THE COST OF REPRESENTATION: AN ARGUMENT FOR PERMITTING PRO SE REPRESENTATION OF SMALL CORPORATIONS IN BANKRUPTCY

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I. INTRODUCTION

Bankruptcy filings have steadily increased as the economy struggles to recover from the mortgage and financial crisis. Total filings increased 27.4 percent from fiscal year 2009 to 2010. In fiscal year 2010, 61,148 businesses filed for bankruptcy, and 13,553 filings occurred under Chapter 11.[1] The failures and subsequent bankruptcies of massive corporations such as Lehman Brothers and General Motors have grabbed headlines. However, large businesses account for only a fraction of total bankruptcy filings. Studies of bankruptcy filings have shown that the vast majority of bankruptcy petitions are filed by small businesses.[2] Small business bankruptcies increased 44 percent from the third quarter of 2008 to the third quarter of 2009.[3]

[1] *Bankruptcy Statistics,* Administrative Office of the U.S. Courts, http://www.uscourts.gov/uscourts/Statistics/BankruptcyStatistics/BankruptcyFilings/2010/0310_f2.xls (last visited Mar. 4, 2011).

[2] *Bankruptcy: The Next Twenty Years,* NATIONAL BANKRUPTCY REVIEW COMM'N, 631 (Oct. 20, 1997) (reporting that seventy-two percent of Chapter 11 debtors had liabilities at the time of filing of less than $2 million); Edward R. Morrison, *Bankruptcy Decision Making: An Empirical Study of Continuation Bias in Small-Business Bankruptcies*, 50 J. L. Econ. 381, 386 (2007) (reporting that eighty-one percent of a sample of debtors had fewer than 20 employees and seventy-five percent had less than $1 million).

[3] Equifax, *Small-Business Bankruptcy Filings Up 44% Year-over-year, Equifax Data Shows*, http://www.equifax.com/cs7/Satellite?c=EFX_News_C&childpagename=US%2FEFX_News_C%2FPressReleasePage&cid=1187892107611&p=1182374863790&packedargs=locale%3Den_us&pagename=EFX%2FWrapper (last visited Mar. 4, 2011).

If these small businesses are corporations, LLCs, partnerships or other artificial entities, they are required to appear in bankruptcy court through a licensed attorney. Even for those businesses that are able to afford such representation, the cost—relative to the firm's assets—can be extremely high, reducing the total assets available to creditors during litigation. This Note argues that bankruptcy judges can and should be more willing to create exceptions to the rule requiring all corporations to attain representation.

Part II traces the origins and justifications for the general rule requiring that a corporation in bankruptcy be represented by an attorney. It argues that the rule is judicially created and prudential, and thus subject to exceptions when its application would be imprudent. Part III questions the universal desirability of the rule. It begins by presenting new empirical evidence showing that the traditional rule predominates in practice. However, the justifications for the rule do not exist in all cases and are particularly absent in small business bankruptcies. In these same cases, representation can be very costly, denying many corporations access to bankruptcy, and also consuming a large portion of the assets of companies that do enter bankruptcy. Part IV builds a framework of potential exceptions to the general rule. There is no simple formula that can determine which cases are appropriate, but this Note concludes by identifying factors that can assist judges in evaluating when an exception might be appropriate.

II. THE REQUIREMENT OF ATTORNEY REPRESENTATION FOR CORPORATIONS IN BANKRUPTCY

There is a general requirement that corporations must be represented by an attorney. As early as 1824, in fact, the Supreme Court recognized that "a corporation, it is true, can appear only by attorney."[4] This general rule has been

[4] Osborn v. Bank of the United States, 22 U.S. 738, 830 (1824).

consistently affirmed.[5] The United States Trustee Manual similarly recognizes the rule and states, "[t]he United States Trustee must[6] move to dismiss cases involving a corporate debtor appearing pro se."[7]

A. Justifications for the Rule

Despite (or perhaps because of) the general consistency of this holding, the rationale and source of the rule are not always apparent. When courts do discuss the rule in detail, the justifications include the need for attorneys to draft proper pleadings, the potential disunity of corporate and individual interests, the separation of corporate and individual identities, and the need to balance the costs and benefits of incorporation.[8]

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[5] *See, e.g.*, Rowland v. Cal. Men's Colony, 506 U.S. 194, 201–02 (1993) ("It has been the law for the better part of two centuries, for example, that a corporation may appear in the federal courts only through licensed counsel."). The informational website for the judicial branch of the U.S. Government states, "[c]orporations and partnerships must have an attorney to file a bankruptcy case." Administrative Office of the U.S. Courts, Filing Bankruptcy Without an Attorney, http://www.uscourts.gov/bankruptcycourts/prose.html (last visited Mar. 4, 2011).

[6] The implication of the word "must" is unclear. The preface of the manual states, "flexibility in the implementation of these guidelines . . . is permissible. Accordingly, the use of the word 'should' is meant to be hortatory, not mandatory, and is intended to mean that . . . the United States Trustee may exercise sound discretion depending on the facts and circumstances . . . ." 1 United States Department of Justice, Legal Manual For United States Trustees, Preface, (Aug. 1988), http://www.justice.gov/ust/eo/ust_org/ustp_manual/docs/vol1-1988AUG-general.pdf (last visited Mar. 4, 2011). The preface indicates a general preference for flexibility and that the word "should" in particular emphasizes the discretion given to the Trustee. It is unclear if the general policy of flexibility survives in instances where the word "must" is used. As an empirical matter the U.S. Trustee files such motions in almost seventy percent of cases. *See* Part III.A.2.

[7] 3 United States Department of Justice, Legal Manual For United States Trustees, § 3-2.4, pt.5 (Oct. 1998), http://www.justice.gov/ust/eo/ust_org/ustp_manual/docs/vol3.pdf (last visited Mar. 4, 2010).

[8] *See* U.S. PolyCon Corp. v. United States, 43 Fed. Cl. 11, 14 (1999).

The most compelling justification for the prohibition on lay representation of a corporation is the benefit of an experienced bankruptcy counsel in avoiding unnecessary errors and delays during the bankruptcy process. The traditional rule prevents non-lawyers from "burden[ing] the court system with poorly drafted pleadings and poorly conducted proceedings."[9] In addition to the traditional burdens pro se litigants are thought to impose on the time of clerks and judges in adversarial courts,[10] the nature of bankruptcy proceedings may create additional costs. In traditional litigation, an error by the pro se litigant is likely to disadvantage only his or her own case. In bankruptcy proceedings, however, a mistake or unnecessary delay by a debtor has the potential to disadvantage all parties involved. Unnecessary delays, mistakes, and mismanagement might reduce the amount of assets available for distribution.[11]

Another justification for the rule is that a corporation is a fictional legal entity that exists independent of its shareholders in the eyes of the law.[12] Because the corporation is distinct from its shareholders, it is difficult for a single shareholder to represent the interest of the corporation as a whole. Therefore, an attorney is necessary to represent the interests of the corporation without the potential conflicting interests of an individual shareholder. Even courts that have permitted pro se corporate representation recognize the need to protect the corporation from representation by a single shareholder with distinct

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[9] *Id.* at 14.

[10] Nina Ingwer VanWormer, *Help at Your Fingertips: a Twenty-First Century Response To The Pro Se Phenomenon*, 60 VAND. L. R. 983, 993 (2007).

[11] Christopher W. Frost, *The Theory, Reality and Pragmatism of Corporate Governance n Bankruptcy Reorganizations*, 72 Am. Bankr. L.J. 103, 151 (1998) (describing waste of small business assets caused by unnecessary delay in bankruptcy).

