THREE FUNCTIONS OF BANKRUPTCY LAW: THE WEST GERMAN CASE

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What are the causes of the inefficiency of bankruptcy proceedings and who has to suffer as a result? The authors conducted a nation-wide study of insolvencies and the legal procedures to deal with them in the Federal Republic of Germany in 1976. A report on this study was presented in 1977. In the following article the authors use the results of the study as a springboard for some sociolegal reflections on the functioning of law in general and bankruptcy law in particular. They emphasize the three main functions of bankruptcy law in any capitalist society (distribution, conflict resolution, and prevention) and describe social organization of these functions in West German bankruptcy law. Bankruptcy, as revealing a situation of breakdown and crisis, poses problems that are not only practical but also theoretical, problems that can stimulate sociolegal reasoning and help us to understand the social foundations of law.

I. INTRODUCTION

A. The Dilemma of Basic versus Applied Research

Bankruptcies and bankruptcy law may seem an unusual topic for a sociological study, especially since most lawyers would regard it as an "exotic" branch of legal studies. On the other hand, it is clear that insolvencies and their legal regulation in the form of bankruptcy proceedings can account for a considerable amount of "social drama." From there it is only a short step to the realization that the breakdown of a business is an important social phenomenon that deserves macro- and microsociological observation: macrosociological because breakdowns mark societal crises and "system-pathologies" as well as conflicts of interest, microsociological because breakdowns indicate the loss of relationships and the need for new orientations, and these have consequences for other members of society.

But in all honesty, such reflections are seldom the original reason for a comprehensive national study, nor were they the source of our study of West German bankruptcy law. It was ordinary curiosity on the part of the practicing lawyers to know more about the bankruptcy law in action, born of a deep dissatisfaction with the prevailing legal technique for dealing with insolvencies and breakdowns of firms. Dissatisfaction and curiosity combined to define a research project that was assigned to the Sociolegal Research Group at the Max-Planck-Institute, Hamburg, and supported by the West German Federal

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Ministry of Justice. The broad central question was: "What are the causes for the inefficiency of bankruptcy proceedings and who has to suffer from the disadvantages of these?"

Though addressed to sociolegal empirical researchers the breadth of this question proved to be a mixed blessing. On the one hand it allowed ample latitude for basic research on the socioeconomic phenomenon of bankruptcy, which had so far attracted virtually no sociolegal research. On the other hand it aroused in practitioners of bankruptcy law distinct expectations of "solutions" to the distressing inefficiency of current West German bankruptcy proceedings. And finally there was public pressure to do the research quickly and produce results.

In order to satisfy these inconsistent demands a research strategy of the "middle line" was adopted, which rested on the assumption that:

1. The opportunity to acquire basic sociolegal knowledge about the functioning of law in the field of bankruptcy should not be lost; accordingly, issues that raised general and theoretical questions should be considered.
2. There should be immediate answers to the questions raised by practitioners about how bankruptcy proceedings function; accordingly, bankruptcy law and related legal problems should be analyzed with a high degree of technicality.
3. The breakdown of a business is not only a legal but also a social and economic problem; accordingly, the study should seek to identify the different interests and their conflicts in the field of bankruptcies.

In view of our overwhelming ignorance of the subject, the study had to be exploratory, descriptive, and comprehensive; it had to eschew hypothesis testing and clinical methodology; and it had to open bankruptcy law to further sociolegal research.

B. The Sample

As sociolegal research demands, the object of study was approached from two perspectives: with a basic questionnaire posing all the legal questions bankruptcy practitioners wanted to answer and with a sociological "map" of the breakdown situation. These were combined into a set of basic questions to be put to persons and organizations in the field of law and economy. To ensure the broadest possible data base, a multilevel study was designed which adapted the set of basic questions to the different situations of particular categories of persons and

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organizations in economic and legal life. Two sets of data were collected: on the handling of bankruptcy cases and on the bankruptcies of businesses. Similarly, the target populations of these two sets of questionnaires were different types of social units: on the one hand, organizations with experience in handling bankruptcy cases—banks, social security authorities, tax offices, labor offices, trade unions, and credit insurance companies; on the other hand, the "participants" in actual bankruptcies—bankruptcy court staff such as judges and legal executives (*Rechtspfleger*), receivers, and creditors of the bankrupt business, both employees and other firms. This last group of respondents received greatly modified questionnaires: for obvious reasons judges and legal executives knew more about bankruptcy than did employees of a bankrupt firm or other creditors; unfortunately, we were unable to interview debtors, as planned, because the rate of response to our questionnaires was thought to be too low. Finally, we conducted a comprehensive analysis of the bankruptcy court records.

Our data base was thus the following:

1. *Bankruptcy courts* (nationwide): 273 questionnaires to courts concerning court organization; 565 questionnaires to court staff (judges and legal executives); 1882 records of bankruptcy courts
2. *Receivers* (random sample drawn from court records): 345 questionnaires
3. *Banks* (regional sample): 234 questionnaires; 275 records of bankruptcy cases and instances of composition
4. *Employees of bankrupt firms* (random national sample): 1015 questionnaires
5. *Social security authorities* (regional sample): 120 questionnaires; 550 records of bankruptcy cases
6. *Labor offices* (regional and national): 50 questionnaires to local offices; questionnaires to each of the 11 regional county offices
7. *Tax offices* (regional sample): 35 questionnaires; 165 records of bankruptcy cases and instances of composition
8. *Creditors* (random sample of business firms): 385 questionnaires
9. *Credit insurance companies* (all three): 3 questionnaires; 300 records of bankruptcy cases
10. *Trade unions* (selection): 445 questionnaires.

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Although the study was designed to generate comparable data from the various sources of information, differences in organization and knowledge among the respondents made it impossible to process all the data in a single program. Therefore, the different sources of information were treated as subprojects, and data were collected and processed separately, though simultaneously, using SPSS.

The study began in January 1976; questionnaires were mailed in July; and data analysis started in September. The report was written between December 1976 to March 1977 and presented to the Federal Ministry of Justice in April 1977. This rapid pace, especially given the size of the task, seemed necessary to the authors in order to respond to public demand for information about bankruptcies in West Germany.

C. Findings and Presentation of Findings

The report had to perform two functions: to provide a detailed extensive description of bankruptcy law in action and to identify the functions and dysfunctions of bankruptcy regulations in situations of economic breakdown, seen from a sociolegal perspective. Serving two (and actually more) masters at the same time is always difficult, and the report proved to be rather too detailed to permit a synthetic overview of the problems of bankruptcy law. Therefore, in addressing a scientific public interested in the sociolegal problems facing any bankruptcy law rather than in the detailed techniques of the West German bankruptcy law, we have decided to focus upon three major functions of bankruptcy rather than present an abbreviated version of our report. These functions are essential to any bankruptcy law in developed industrial societies: distribution, conflict resolution, and prevention. Each will be discussed separately, and we will not attempt here to link them together into a functional whole, although the discussion of the distribution function will provide an introduction to some of the technical details of German bankruptcy law.

A presentation such as this, which puts the results of an empirical study in the wider perspective of the historical, economic, and social development of a society, employing its own appropriate theoretical guidelines and viewpoints, can give only a partial picture of the functioning of bankruptcy law; it should not dissuade anybody from going back to the "hard data" of the published report (Gessner *et al.*, 1978).

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II. THE FUNCTION OF DISTRIBUTION

A. The Principle of Distribution in Bankruptcy Law

"Bankruptcy proceedings are court proceedings for the equal satisfaction of all creditors" (Seuffert, 1899:1). Most important works on bankruptcy have defined its true purpose in this or a similar vein since its codification in the nineteenth century. Bankruptcy (German: *Konkurs*, from Latin: *concurrere*, to come together) overcomes the archaic individual disintegration of a debtor's multiple relationships with creditors by substituting a collective solution. No longer shall the creditor who is first in time to reach the bankrupt's inadequate assets satisfy his claims in full, leaving subsequent creditors empty-handed; instead the losses shall be borne by all creditors. Kohler therefore talks of "the social nature of law" and of the bankruptcy law as "a piece of social legislation" (1891:1). Through the elimination of the right of priority a number of (previously independent) relations created by private law contracts, which have no point of contact other than a common link to the same bankrupt, are brought together into a community. "It is the consideration that it is less costly to distribute this deficit among all the creditors than to give one creditor total satisfaction and make the rest go empty-handed that the bankruptcy proceedings must thank for their genesis and justification" (Seuffert, 1899:1). This community of interests, ordained "on behalf of the state" or initiated by the "self-help" of the creditors (Kohler, 1891:2), came into being, and could only come into being, when the money and credit economy had reached an advanced stage.

The practice of waiving individual priorities in favor of a joint solution could not develop until there was an acceptance of the fact that it is often impossible to pay every debt and that this is one of the risks that creditors necessarily assume. The community of interests among creditors exists in latent form as soon as credit is advanced because all creditors depend on the same source to recover their money. When a debtor breaks down under the burden of his debts and has insufficient assets to settle all of them the community of interests becomes a joint and several community to overcome the fortuitousness of the principle of priority and reduce individual loss. Just as the development of credit itself depends on social solidarity, so every creditor who happens to have the first chance to plunder the debtor's assets must be prepared to give up this accidental advantage. Bankruptcy is based on such considerations of reci-

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procity; the principle of distribution is the core of bankruptcy law, reducing the risk of the creditor in the case of loss. Bankruptcy thus increases the availability of credit and becomes an essential precondition for economic development.

B. The Historical Development of Distribution in Bankruptcy Law

Although the institute of *missio in bona*[1] is found in Roman law the old principle of priority remained valid in the German countries, with their poorly developed money economies, until the fifteenth, sixteenth or even, in some areas, the seventeenth century. But the race to obtain priority became dysfunctional with the growth of economic resources and was gradually replaced by bankruptcy, first in the Hansa towns, the business centers of the Middle Ages (Kohler, 1891:32). Ever since then, the satisfaction of creditors from the liquidated assets of the bankrupt has been the cornerstone of bankruptcy law. Today, when the ability of bankruptcy law to function adequately in the Federal Republic of Germany is in question as "the bankruptcy of bankruptcy," the majority of critics focus their attention on the decline of this principle of distribution.

