

Michigan Law Review

Volume 91 | Issue 7

1993

The Fantastic Wisconsin Zero-Bureaucratic-Cost School of Bankruptcy Theory: A Comment

James W. Bowers
Louisiana State University Law Center

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Bankruptcy Law Commons](#), and the [Legislation Commons](#)

Recommended Citation

James W. Bowers, *The Fantastic Wisconsin Zero-Bureaucratic-Cost School of Bankruptcy Theory: A Comment*, 91 MICH. L. REV. 1773 (1993).

Available at: <https://repository.law.umich.edu/mlr/vol91/iss7/6>

This Correspondence is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

CORRESPONDENCE

The Fantastic Wisconsin Zero-Bureaucratic-Cost School of Bankruptcy Theory: A Comment

James W. Bowers*

We must beware of the pitfall of antiquarianism, and must remember that for our purposes our only interest in the past is for the light it throws upon the present. I look forward to a time when the part played by history in the explanation of dogma shall be very small, and instead of ingenious research we shall spend our energy on a study of the ends sought to be attained and the reasons for desiring them. As a step toward that ideal it seems to me that every lawyer ought to seek an understanding of economics. The present divorce between the schools of political economy and law seems to me an evidence of how much progress in philosophical study still remains to be made.

— Oliver Wendell Holmes, Jr.¹

In two recently published articles,² Wisconsin Law Professor Lynn LoPucki and Pennsylvania Law Professor Elizabeth Warren, nearly simultaneously, fired the latest shots in one of academia's hottest ongoing debates: whether any good reason for having bankruptcy law exists.³ Justice Holmes once opined that the future belonged to the

* Professor of Law, Louisiana State University Law Center. B.A. 1964, LL.B. 1967, Yale. — Ed. My thanks to John Church and Lucy McGough for helpful comments on earlier drafts. Credit for saving me from errors, but no blame for those remaining, is also due to Bob Rasmussen and Bruce Markell. Lynn LoPucki and Elizabeth Warren also graciously suggested improvements, some of which I made. They are obviously innocent of any sins that are left.

1. Oliver Wendell Holmes, Jr., *The Path of the Law*, 10 HARV. L. REV. 457, 474 (1897).

2. Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosenzweig*, 91 MICH. L. REV. 79 (1992); Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 YALE L.J. 437 (1992). The text identifies these authors with the institutions with which they were affiliated at the time these articles were written. Professor LoPucki has subsequently joined the faculty of Washington University in St. Louis, and Professor Warren has joined the Harvard Law School faculty.

3. The current debate began with Thomas M. Jackson, *Bankruptcy, Non-Bankruptcy Entitlements, and the Creditors' Bargain*, 91 YALE L.J. 857 (1982) (arguing that state "grab-law" creditors' remedies were inefficient, and that creditors would therefore agree ex ante to a collective remedy system resembling bankruptcy in order to overcome those inefficiencies). Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127 (1986), fired the next salvo, arguing that the justification for bankruptcy law probably did not apply to publicly traded companies. This work elevated the matter to the state of a recognized debate by provoking an exchange in the *University of Chicago Law Review* between Baird and Professor Elizabeth

lawyer skilled in statistics and economics.⁴ LoPucki and Warren apparently agree about statistics but argue that, in a world with positive transaction costs, economic theory has little to contribute to our understanding about the justifications for bankruptcy law.

I write to highlight what one might easily overlook in LoPucki's and Warren's pieces. As they assail the usefulness of economic analysis, particularly analysis that begins by assuming zero transaction costs, they simultaneously inaugurate a new analytic tradition: the Fantastic Wisconsin School⁵ of Zero-Bureaucratic-Costs. They use their new theory to argue that markets are costly and thus are of limited or no use to people who want to take businesses apart or to reconfigure them. Corporate reorganizations, they urge, require the costless and perfectly functioning political appointee, the bankruptcy judge. The birth of this jurisprudential school is too significant to be permitted to pass unheralded.