[12] PolyCon Corp., 43 Fed. Cl. at 14 ("The interests of an association of individuals cannot be adequately represented by any single member. Stated another way, if a non-lawyer shareholder or officer represents a corporation, the interests of absent shareholders, officers and directors may be adversely affected through inept or vexatious handling.").

and independent interests.[13] A closely related justification is that because a corporation is an artificial entity, it cannot appear in a court on its own behalf and must be represented by an agent. Similarly, only an attorney can appear as an agent for another party in courts. Thus, it follows that a corporation can only appear in court through an attorney.[14]

Finally, some courts point to the fact that the decision to incorporate has benefits and those who make that choice should bear the costs. One of those costs is the requirement of attorney representation.[15]

B. Source of the Rule

1. Federal Statutes

Although the existence of this general rule is universally recognized, a Federal Bankruptcy Court noted that:

> [t]here is some uncertainty as to whether the above-stated rule remains a common-law rule enforced by the courts to maintain the integrity of the judicial process and thus may be subject to judicially-created exceptions, or whether such rule has been codified by a federal statute (e.g., 28 U.S.C. § 1654) or a rule of procedure (e.g., Fed. R. Bankr. R. 9010) and thus is not subject to judicially-created exceptions.[16]

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[13] *Id.* ("The second rationale, concerning the interests of absent shareholders and other affected persons, is certainly valid and persuasive with respect to corporations and associations with numerous stockholders or members.").

[14] *Id.* ("Since a corporation is an artificial entity, it can only act through agents, and those agents must be acceptable to the court.").

[15] *Id.*; *see also* Mercu-Ray Indus., Inc. v. Bristol-Myers Co., 392 F. Supp. 16, 20 (S.D.N.Y. 1974), *aff'd* 508 F.2d 837 (2d Cir. 1974) ("Kreager chose to accept the advantages of incorporation and must now bear the burdens of that incorporation; thus, he must have an attorney present the corporation's legal claims.").

[16] In re Interiors of Yesterday, LLC, 284 B.R. 19, 24 (Bankr. D. Conn. 2002).

According to 28 U.S.C. § 1654, "[i]n all courts of the United States the parties may plead and conduct their own cases personally or by counsel as, by the rules of such courts, respectively, are permitted to manage and conduct causes therein."[17] Courts have taken two different approaches in interpreting this section in relation to the ability of corporations to appear pro se. Two decisions provide an example of the contrasting interpretations. In *Eagle Associates v. Bank of Montreal*, the Second Circuit held that "28 U.S.C. § 1654 prohibits a layperson from appearing on behalf of a partnership."[18]

However, *Fraass Survival Systems, Inc. v. Absentee Shawnee Economic Development Authority* held "the text of § 1654 certainly means that courts cannot reject pro se individuals, but it does not determine for all other cases whether a court can accept pro se non-individuals when the court deems appropriate."[19] In addressing *Eagle*, the *Fraass* court noted that cases prior to *Eagle* clearly distinguished between the statutory grant of power for an individual to appear pro se, and the non-statutory general rule against corporations appearing pro se.[20] Additionally, the Second Circuit's affirmation of exceptions to the rule demonstrates its flexible nature: "[i]f § 1654 were definitive, then such judicial exceptions could not be created."[21] The court also placed emphasis on the fact that, as a matter of statutory interpretation, congressional silence ought to be interpreted as an intention that the current common law rule survives.[22] Given the existence of exceptions to the general rule and the plain reading of 28 U.S.C. § 1654, the interpretation by the court in *Fraass* seems to be correct; *Eagle* "is therefore best understood as holding merely that § 1654 does not guarantee partnerships the right to appear pro se, rather than as

[17] 28 U.S.C. § 1654.

[18] 926 F.2d 1305, 1310 (2d Cir. 1991).

[19] 817 F. Supp. 7, 9–10 (S.D.N.Y. 1993).

[20] *Id.* at 9 (citing Jones v. Niagara Frontier Transp. Auth., 722 F.2d 20 (2d Cir. 1983)).

[21] *Id.*

[22] *Id.* (citing Evans v. United States, 504 U.S. 255, 269 (1992)).

holding that § 1654 precludes partnerships and all other non-individuals from appearing pro se."[23] The approach of *Fraas* is the most sensible given the language of § 1654 and the existence of exceptions to the traditional rule. Thus, 28 U.S.C. § 1654 does not allow, nor does it prevent, corporations to appear pro se.

2. The Federal Rules of Bankruptcy Procedure

Federal Rule of Bankruptcy Procedure 9010(a) is similar to 28 U.S.C. § 1654 and is potentially subject to similar interpretations. The rule states:

> [a] debtor, creditor, equity security holder, indenture trustee, committee or other party may (1) appear in a case under the Code and act either in the entity's own behalf or by an attorney authorized to practice in the court, and (2) perform any act not constituting the practice of law, by an authorized agent, attorney in fact, or proxy.[24]

However, the Advisory Committee notes make clear that the rule does not prohibit pro se corporation representation. The Advisory Committee Note states, "[t]his rule. . . does not purport to change prior holdings prohibiting a corporation from appearing pro se."[25] In *Las Colinas Development Corp*, which the Advisory Committee notes cited approvingly, the court found the general rule to be based on "a tradition that goes back to the common law" and "practical considerations."[26] The Federal Rules of Bankruptcy Procedure and Advisory Committee notes thereto are evidence that the prohibition on lay representation of a corporation is a judicial policy decision.

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[23] *Id.*

[24] Fed. R. Bankr. P. 9010(a).

[25] Fed. R. Bankr. P. 9010 advisory committee's note.

[26] In re Las Colinas Development Corp., 585 F.2d 7, 10 (1st Cir. 1978).

3. Local Rules of Bankruptcy

Local rules in certain districts require counsel to represent artificial entities.[27] However, it is a "widely-accepted idea that a district court should be accorded considerable latitude in applying local procedural rules of its own making, and in departing from them."[28] Such discretion is not unlimited, however. To depart from local rules, the court "(1) must have a sound reason for doing so, and (2) must ensure that no party's substantial rights are unfairly jeopardized."[29] An exception to the requirement of counsel in certain cases would meet both of these criteria. Increasing creditor recovery is a core goal of bankruptcy and is a sound reason for departing from the rule. Additionally, reasonable exceptions would preserve value and benefit all parties in the bankruptcy. Thus, local rules do not deprive judges of the discretion to make an exception to the general requirement that corporations obtain counsel.

III. THE OVER-INCLUSIVENESS OF THE CURRENT RULE

Although the rule is based on sound policy, it is overinclusive and imposes high costs on the bankruptcy process. A simple illustration, modeled after an actual debtor, demonstrates the costs associated with applying the rule to all businesses.

Felix was a leather craftsman operating the retail store Penn Leather as a sole-proprietorship.[30] His primary assets were approximately $2,000 in cash and savings and $15,500 in business equipment and inventory—sewing machines, a

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[27] *See, e.g.*, M.D.N.C. Local Bankr. R. 9011-2.

[28] United States v. Diaz-Villafane, 874 F.2d 43, 46 (1st Cir. 1989).

[29] *Id.*

[30] This example is based on the Petition from In re Felix Gustavo Fermin d/b/a Penn Leather, a Chapter 13 case filed in the Middle District of Pennsylvania. The facts are not changed unless indicated. *See* Petition, In re Felix Gustavo Fermin d/b/a Penn Leather, No. 1:03-bk-03886-MDF (Bankr. M.D. Pa.) (Jul. 1, 2003).

cash register, and leather clothing.[31] Felix owed $6,000 to the store's landlord,[32] $2,500 to the Internal Revenue Service, $1,000 to a newspaper for advertising purchased on credit,[33] and $300 to a dentist.[34] Felix also owed small amounts to various collection agencies—the source of many of these debts is unknown.[35]

Unfortunately, Felix found himself financially insolvent, unable to generate enough cash to pay his bills. However, his business was economically viable and represented a good case for reorganization. Felix filed for bankruptcy pro se and proposed a Chapter 13 reorganization plan. Felix's landlord objected to the plan and Felix amended the plan in response; the amended plan was confirmed.[36] Pursuant to the amended plan, Felix paid over $12,000 to creditors over two years.[37] All creditors were paid 100 percent of their claims.[38] Because Felix appeared pro se there were no debtor

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[31] *Id.* at Schedule B.