The history of bankruptcy law reveals that this complaint has been voiced before. Bankruptcy law is affected by economic trends more than almost any other law: it experiences a boom in periods of recession and is consequently subjected to attack (Arnold, 1977:385); this has recurred cyclically ever since the law was promulgated during the first great depression (1877) of the newly founded German Reich. Although lawyers extolled it as "the pearl of the Reich's laws" (Jaeger, 1930:34), economic circles expressed a very different opinion. The reasons for this are to be sought in the development of the national law out of a bankruptcy law that had originally been formulated only for Prussia.

Under Prussian leadership and influenced by the rapid growth of trade during the nineteenth century, a large number of small states combined to form the German Reich. Local demand was no longer the frame of reference for the producer; expanding economic units required a larger market accessible without prohibitive customs duties. Before the foundation of the Reich (1871), during the early period of economic change, Prussia passed a bankruptcy law (1855) (along with other legislation), which was supposed to meet the needs of the new patterns of trade. It was drafted by a bureaucracy that was

1. This is a court procedure by which the creditors obtain joint possession of the debtor's assets, and supervise and administer them together.

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conservative but economically open-minded (Lütge, 1966:491; Gotthold, 1975:23 ff.) and furthered the development of economic resources. The basic framework of this early Prussian draft was adopted by the legislators of the German Reich. However—and this is part of the reason why critics attacked the new law so soon after its introduction into Germany—in the intervening twenty years a fundamental economic change occurred, although it was hard to recognize at the time. The notion underlying the Prussian concept, the basic principle of economic liberalism that all market participants freely compete with each other, was already anachronistic and certain to become more so.

Economic change in Prussia called for a new bankruptcy law that altered the relative emphasis of its different functions. With the increase in trade and commerce the inadequacy of assets to satisfy debts became a recurrent problem, requiring a law that could regulate the resulting conflict (see Part III: The Function of Conflict Resolution). The emphasis changed from justice, which had been the ordering principle in proceedings under the *vis attractiva*,[2] to more purely economic considerations of efficiency. A shortened procedure was supposed to provide a practicable form of liquidation which would be more in line with economic cost-benefit calculations, rather than absolute justice.

The deterrent function of the punishment of the bankrupt, which had still figured in the precursors of modern bankruptcy law, also lost importance (see Part IV: The Preventive Function of Bankruptcy Law). It was replaced by the idea that bankruptcy law should be the legal equivalent of what liberal economic theory saw as the special function of the competitive system: the market process of removing producers who could not keep pace with its demands. The failure of the bankrupt was no longer regarded as indicative of individual dishonor and therefore was not punished. Rather such failure was seen as the inevitable risk of free trading and the disappearance of the bankrupt from the market as a functional contribution to the permanent reorganization and stabilization of the whole economic system.

2. The legal understanding of the *vis attractiva* that prevailed from the seventeenth to the nineteenth century characterized bankruptcy as a proceeding in which "all pending suits of the bankrupt were taken over by the bankruptcy court," which retained responsibility for all decisions about the bankrupt's estate until it was finally settled. The proceedings usually lasted several years and thereby delayed the distribution of assets among the creditors (Hellmann, 1907:88).

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The principle of equality, which originally underlay the distribution proceedings, had been considerably weakened by the privileges individual creditors and groups of creditors had accumulated in the course of time. This rendered the proceedings more complicated and more time-consuming. In the new bankruptcy law the principle of equality was revived and became another of its mainstays. Because the external function of bankruptcy had been confined to weeding out unhealthy economic actors the distributive functions assumed a position of prime internal importance. All monetary creditors were given satisfaction from the bankrupt's estate; persons affected in ways not readily measurable in terms of money—for example, by the loss of a job, breach of contract through sudden withdrawl of a promised service, or loss of customers or suppliers—were dismissed with the argument that the positive effects on the economy as a whole outweighed the negative effects that this destruction of firms might have for individuals. The distribution among money creditors took place on the basis of an equal share for all, the postulate of the equality and equivalence of all market participants being fundamental to the classic economic liberalism that prevailed when Prussian bankruptcy law came into existence in the 1860s (Lütge, 1966:493). A contemporary explication of the law commented that "the basic idea of the necessity of privilege and priority everywhere" was recognized as being "a grave mistake" because they "impede and delay" the distribution and hamper "the drawing up of a settlement." Furthermore, and this was seen as the most weighty argument, "every person who wishes to do business with the debtor . . . must easily be able to assess whether the resources of the debtor are enough to cover his own demands and those made by others" (Motive, 1873:329).

C. Priority and the Principle of Distribution

The legislature could not eliminate all priorities, although the explication stated that "the removal of all privileges . . . must be the goal that legislation must not lose sight of and from this viewpoint . . . all exceptions that laws thought they had to make must be checked" (Hahn, 1881:238).

The legislature acknowledged two justifications of privileges: "regard for the public good" and "the need for particular protection of certain creditors" (Hahn, 1881:329). As a result, it established the following order of priority for all creditors of a bankrupt.

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First, satisfaction was to be given to employees for wages earned during the year preceding the adjudication of bankruptcy, including contributions to the social welfare scheme, holiday bonuses, payments to savings schemes, and other gratuities agreed upon. Next were the claims of the state for taxes that had accrued during the preceding year. Third were the claims of churches, schools, and other public law associations and institutions arising during the preceding year. Fourth place was given to doctors, surgeons, veterinary surgeons, chemists, midwives, and nurses for services rendered during the preceding year. Fifth came the distribution of assets to the children and wards of the bankrupt. Every creditor with a higher priority had to be satisfied completely before anything could be distributed to the next in rank. Not until all these groups had been completely satisfied could the claims of the rest of the creditors be considered. These last jointly shared the residual estate which, when assets were inadequate, could only provide them with a liquidating dividend.

Two other claims against the estate lie outside this order of priority and take precedence over it. The first are secured rights created by contract with the bankrupt. These take the form of rights of exemption or separation (*Aus- und Absonderungsrechte*) and can be enforced outside the court proceedings. They are always valid regardless of whether a bankruptcy proceeding is initiated or, if initiated, is terminated before adjudication because the estate is inadequate to cover the costs. Assets separated and exempted by special rights are not part of the bankrupt's estate. The second are the costs and debts of the estate arising out of the proceedings themselves, including not only the costs of administration and of realizing the bankrupt's assets but also financial support for the bankrupt and his family and the cost of fulfilling pending contracts or new contracts made by the receiver. Contemporary distributions no longer comport with the original principle of equality. The empirical data we collected show clearly which groups of creditors claim which parts of the estate for themselves, which assets can be realized, and the degree to which the principle of equality is violated by the changed structural conditions under which the proceedings occur.

1. The creditors of the estate should, strictly speaking, be excluded from consideration since their claims do not arise until after bankruptcy has been adjudicated and they are therefore not part of the community of genuine creditors in bankruptcy.[3] But their claims cannot be ignored, even if the

3. The creditors of the estate are those whose claims are created by the bank-

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function of distribution is already frustrated by giving priority to too many large claims against the estate. A procedure that only manages to finance itself and leaves barely any assets for the creditors hardly deserves to be called distribution.

After the separation and exemption of assets that do not belong to the distributable estate, about 65-70 percent of what remains still escapes the creditors of the estate when proceedings are held. The idea of a fair distribution among the creditors of a bankrupt is thus already badly compromised by the excessive cost of the distribution procedure. The receiver's fees constitute a major part of these costs, whereas the court fees are less burdensome. Other claims on the estate are made by the State Treasury, which seeks unpaid taxes and, under certain conditions, the employees.

2. It was never doubted that employees needed special protection and had to be given a preferential right.

> This privilege would indeed appear to correspond to the natural state of relations. Persons dependent on such relations of service must hire themselves out without being in the position to get security for their claims. The nature and length of service make it difficult to initiate an action against the master. The provision of necessary protection through the granting of a preferential right is in contradiction neither to the nature of general credit nor to the rights of the other creditors. [Hahn, 1881:348]

Because this situation has remained essentially unchanged for decades it was impossible to deprive employees of their privileges and relegate them to the ranks of ordinary creditors. It was not until secured rights proliferated, thereby undermining the five privileged statuses described in Section 61 of the Bankruptcy Law (*Konkursordnung*, hereafter KO), that the preferential rights of the employees frequently became nothing but paper claims. An additional difficulty was that employees frequently had to endure intolerable delays before satisfying their outstanding claims because the receiver was only allowed to attend to these after the first general hearing (§ 170 KO).

The first attempt to correct this deplorable state of affairs was the law on compensation for wages lost due to bankruptcy (*Konkursausfallgeld*) passed in 1974.[4] At the same time some

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ruptcy itself, and therefore arise after it has been declared. They are to be contrasted with the "original" creditors of the firm, whose claims antedate the bankruptcy. However, the claims of employees accruing three to six months before insolvency are also treated as debts of the estate.

4. Compensation for wages lost because of bankruptcy covers all employee claims arising during the last three months before the declaration of insolvency. It is not dependent upon the debtor's estate but is paid automatically after the bankruptcy proceedings, from a fund financed by all employers in proportion to their size. It is therefore a system of compulsory insurance in which engaging in business is viewed as a risk and the employer required to pay a premium.

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of the other provisions of the Bankruptcy Law were modified. Unpaid claims less than six months old were placed in the second priority but wage claims between six and twelve months old were left in the first priority (§ 61 KO). The extent to which this latest legal development has altered the balance of the scales in the distribution of the estate could not be established by our study.

At the same time, the employee's right to recover in bankruptcy what he was owed under the labor law and the law on the constitution of firms (*Arbeits- und Betriebsverfassungsrecht*) was also strengthened. Particularly significant was the recognition of obligations under the social welfare scheme,[5] either as a debt of the estate or within the first priority (§ 61 KO). While these laws were being reinforced and implemented more thoroughly wages were growing as a fraction of production costs, which increased the importance of employees' preferential rights and further undermined the idea of equality in distribution. Thus, "the gap between wages and prices" in the middle of the nineteenth century "led to a great profit" (Lütge, 1966:473) of a magnitude that can rarely be realized today given present costs.[6] Whereas the explication of the original bankruptcy law spoke of employees' privileges "being in terms of volume hardly worth the creditors' consideration" (Hahn, 1881:248), the law has still been criticized by many creditors, particularly the smaller creditors, for being overly solicitous of the employees' social welfare, although the amendments to the law are based on the old unchanged reflections.