I. THE BANKRUPTCY DEBATE: THEORY AND DATA

The bankruptcy debate, one of the few squabbles in academic commercial law ever to have hit the newspapers,⁶ is over whether chapter

Warren. Compare Elizabeth Warren, *Bankruptcy Policy*, 54 U. CHI. L. REV. 775 (1987) (arguing that chapter 11 was intended to benefit workers and communities, and dismissing as irrelevant that it might be shown, in economic theory, to be costly for shareholders and creditors) with Douglas G. Baird, *Loss Distribution, Forum Shopping, and Bankruptcy: A Reply to Warren*, 54 U. CHI. L. REV. 815 (1987) (arguing that arguments like Warren's were too atheoretical to be helpful, and that bankruptcy should not be concerned with the redistributive policies favored by Warren). After at least one partial symposium, *Symposium on the Law and Economics of Bargaining*, 75 VA. L. REV. 155 (1989), and several articles later in various journals, see, e.g., references cited *infra* notes 21 and 39, came a climactic point, at which the debate returned to the *Yale Law Journal*: Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043 (1992) (reporting an empirical study which claimed that the adoption of chapter 11 in 1978 had increased the bankruptcy losses suffered by corporate shareholders, and proposing that chapter 11 be repealed and replaced with a market system of contingent equity contracts). It is this piece that was the subject of the Warren and LoPucki articles.

4. "For the rational study of law, the black-letter man may be the man of the present, but the man of the future is the man of statistics and the master of economics." Holmes, *supra* note 1, at 469. I am grateful to my erudite colleague Paul Baier for pointing out and then unearthing this and the introductory Holmes reference for me.

5. Legal academia already boasts at least one famous "Wisconsin School," that of J. Willard Hurst, who championed the application of social science methods to the study of legal history. See Lawrence M. Friedman, *American Legal History: Past and Present*, in AMERICAN LAW AND THE CONSTITUTIONAL ORDER 464, 465-67 (Lawrence M. Friedman & Harry N. Shieber eds., 1988). It is thus propitious that Warren reached so nearly simultaneously conclusions similar to LoPucki's, permitting their discovery to be named the Wisconsin School and eliminating the potential for confusion that might have arisen between "Wisconsin Schools" had LoPucki written alone.

6. See, for example, Lopucki, *supra* note 2, at 80 nn.5 & 6 for citations to numerous articles in the financial press discussing the Bradley and Rosenzweig conclusions. Recently the debate has reached the popular press as well, even the front page of the *New York Times*. Peter Passell, *Critics of Bankruptcy Law See Inefficiency and Waste*, N.Y. TIMES, Apr. 12, 1993, at A1.

11 of the Bankruptcy Code is justifiable. Michael Bradley and Michael Rosenzweig published an empirical study⁷ that compared the stock market value declines in the securities of firms taking bankruptcy under chapters X and XI of the pre-1978 Bankruptcy Act regime⁸ with firms filing under the current chapter 11.⁹ The study was limited to companies whose securities were traded on major stock exchanges because there are no easily available, reliable data on the market values of the securities of unlisted firms.¹⁰ The study seems to show that shareholders are much worse off under the current law than under the former one.

LoPucki and Warren critically scrutinize this study.¹¹ LoPucki argues that the theoretical model into which Bradley and Rosenzweig fit their data was inapposite because, among other things, it failed to discriminate between losses due to the Bankruptcy Code and ordinary transaction costs incurred in recapitalizing businesses.¹² He and Warren also question Bradley and Rosenzweig's analysis, arguing that the coming of the "junk bond" era made bankrupts in the two different time periods impossible to compare for purposes of making statistical inferences.¹³ Warren further insinuates, but does not show, that there

7. Bradley & Rosenzweig, *supra* note 3.

8. The Chandler Act of 1938, ch. 575, 52 Stat. 840 (repealed 1978).

9. The Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, 92 Stat. 2549 (codified as amended at 11 U.S.C.A. §§ 101-1330 (West 1979 & Supp. 1992)).

10. Bradley & Rosenzweig, *supra* note 3, at 1058.

11. I too am critical of certain aspects of the Bradley and Rosenzweig study. On one important argument I agree with Warren and LoPucki that Bradley and Rosenzweig were unpersuasive. Bradley and Rosenzweig argue that the beneficiaries of chapter 11 were managers who were able, because of chapter 11, to extract wealth from the shareholders and bondholders of their firms. LoPucki and Warren analyze other studies on the fortunes of the managers of companies that took chapter 11 and show that other data contradicts Bradley and Rosenzweig's conclusion. See LoPucki, *supra* note 2, at 94-97; Warren, *supra* note 2, at 448-55. My shared criticism is based on theoretical rather than empirical grounds. If chapter 11 tended to give managers new ways of enriching themselves, and the market for management talent functioned minimally well, then the adoption of chapter 11 should have caused a decline in other forms of executive compensation sufficient to make up for the new benefits chapter 11 confers on managers. Thus the values of the securities of the filing companies would not necessarily be affected by the adoption of chapter 11. I would therefore accept Bradley and Rosenzweig's conclusion that managers are winners only after learning what sort of defect they posit must exist in the labor market for managers which prevents such adjustments in executive wages.