[32] It is unclear if this debt was for residential rent or business rent. Because the case was that of a sole-proprietor the difference is not relevant. For the purposes of this example, it will be treated as a business rent because the difference becomes relevant in the corporate context.

[33] The petition does not indicate the reason for the debt to the newspaper. However, given that a yearly subscription for this newspaper is only $8, it is reasonable to assume the $1,000 debt was a business expense. The Paxton Herald, http://www.thepaxtonherald.com/Forms/SubscriptionBlank.PDF (last visited Mar.4, 2011).

[34] Chapter 13 Standing Trustee's Final Report, In re Felix Gustavo Fermin d/b/a Penn Leather, 1:03-bk-03886-MDF (Bankr. M.D.Pa.) (Nov. 15, 2006). A secured claim of "Zeelander USA" is excluded from this hypothetical because it appears to be a boat unrelated to the business. It was paid in full as part of the plan of reorganization.

[35] Petition, at Schedule F, In re Felix Gustavo Fermin d/b/a Penn Leather, No. 1:03-bk-03886-MDF (Bankr. M.D. Pa.) (Jul. 1, 2003).

[36] Chapter 13 Plan, In re Felix Gustavo Fermin d/b/a Penn Leather, No. 1:03-bk-03886-MDF (Bankr. M.D. Pa.) (Jul. 22, 2003); Amended Chapter 13 Plan, In re Felix Gustavo Fermin d/b/a Penn Leather, No. 1:03-bk-03886-MDF (Bankr. M.D. Pa.) (May 9, 2004).

[37] Chapter 13 Standing Trustee's Final Report, In re Felix Gustavo Fermin d/b/a Penn Leather, 1:03-bk-03886-MDF (Bankr. M.D. Pa.) (Nov. 15, 2006).

[38] *Id.*

attorney's fees, which would have been priority administrative claims. The process involved no complex legal issues and the debtor resolved the dispute that arose with his main creditor. Felix continues to operate the leather store today.[39]

Now suppose that Felix had instead made the decision to incorporate Penn Leather and operate the exact same business as a single shareholder corporation. The corporation's assets and liabilities would remain nearly the same. However, in this hypothetical, Felix cannot file for bankruptcy on behalf of the corporation pro se, as he would need an attorney to represent the corporation. Securing an attorney under these conditions would likely be difficult because many attorneys require large up-front retainer fees.[40] Given the state of his finances, Felix could not have afforded a retainer, and he would have been unable to file for bankruptcy. His store would have closed and his inventory liquidated under state law. Felix's economically viable firm would have been put out of business because it was organized as a corporation. By contrast, an identical firm organized as a sole-proprietorship was reorganized and continues to operate today.

It is possible that Penn Leather, Inc. could have obtained bankruptcy counsel to represent the corporation. However, the result would have been costly. The attorney would have filed for Chapter 11 and filed a reorganization plan.[41] Felix did not have many creditors and, just as the main creditor dropped its objection to the Chapter 13 plan, it is likely that the creditors would have approved a Chapter 11 plan that

[39] *See* PENN LEATHER, http://www.pennleather.com (last visited Mar. 4, 2011).

[40] *See, e.g.*, Letter of Rabbi Harry S. Dombek to Judge John J. Thomas, In re Mount Laurel Cemetery, No. 5:05-bk-50372-JTT (Bankr. M.D. Pa. Mar. 31, 2005) (attaching letters from bankruptcy counsel).

[41] A corporation is not eligible to file for Chapter 13 and must file for Chapter 11. There are various differences between the two chapters. *See* Bruce A. Markell, *The Sub Rosa Subchapter: Individual Chapter 11 After BAPCPA*, 2007 U. ILL. L. REV. 67, 79–81 (2007). However, none of the differences are likely to be relevant in this example.

resembled the Chapter 13 plan. Assuming the attorney's fees were near the mean for small businesses, they would have been around 31.5% of the debtor's assets, or $5,512.50.[42] Unsecured creditors are not likely to fare well in such a situation, and they could see their recovery disappear entirely due to the attorney's fees.

Under this hypothetical, Felix and his creditors would clearly be worse off than they were in his actual case where he operated Penn Leather as a sole-proprietorship. The two companies are identical in every way other than the fact that one is incorporated and one is not; yet, they are treated differently in bankruptcy. This difference is costly. The justifications for requiring attorney representation of this corporation are noticeably absent in this case. Felix's case is not an isolated example, and similar facts are likely to be repeated, imposing costs on creditors and debtors.

A. The Current Predominance of the Rule

1. The *Holliday's* Exception in Small Business Bankruptcy

Despite the general rule against corporations appearing pro se, some courts have questioned the universal applicability of the rule. For example, a commonly recognized exception to the rule is the ability of corporations to appear pro se in small claims court.[43] Additionally, in *Matter of Holliday's Tax Services, Inc.*, Judge Weinstein held that a small corporation could appear pro se in a Chapter 11 bankruptcy proceeding.[44]

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[42] *See infra* Part III.C.1 and accompanying text.

[43] *See, e.g.*, Prudential Ins. Co. of America v. Small Claims Court of City, 76 Cal. App.2d 379, 386 (Cal. Ct. App. 1946) ("[S]ection 117g [of the California Code of Civil Procedure involving small claims court] must be interpreted as conferring on corporations the right to appear through some representative other than an attorney.").

[44] *In re* Holliday's Tax Servs., Inc., 417 F.Supp. 182 (E.D.N.Y. 1976), *aff'd sub nom. without opinion* Holliday's Tax Servs., Inc. v. Hauptman, 614 F.2d 1287 (2d. Cir. 1979).

Holliday's began with the filing of a Chapter 11 bankruptcy petition by Coniel Holliday, the sole shareholder of Holliday's Tax Services.[45] Holliday filed a petition individually and a petition on behalf of the corporation.[46] The bankruptcy court dismissed the corporate petition on the grounds that a corporation cannot appear pro se.[47] On appeal, Judge Weinstein of the Eastern District of New York reversed, and the Second Circuit affirmed without opinion.[48] Consistent with the general rule, the district court recognized that a "virtually unbroken line of state and federal cases has approved the rule that a corporation can appear in court only by an attorney."[49] However, Judge Weinstein recognized that a "person's day in court is . . . more important than the convenience of judges" and that "[t]o require this corporation to appear by a lawyer is effectively to exclude it and its sole shareholder from the courts."[50] Further, Judge Weinstein noted that the court had "inherent power" to supervise the proper administration of justice, which allowed it to make an exception to the general rule.[51] The Bankruptcy Code recognizes this power—11 U.S.C. § 105 allows the court to "issue any order, process, or judgment that is necessary or appropriate to carry out the provisions of this title."[52]

In *In re MSD Woodworking Co., Inc.*, the debtor was a small, closely held corporation that did not have enough assets to secure counsel.[53] Unlike *Holliday's*, the debtor in *MSD Woodworking* was seeking approval of a sale of assets and conversion to Chapter 7.[54] Citing *Holliday's*, the court noted that 11 U.S.C. § 105 empowered the court to make an

[45] 417 F. Supp. at 183.

[46] *Id.*

[47] *Id.*

[48] *Id.*; 614 F.2d at 1287.

[49] 417 F. Supp. at 183.

[50] *Id.*

[51] *Id.* at 184.

[52] 11 U.S.C. § 105 (2006).

[53] 132 B.R. 631, 631–32 (Bankr. D.S.D. 1991).

[54] *Compare id.* at 631 with *Holliday*'s, 417 F. Supp. at 184.

exception to the traditional rule.[55] The *Holliday's* rationale has also been used by courts in contexts other than bankruptcy to allow lay representation of a corporation.[56] In addition to these cases, there has been some academic criticism aimed at the rule requring attorney representation.[57]

2. New Empirical Evidence

Despite a few applications of the *Holliday's* exception, most courts have been reluctant to apply it, and the exception is all but dead in the small business bankruptcy context. The cases applying *Holliday's* are generally from the 1990s, and *Holliday's* itself is a pre-Bankruptcy Code case decided in 1976.[58] Some courts have ostensibly recognized a *Holliday's* exception, but limited the exception narrowly and refused to apply it. One group declines to extend a *Holliday's*-type exception beyond bankruptcy,[59] while others severely narrow the exception to the facts of

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[55] 132 B.R. at 632.