Because of this change in the structure of costs ordinary creditors no longer accept the privileges of employees, although the former have also gained some relief from the law on compensation for wages lost due to bankruptcy. Criticism by creditors today focuses on the large proportion of assets consumed by social welfare schemes. From the point of view of the employee, however, the social welfare scheme is an inadequate monetary indemnity for the incalculable existential crisis experienced by the employee when he suddenly loses his job. The asymmetry between the legal treatment of the claims of employees and general creditors is more than outweighed by

5. The social welfare scheme, legally required since 1972, is negotiated between the firm and its works council when there is a mass dismissal and is intended to cushion the impact of the dismissals upon the labor force.

6. This phenomenon can be explained by the Marxist law of declining profits, which has been elaborated recently by the theoreticians of state monopoly capitalism in France (Boccara *et al.*, 1973).

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the less visible but more important asymmetry between the existential threat of loss of employment and the mere loss of capital.[7] The apparent inconsistency between the rights of employees and the idea of equality disappears when it is recognized that the employees' claims are not merely financial but rather an inadequate monetary compensation for a much more severe loss.

3. Since the introduction of the Bankruptcy Law the gap between the gross and net incomes of an employee has greatly expanded because of taxes and especially contributions to the various social security authorities: sickness and retirement benefits, unemployment benefits, and health schemes. These three schemes are financed equally by employers and employees, who make all their payments to the health insurance agencies. The employees' accident indemnity scheme, on the other hand, is financed exclusively by the employer and administered by the respective professional associations. Social security contributions are generally included in the employees' gross wages because they are calculated on an individual basis and affect the compensation that may be claimed. Those inadequately insured by social security may appeal to a safety net of state services but these only advance money and the services they offer are generally of a lower quality. Therefore a termination of social security contributions may mean a substantial loss to an employee. Consequently social security contributions are closely tied to wages in the case of a bankruptcy and share the same priority.

Although the law of bankruptcy treats the claims of employees and of social insurance equally, in practice 84 percent of the latter were satisfied but only 65 percent of the former.[8] Legal measures alone cannot guarantee their own realization. The recovery of outstanding claims also depends on organizational structure and resources. The medical insurance agencies have professionalized their recovery of claims: they routinely issue letters of request for payment and pursue outstanding debts when payments cease or an insured firm goes bankrupt. Moreover, because they are responsible for collecting money owed to the other social security authorities they feel additional pressure to obtain an optimal settlement. By

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7. This can also lead to an existential crisis for unsecured creditors who are owed very little as well as for secured creditors with small claims on the estate. Those whose losses are limited to capital make this argument against the social welfare scheme.
8. Among proceedings that had been completed; most of these were adjudicated before the 1974 amendment to the law.

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contrast, bankruptcy is usually a unique experience for employees, who lack the warning that medical insurance agencies obtain when an employer stops paying social security contributions.

Equality in distribution therefore depends not only on the existence of adequate legal rights but also on the capacity of the individual to exercise them, as long as the satisfaction of one claim means the loss of another. But the differential capacities of employees and social security authorities do not affect claims under the law for compensation of wages lost due to bankruptcy. The direct confrontation which results from competing claims to limited assets has been avoided through the introduction of a system of insurance. The amount sought in any individual case does not significantly impair the resources of the insurance fund, so that all legitimate claims can be satisfied without having to weigh one against another. The effort of the individual to obtain a more favorable share of the distribution loses its meaning.

4. Discussion of the privilege of the Treasury is as old as bankruptcy law itself. It is justified in terms of the general good but even more by the fact that the Treasury cannot exercise any choice in making its claims. It must give credit to the potential bankrupt, and usually learns what it is owed after the debt arises, through a preliminary declaration of taxes or a tax statement. Although the privileged position of the Treasury was eliminated in a preliminary draft, its second priority was restored in the final version. We shall not enter the controversy over whether this fiscal priority should be viewed as the conservative expression of a dying mercantile state in the process of changing into a liberal economic order or whether it is evidence of a fundamental change to a modern tax system as the source of income. What is certain is that this privileged position only becomes justifiable when the state is transformed from "nightwatchman" to guarantor of social welfare, charged with more and more tasks of ordering and guiding; but this change did not even begin until after the passage of the German Bankruptcy Law. Nevertheless, representatives of economic interests have advocated abolition of this privilege with increasing vehemence over the years, culminating in a motion to strike it completely, placed before the Tenth Law Society Conference in 1977. In order to understand this position it must be remembered that the tax system has expanded greatly since the middle of the nineteenth century. Income tax in Prussia never exceeded 4 to 6 percent and the trade tax was

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much lower than it is today. At that time, therefore, the fiscal privilege accorded to tax obligations only removed very limited assets from the bankrupt's estate; today the tax debts in a bankruptcy case would, if completely recovered, strongly endanger the principle of equality in the distribution proceedings.

If the privilege were abolished, its opponents argue, the assets distributed among the next-ranking creditors, and especially the general creditors, could be doubled or tripled without invading the rights of secured creditors. They point to the fiscal privilege as the original cause of the increased use of secured rights: because the state, though pretending to support the principle of equality, granted itself a preferential right, its rising revenue forced ordinary creditors to protect their claims with a lien in order to obtain even partial satisfaction in case of bankruptcy. The Treasury takes such a large share of the assets that all general creditors must accept a total loss.

But what happens in reality? Only if the Treasury recovers its claims in full can its privileged position be the cause of the poor dividends paid to lower ranking creditors. If the estate is not large enough to satisfy even the Treasury, the factors that drain the estate must be sought higher up than the Tax Office. This is generally the case. In adjudicated proceedings only an average of 15 to 20 percent of the original claims of the Tax Office are met. This is partly the work of the receiver, who usually tries to reduce the high tax demands and contests the justified claims of the Tax Office. We saw, in the case of the social insurance, how professionalization in seeking payments leads to a more favorable distribution; here we can observe how the receiver's strategy of actively contesting tax claims has the opposite result. The significance of a privilege therefore turns on the intensity of the effort made by one side or the other to obtain those rights. The Treasury does not pursue its claims very assiduously but tends to play a passive role in the entire distribution procedure, as demonstrated by the infrequency of its participation in creditors' meetings: the Tax Office sent a representative to less than 2 percent of all proceedings and was never once represented at a creditors' committee.

The Treasury thus adopts a policy of restraint in exercising its controversial preferential right. Although it generally has relatively good information about the liquidity of the potential bankrupt prior to bankruptcy, it is nearly always willing to continue extending the terms of payment of outstanding debts and generally refrains from filing a bankruptcy petition itself. But

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this means that the tax obligations are relatively large when the business goes into liquidation and constitute a major burden on the estate: an average of DM 117,000. Because a redistribution of this amount would not substantially increase the dividend of the general creditors, the argument of those opposed to the fiscal preference appears specious. Although the privileged position of tax claims might seem to jeopardize the principle of equality, in fact it only makes a limited contribution to the asymmetric distribution.

5. The preferential rights of churches and schools, doctors and chemists, and children and wards of the bankrupt are of little importance in contemporary liquidations. The claims of the church generally refer to church taxes. Because of the existence of a State Church in the Federal Republic of Germany the Tax Office collects the contributions of those employees who are members of the Church and distributes them to the various denominations. The Church claims an average of DM 2,300 from the estates of bankrupts, of which it recovers an average of 16 percent in adjudicated proceedings, a sum that scarcely affects the total distribution. Payments to schools have become unimportant with the prevalence of free schooling. The preferential right given to doctors was originally intended to ensure that the needy debtor would not be refused help in an emergency because the doctor or chemist could not count on being paid. The social insurance system has also made this sort of claim anachronistic. Claims by children or wards are rare.

6. The sixth place is occupied by those who constitute the central issue in bankruptcy law: the pool of general creditors whose rights did not appear worthy of special protection. They stand on an equal plane and must select (or accept) a receiver to divide the assets among them. This is an extremely heterogeneous group composed of banks, suppliers of goods and services, and private financiers. It also includes the creditors who would be entitled to a preference but for the fact that their rights to payment matured more than a year before bankruptcy. General creditors receive an average of 3 percent of their demands. If one also considers those proceedings that terminate by default (under § 20 KO) because the estate is not large enough to cover the costs, the general creditors obtain only 2 percent of what they are owed. Although the various groups of creditors in the last category of priority have the same legal status, in practice they recover different proportions of their claims. But in order to investigate what each group re-

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ceives it is necessary to examine the special rights of separation and exemption as well. These special rights, which are expressly removed from the distribution under bankruptcy law and can be satisfied out of the debtor's assets prior to and independent of the bankruptcy proceedings, permit an exit from the compulsory community of creditors in bankruptcy, thus undermining the distribution procedure. This separation of the liens from the proceedings was already recognized as problematic when it was first introduced into bankruptcy law. However, in the dispute over the universality of the bankruptcy proceedings (*vis attractiva*), it was decided that it would be unfair to delay the satisfaction of the secured creditors until the end of the proceedings. Such a decision was facilitated by the recognition that, at the time, liens had "only an extremely small realm of validity in Germany" (Hahn, 1881:39). But this is no longer the case: secured creditors have become one of the largest impediments to equal distribution.

Banks make by far the most frequent use of secured rights, accounting for over 70 percent of all rights of separation and exemption. The assets secured constitute about three-fifths of the bankrupt's assets as assessed before the declaration of bankruptcy. Because banks are careful to render their secured interests "bankruptcy-proof" they suffer the smallest drop in value when those assets are realized: 81 percent of their claims against the bankrupt are secured; put differently, they participate in the distribution procedure as a general creditor in the last category of priority for a mere 19 percent of their demands. Moreover, because they claim against small estates less often, and make smaller claims when they do, they recover an overall average of 84 percent. Thus, despite the fact that they are at the bottom of the order of distribution they get the best results of any creditor.

In an economic system where business concerns are, on average, 60 to 70 percent in debt, banks naturally play an important role when a firm goes into liquidation. Their demands make up 38 percent of the total claims against the bankrupt, and usually only a few banks are involved. No other group of creditors can obtain comparable information about debtors. By observing movements to and from a bank account and making constant checks on credit they can establish the liquidity of a firm at any moment and arrange to be given a security interest as a matter of routine. No other creditor is their equal. On the contrary, many ordinary creditors complain that banks are able to determine whether and when business insolvency will occur.

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The banks keep a business going by extending credit as long as it remains profitable to do so and until the obligations of the business have been adequately secured. If the bank then stops additional credit there is usually only a very small estate left for distribution among ordinary creditors. The creditors who must initiate legal proceedings for insolvency are not those who really brought about economic collapse. By the time a bankruptcy petition is filed all that remains are the residual tasks of sorting out and clearing up. Because the important decisions are made prior to the bankruptcy proceedings the latter are reduced to a sharing out of the leftovers among poorly informed and inadequately secured creditors.