My disagreement with them does not undercut the validity of their ultimate conclusion that chapter 11 should be repealed. It may be that the losses they measure in their study are simply the dissipation of value that occurs in classic rent seeking when chapter 11 blurs the boundaries of everybody's property rights. See, for example, Anne O. Krueger, *The Political Economy of the Rent-Seeking Society*, 64 AM. ECON. REV. 291 (1974), and Gordon Tullock, *The Welfare Cost of Tariffs, Monopolies, and Theft*, 5 W. ECON. J. 224 (1967), for the seminal rent-seeking literature. If rent seeking explains the losses, then *nobody* necessarily wins by the adoption of the new chapter 11. The bottom-line conclusion that chapter 11 should be repealed, however, is not undermined by a "nobody wins" thesis, even if a "managers win" thesis is partially discredited.

12. LoPucki, *supra* note 2, at 84 n.17.

13. *Id.* at 81; Warren, *supra* note 2, at 460-61.

may be hidden biases in the samples used by Bradley and Rosenzweig which make them nonrepresentative of the real world and cast doubt on the validity of the conclusions Bradley and Rosenzweig draw from them.¹⁴ Because this part of LoPucki's and Warren's work does not advance their revolutionary new theory of zero-bureaucratic-costs, I will leave to Bradley and Rosenzweig the defense of their empirical model and statistical technique.¹⁵

LoPucki and Warren make three principal theoretical criticisms of the Bradley and Rosenzweig analysis which *do* invoke their new theory:

1. The first, argued by LoPucki alone, is that the Bradley and Rosenzweig data, strictly speaking, only justify replacing chapter 11 with chapters X and XI of the Chandler Act;¹⁶
2. The second, advocated by both, is that a showing of increased bankruptcy losses for publicly listed firms does not justify a repeal of the statute insofar as it applies to unlisted companies;¹⁷ and
3. Third, both argue that there are possible corporate stakeholders whose gains might outweigh the losses chapter 11 imposes on stockholders and bondholders.¹⁸ If so, one cannot justify repeal of chapter 11 by showing losses to those holding claims listed on public exchanges unless one can also show that the gains to these other, unexamined stakeholders were less than the losses.

In light of these observations, LoPucki concludes that Bradley and Rosenzweig's proposal to replace chapter 11 with a market system is not based on their empirical findings, but rather on their economic analysis of bankruptcy.¹⁹ According to LoPucki, however, economic

14. See, e.g., Warren, *supra* note 2, at 455-59.

15. Bradley and Rosenzweig give a summary defense of their technique in Michael Bradley & Michael Rosenzweig, *The Still Untenable Case for Chapter 11* (1993) (unpublished manuscript, on file with the author). To deal with the claim that the chapter 11 firms were "junk bond" issuers unlike the chapter X and XI firms, and thus were systematically more highly leveraged, Bradley and Rosenzweig reran their comparisons on an even larger sample, holding leverage constant in their comparisons of pre- and post-1978 filing firms, and arrived at identical conclusions.

16. LoPucki, *supra* note 2, at 97 n.66.

17. *Id.*; Warren, *supra* note 2, at 444-46.

18. LoPucki hypothesizes that creditors other than bondholders gain as much as the holders of those publicly traded claims lose. LoPucki, *supra* note 2, at 83 n.14, 94. Warren argues that chapter 11 was intended to redistribute debtors' wealth to multiple other parties. Warren, *supra* note 2, at 467-71. Since the claims of those other parties and creditors do not trade in active markets, however, this hypothesis is likely to be nearly untestable. Even if true, therefore, its truth must be accepted as a matter of faith.

19. "It is on the basis of their nonempirical economic analysis that they conclude that court-supervised bankruptcy reorganization should be eliminated entirely." LoPucki, *supra* note 2, at 97-98. Warren would probably not disagree because she argues that the Bradley and Rosenzweig

analysis can never give meaningful, or even interesting,²⁰ insights in the real world. He therefore concludes that the Bradley and Rosenzweig argument, lacking both empirical and theoretical support, is utterly unfounded. Warren argues similarly that chapter 11 was adopted to replace market transactions because the use of markets entails high costs.²¹ In the drawing of this conclusion and in its elaboration, LoPucki and Warren inaugurate their revolutionary mode of analysis. Since the three critiques are pregnant with the tenets of the new Wisconsin School, it will be useful to examine them a bit more closely.