[56] *See, e.g.*, Pension Benefit Guar. Corp. v. Viking Food Serv., Inc., No. 93 Civ. 6837, 1994 WL 702042, at *1–2 (S.D.N.Y. Dec. 14, 1994) (allowing defendant/third party plaintiff to appear pro se in civil suit); U.S. PolyCon Corp. v. United States, 43 Fed. Cl. 11, 12 (Fed. Cl. 1999) (allowing corporation to sue the United States pro se in the United States Court of Federal Claims); United States v. Priority Prods., Inc, 615 F. Supp. 593, 596 (Ct. Int'l Trade 1985) (allowing corporation to answer complaint pro se in the United States Court of International Trade).

[57] *See, e.g.*, Robert Laurence, *Swimming Upstream: A Final Attempt at Persuasion on the Issue of Corporate Pro Se Representation in Arkansas State Court*, 54 ARK. L. REV. 475 (2001); Robert Laurence, *A Trio of Small, Conversation-Inspired Bankruptcy Issues*, 1999 ARK. L. NOTES 79 (1999); Robert Laurence, *Update: Recent Developments in the Arkansas Law of Garnishment*, 1997 ARK. L. NOTES 95 (1997).

[58] Although *Holliday's* pre-dates the modern Bankruptcy Code, nothing in the Code requires an opposite conclusion from that reached in *Holliday's*. *See supra* Part II.C. In fact, 11 U.S.C. § 105 codifies the broad equitable powers relied upon in *Holliday's*.

[59] *See* Sanchez v. Marder, No. 92 CIV. 6878, 1995 WL 702377 at *2 (S.D.N.Y. Nov. 28, 1995) (limiting *Holliday's* to bankruptcy).

Holliday's—a corporation with zero assets—leaving little room for any exception at all.[60]

An empirical survey of bankruptcy cases confirms that current courts are hesitant to apply an exception to the rule. To identify pro se corporate bankruptcy filings, I began with the Interuniversity Consortium for Political and Social Research's (ICPSR) database *Federal Court Cases: Integrated Data Base Bankruptcy Petitions, 2005*.[61] The database includes basic information for all bankruptcy cases terminated in 2005. I limited the data to cases identified as (1) business debt,[62] (2) voluntary cases, (3) corporate or other business entity, and (4) at least one pro se debtor.

The resulting set of cases was overinclusive. Cases were coded by the ICPSR as "at least one pro se debtor" if the top of the PACER docket indicated the existence of a pro se debtor. PACER identifies certain cases as having debtors appearing pro se, but the docket indicates that this designation is inaccurate. These cases arise in a few common instances, and I excluded them from the data.[63]

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[60] *See* Bijan-Sara Corp. v. Fed. Deposit Ins. Corp., 203 B.R. 358, 359 (B.A.P. 2d Cir. 1996) (distinguishing *Holliday's* because the debtor had more than zero assets).

[61] Federal Judicial Center. Federal Court Cases: Integrated Data Base Bankruptcy Petitions, 2005 [Computer file]. ICPSR23080-v1. Ann Arbor, MI: Inter-university Consortium for Political and Social Research.

[62] The ICPSR identifies business debt based on the face of the bankruptcy petition and limiting by this variable likely excluded business cases with incorrect petitions. *See* Robert M. Lawless & Elizabeth Warren, *The Myth of the Disappearing Business Bankruptcy*, 93 CAL. L. REV. 743 (2005) (describing how the rise in computerized bankruptcy forms has led to systematic misidentification of many business filings as consumer). Because this misidentification occurs primarily in cases where the debtor is an individual, and not an artificial entity, the number of excluded cases is likely small given that the sample includes only artificial entities.

[63] First, some petitions are docketed in the ECF system prior to entering the appearance of the debtor's attorney, even though an attorney has signed the petition. Second, some petitions apparently pre-date the use of PACER in certain districts. In these cases, early pleadings are identified on the docket but are not accessible because they were not filed by an attorney using ECF and are treated as pro se even if an attorney

After excluding these cases, the resulting set represents the 106 corporate bankruptcy petitions that were terminated in the year 2005 and filed pro se in any district. I accessed the dockets for these cases via PACER, and determined their disposition. None of the cases resulted in successful confirmation plans, and all of the cases were dismissed.[64] As noted in Table 1, 68.9 percent of cases were dismissed either on the motion of the U.S. Trustee or on the court's own motion for lack of counsel. Nearly a quarter of the cases were dismissed for other reasons, such as a failure to file the required forms, a violation of an order to not re-file, or bad faith.[65]

Table 1

Resolution	N	%
U.S. Trustee successfully moves to dismiss because of pro se status	36	34.0%
Sua sponte dismissal because of pro se status	37	34.9%
Counsel appeared after threat of dismissal	4	38.0%
Creditor successfully move for dismissal	5	47.0%
Dismissal or conversion because of failure to prosecute or other defects	24	22.6%
Total	106	100%

3. A Few Aberrant Cases

Part of the reluctance to revive *Holliday's* may be grounded in Supreme Court dicta. The Supreme Court has never squarely addressed the issue, but made the following

filed the petition. Third, if an attorney withdraws at any time during the case PACER identifies the debtor as pro se even if new counsel is later added or the case is dismissed.

[64] It is possible that firms obtained counsel and re-filed.

[65] Data available from author and on file with the *Columbia Business Law Review*.

comment in *Rowland v. California Men's Colony, Unit II Men's Advisory Council*:

> save in a few aberrant cases, the lower courts have uniformly held that 28 U.S.C. § 1654, providing that "parties may plead and conduct their own cases personally or by counsel," does not allow corporations, partnerships, or associations to appear in federal court otherwise than through a licensed attorney.[66]

In a footnote regarding those "few aberrant cases," one of which was *Holliday's*, the Court noted, "[t]hese cases neither follow federal precedent, nor have themselves been followed."[67] The four dissenting justices noted that "[a]n artificial entity's inability to proceed pro se . . . has no bearing upon *whether* it may benefit [from the *in forma pauperis* statute]. And that, after all, is the question presented in this case."[68]

Lower courts have acknowledged that the majority's language in *Rowland* casts doubt on the validity of *Holliday's* and the flexible nature of the general rule. For example, a recent District Court decision stated that, "given the overwhelming caselaw that is contrary to the holding in *Holliday's*, particularly the Supreme Court's statement in *Rowland* that *Holliday* is an aberrant case," the general rule should be applied.[69]

The Ninth Circuit has gone even further and read the Supreme Court's footnote in *Rowland* as overturning the "aberrant cases." The other "aberrant" case cited was *United States v. Reeves*, in which the Ninth Circuit allowed a partnership to be represented by a partner.[70] The Ninth Circuit held that to the extent *Reeves* "stood for the

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[66] Rowland v. Cal. Men's Colony, 506 U.S. 194, 202 (1993).

[67] *Id.* at 202 n.5.

[68] *Id.* at 218 (Thomas, J., dissenting).

[69] N.Y. State Teamsters Conference Pension & Ret. Fund v. Comac Builders Supply Corp., No. 06-CV-208, 2008 WL 150515, at *4 (N.D.N.Y. Jan. 14, 2008).