Suppliers of goods exercise less influence on the course of a business prior to a financial crisis but they do seek security whenever they extend credit. The majority of suppliers follow a fixed pattern and use set phrases for this purpose. Unlike credit relations with banks, in which the debtor is always in a dependent position, the relationship between supplier and purchaser takes on different forms. This form in turn, influences the information available to a supplier who has extended credit, and thus whether he is free to end the relationship or must continue to supply the business despite his misgivings. His security is usually less adequate than that of the banks. Suppliers of goods assert an average of 14 percent of all claims, of which a little less than two-thirds is covered by securities, i.e., they only have to register a third of their claims for distribution from bankruptcy assets in the lowest category of priority. They claim about 20 percent of the assets subject to rights of separation and exemption and realize approximately the same share.

The Treasury cannot claim any preferential right for taxes owed more than a year. Because the Tax Office frequently grants taxpayers a respite from payment, and even refrains from execution altogether, its rules require that it seek security for these outstanding debts. These secured interests constitute about 3 percent of the total secured assets, as evaluated before insolvency, and only 2½ percent of the secured assets realized. This confirms the restraint exercised by the Treasury as creditor, which we saw earlier in its pursuit of privileged claims. A secured interest is obtained, as required, but generally of the worst sort, capable of being realized partially if at all. The practice of the Treasury in obtaining security is therefore virtually meaningless: claims it has not been able to satisfy

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through its preferential rights are unlikely to be covered by its secured interest.

Finally we must mention the handicraft firms, suppliers of services, and other general creditors who cannot be listed individually. They do the worst on the whole. They claim only 11 percent of the secured rights, as evaluated before bankruptcy, and realize only 7 percent of all rights of separation and exemption.

D. The Asymmetry of Distribution Today

The attempt to draw up a complete account of the proceedings is difficult because not all groups of creditors are represented in all types of proceedings. But some facts are clear. The largest share goes to those with secured rights, regardless of whether proceedings are terminated by default or are carried through to completion. Secured rights consume an average of 87 percent of the bankrupt's estate in all proceedings. In order to estimate the proportional distribution among the other groups of creditors the following values were calculated on the basis of completed proceedings. Taking the remaining 13 percent of the bankrupt's estate as a whole, claims against the estate account for 67 percent, privileged creditors 22 percent, and general creditors 11 percent of the total disposable estate.

In terms of the total amount of claims asserted by those creditors who must be satisfied from the bankrupt's assets (that is, excluding the demands of employees and the claims of the social security agencies) the following are the proportions of their claims that each category of creditors realizes, either from their secured interests or from the liquidating dividend.

Banks	79%
Suppliers of goods	64%
Tax offices	11%
Other creditors	14%

If the available assets were to be distributed equally among all the creditors (again excluding employees and social security authorities insofar as their claims from other sources are met), each would obtain 46 percent of its claims. These figures show the extent to which distribution has departed from the basic principles of equality. If each creditor received this average proportion bankruptcy proceedings could still be wound up as compositions, whereas today general creditors have virtually no chance of obtaining satisfaction.

It is primarily the secured rights that have so undermined the idea of distribution, for they obtain satisfaction before the

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start of the proceedings proper and consume the largest share of the assets. Nor would it be correct to argue that the distribution now simply occurs among the secured creditors because there is no question of equality among them and no process of sharing a common dividend. On the contrary they meet as inconsistent interests with rights of different quality. Rights secured by real property, for example, lose an average of 34 percent of their value, those secured by movables 22 percent, and those secured by money about 50 percent. Thus the archaic solution to the problem, whereby the first creditor to take action achieves satisfaction of all his demands, has experienced a certain renaissance by way of secured rights. The only difference is that it is not a question of the first creditor in time but rather the one with the best security. In this situation the information available to the creditor about the nature of the debtor's assets and his liquidity, as well as the creditor's ability to demand secured rights, become the criteria for the creditor's position in a case of bankruptcy.

If bankruptcy proceedings do reach adjudication (rather than terminate in default) despite the extensive rights of separation and exemption, the high costs of liquidation are the next major obstacle to the distribution of the bankrupt's estate among his creditors. The receiver's fees, tax demands (which depend on how active the receiver is in administering the bankrupt firm), the costs of separating and exempting assets, and the demands made by the social welfare scheme put such a heavy burden on the estate that proceedings frequently have to be ended without declaring a liquidating dividend. The administrative costs are often out of all proportion to the benefits derived by the creditors.

If, nevertheless, the proceedings do lead to a satisfaction of the creditors' demands, the realization of a particular claim depends not only on its rank in the order of priority but also on the extent to which the creditor aggressively asserts the claim and on the creditor's organizational capacity to do so. This was shown by the fact that though the claims of employees and the social security authorities both occupy the highest priority, these categories of creditors still obtain dramatically different results at the conclusion of the proceedings. Similarly the Tax Office, which pursues a policy of reticence, obtains a relatively poor result despite its preferential right.

In order to counteract these distortions and to protect the claims of the employees the legislature has assured them payment through an insurance scheme that bypasses the distribu-

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tion of the estate. The idea of giving security to the demands of all the creditors through a proportional distribution of the bankrupt's assets was thus abandoned in this instance.

We conclude that the principle of a fair distribution, as developed by the legislature in the explication of the bankruptcy law, has largely lost its meaning in the actual practice of liquidation. Bankruptcy law was codified in the nineteenth century for an early capitalist economy characterized by little monopolization and relatively small differences in economic power, compared with the present. In such a situation equality for all the creditors in the case of business collapse did justice to the clash of relatively balanced interests. The gap between the economic poles began to widen with increasing monopolization. Moreover the growing importance of credit intensified the clash of individual interests occurring in the case of bankruptcy. Bankruptcy law was no longer able to hold such disparate forces together in a common distribution procedure. Those who were economically stronger sought other ways of satisfying their demands and abandoned the distribution procedure to the weakest. Thus the bankruptcy law of the nineteenth century, whose essence was an equal distribution among all creditors, is no longer adequate to contemporary economic activity because it can no longer provide the weaker with adequate protection.

Moreover further problems have arisen with the advanced division of labor and the increase in economic complexity. A modern bankruptcy law must take greater account of the external ramifications of the economic collapse of a firm. Distribution, by itself, offers too short-term a solution because it is restricted to providing a monetary settlement out of the assets of the bankrupt's estate. This always entails the destruction of an economic unit and the dissolution of an extensive network of relationships. This does not always make economic sense. There is a growing dependence of business on financiers who are more concerned about the yield of their capital investment than about the economic health of the undertaking. But in some cases it would be more desirable to reorganize and rebuild a business than to destroy it through bankruptcy proceedings.

The idea of distribution in the bankruptcy law had offered a common solution to the problem for all those with direct financial interests. A law that seeks to regulate business collapse in a manner appropriate to contemporary circumstances must take other relationships into consideration. Therefore, it

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is not sufficient to reform the bankruptcy law by finding a new way of implementing the distribution procedure.

III. THE FUNCTION OF CONFLICT RESOLUTION

A. The Basic Idea of Order behind the Insolvency Law

Assigning a purpose to a legal text is often unsatisfactory because the reason *why* the legislature decided to take particular action may not be readily deducible from *what* the legislature did. The "essence" of bankruptcy, or so the most important text books and commentaries begin, is the provision of equal satisfaction for all personal creditors out of the liquidated assets of the bankrupt. However, this "essence" becomes more and more elusive when one looks at bankruptcy law historically and comparatively. True, each of these laws shares the aim of depriving the creditor who acts first of the power of exhausting the assets of the bankrupt. However, as long as the creditor can prove the existence of preferential rights created before the collapse of the business, this goal cannot be achieved. As far back as the days of Roman institute of *missio in bona* the dead pledge creditors and the creditors with a special mortgage security did not take part in the proceedings (Fuchs, 1877:2) and most laws passed since then have retained and built on these possibilities.

The aim of assuring the remaining creditors a fair share of the residuary assets is also a common one. Justinian, however, had already excluded a section of the creditors by requiring that they register their claims within a fixed period (2 years for creditors settled in the same province, 4 years for those from other parts) and all bankruptcy law bears the stamp of an argument about preferential rights and privileges—"a path which called for perpetual revision and piled preferential right upon preferential right, so that a creditor had to be privileged if he were to stand any chance of achieving satisfaction" (Hahn, 1881:236). As the preceding section has shown, even this recognition of the inequities created by orders of priority still produced a nineteenth century bankruptcy law that came no nearer the aim of providing equal satisfaction for all creditors.

One could easily adduce additional evidence, that the so-called essence of bankruptcy law is just a label that can be affixed to nearly any legal provision that affects relations between an insolvent debtor and his creditors.[9] We therefore find

9. The concept of debtor varies historically from the circle of the family (parents, brothers, sons, housemates) under the *Statuto della marcanzia de*

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the customary definition meaningless and endorse the alternative view that the reason for this radical intervention of law in economic life[10] is to provide a framework within which to settle a situation of conflict that the legal order finds unbearable.

That bankruptcy law serves to eliminate a dangerous source of conflict emerges in legal writing despite its emphasis on the ostensible goal of distribution. Kohler (1891:1) stresses that apportionment of the losses of the different creditors should take place in an "orderly procedure." Berges (1965:5) fears that the "function of order and guidance of jurisdictional authority" is "seriously jeopardized when insolvency disputes are not settled within the frame of the contemporary bankruptcy law." Hanisch (1977:5) argues that reform of the law of insolvency is of utmost urgency because "a fully developed legal system cannot tolerate the existence of a competition which favors the stronger and cleverer parties or the existence of a free-for-all, as is often the practice today." This justification of legislative intervention in economic activity in terms of the need for nonviolent conflict resolution rather than for an equitable distribution of assets makes it imperative that different standards be established for bankruptcy law. The criteria for legislative success must be whether the legal system responds to conflicts arising out of insolvency and whether the procedure for conflict resolution manages to reduce the conflict effectively.

B. Order and Conflict in the Reality of Insolvency

If one judges proceedings under the Bankruptcy Law of 1877 by the criterion of avoidance of open conflict over the residual assets, the law appears to be very successful. The following data show that insolvency proceedings are concluded without conflict to an unexpected extent.