A. *The Pull of Positivism*

The Bradley and Rosenzweig study shows that a regime in which bankruptcy relief is easy to obtain creates more losses than a regime in which such relief is harder to obtain.²² Technically, Bradley and Rosenzweig admit, the direct conclusion to be drawn from this finding is that the current law ought to be repealed in favor of the former law.²³ However, making bankruptcy relief easier to obtain seems to increase

conclusions should be limited to the cases they studied, which were all cases of listed companies. Warren, *supra* note 2, at 440.

20. "Bradley & Rosenzweig's economic analysis of bankruptcy reorganization tells us more about economic analysis than about bankruptcy. The way problems melt away in this PM-ZTC [Perfect Markets-Zero Transaction Costs] World seems at first elegant, then suspicious, and finally boring." LoPucki, *supra* note 2, at 106. Strictly speaking, he may assume that there are several subsets of economic analysis and find boring only the sect which uses the concept of zero transaction costs as an analytical tool. LoPucki's work has nevertheless been consistently suspicious of whether economic arguments can ever advance our understanding, whether or not such arguments were explicitly based on zero-transaction-cost models. See, e.g., Lynn M. LoPucki & William C. Whitford, *Bargaining over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125, 183 (1990) (arguing that an a priori economic model of bankruptcy "cannot establish factually what the most efficient rule governing distributions in bankruptcy would be"). Warren has been critical of the contributions of economic analysis in the bankruptcy field before. See Warren, *supra* note 3. In the piece discussed in this correspondence, however, she limits her theoretical critique to an expression of skepticism over whether analyses which assume zero transaction costs are valid in a real world where such costs are positive. Warren, *supra* note 2, at 474-77.

21. Warren, *supra* note 2, at 474-77. She does not address the theoretical reasons for believing that market systems encourage and permit institutions and behaviors that lower transaction costs and thus tend to produce optimally low-transaction-cost interactions among people. See, e.g., *infra* section II.B. I have made this argument explicitly in connection with the nonbankruptcy law of creditors' remedies, showing that when investment in cost-saving technology is necessary in order to reduce transaction costs, the incentives generated by the nonbankruptcy creditors' remedy system are most apt to induce the appropriate investment. James W. Bowers, *Whither What Hits the Fan?: Murphy's Law, Bankruptcy Theory, and the Elementary Economics of Loss Distribution*, 26 GA. L. REV. 27, 46-51 (1991).

22. The primary effects of the new law are to make it easier for firms to seek bankruptcy relief and to consolidate the postbankruptcy control of the firm's management in the face of competing claims of creditors for the right to control the bankrupt firm's fortunes. See Bradley & Rosenzweig, *supra* note 3, at 1048.

23. *Id.* at 1077 n.80.

bankruptcy losses, a fact from which one might also infer that chapter 11 ought to be repealed entirely. The process of inference employed to arrive at this last conclusion is not, at least obviously, based on any economic analysis. It is as simple as drawing the following common sense conclusions:

1. *Premise:* Less unpleasant states of the world are preferable to more unpleasant states.
2. *Data:* I hate a regime in which you stick needles into my body for ten minutes more than one in which you stick them in for only two minutes.
3. *Strict Empirical Observation:* The two-minute needle state of the world is better than the ten-minute state.
4. *Extended Inference:* The best of all worlds is probably neither the two- nor the ten-minute state, but instead a third one in which you do not stick needles into me at all.

LoPucki's first argument²⁴ relies on the proposition that by itself data supports only a strict empirical observation but will not support any extended inferences so that, if you draw them, their source has to be some entirely extraneous theory.²⁵ For his argument and my acupuncture hypothetical, we have trend data on only two regimes from which we drew a conclusion about a yet-to-be experienced third regime.²⁶ Perhaps it is an inherent weakness in legal argument that lawyers would recognize and even approve of this process of reasoning. It is probably true that many of Bradley and Rosenzweig's readers understood and agreed with this process of reasoning as a valid exercise in the drawing of inferences. True, it would be better to have had strict empirical observations of my actual preferences about the third regime prior to arriving at the extended inference.²⁷ That there could be stronger empirical support for that inference is not, however, the same as saying that there is *no* support for it in the data.

It is very difficult to obtain data which support strict empirical

24. See *supra* text accompanying note 16.

25. After reviewing a draft of this comment, LoPucki with great charm advised me that he is not skeptical of all possible extended inferences which would be drawn from Bradley and Rosenzweig's data, but only of those that tend to undermine the justification for chapter 11. He enthusiastically endorses any that tend to *vindicate* chapter 11. Indeed, as he pointed out to me, he has argued for at least three other interpretations of the data, each of which he considers to be a more plausible inference than that drawn by Bradley and Rosenzweig. LoPucki, *supra* note 2, at 94.