[70] 431 F.2d 1187, 1189 (9th Cir. 1970).

proposition that non-attorney members of a partnership could appear on behalf of the partnership, the Supreme Court in [*Rowland*] has overruled that holding."[71]

It is surprising that the Ninth Circuit was so willing to abandon its precedent based simply on a footnote (to a statement that itself was dicta) calling the case "aberrant." As argued by the dissent in *Rowland*, the ability of an artificial entity to appear pro se was not essential to the holding, giving the Ninth Circuit potential room to save *Reeves*.[72] The Ninth Circuit's willingness to dismiss *Reeves* quickly might be explained by looking more closely at the *Reeves* decision itself. *Reeves* did not recognize the general rule, nor did it claim to be an exception that applies in narrow circumstances. *Reeves* merely asserted that because a partner has an interest in the partnership he may appear pro se pursuant to 28 U.S.C. § 1654.[73] The Ninth Circuit is thus correct: to the extent *Reeves*' holding plainly ignored the general rule, that is, that *Reeves* "stood for the proposition that non-attorney members of a partnership could appear on behalf of the partnership," it is contradicted not only by *Rowland*, but also centuries of common law.[74]

On the other hand, *Holliday's*, in stark contrast to *Reeves*, recognizes that there is a general rule prohibiting lay representation of a corporation, but acknowledges the existence of an exception.[75] In fact, *Holliday's* is often cited for the proposition that there is a general prohibition against pro se corporate representation.[76] A district court in the Second Circuit, where *Holliday's* is still good law, held that "[d]espite the fact that such cases 'neither follow federal precedent, nor have themselves been followed,' they suggest that the rule requiring corporations to appear by counsel has

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[71] In re Am. W. Airlines, 40 F.3d 1058, 1059 (9th Cir. 1994).

[72] *Rowland*, 506 U.S. 194 at 217 (Thomas, J., dissenting).

[73] United States v. Reeves, 431 F.2d 1187, 1188 (9th Cir. 1970).

[74] *America West*, 40 F.3d at 1058.

[75] Matter of Holliday's Tax Services, Inc., 417 F.Supp. 182, 183 (E.D.N.Y. 1976), *aff'd sub nom without opinion*, Holliday's Tax Services, Inc. v. Hauptman 614 F.2d 1287 (2d. Cir. 1979).

[76] *See, e.g.*, Sharp v. Bivona, 304 F.Supp.2d 357, 365 (E.D.N.Y. 2004).

exceptions."[77] The court then recognized *Holliday's* as creating a possible exception and ordered the defendant to produce evidence proving that they were unable to obtain counsel and therefore should be granted an exception.[78]

Thus, most courts are unwilling to apply exceptions to the general rule and allow corporations to be represented by a non-attorney. However, the questions raised by cases like Holliday's have never been thoroughly investigated, and the ability to make exceptions has not yet been foreclosed. An examination of the costs and benefits of the rule indicates that the refusal to consider exceptions is imposing high costs on the bankruptcy system with very little benefit.

B. Appropriate Exceptions in Small Business Bankruptcy

1. Quality of Proceedings

Jan Samuel Ostrovsky, U.S. Trustee and an experienced observer of bankruptcy proceedings, claims that there is strong evidence that simple, avoidable, and costly mistakes are commonly made by debtor's attorneys.[79] For example, he states that it is not uncommon for schedules to include "clearly incorrect information," "internal inconsistencies," figures that are "incomplete or not credible on their face," and "plans that are not mathematically possible."[80] Within the context of small business Chapter 11, it has been claimed

[77] Sanchez v. Marder, No. 92-cv-6878, 1995 WL 702377 at *1 (S.D.N.Y. Nov. 28, 1995) (citing Rowland California Men's Colony, Unit II Men's Advisory Council, 506 U.S. 194, 203 n.5 (1993)).

[78] *Id.* at *2–3.

[79] Jan Samuel Ostrovsky, *Ensuring Good Counsel for Debtors: Quality of Representation Raises Troubling Questions,* 20-10 AM. BANKR. INST. J. 14, 14 (2002) (discussing proposals to require attorneys to inform debtors of the legal effect of certain decisions and proposals to require attorneys to conduct a reasonable investigation prior to the filing of the petition).

[80] *Id.*

that "incompetent counsel frequently torpedo[] a case that otherwise could be successful."[81]

Empirical evidence supports the anecdotal observation that debtor's attorneys often make obvious and preventable mistakes. Steven W. Rhodes, United States Bankruptcy Judge in the Eastern District of Michigan, conducted an empirical study of 200 randomly selected consumer[82] bankruptcy schedules filed in the first half of 1998 in the United States Bankruptcy Court for the Eastern District of Michigan, Southern Division at Detroit.[83] Over fifty percent of the filings were incomplete in six of the eleven completeness factors. "A total of 687 errors and problems were found. These errors and problems were observed in 99% of the study cases (198 of 200 cases). The median number is 3.0 per case. The mean, or average, is 3.4 per case, with a standard deviation of 1.6."[84]

Although a very valuable measure of attorney error, the use of disclosure statements by Judge Rhodes has limitations in assessing the value added by bankruptcy counsel that should be recognized. The value of an attorney obviously cannot be reduced to the ability to fill out forms. For example, bankruptcy attorneys, even if they make mistakes

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[81] American Bankruptcy Institute, National Bankruptcy Review Commission Meeting Minutes, Jan. 22–23, 1997, http://www.abiworld.org/AM/Template.cfm?Section=Meeting_Minutes&Template=/CM/ContentDisplay.cfm&ContentID=36388.

[82] The use of consumer bankruptcy filings does not substantially reduce the value of the study. It is possible that businesses may attract higher quality counsel. However, even if this were true, the study indicates that almost no attorney is immune from making these mistakes. In fact, the study found no correlation between fees charged by the attorney or debtor assets and the number of mistakes made. Hon. Steven W. Rhodes, *An Empirical Study of Consumer Bankruptcy Papers*, 73 AM. BANKR. L.J. 653, 680–82 (Summer 1999). Additionally, Rhodes notes that it is entirely possible, if not likely, that some of the petitions were actually small businesses erroneously filed as consumer claims—a common error. *See id.* at n.87 (citing studies that point to large error rates that cause under-identification of business bankruptcies).

[83] *Id.* at 653.

[84] *Id.* at 678.

in disclosure statements, are experienced with the procedures and strategy of bankruptcy.

Despite the limitation on Judge Rhodes's study, it provides an objective measurement of the quality of representation available to debtors and "establish[es] substantial cause for concern."[85] The fact that mistakes are commonly made by attorneys should be taken into account when considering the relative quality of lay representation. The fact that a lay representative will likely make mistakes and file poor pleadings is not necessarily a reason to force corporations to obtain counsel, as mistakes in various steps of the process appear to be inevitable regardless of whether or not corporations are represented by an attorney.

There is reason to believe that there are owner-operators, like Felix, who are capable of competently representing themselves. First, small business entrepreneurs may have multiple opportunities to hone their bankruptcy skills. Serial entrepreneurs, over seventy-five percent of small business owners in a random sample, will restart their business or run multiple businesses at the same time, and given that nearly eighty percent of small businesses will fail in six years, the chance of multiple bankruptcies for one owner are high.[86]

Additionally, individuals and sole proprietorships are currently allowed to file pro se bankruptcy petitions. This ability to file pro se is codified by 26 U.S.C. § 1654 and also recognized by Federal Rule of Bankruptcy Procedure 9010(a). This statute and rule demonstrate a judgment that the benefits of pro se representation outweigh the cost. This judgment does not change because a business is incorporated and not a sole-proprietorship. While many factors such as the size of the corporation and the nature of its debts may influence the complexity of the case, the corporate status of the business does not substantially change the nature of the proceeding.

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[85] *Id.* at 655.

[86] Douglas G. Baird & Edward R. Morrison, *Serial Entrepreneurs and Small Business Bankruptcies*, 105 COLUM. L. REV. 2310, 2337 (2005).

One court has gone so far as to say that because individuals are allowed to file pro se, despite the clear risk that they will file awkward pleadings, corporations cannot be denied this same right based on the possibility of filing poor pleadings; because both are equally likely to file bad pleadings the different treatment must be based on some factor that makes corporations unique.[87]

The statutory right of individuals to appear pro se also limits the ability of the traditional rule to prevent business owners from filing their own pleadings. In as many as eighty-five percent of small business bankruptcies, the owner-operator has personally guaranteed the debts of the corporation.[88] In such cases it is common for an individual to file bankruptcy personally at the same time as filing for the business. Even if the business's bankruptcy petition is dismissed for lack of counsel, the court does not avoid having to entertain pro se pleadings, as the debtor's individual pro se case is unaffected.