1. Fewer than one creditor in ten attends a meeting of creditors in order to pursue his interests, either by himself or with other creditors of the same rank. The creditors' pools so frequently mentioned in the literature are in practice very rare.
2. In 92 percent of all proceedings no formal appeal is made. Those formal appeals that do occur are generally sought by the bankrupt against the decision

Brescia (see Kohler, 1891:15)—a very broadly defined liability—to the limited company (GmbH und Co. KG)—a very narrowly defined liability.

10. Dogmatic bankruptcy law cleverly avoids dealing with the fact that the debtor is practically expropriated.

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to adjudicate. Creditors hardly ever appeal against the decisions of the official receiver or the court.

3. Creditors very rarely claim damages against the bankruptcy judges or legal executives for errors of office. This is partly explained by the fact that bankruptcy courts have little to do with the administration of insolvency. However, even the official receivers are seldom held liable, though their actions significantly influence the satisfaction of the creditors.
4. Creditors rarely invoke their power to reject the official receiver chosen by the court or to file an application for the dismissal of a receiver.

However, we should not overlook the fact that one important reason for the "conflictlessness" of bankruptcy proceedings lies in the law itself. In 1877 the legislature did not follow the example of earlier legislation which, influenced by the *vis attractiva* of bankruptcy, had given the bankruptcy court the power to decide all matters connected with the bankruptcy and in any way relevant to the proceedings, as was the case in German common law.[11] The Bankruptcy Law limited the competence of the bankruptcy court to those decisions that concern either the legal relations between all creditors and the bankrupt or administrator, or disputes that have arisen in the course of the proceedings.

Disputes over claims against the estate or claims against objects that are not part of the estate and disputes with the receiver over his administration of the estate remain outside bankruptcy proceedings. The legislative intent, however, is that these conflicts cannot be allowed to turn into "a free-for-all," but should be heard by the ordinary courts of law (Hahn, 1881:271). "The legal problems of the bankruptcy law and bankruptcy proceedings will not be settled so much during the course of the proceedings as in the legal disputes arising out of them" (Hahn, 1881:272). Proceedings before the ordinary courts of law should therefore be included in an assessment of the level of conflict in the legal liquidation of insolvency. Our research disclosed that these proceedings are very uncommon. According to the information provided by receivers an action of avoidance (challenging the receiver's administration of the estate) is brought in only one out of every five bankruptcies. In about one-third of the files of adjudicated bankruptcy proceed-

11. Compare the bankruptcy laws valid prior to 1877 in Bavaria (Art. 1199ff.), Oldenburg (Art. 352), Bremen (§§ 88, 95), and Lübeck (§ 40).

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ings there is a record of another legal action between a creditor and a receiver. Furthermore, the small fee paid to the receiver or other legal representative of the bankrupt's estate (an average of DM 960) indicates that there are few problems with the creditors outside the proceedings. Nevertheless, there appears to be some evidence of conflict in the number of claims challenged by the receiver: 10-15 percent of the claims are fully contested and a similar number partially contested, so that altogether 12-25 percent of the claims are challenged. The impression that the present bankruptcy law achieves such a high level of order has to be qualified, however, by an awareness of those instances in which creditors take matters into their own hands. If people take unauthorized action, the ordering function of bankruptcy proceedings breaks down completely, since it is not possible to draw these conflicts into a legal proceeding. However, judging from the information we obtained in the course of this study, cases where creditors have resorted to self-help are insignificant. According to these data bankruptcy proceedings in Germany are surprisingly orderly and free from conflict. But there are two very important reservations to this generalization. First, the peaceful nature of the proceedings may express the creditors' resignation in view of the poverty of the estate in most bankruptcies. Conflicts may be avoided not because the legal proceedings operate successfully but simply because there is nothing worth arguing about. Second, the selection of these insolvencies that are administered according to bankruptcy law may distort the picture. If those insolvencies that contain the greatest potential for conflict are resolved in the business world without the intervention of the court, then one cannot justifiably talk about the efficacy of the ordering function of bankruptcy law.

With the help of the available data we can explore the first possibility by comparing the behavior of creditors in bankruptcies where the estates vary in size. We measured the size of the distributable estate by whether a dividend was distributed among the nonprivileged creditors and, if so, how large. We found no significant correlation between indices of the activity of the creditors or their readiness to become involved in conflict and the size of the distributable estate. The number of people attending the creditors' meeting does not increase with the size of the distributable estate nor is there any correlation between the size of the estate and the size of the lawyers' fees in cases where a dispute was taken to court. Neither the frequency of lawsuits nor the number of appeals filed during the

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proceedings correlates with the dividend paid. People are not more disputatious in asserting their claims against the estate when the chances of obtaining satisfaction are greater.

These negative findings force us to reject the hypothesis that the tranquility of bankruptcy proceedings is the quiet of the grave, that creditors display a resigned silence as the estate slowly disappears before them. One therefore could not expect any increase in the activity of creditors were it possible to increase the average size of the distributable estate through legislative measures.

It is harder to determine whether a free-for-all takes place outside the court proceedings. This is a critical question in the vast majority of insolvencies. About 70 percent of applications to initiate proceedings are rejected because the estate is not large enough to cover the cost of the proceedings and 40 percent of those that are filed are quashed during the course of the proceedings for the same reason. In addition there are the cases of insolvency where neither bankruptcy nor a petition for composition was ever filed and where the firms were quietly liquidated within the business world or refloated. We estimated that such extralegal liquidations occurred almost half as often as the insolvencies in which a bankruptcy petition was filed (with respect to all commercial firms except one-man businesses). There are no data available on the number of firms saved from insolvency. One may assume that in 80 to 90 percent of all insolvencies there is no legally ordered distribution of the estate.

Little is known about the way in which insolvencies are handled out of court and this is not illuminated in our study. But it is safe to assume that such procedures (whether liquidations or rescues) occur in an ordered manner. Strong evidence for such a conclusion is Karl Künne's "Aussergerichtliche Vergleichsordnung" ("Guidelines for Out-of-Court Settlements") (1968), which first appeared in 1936 and has since been expanded. These guidelines, drafted like a statute and furnished with a detailed commentary, are a remarkable phenomenon for the sociology of law. One lawyer, entirely on his own, has constructed a normative framework that has no claim to validity beyond its utility and is, without doubt, in common use. The situation in which the creditors find themselves competing with one another for meager assets motivates all concerned to grasp at any offer of order that makes quick decisions possible and helps avoid long and tedious disputes over matters of procedure. It is therefore not surprising that Künne should report

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that "destroyers [i.e., opponents] of a settlement . . . are in a tiny minority today and almost of no significance. . . ." (1968:xxxiv). In view of the existence of a well established method of winding up insolvencies out of court, the "destroyer of the settlement" would have no option but to file a bankruptcy petition, which would only reduce his possibilities of negotiation.

Insolvencies in which bankruptcy proceedings have been quashed for lack of funds (§ 204 KO) also ought to terminate peacefully. Disputes with and between the privileged creditors are normally over by the time the proceedings are quashed and the rest of the creditors have no interest in getting involved in a dispute when the estate has already been exhausted.

Insolvencies in which a bankruptcy petition has been filed but proceedings cannot be adjudicated because of inadequate assets remain problematic from the point of view of order. Although unsecured creditors again remain uninvolved and simply write off their claims, secured creditors compete over assets that have been used as security more than once or already transferred by the bankrupt, over goods that are no longer identifiable because they have been processed further, and over claims that are substitutes for the reservation of title. In a bankruptcy proceeding the receiver regularly intervenes in resolving these claims, although by law such disputes are external to the proceedings, so that he can present the creditors with an estate that has been "ironed out." In a bankruptcy where there is no estate the receiver cannot perform this function and conflicts may therefore be more frequent.

The findings of our effort to uncover conflicts in insolvency are that bankruptcy law and the organized liquidation of insolvencies out of court managed by an autonomous parallel order are able to resolve most insolvencies without conflict. In the numerous cases in which adjudication of the bankruptcy is quashed (§ 107 KO) conflicts between secured creditors with overlapping rights and between the secured creditors and the bankrupt are probably more frequent. For here the receiver cannot act as helper and arbitrator, a function he assumes informally, and alongside his legal duties, in an official proceeding. We must now consider the reasons for this lack of conflict, looking particularly at the social relations of those involved in insolvency and at the different mechanisms of bankruptcy proceedings.

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C. Insolvency Conflicts and Insolvency Proceedings

In appraising the potential for conflict created by a business insolvency one is occasionally confronted with highly dramatic reports. There have been stories in the press about police action taken to safeguard the residual assets of a large self-service chain store, of the violent hijacking of a ship when the shipping firm went bankrupt, and of the occupation of a large French clock and watch manufacturer. Recognizing that these steps were taken by creditors whose claims, in general, were doubtless justified, one has to ask why such disputes do not occur more frequently. The collapse of a bankrupt firm ought to contain a considerable amount of social dynamite. It is said that when a small or moderate sized firm goes bankrupt in Japan bands of gangsters are regularly sent out by creditors to collect their debts and bankrupts often have to protect themselves with bodyguards. Violent confrontations of this kind are either nonexistent or extremely uncommon in Europe.

The concept of anomie may help us to understand why this is so. Anomie is a state in which there are no rules or regulations, or at least no certainty about the norms of interaction, so that it is no longer possible to play one's role. We can assume that in Japan bankruptcy creates a very high level of anomie because of the extremely high degree of interdependence and integration in economic relations (Kawashima, 1969). Bankruptcy transforms the rigidly cemented role behavior of "normal" business relations into a game of deviant roles with its own norms and techniques of control.

Business dealings in Western industrial societies display a different pattern. As investigations in the sociology of law have shown (Macaulay, 1963, 1977; Kurczewski and Frieske, 1977), interaction among business associates is considerably more complex—determined by more norms—than one would realize by looking only at the terms of formal contracts. However, the informal rules that operate parallel to the legal norms are not particularistic—limited to a certain social context such as the family, community, or branch of business—as in Japan; they are universalistic—valid for all objects with the same features (Parsons, 1968:61-63). Unlike the particularistic business relationships dominant in Japan, these norms, which function universalistically in the entire economic subsystem, remain valid and effective even when an individual social relationship breaks down. Creditors who have been disappointed by the insolvency and possibly even deceived do not find themselves faced by a situation of unregulated anomie but still feel bound

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by the rules of the economic system. Therefore deviant behavior, like that of the Japanese bands of gangsters, cannot arise.

