigid requirements at the front door. This argument seems ill-founded, since the outer limit proposed in this Article provides an expansive space in which bankruptcy law can operate. A debtor may file a voluntary case when it is cashflow insolvent, balance-sheet insolvent, or even USA insolvent — just like a contract party may repudiate its contracts or a litigant may seek a declaratory judgment. That broad sweep

²⁴⁰ 11 U.S.C. § 303(h)(1).

²⁴¹ See Brubaker, *supra* note 19, at 8.

might even encompass many famous debtors that filed proactively, like Johns-Manville, A. H. Robins, Dow Corning, and Pacific Gas and Electric Company.²⁴² Debtors that truly need the relief offered in the Bankruptcy Code will not be prohibited from filing.

The third, and most extreme counterargument, is that the Bankruptcy Code embodies a form of refinancing or liability management that is efficient even in cases where financial distress is not present.²⁴³ If that is correct, then Congress should be able to embody those efficiencies in other areas of law, like class actions or multidistrict litigation, drawing from its other fonts of legislative authority, like the Commerce Clause and diversity jurisdiction. If, however, the “efficiencies” are remedies unique to bankruptcy, like the disallowance of claims for unmatured interest,²⁴⁴ judicial estimation of claims,²⁴⁵ judicial factfinding without a jury, or the discharge,²⁴⁶ those remedies are justified only because the debtor cannot pay its debts.²⁴⁷

CONCLUSION

Bankruptcy is a coercive, collective proceeding to resolve disputes between a fraudulent, insolvent, or nonpaying debtor and its creditors as a body. The core problems it solves are provoked by cashflow insolvency, such as the limited fund problem, the race to the courthouse, breathing room for the debtor, and the need to preserve go-forward value. But for pragmatic reasons, Congress

²⁴² See Skeel, *supra* note 14, at 217–18; *In re PG&E Corp.*, 46 F.4th 1047, 1051 & n.1 (9th Cir. 2022); *In re Johns-Manville Corp.*, 36 B.R. 727, 739–40 (Bankr. S.D.N.Y. 1984) (observing that the Code contained no insolvency requirement but pointing out that Johns-Manville faced crushing punitive damages and its “present holdings of cash and liquid assets would be insufficient to pay these obligations”).

²⁴³ See, e.g., Casey & Macey, *supra* note 234; Bussel, *supra* note 234.

²⁴⁴ 11 U.S.C. § 502(b); see also 2 BLACKSTONE, COM. 488 (describing the cessation of unmatured interest as the “usual rule”).

²⁴⁵ *Id.* § 502(c).

²⁴⁶ *Id.* § 1141 (providing for a discharge upon confirmation of a plan unless otherwise provided for in the plan).

²⁴⁷ See Ralph Brubaker, *Assessing the Legitimacy of the “Texas Two-Step” Mass-Tort Bankruptcy*, 44 BANKR. L. LTR. I 9–10 (Oct. 2024) (arguing that the Supreme Court has only allowed the termination of opt-out rights when the defendant’s funds are insufficient to pay all the claims against it) (quoting *Ortiz v. Fibreboard*, 527 U.S. 815, 837 (1999)).

has allowed debtors who are balance-sheet insolvent or who have unreasonably small assets to file on a voluntary basis, much like contract counterparties may repudiate a contract before breach or a litigant may seek a declaratory judgment before getting sued. Debtors who meet none of these criteria present a constitutional problem, whether viewed through an as-applied constitutional challenge or through ripeness doctrine.

The best way to understand the proliferation of “good faith” doctrines is as constitutional avoidance,²⁴⁸ an attempt to evade a serious constitutional problem through constructive doctrines. Ultimately, though, if bankruptcy remains an attractive option for debtors seeking to refinance or manage their liability, the Supreme Court will need to hand down a single test. It would be the bankruptcy case of a generation, perhaps the most important since *Continental Illinois* in 1935. But if Congress does not want the Court to intervene, it can steer bankruptcy law away from the constitutional turbulence by reducing the attractiveness of bankruptcy to solvent debtors or by creating alternate procedures that do the job better.

* * *

²⁴⁸ See Brubaker, *supra* note 19, at 7 (arguing that good faith dismissals for lack of financial distress comprise constitutional avoidance decisions); Ralph Brubaker, 23 FLA. ST. UNIV. BUS. REV. 111, 128 (2024).