2. Unity of Interest

Although in many cases shareholders of a corporation have many divergent interests, the court in *Holliday's* stated:

> [small businesses] are set up by the thousands. Many, such as the one before us, are in the name of the person doing business. In these instances, incorporation is merely a technicality, facilitating competitive economic activity by individuals. Failure of the "corporation" is, for all practical purposes, the failure of the individual entrepreneur.[89]

This observation has been confirmed by recent empirical research. A study examining bankruptcy filings in the

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[87] Fraass Survival Sys., Inc. v. Absentee Shawnee Econ. Dev. Auth., 817 F. Supp. 7, 10 (S.D.N.Y. 1993) (noting that the poor pleading problem "offers no basis for distinguishing between individuals and groups").

[88] Baird & Morrison, *supra* note 86, at 2356.

[89] Matter of Holliday's Tax Servs., Inc., 417 F.Supp. 182, 184 (E.D.N.Y. 1976).

Northern District of Illinois concluded that, while some bankrupt companies did have an identity separate from any individual, "[m]uch more common are businesses organized around the skills of the owner-operator. The business and its owner-operator are one and the same . . . it is impossible to separate the business from the person running it."[90] These closely held corporations are often owned and operated by a single individual. In addition to the usually close substantive relationship between the corporation and individual owner of a typical small business, the legal rights of the two parties are also often aligned. A very large majority of small business owners, eighty-five percent in one study, personally guarantee the debt of the corporation.[91]

It is clear that, although the potential for divergent interests of the corporation and a shareholder is real, it is not universal. No elaborate inquiry is required to identify cases in which a corporation has substantially the same interests as its primary shareholder. A corporation with a single shareholder, such as *Holliday's* or the hypothetical Penn Leather, Inc., is an obvious example.

The unity of interest between the corporation and owner-operator also calls into question the third justification for the rule—that an owner-operator is barred from appearing on behalf of the corporation because it is a separate legal entity. The fact that there is often a unity of interest between an owner-operator and her corporation justifies treating them as a single entity for the purpose of allowing pro se representation. As explained by one court:

> [t]he doctrine that a corporation is a legal entity existing separate and apart from the person composing it is a legal theory used for the convenience of the business world. The concept cannot, therefore, be extended to a point beyond its reason and policy, and when invoked in support of an

[90] Baird & Morrison, *supra* note 86, at 2327.

[91] *Id.* at 2356.

> end subversive of this policy, will be disregarded by the courts.[92]

This is an instance in which an owner-operator should be permitted to appear pro se on behalf of a corporation, just as she would on behalf of a sole-proprietorship.

3. Costs of Incorporation

The costs of incorporation are traditionally considered to include tax implications, restrictions on the sale and allocation of stock, and exposure to regulations designed to protect shareholders.[93] These costs are means to desirable ends of tax policy and shareholder protection; making incorporation costly is not a desirable end itself. The rule against corporate pro se representation was not established for a similar policy justification and this Note calls into question the judgment behind this rule.[94] The mere fact that it is currently identified as a cost of incorporation does not provide an independent basis for the rule's continued existence.

A stronger version of this argument would be that the owner-operators were aware of the rule at the time they chose to incorporate, and thus they should be bound by their decision. However, it is highly unlikely that the need to hire an attorney in the event of bankruptcy is on the minds of owner-operators choosing to incorporate. Even if owner-operators could be expected to consider the cost of legal representation during bankruptcy, that fact does little to justify such a rule. The question still remains whether the

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[92] Robert Laurence, *Swimming Upstream: A Final Attempt at Persuasion on the Issue of Corporate Pro Se Representation in Arkansas State Court*, 54 ARK. L. REV. 475, 483 (2001) (quoting Wikelund Wholesale Co. v. Tile World Factory Tile Warehouse, 372 N.E.2d 1022, 1024 (Ill. App. Ct. 1978) (citing State Bank of Cerro Gordo v. Benton, 317 N.E.2d 578, 580 (Ill. App. Ct. 1974)).

[93] *See generally* Larry E. Ribstein, *The New Choice of Entity for Entrepreneurs*, 26 CAP. U. L. REV. 325 (1997).

[94] U.S. PolyCon Corp. v. United States, 43 Fed. Cl. 11, 14 (1999) (enumerating reasons for the general rule that corporations must appear through duly-licensed attorneys).

rule is overinclusive and imposes unnecessary costs on small businesses in bankruptcy. If the rule is independently costly, it should not be consistently adhered to just because it existed at the time of incorporation.

C. The Costs of the Traditional Rule

Requiring corporations to be represented by counsel incurs at least two costs. First, the costs of hiring an attorney can consume a large percentage of the debtor's assets and adversely affect creditor recovery. Second, as costs rise federal bankruptcy becomes less attractive, or even impossible, and corporations may be denied access to federal bankruptcy protection.

1. Creditor Recovery

Ensuring maximum creditor recovery is an important goal of bankruptcy law. According to one view of bankruptcy law, advocated by Douglas Baird and Thomas Jackson, all bankruptcy rules should be measured by their ability to preserve the value of the debtors and maximize creditor recovery.[95] This view is subject to strong criticism; critics view bankruptcy as a more complex attempt to distribute losses among different actors.[96] Despite this disagreement about the goals of bankruptcy law, "[a]ll agree that it serves as a collective debt-collection device."[97] Under either view, a policy that reduces the total assets available for distribution should be disfavored if it does not create benefits to compensate for the losses. Requiring representation by

[95] Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations And The Treatment Of Diverse Ownership Interests: A Comment On Adequate Protection Of Secured Creditors In Bankruptcy*, 51 U. CHI. L. REV. 97, 100 (1984).

[96] *See* Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775, 777 (1987) ("Professor Baird and I hold very different views of the purpose bankruptcy law serves. I see bankruptcy as an attempt to reckon with a debtor's multiple defaults and to distribute the consequences among a number of different actors.").

[97] THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 7 (2001).

counsel for all corporations is one such rule; it generates large administrative costs that directly reduce the assets available for distribution.

Empirical research shows that professional fees consume a significant portion of a debtor's assets in a typical small business bankruptcy case. A study of individual and business Chapter 11 filings in six geographically diverse districts between 1986 and 1993, finds administrative costs equal to 3.5% of assets (at filing) in the median case.[98] However, statistics at the median do not adequately describe the costs to small businesses that file for bankruptcy. An empirical study of Chapter 7 and Chapter 11 cases in New York and Arizona found that median professional fees equaled twenty-three percent of asset value (as reported at filing) among firms with assets worth less than $100,000.[99] Mean fees for businesses with assets less than $100,000 were 31.5%.[100]

These studies are likely to substantially underestimate attorney's fees. The author of one of the studies recently testified that "the new [bankruptcy] law's complexity has caused attorneys' fees to rise 50–100%."[101] More systematically, the use of total assets as the denominator will underreport the true costs of professional fees. Many assets are pledged as collateral to secured creditors and are not in the pool assets available for distribution to unsecured creditors or professionals. For example, although costs were 3.5% of assets in the median case in the national study, the

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[98] Robert M. Lawless & Steven Ferris, *The Expenses of Financial Distress: The Direct Costs of Chapter 11*, 61 U. PITT. L. REV. 629, 651 (2000).

[99] Arturo Bris, Ivo Welch & Ning Zhu, *The Costs of Bankruptcy: Chapter 7 Liquidation Versus Chapter 11 Reorganization*, 61 J. FIN. 1253, 1282 (2006).