What are these autonomous norms of the economic system that are independent of the law and yet significantly overlap with it? It is neither possible nor necessary to provide a general answer to this question here. One strand in recent sociology emphasizes that contemporary economic behavior is preeminently the behavior of organizations, which are governed by their own principles, distinct from those that explain individual behavior. Among the significant influences are the internal and external orientations of bureaucratic decisionmakers and their positions in the hierarchial structure (Evan, 1976:84). The nature and extent of power is also an indispensable criterion in the explanation of role play in interorganizational relations (Philipps, 1976:17) and the structure of the interaction requires a multiplicity of additional levels (Blau, 1976:58; Evan, 1976:85). These bureaucratic organizations are much more successful in achieving what has been the prime goal of the economy since its differentation into a separate system: avoidance of conflict. The latent conflict generated by competition is controlled by rules such as "keep channels open between partners!" or "be careful about fighting in public!" (Gessner, 1976:233). Textbooks and handbooks for industrial managers are full of practical advice to this effect and patterns of behavior have developed to anticipate conflict when dealing with uncooperative business partners.[12] It may often be a pecking order that determines behavior, but the purpose of pecking orders is the avoidance of cockfights.

The effectiveness of such rules of conflict avoidance appear clearly in our empirical report. Creditors who were involved in a bankruptcy and who, in reply to questions about the particular case, reported that they did not sue or take steps against the estate, other creditors, or the bankrupt, or did not appeal decisions of the receiver or the bankruptcy court, were asked for their general opinions about contemporary practice in bankruptcy cases in another part of the questionnaire. There they voiced bitter reproaches against the receivers, against the success of the banks in getting security, and against employee claims for payments under the social security system. One employee who asked rhetorically "how one can justify taking away income of a family of four from one day to the next" had

12. According to Reifner (1975:142), German creditors use eight different ways to remind and warn debtors that they are behind in their installment payment. None of these invokes the courts and yet they are successful in 85 percent of all cases.

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done nothing to enforce his own rights. Another creditor, who had written letters to the Employment Exchange, the trade union, and the newspaper *Bildzeitung*, responded: "So far no one has given me any help and that's the way it will probably stay."

Habermas speaks of the ambivalent state of social integration in the economic system of Germany (1977:67). On the one hand it appears to be stable: compared with other national economies it functions well and side effects can be controlled through social policy. On the other hand, under the surface there appear to be conflicts smouldering that cannot be fought out but must find expression in other spheres, such as in people's private lives. Habermas uses the term "pathological stability," which seems to be a good characterization of the peace and quiet of the insolvency scene. The potential for conflict is considerably greater than the conflict that actually emerges in concrete instances of insolvency and even greater than that which can be seen in the political controversies over preferred rights, the effect of social security schemes, or the priority of tax office claims (in which the only actual change has been the law for compensation of wages lost due to bankruptcy). The universalistic nature of economic norms seems to mean that conflicts are quickly transferred to a more abstract plane, but this is only an advantage for the whole system when such disputes adequately reflect the real opposition of interests.

Because of the high level of social control exercised over potential conflicts in insolvency through the very effective rules of conflict avoidance there are only a few other features that contribute to the orderliness of the process. First, the fact of a proceeding significantly enhances order. Those participating in it must stick to the rules and no longer have a free choice of ways to pursue their personal interests (Luhmann, 1969:3). In German bankruptcy proceedings these rules are intended to keep disputes out of the distribution of the residual estate whenever possible. These regulations are applied in practice even more energetically than is required by the text. In response to our questionnaires 93 percent of all judges and legal executives were vehemently against giving creditors a greater say in bankruptcy proceedings; one can hardly talk, today, about creditors' self-administration. The opposition of receivers is even stronger (96 percent); it is also striking that the vast majority are not prepared to recognize that the different groups of creditors—such as banks, social insurance schemes, employees, and general creditors—have inconsistent interests.

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This orientation toward the peaceable resolution of conflict means, for example, that bankruptcy courts do not make full use of their powers (§ 75 KO) to summon witnesses or invite experts to testify in order to throw light on anything relating to the proceedings (see Section IV.B., *infra*). Bankruptcy proceedings offer virtually no help in dealing with what is potentially one of the most important conflicts between the creditors and the bankrupt: attempts by the bankrupt to transfer assets before the receiver can sequester them. Neither courts nor receivers are active here, although they have adequate legal authority, and even when an economic crime has been established there is cooperation with the public prosecutor in only half the cases. It is noteworthy that the economic situation of the bankrupt firm is almost never an object of discussion, perhaps because analysis and prescription always give rise to a clash of opinions. In 86 percent of the cases the bankruptcy court did not even have a copy of the firm's balance sheet. Therefore the court can only see that the proper procedures are followed; it cannot seek a solution that makes substantive economic sense. Receivers do not inform themselves adequately and certainly do not exhaust the available sources of information about a firm. As a result 86 percent of the receivers who responded seldom or never have sought to save an insolvent firm or at least a substantial part of it. The practice with bankruptcy today is to avoid all conflict or deal with it outside the proceedings, although the structure of bankruptcy law does not require this. The complex social events surrounding insolvency are so constricted that only a remnant of the real problem is left and this can be dealt with relatively easily and as a matter of routine.

The fact that this phenomenon is not unique but indeed characteristic of contemporary society makes it harder to evaluate. The increasingly selective registration of the complex circumstances of life by a multiplicity of bureaucracies working parallel to one another has caused economic or administrative rationalities to supplant the practical rationality of the persons involved. The advantage of having particular limited aspects dealt with efficiently is bought at the cost of losing a comprehensive overview of social problems. When, as in the case of tensions arising out of insolvency, this selective manner of dealing with problems is coupled with social rules that are directed at avoiding public controversies, conflicts continue to smoulder under the surface without being recognized or without having their social content taken seriously.

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IV. THE PREVENTIVE FUNCTION OF BANKRUPTCY LAW

A. Law, Conflict, and Prevention

In addition to redistribution and conflict resolution, discussed above, bankruptcy law performs another function common to all law: the preventive function of a normative structure. Bankruptcy law not only tries to resolve the conflict created by the insolvency of a debtor through a legal procedure that seeks to satisfy the interests of both the participants and the general economy, it also strives to prevent such conflict from occurring. This is the basic function of every normative structure and such leading figures in the sociology of law as Eugen Ehrlich and Leon Petrażycki long ago showed that the intrusion of a law court in the activities of daily life evidences a dysfunction in the legal structure, a "pathological" correction of wrong behavior. Social and legal norms should guide social relations in such a way as to make court procedures largely superfluous. Law has the capacity to use norms in order to create expectations and social orientations and thus organize social relations in a context free of conflict, even if the realities of social life seem to be opposed to this result. The functional device through which law achieves this is the social organization of normative expectations in the framework of an integral structure. Its historical and social evolution has already been discussed (Luhmann, 1972; Ziegert, 1975:173). Here it is important to stress the capacity of the legal system to produce an institutionalized and socially legitimated stock of widely approved norms for social actions, which enable any member of society to formulate accurate expectations about the actions of other members and thereby "plan" his own social behavior.

The essential steps in constructing a legal system, therefore, are to pretend that there is a general consensus among *all* members of the society and then to institutionalize this fictitious consensus. It is obvious that the social reality of any given society does not contain such a consensus. All members of the society do not develop normative expectations with respect to all actual or potential social activities. The different and often conflicting expectations that do exist cannot be ascertained and harmonized so as to form a "realistic" legal structure of normative expectations. Finally, the differing interests in society generate antagonistic normative expectations. Therefore the legal structure, institutionalized in society and upheld by social organization but nevertheless fictitious as far as any factual social consensus in concerned, cannot avoid violation of

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normative expectations: the case of conflict. Even then the primary aim of the legal structure is not to regulate the conflict—this is the material interest of the courts and of the contending parties—but to call public attention to norms and expectations and thereby identify some as "right" and others as "wrong." Seen in this perspective, the purpose of the legal sanction, and of legal procedure as a kind of sanction, is not punishment or the repression of individual behavior but the confirmation or revision of the existing normative structure (Luhmann, 1972:54) with the attendant consequences for law as a means of social orientation (Ziegert, 1978:90).

All this naturally applies to bankruptcy law as well. Thus we could ask to what extent the norms, roles, and procedures of bankruptcy provide guidance (norm orientation) for the activities of the people concerned and give normative direction to economic behavior so as to facilitate trouble-free interaction, especially through the avoidance of insolvencies. Avoidance of insolvencies through the preventive function of bankruptcy law should be clearly distinguished from the insurance aspect of bankruptcy procedures in the case of the insolvency of a debtor: whereas the latter is the concern of particularistic interests and therefore is advanced by the assertion of individual rights, the preventive function is, so to speak, the "structural interest" of the legal order in organizing economic life without friction and loss. This "structural interest" is constituted by the specific economic conditions of a given society and varies according to historical settings and geographical situations. One expression of this "social interest" is the fact that law serves certain economic interests better than others since it cannot be organized independent of the political structures in a given society. We are interested here not in how the different parties to a business relationship try to minimize their losses in the case of insolvency by using law and in particular by acquiring a secured interest—the view that prevails in the legal literature which treats bankruptcy as a conflict regulating device. Instead, we are concerned with the structural function of bankruptcy law as a means of completely avoiding trouble and conflict in economic life.

Moving from such general thoughts to the concrete example of the German Bankruptcy Law it must be clear that a systematic dogmatic code of preexisting bankruptcy rules that has now been in existence for a hundred years without any major revision can hardly have a problem-free preventive effect on economic behavior. First, legal codes are rarely free of obsolete

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motives and historical meanings; second, it is doubtful whether a code directed at the specific economic conditions of the nineteenth-century German Reich can be adapted to the substantially changed situation of a modern post-industrial mixed economy. In order to analyze these problems we will focus, for now, on two aspects of the preventive function:

1. The penal function of bankruptcy law, which is primarily of historical interest and has been thoroughly analyzed in the jurisprudential literature.
2. The orientation function of bankruptcy law as a general procedure that takes into account all the aspects of the insolvency of a firm. This is of particular interest for legal policy and knowledge about its social effects is necessary for a political-economic analysis of the functioning of law.

In presenting these aspects of the preventive function of bankruptcy law as two sides of the same coin we are advancing two basic hypotheses. First, the penal aspect of bankruptcy law is a well defined, historically documented form of the preventive function of bankruptcy law. Second, this penal aspect is only a special historical form of a general procedure for dealing with insolvency in such a way as to serve the general orientation function of law. The purpose of the following discussion, then, is to study the penal function of bankruptcy law related to the structural elements of the orientation function, and how both bring about preventive effects.