[100] *Id.*

[101] *Oversight of the Implementation of the Bankruptcy Abuse Prevention and Consumer Protection Act: Hearing Before the Subomm. on Admin. Oversight and the Courts of the S. Comm. on the Judiciary*, 109th Cong. (2006) (statement of Robert Lawless, University of Illinois College of Law), *available at* http://judiciary.senate.gov/hearings/testimony.cfm?id=2442& wit_id=5936.

number rises to 17.9% as a percentage of distributions to unsecured creditors—more than a five-fold increase.[102] Similarly, another study found that unsecured creditors would recover twenty-five cents on the dollar without fees, but that they recover only twelve cents on the dollar when fees are distributed.[103] Costs as a percentage of distribution to unsecured creditors have not been calculated specifically for small businesses but reducing the denominator will inevitably increase the costs. Small businesses generally have less secured debt as a percentage of total assets than the median firm, so the change may not be as dramatic as the five-fold increase found when considering all firms.[104] However, given that small business costs are nearly twenty-five percent when *measured* against total assets, even a less dramatic increase could cause professional fees to consume nearly all of the unsecured assets of a small business.

Research on the recovery of unsecured creditors confirms this assumption. The high costs associated with small business bankruptcies negatively impact creditor recovery. The study of New York and Arizona bankruptcies calculated the median recovery rate for non-priority unsecured claims. Among firms with assets (at filing) under $200,000, the recovery rate was zero; creditors holding non-priority unsecured claims did not recover any of the debt owed to them.[105] This calculation indicates that priority unsecured claims (tax claims) and professional fees consume 100% of the firm's unsecured assets in the median small business case. Tax claims are around twenty-five percent of the median small businesses debt as owner-operators dip into segregated tax accounts to fund operations.[106] The division of tax claims and professional fees has not been calculated.

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[102] Lawless & Ferris, *supra note* 98, at 662.

[103] Douglas Baird, Arturo Bris & Ning Zhu, *The Dynamics of Large and Small Chapter 11 Cases: An Empirical Study*, 23–24 (Yale Int'l Ctr. for Fin., Working Paper No. 05-29, 2007), *available at* http://ssrn.com/abstract=866865.

[104] *Id.* at 26–27.

[105] *Id.* at 23–24.

[106] *Id.* at 24–25.

Even so, it is clear that attorney's fees are substantial and prevent recovery by unsecured creditors.

2. Access to Bankruptcy

The requirement of attorney representation effectively excludes many small businesses from bankruptcy protection entirely.[107] Many corporations are excluded from bankruptcy because they are unable to find an attorney willing to represent them. A review of recent corporate pro se cases demonstrated that numerous debtors appear unable to obtain counsel. Out of 106 cases in which a corporation filed a bankruptcy petition pro se, the U.S. Trustee or bankruptcy judge moved for dismissal based on a failure of the corporation to be represented by counsel in seventy-seven cases. The debtor was able to obtain counsel and continue the bankruptcy in only four of those cases. In the other ninety-five percent, the petition was dismissed for lack of representation.[108] The assets of these corporations are likely liquidated through state foreclosure procedures.[109]

Even for corporations that may be able to afford an attorney, the costs associated with hiring an attorney decrease the likelihood of a federal bankruptcy filing. A model of bankruptcy decision-making demonstrates that cost associated with the proceedings is one of the primary factors discouraging federal bankruptcy.[110] Thus, by allowing pro se corporate representation, courts could allow cost-sensitive

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[107] *See supra* Part III.A.2.

[108] It is possible that these companies refiled with an attorney. However, given that they were given an opportunity to obtain counsel and failed to do so it does not seem that this is a likely result.

[109] Edward R. Morrison, *Bargaining Around Bankruptcy: Small Business Workouts And State Law*, 38 J. LEGAL STUD. 255, 263 (2009) (describing Illinois auction procedure and indicating that some auctioning firms had previously filed a bankruptcy petition).

[110] *Id.* at 263 ("Because a federal case imposes significant costs on creditors, senior lenders will be willing to pay owner-managers not to file a federal bankruptcy petition. If the payment exceeds any benefits the owner might receive in federal court, the owner will agree to use state insolvency procedures instead.").

corporations otherwise excluded from the bankruptcy proceedings to avail themselves of federal bankruptcy.

Proponents of the traditional rule claim that requiring licensed counsel discourages corporations from filing frivolous suits.[111] It is quite possible that relaxing the requirements of counsel could cause an increase in filings, some of which may be in bad faith. Access to courts is not universally good if it is subject to abuse. However, dismissing petitions because of a lack of counsel can actually empower bad faith filers. Relaxing the traditional rule will empower bankruptcy judges to better identify and eliminate abuse of the system.

Courts can and do make direct inquiries into whether or not a petition was filed in a bad faith attempt to benefit from the automatic stay.[112] The Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 empowered judges to dismiss a frivolous complaint with prejudice, which prohibits refilling within 180 days.[113]

Perhaps counterintuitively, the traditional rule creates a problem of repeat bad faith filings. First, pro se debtors can access the automatic stay. Courts do not outright reject attempts to file on behalf of corporations pro se. The petitions are only dismissed on a motion, either of the U.S. Trustee, or the Court. For example, over 100 bankruptcy cases that closed in 2005 were initially filed pro se on behalf of corporations.[114] In these cases, the debtor had the protection of the automatic stay immediately upon filing the petition.[115] Thus, even under the rule requiring a corporation to be represented by counsel, nothing prevents a debtor from

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[111] Matter of Holliday's Tax Svcs., Inc., 417 F. Supp. 182, 185 (E.D.N.Y. 1976).

[112] *See, e.g., In re* Sacramento Metro. Real Estate Inv., 28 B.R. 228 (E.D. Cal. Bankr. 1983); 11 U.S.C. § 707 (2006).

[113] 11 U.S.C. § 109(g)(1) (2006).

[114] Author calculations based on ICPSR data. Federal Judicial Center. *Federal Court Cases: Integrated Data Base Bankruptcy Petitions*, 2005 [Computer file]. ICPSR23080-v1. Ann Arbor, MI: Interuniversity Consortium for Political and Social Research.

[115] 11 U.S.C. § 362(a) (2006).

filing a petition in bad faith in order to obtain an automatic stay before the case is dismissed for lack of representation.

Second, the ability to easily create new corporations and the ability to transfer assets outside of bankruptcy prevent judges from barring subsequent bankruptcy petitions filed in bad faith by corporations. A recent case provides an example of how creating an exception to the prohibition against corporate pro se representation can be used to curb bankruptcy abuse. On August 19, 2004, a Debtor filed his twenty-second bankruptcy filing on behalf of himself or a corporation he owned. All of these filings, spanning twenty-six years, were attempts to prevent foreclosure on property owned by the Debtor or one of the numerous corporations he created. At a hearing, Judge Lee observed that Golden State Capital Corporation was not properly represented before the court, and the Debtor made no justification for this defect.[116] However, Judge Lee commented that "I am very reluctant to take the easy way out, and that's just dismiss you again. I'm inclined to just keep Golden State Capital Corp., whatever it may be, in bankruptcy for a while . . . and give [the County] an opportunity to move forward with [the] foreclosure."[117] Judge Lee did not dismiss the case and the County moved forward with its tax sale.[118]

In short, the rule against pro se corporate bankruptcy does not prevent bad faith corporate bankruptcy filings. Allowing the bad faith corporate pro se filer to remain in bankruptcy, unrepresented by an attorney, gives the court the ability to restrict the corporation's activities and grant

[116] Transcript of Hearing at 13:22–13:25, *In re* Golden State Capital Corp, No. 04-17201-WRL (Bankr. E.D. Cal. Sept. 23, 2004).

[117] *Id.* at 22:8–22:12

[118] The Debtor again transferred title of the property on the eve of the foreclosure sale. However, because Golden State Capital Corp. was still in bankruptcy and the traditional rule was not applied, the transfer violated 11 U.S.C. § 363(b)(1). The U.S. Trustee was able to reach a stipulation allowing the sale, dismissing the case and also preventing the Debtor, or any entity controlled by him, from filing a bankruptcy petition without leave of court for six years. Stipulation of United States Trustee and Debtor Dismissing Case and Barring Future Filings for Six Years, *In re* Golden State Capital Corp., No. 04-17201 (E.D. Cal. Feb. 18, 2005).

relief from the automatic stay to facilitate non-bankruptcy remedies.