B. The Penal Function of Bankruptcy Law

"Falliti sunt deceptores et fraudatores" ("Bankrupts are deceivers and frauds"). This is how commercial society in the medieval north Italian city-states labeled the bankrupt merchant, thereby endorsing the penal objectives of bankruptcy procedure: expropriation of the bankrupt, distribution of his estate among the creditors through a collective procedure, and examination of the bankrupt's economic activities by the court (Treiman, 1927:5). There is certainly a connection between the expanding economy of northern Italy at that time and the formulation of bankruptcy statutes that subsequently were "exported" to so many other jurisdictions. For it was not Roman law but the early Italian Merchant Law that became the conceptual basis of bankruptcy law in every important commercial center in early medieval times, whether in Spain

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(Treiman, 1927:47),[13] England, or the cities of the Hanseatic League.[14] The distinctive features of that law were:

1. The avoidance of priorities
2. A comprehensive procedure for execution
3. Control by the creditors over the administration of the procedure (through an elected "curator"-trustee and a board of *sindici*)
4. The possibility of an agreement among the creditors to give the debtor a "safe conduct" for a limited period of time while he tries to reorganize his affairs
5. Public (legal) inspection of the economic behavior of the bankrupt that led to insolvency
6. The possibility of declaring bankruptcy voluntarily in order to avoid the penal sanctions associated with the verdict of bankruptcy, although this procedure, too, carried a moral stigma and social disqualifications.

The conjunction in the historical treatment of insolvency by different societies—an economic boom and the expansion of commerce and industry on one hand and, on the other, a very precise description of bankruptcy procedures, with their associated penal and moral sanctions, in the form of publicly announced statutes—reveals a general structural pattern of law. A type of social behavior that is felt to be detrimental to society as a whole is exposed to public view by a legal procedure and thereby furnishes an example that reaffirms the norms of the society. It is clear that a bankruptcy inflicted a substantial loss upon the economic strength of a medieval merchant community. The problem, then, was to devise a legal remedy that would not only anticipate insolvency through securities and preferences, and the rights that the bankruptcy procedure guaranteed to every member of society but also, and even more important, to prevent insolvency from happening at all.

That the early laws actually pursued this latter aim can be seen in the Hamburg Bankruptcy Acts of 1630 and 1753, which clearly state that they were enacted to prevent fraudulent economic activities and the consequent damage to creditors, above all the "disturbance of commerce" by the negligent economic behavior of members of the community (*Hamburger Falliten*

13. The term "bankruptcy" derives from the Spanish practice of breaking the (money) counters of insolvent merchants (*banka rotta*) in order to prevent them from engaging in further trade (Treiman, 1927:47).

14. This is clearly demonstrated by the Hamburg bankruptcy statutes of 1630 and 1753 (*Hamburger Falliten Ordnung*).

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Ordnung, 1753). It is questionable how effective these bankruptcy laws were in achieving this deterrent objective, which is the effect usually ascribed to penal procedures. More interesting, however, and structurally far more relevant, is the question of the *orientation effect* of these early bankruptcy statutes as guides to economically correct behavior, for this is certainly what the legislature had in mind. Anyone participating in a commercial enterprise should calculate the risks of careless economic behavior, which were laid down in the statutes, and be aware of the fact that law would prosecute improper economic activities. The threat of penal sanctions in the form of expropriation and imprisonment was intensified by moral condemnation of a bankrupt, so severe that it could bar him from any further participation in economic or social life as a respectable citizen. This strong moral pressure could even lead the court to dispense with penal sanctions where a bankrupt voluntarily handed his estate over to his creditors (*cessio bonorum*). By doing that he became immune from punishment and further prosecution by his creditors, although he sometimes still had to face very humiliating and stigmatizing procedures.[15]

Thus the bankruptcy court procedure fulfilled two functions: it distributed the estate of the bankrupt in a lawful and calculable way equally among his creditors and it judged the bankrupt and decided his future. The judicial inspection was intended to reveal whether insolvency had been caused by fraud or negligence or merely by misfortune or accident (*Hamburger Falliten Ordnung*, 1753). Depending on the outcome of the court's scrutiny the bankrupt would either suffer some form of punishment and exclusion from public economic life or would be allowed to reenter society. A bankruptcy procedure that tries to maintain a fair balance between the interests of debtor and creditors and yet simultaneously publicly investigates the economic behavior of the bankrupt prior to discharge can still be found today, in the English Bankruptcy Act of 1914.

The German Bankruptcy Act of 1877, however, decriminalized the bankruptcy procedure by incorporating it into the dogmatic system of private law. This system requires the procedure to focus on the rights of individual creditors and on the distribution of the bankrupt's estate. The criminal aspect of bankruptcy is only of marginal interest: an evaluation of the

15. A number of such practices were found by Treiman (1927:127) in medieval bankruptcy statutes, for instance the wearing of a green cap (France) or a yellow coat (Scotland) in order publicly to stigmatize a bankrupt.

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economic behavior of the bankrupt is not desirable in such a procedure and the future fate of the bankrupt is no longer a concern of the court. Legal scholarship is unanimous that with the passage of this act and particularly under contemporary economic conditions, one can no longer talk of the punitive functions of bankruptcy law (see Siedschlag, 1971:20; Röpke, 1951:87; Reuter, 1965:5; Muthesius, 1961:186; Stockum, 1955:131).

The results of our empirical study of the functioning of German bankruptcy law underlines these juridical assumptions. Because bankruptcy proceedings under the civil law reify the insolvency situation there is very little opportunity to inspect the economic behavior of the bankrupt once he is divested of the estate and it has been handed over to the receiver. Even the few possibilities that remain are not fully utilized. A closer look at the requirement that the court make its own inquiries into the bankruptcy (§ 57 KO) shows that in practice this means little more than questioning the debtor and recording his personal data. Civil proceedings are followed by a criminal investigation and prosecution in only 17 percent of all bankruptcies declared. However, bankruptcy proceedings are administratively so totally segregated from criminal inquiries that the bankruptcy records rarely contain information about whether such steps have been taken; in over 60 percent of the records this could not be ascertained.

The transformation of bankruptcy proceedings into an "administrative" procedure represents a continuing trend: after the initial phase (*Eröffnungsverfahren*, i.e., examination of the bankruptcy petition and appointment of a receiver) nearly all proceedings are transferred from the judge to a legal executive (*Rechtspfleger*). Indeed, the court staff are generally in favor of giving the legal executive official control over the entire proceedings, which is what actually happens in almost all bankruptcy courts in West Germany today. An equally routinized procedure can be observed where state authorities, such as the social security agencies, are bankruptcy petitioners (see section II.C.3, *supra*). These authorities are the most frequent petitioners among all the creditors because they are unusually well informed about the economic strength of the firm (the employer's contribution to social security has to be paid in advance each month) and have a special legal position that enables them to know when an individual has been unable to execute a claim (the authorities of the obligatory social security scheme can acquire legal title in execution of their claims without recourse to court). Moreover the social security au-

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thorities are not particularly interested in encouraging further economic activity on the part of the bankrupt firm, in sharp contrast with the fiscal authorities. Finally, the special law on compensation for wages lost due to bankruptcy guarantees the claims of both the social security authorities and the employees (see section II.C.2, *supra*). This mechanism, which the social security authorities view as a perfect response to the problem of insolvency, does not require confrontation in court with the bankrupt firm or its directors. Consequently representatives of the social security authorities rarely participate as creditors in court proceedings (assembly, board of inspection, etc.). In such a bureaucratic procedure the debtor experiences no stigmatizing public inquiry and there is no social drama, especially since the law for compensation of wages lost due to bankruptcy removes the worst economic hardship from the proceedings (that of employees). It is therefore not surprising that the social security authorities, who have unusually good information about insolvent businesses, are more likely to see the bankrupt as the "secret winner" of the bankruptcy proceedings than are the bankruptcy court staff and receivers: 53 percent of the interviewees who worked in a social security authority felt that the bankrupt obtained an unfair advantage in bankruptcy proceedings, whereas 63 percent felt that the banks did so, but only 23 percent felt that secured trade creditors did so.[16] In contrast, a much smaller proportion of the bankruptcy court staff (18 percent of judges and legal executives interviewed) felt that the bankrupt obtained an unfair advantage than felt that such an advantage was obtained by the banks (55 percent), secured trade creditors (40 percent), and tax offices (31 percent). It is interesting that the smallest proportion of receivers (5 percent) thought that the bankrupt obtained an unfair advantage, less than the proportions for five other participants in bankruptcy.

The conclusion in the preceding section that bankruptcy proceedings avoid conflict can thus also be applied to the preventive function of bankruptcy law: because these proceedings do not expose the economic behavior of the bankrupt to review in the public forum of a court they cannot influence behavior or can do so only marginally. The increase in the importance of

16. The exact question put was: "Do you find that in your experience there are participants in bankruptcy proceedings who receive an unfair advantage in the proceedings (and can make a disproportionately large profit out of a bankruptcy)? If so, which of the following?" The list of participants in bankruptcy proceedings was comprehensive and interviewees who answered the first question affirmatively could name as many participants as they wished.

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the administrative structures in bankruptcy proceedings, justified by arguments of greater efficiency, has been accompanied by a decline in judicial decisionmaking. It is highly questionable, however, whether increased efficiency—for instance, through a speeding up of bankruptcy proceedings—can be achieved by using administrative structures of decisionmaking. Contemporary German bankruptcy proceedings, which last an average of two years and four months, are not delayed by court activities but by complications involved in distribution of the estate by the receiver. It is clear that the penal function of bankruptcy law—if such a function is desirable—is merely a side effect of the proceedings, which focus on the "clean" material question of the distribution of the estate.

This forces us to ask whether the penal function of the bankruptcy proceedings can have any preventive effect at all and, if so, whether it should. The latter, policy, question obviously has to be approached from the historical perspective of business cycles: because of an exaggerated estimate of its potential preventive effects, there is always a call for emphasizing the penal function of bankruptcy law whenever there is a notable increase in insolvencies. This overlooks the fact that insolvency is caused by economic and especially structural principles and not by legal rules. Bankruptcy is merely a legal consequence of economic facts. Nevertheless, the English House of Lords proposed inflicting the death penalty for fraudulent bankrupts in the early eighteenth century, thus regressing to the draconian sanctions of early Roman times, and it was no less a figure than Daniel Defoe who polemicized against this "easy way out" of preventing an increase in insolvencies (Defoe, 1705). And a significant proportion of the bankruptcy court staff in West Germany today would like to see bankruptcy punished more severely: 45 percent of those interviewed blamed the inefficiency of penal sanctions for the poor results in the distribution of the estates of bankrupts. However, one should not overlook the fact that the penal function of bankruptcy law, like that of any law, can be directed at only a very narrow target—individual economic behavior—and furthermore that the penal function of bankruptcy law, like the economic system to which it applies, is constantly undergoing change. This means that the penal function of bankruptcy law is also historically variable: under economic conditions where the cause, and the responsibility, for insolvency were held to reside with the individual (the "regal merchant," the entrepreneur) a bankruptcy proceeding, with its attendant disqualifica-

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tions and penal threats, might affect the map of expectations about business relations and economic behavior, which could serve to orient other people in the economic sphere. There is historical evidence that in the transition from an economy of exchange to a monetary economy, bankruptcy law significantly stabilized the economic system by greatly increasing the circulation of goods and money with the help of a system of credit. It was efficient in the sense of being a legal guarantee and in eliminating "disturbing elements"—such as fraudulent bankrupts and fugitive debtors—from the world of trade and commerce. Collective bankruptcy proceedings thus stress the social character of the legal sanction.

With the emergence of forms of enterprise no longer owned by one natural person or by partners, the economic system of developed capitalism in the nineteenth century severed the clearcut relationship between business activities (and consequences) and individuals. The German Bankruptcy Act of 1877 seems to draw a very logical conclusion from that transformation: the judgment of a bankruptcy court about economic behavior should be of little importance compared with the distribution of the bankrupt's estate because depriving the bankrupt of his estate disabled him from further involvement in economic activities and constituted a quasi-penal sanction. However, the act reduced the ordering and orienting functions of bankruptcy by adapting the proceedings to the material needs of distribution without replacing the penal procedures that were eliminated with some public (court) inspection appropriate to contemporary economic conditions. Under similar historical circumstances English bankruptcy law took a different direction: in addition to bankruptcy as a general court procedure for ordering the situation of insolvency, it created a procedure for liquidating companies, thus acknowledging the significant differences between individuals and organizations.

Economic change since the introduction of the Bankruptcy Act has caused a significant decline in the type of firm envisioned by the legislators of 1877. Furthermore, bankruptcy proceedings today are structurally incapable of dealing with the interdependence of the state, capital, and labor (see section II, *supra*). As a result, those proceedings have not only lost their penal function but also the quasi-penal effect of state intervention in the private sector of the economy, and thus the preventive effect for the economic system in general. The question, then, is whether the only function of bankruptcy proceedings should be to rubberstamp the historical residues of economic

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development or whether the law should not, instead, create bankruptcy proceedings that are structurally as adequate to the complex situation of business insolvency in contemporary West Germany as the disqualifying penal bankruptcy of the early Italian Merchant Law was in its time.

C. The Orientation Function of Bankruptcy Proceedings

In talking about the "penal function" of bankruptcy and its various historical forms we have concentrated upon a rather easily defined function of that law. Nevertheless, this function is far broader than what we commonly understand by "punishment": the penal threat of a legal inquiry primarily serves to bring the statutory framework of legal rules to public attention. Participants in the system of economic exchange should be able to use this body of norms as a basis for calculating possible disturbances in business relations caused by insolvencies when entering into and maintaining those relations. The basic mechanism for instilling such orientations has not been punishment but a public inquiry in the form of a general court proceeding, which simultaneously affirms the existing rules of sound economic behavior and creates confidence in a "final" regulation of potential insolvency.

However, fundamental economic change in the direction of increasing division of labor in producing and distributing goods and services has brought about greater interdependence among economic activities. It is obvious that bankruptcy has to adjust to highly complex situations of insolvency affecting legal relationships beyond those of debtor and creditors if the law is to retain its orientation function. The problem all highly developed capitalist societies face is that of extending the structural features of general bankruptcy proceedings as a court procedure (and not just their penal function) and adapting them to the structure of a "mixed economy" without eliminating the orientation function, which remains the core of the preventive function.

Our study of the West German bankruptcy law in action shows its inadequacy as a general regulation of insolvency and its consequent incapacity to perform a preventive function: only 30 percent of all insolvencies in which a petition has been filed end up in actual bankruptcy proceedings. Proceedings are refused in the rest of the cases because German bankruptcy law requires an estate large enough to pay the costs of the procedure. But even those proceedings that begin do not necessarily reach completion: 41 percent are terminated prema-

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turely because the estate is exhausted. This means that of all insolvencies where a bankruptcy petition has been filed only 17 percent complete the regular bankruptcy proceedings and only 2 percent end up with composition after bankruptcy proceedings. These figures, however, only include those insolvencies that come to courts; many never reach court, which cannot be assessed accurately—noiseless liquidations regulated by the parties themselves. It is estimated that these represent at least 20 percent of all insolvencies in West Germany (Döring, 1974:15). Finally there is an unknown, but vast, number of "reorganizations" by mergers, takeovers, and state intervention, the procedures of which are unclear. This makes it obvious that the economic system itself regulates most insolvencies, outside the realm of public control and without following legal procedures. Only those bankruptcies for which there is no economically viable solution are handled by legal procedures in court.

The dynamics of the economic system are also clearly revealed by the relative impoverishment of the estates of those bankrupts that come to the courts: in those proceedings that reached completion the claims of the general creditors represent 83 percent of the total amount claimed but these creditors receive an average of only 8 percent. This means that it must seem pointless to any creditor without preferential rights (through one of the five priorities in bankruptcy, the social security laws, or as a secured creditor exempted from the proceedings) to expect bankruptcy to protect his rights. The apathy of creditors in bankruptcy proceedings, which is an expression of this view, has been described above (see section III.B. *supra*); it is further evidenced by the fact that this group of ordinary creditors, although numerically the largest, initiate only 10 percent of all bankruptcy petitions. Nor is this view limited to the general creditors; as we saw earlier (see text accompanying note 15) the staff of the bankruptcy courts (judges and legal executives), social security authorities, and receivers all feel that banks, secured trade creditors, the tax offices, employees, and the bankrupts themselves (in varying proportions) receive an unfair advantage at the expense of the general creditors.

However, it is not only general creditors who are unsatisfied by bankruptcy proceedings; even creditors with first priority (employees of the bankrupt firm and social security authorities) (§ 61.1.1 KO) receive an average of only 42 percent of their claims. The only secure business relations are those

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satisfied outside the bankruptcy proceedings (secured creditors, claims for compensation of wages lost due to bankruptcy, claims covered by credit insurance). By being exempted from bankruptcy, however, these business relations put an additional strain on the proceedings (the estate is diminished and the receiver has to devote time and money to assessing these exemptions at the cost of the bankruptcy proceedings, i.e., ultimately at the expense of the other creditors) and devalue the proceedings into a meaningless charade—those who can take advantage of social security benefits or insurance no longer need a distribution procedure.

Apathy in bankruptcy proceedings and the insufficiency of the estate are thus symptoms of two fundamental tendencies in insolvencies in West Germany today. First, the preventive structures for regulating insolvency have moved from the official bankruptcy proceedings into the economic system itself. Economic behavior is no longer oriented to bankruptcy proceedings in cases of crisis in business relations but to the particular arrangements made with business associates on a case-by-case basis often (though not always) in the form of individually secured rights. The aim is to obtain protection not only against the bankruptcy of a business associate but also against the bankruptcy proceedings. This means that there is a great number of different *economic* procedures for the regulation of insolvency, all of which remain outside the general court procedure. Though this may permit a high degree of flexibility in reacting to the problems of firms on the brink of insolvency or already insolvent, it also means considerable uncertainty in insolvency regulation. Moreover, these economic procedures of conflict resolution directly reflect the economic power structures of society, with the result that different members of the production process do not have an equal and legally guaranteed position.

The second tendency is that bankruptcies only come into contact with bankruptcy courts if they do not lend themselves to meaningful economic regulation or reorganization. In such cases there is not much for the proceedings to do except rubberstamp the fact of bankruptcy without paying too much attention to economic questions. It thus suffices to make the boundaries of the bankruptcy case coterminous with the legal scheme of debtor and creditors. As a result, these proceedings can be, and are, handled administratively without judicial decisionmaking. Very few cases resemble a general procedure for the regulation of an insolvency, and most of these are ex-

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plained by the presence of a receiver who is expert in economics. The court staff interviewed agreed: 29 percent thought that the efficiency of the proceedings was very low, 54 percent thought it low, 12 percent thought it sufficient, and 4 percent thought it good. But they do not attribute this to procedural problems; there is very little inclination to accept procedural reform. Their main complaint, from bitter experience, is that bankruptcy petitions are filed too late and that the length and cost of the proceedings is grossly disproportionate to the average size of the estate distributed. Consequently, they demand very substantial changes in the law governing the activities of business firms.

These tendencies in West German bankruptcy law provide the clue for the definition of the preventive function of bankruptcy proceedings. Only a procedure that can tackle all relevant aspects of the crisis of a firm in relation to other economic structures and that occurs in court, so as to guarantee due process to all participants, can guide and structure business relations and economic behavior. The historical description of the punitive bankruptcy law operating within a homogenous merchant community showed how a general procedure for bankruptcy, concerned with all aspects of the insolvency crisis, could have a preventive, orienting effect. In order to achieve a similar effect under the present conditions of societal production bankruptcy law has to adopt new concepts: it has to react faster, it has to encompass more of the economic relations of the bankrupt firm, and it has to seek long-term solutions to insolvency problems. This reform can only be achieved if bankruptcy law is freed from the historical model of the entrepreneur who acts entirely of his own free will bound by obligations to his creditors alone, and grounded upon the structural conditions of a mixed economy. But the functional means to attain a preventive effect have not changed; it does not require resort to deterrence through punishment, dressed in modern clothes. What is needed is a guarantee of a legal, public, and transparent procedure of inquiry that will decide whether liquidation or reorganization is desirable in order to protect all the interests in the production process, not a procedure that only rubberstamps a decision of liquidation, or of reorganization, already taken outside the courts. The results of our study have shown that West German bankruptcy law, in its present form, certainly does not provide this guarantee.

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