IV. RELAXING THE RULE IN THE SMALL BUSINESS BANKRUPTCY CONTEXT

There is no reason to doubt the general validity of the rule against corporations appearing pro se in bankruptcy or other cases. However, there are strong reasons to doubt the wisdom of applying the rule in all cases. The current rule imposes high costs on the bankruptcy system in cases where justifications for the rule are not compelling. The solution to the problem is relatively straightforward. Bankruptcy judges should be more willing to allow an owner-operator or another shareholder to appear in court on behalf of the corporation in the same way a sole-proprietor may appear pro se. In the hypothetical Penn Leather, Inc., discussed above, this would mean allowing Felix to represent the corporation.[119] This would reduce the different treatment between Penn Leather, Inc., and Penn Leather the sole-proprietorship and allow both cases to successfully reorganize at a low cost.

A. Where Change is Required

Because the rule is based on prudential judgment, there is no need to enact any changes to the bankruptcy code, the Federal Rules of Bankruptcy Procedure, or any other federal statutes. Bankruptcy judges often recognize the unique nature of bankruptcy proceedings and the discretion trusted in them to experiment with innovative solutions to problems of administering the bankruptcy system.[120] The common law legal system recognizes the benefits of judicial discretion. Instead of abrupt changes, such as eliminating the requirement altogether, change comes gradually and by the reasoned judgment of experienced judges examining a

[119] *See supra* Part III.

[120] *See, e.g.*, Hon. A. Thomas Small, *Small Business Bankruptcy Cases*, 1 AM. BANKR. INST. L. REV. 305, 315 (1993) (describing the "fast track" bankruptcy procedure in the Eastern District of North Carolina).

particular circumstance. Because the competence and necessity of a small corporation to proceed pro se cannot be reduced to discrete requirements, the experience of judges and cases like *Holliday's* can serve as an essential guide in evaluating each case. Such an approach would not necessarily bind the court to its initial decision if it turns out the exception is not appropriate. As the *Holliday's* court noted, "[t]he bankruptcy judge may require an attorney to appear for the corporation on pain of dismissal should he find that lay representation is causing a substantial threat of disruption or injustice . . . ."[121]

Other changes are not essential but would help facilitate corporate pro se representation within bankruptcy. First, local rules, which require that corporations always be represented by counsel, should be repealed or their language should recognize the possibility of exceptions. As discussed above, judges have the power to make exceptions to local rules but it is likely that judges are less willing to make an exception that is contrary to a clear rule. Similarly, the language of the U.S. Courts website should be modified to reflect the ability of judges to make exceptions to the rule. The U.S. Trustee manual should similarly be modified to explicitly recognize that the rule is not absolute and that discretion should be exercised when moving to dismiss for lack of representation. There is currently ambiguity in the level of discretion given to the U.S. Trustee and explicitly recognizing discretion is consistent with the policy of flexibility recognized elsewhere in the manual. The U.S. Trustee may be in a good position to evaluate the factors discussed below and determine whether a corporate debtor may successfully appear pro se but the current manual often leads to an automatic motion for dismissal.

B. Factors to Consider in Each Case

Deciding when an exception to the general rule is appropriate will be a fact-specific inquiry, but a few

[121] *In re* Holliday's Tax Servs., Inc., 417 F.Supp. 182, 185 (E.D.N.Y. 1976).

principles emerge that point to certain factors that should inform such a decision. The position of the creditors, the nature of the corporation, its representative, and the ability to otherwise obtain counsel should all be considered in determining whether an exception is appropriate.

1. Consent of the Creditors

The bankruptcy court in *MSD Woodworking* recognized the importance of creditors' interests in determining if an exception should be created. The court entered a stipulation over the objection of the U.S. Trustee because although a non-attorney corporate representative of the debtor signed it, counsel for the secured creditors also signed the stipulation.[122] The creditors were thus able to ensure that their rights were adequately protected and not interfered with by the lack of corporate counsel for the debtor.

Consent of the creditors has limits and it should not be dispositive without further consideration. First, although creditors may have more information than judges, they are also acting on limited information and, at the outset of the case, may not know how complex it will become or how competent the non-attorney representative may be. Additionally, determining the position of the creditors may be difficult. Outside of cases like *MSD*, where the creditors affirmatively agreed to a stipulation with a pro se debtor, consent will likely be implied from silence. It is possible that creditors would be harmed by pro se representation, but their stake is insufficient to justify the costs of objecting.

2. Number of Shareholders

The number of shareholders is an important factor in determining if a corporation should be allowed to file for bankruptcy without an attorney. A corporation with a sole shareholder who is also the person seeking to represent the corporation is the strongest candidate for allowing an exception. Such cases do not risk complicating the rights of

[122] In re MSD Woodworking, 132 B.R. 631, 631 (Bankr. D. S.D. 1991).

other shareholders and the corporation can be described as the "alter ego" of the individual.[123] Large corporations with numerous, diverse shareholders lie on the other end of the spectrum and create the possibility that a non-attorney shareholder representative could sacrifice the interests of the other shareholders or the corporation as a whole for their own gain. The difficult cases will lie in between the two extremes. Judges should be open to allowing pro se representation outside of sole shareholder corporations but must do so cautiously and with the interests of the absent shareholders in mind.

3. Competence and Experience of the Representative

The court must also consider the ability of the non-attorney representative to properly represent the firm throughout bankruptcy. The representative's education, experience, and access to legal research should factor into this decision. The ability to accurately complete the filing requirements is a difficult task that might signal the representative is somewhat competent. Courts should be careful not to be too demanding on pro se debtors, as even experienced bankruptcy attorneys often make mistakes when completing bankruptcy forms.

4. Complexity of the Case

The complexity of the case will influence how well the non-attorney will be able to represent the debtor. In simple cases the court should be more willing to allow owner-operator representation. As cases become more complex the court will have to determine if the representative is capable. As discussed above, courts have the power to monitor proceedings and may find that a once simple case has become too complex and thereafter requires counsel. Unfortunately, simplicity is not a virtue of the Bankruptcy

[123] United States v. Priority Prods., Inc, 615 F.Supp. 593, 596 (Ct. Int'l Trade 1985).

Code, particularly given the 2005 Amendments. There have since been various proposals aimed at simplifying the code, which would make pro se representation much more attractive and could generate significant cost savings.[124]

V. CONCLUSION

The traditional rule requiring a corporation in bankruptcy to be represented by an attorney has strong prudential justifications. The need to protect shareholders is obviously important. However, it is often impossible to distinguish a small corporation from its owner. Thus, the risk of poor pleadings is often the only compelling justification for prohibiting pro se representation of small, closely-held, corporations in bankruptcy. While the risk of poor pleadings is real, it should not be overstated. Expert bankruptcy attorneys often file poor pleadings and they do so while draining the assets of the debtor and reducing potential recovery for the creditors. In addition, individuals and sole proprietorships have a statutory right to access federal bankruptcy courts pro se despite concerns that their pleadings may have deficiencies.

The high costs associated with attorney's fees in a small business bankruptcy, and the potential for these fees to consume the assets of the debtor, provide a compelling reason to consider creating exceptions in these instances. Judges and court clerks can monitor pro se corporations, just as they do pro se individuals and sole proprietorships, to help mitigate the costs of pro se representation. Unlike individuals, who have a statutorily protected right to appear pro se, judges may dismiss a pro se corporate case if the representative is truly incapable of representing the corporation. Thus, the risks of allowing pro se corporate

[124] *See, e.g.*, NATIONAL BANKRUPTCY CONFERENCE, *A Proposal for Amending Chapter 12 to Accommodate Small Business Enterprises Seeking to Reorganize*, Dec. 17, 2009, http://www.nationalbankruptcyconference.org/images/NBC%20Small%20Business%20Rept%20Dec%2017,%202009.pdf (arguing for an amendment that would allow small businesses reorganize under the much simpler Chapter 12, currently only available to family farmers).

representation are manageable and the benefits, in terms of assets saved from attorney's fees, are concrete and large. Such a situation calls for employing the discretion and wisdom of bankruptcy judges to craft exceptions to the unnecessarily rigid prohibition against pro se corporate bankruptcies.