26. By treating his argument skeptically, I do not mean to suggest that the extended inference is not implied by the initial premise; the inference is heavily dependent on the theory embodied in that premise. I do contend, however, that the ultimate conclusion is, in common sense, also implied by the data.

27. To negate, for example, the possibility that I have a minor masochistic preference for being poked with needles but only for time periods shorter than two minutes.

observations about prospective future states of affairs that have never existed. To demand that legal conclusions be based only on what can be proven by strict empirical observation, as LoPucki apparently does, is to carry the demands of positivistic methodology to an untenable extreme. Applying such standards creates large gaps between what we think we can know confidently and what we can actually know from proof. Among other things, the requirement outlaws all aspirational reasoning processes unless one aspires to some golden age in the past about which data might hypothetically be available. Those who aspire to futures that do not duplicate some golden era hold unjustifiable aspirations if only conclusions based on strict empirical observation alone can be justified.

Not so "strictly speaking," we can draw the inference that Bradley and Rosenzweig drew without resort to any theory other than one which holds that regimes in which costs are low are preferable to regimes in which costs are high. Indeed, I show below that the Fantastic Wisconsin Zero-Bureaucratic-Cost Model that drives the LoPucki and Warren critiques relies on this same preference hypothesis. It might thus be argued that the Bradley and Rosenzweig conclusion, insofar as it cannot be inferred directly from their data, is based on LoPucki's and Warren's hierarchy of values instead. It is doubtful that many of the arguments of any defender of chapter 11, including those of LoPucki and Warren, pass the test of being based only upon strict empirical observations.

B. *Stakeholders and Close Corporations: Markets and Values*

The second and third arguments that both Warren and LoPucki make are especially curious in light of LoPucki's first one. If one may not form valid conclusions from anything other than strict empirical observations of facts, LoPucki cannot know anything about the market values of closely held corporations because nobody has reliable data about the value of claims to the assets of such firms. It follows that he can say to Bradley and Rosenzweig, "you do not know." He cannot say, "you are wrong."

In the absence of empirical information about close corporations, whether Bradley and Rosenzweig can appropriately draw inferences about close corporations from data on publicly traded firms depends on whether extended inferences from empirical data are ever permissible and, if so, when. Answering these questions requires dealing critically with the differences between the anticipated behavior of financially troubled small businessmen, as opposed to big businessmen, in responding to the existence of creditors. Adoption of the strict em-

pirical observation test is a slick way for LoPucki to relieve himself of the need to do this analysis.²⁸ Similarly, without explicit data permitting strict empirical observations, LoPucki cannot ever know whether other stakeholders such as nonbondholding creditors have gained or lost welfare as a result of the passage of chapter 11, and thus cannot validly criticize Bradley and Rosenzweig for ignoring them either.

The difficulty is not only in the extent of our present knowledge, however. It is apparently LoPucki's position that whether chapter 11 is justifiable is inevitably unknowable. Bradley and Rosenzweig are quite explicit that their study limited itself to companies whose securities were listed on major stock exchanges because hard information on market values was available only for those companies.²⁹ The strict empirical observation limitation means that the impact of chapter 11 on closely held corporations and on stakeholders whose claims do not trade in markets can never be knowable.³⁰ It will thus never be possible either to justify the application of bankruptcy or to justify its repeal as it applies to such corporations or stakeholders unless either justification comes from a *theory*. This realization, when combined with LoPucki's succeeding argument in favor of having chapter 11 apply to close corporations and other stakeholders, leads to the insight that he is ignoring his own strict empirical observation restriction by employing a theory based on extended inference himself. That insight prompts this attempt to unearth the principles of his theory.

28. Warren, on the other hand, lays out a taxonomy of differences that exist between listed and unlisted firms and then asserts that the existence of these differences "casts serious doubt on Bradley and Rosenzweig's claim that their data apply with equal force to all corporations." Warren, *supra* note 2, at 442-43. This stops just short of saying that nothing we know about listed corporations can ever serve as a basis for an extended inference about corporations generally, a position that comes close to insisting on strict empirical observation rigor. However, the tone of Warren's critique suggests that she might even be willing to infer that chapter 11 makes stockholders of close corporations better off from the fact that it makes holders of listed shares worse off because the types of firms are so different. *Id.* at 443. This position finesses the problem nearly as effectively as LoPucki's strict empirical observation requirement but, because it is itself an extended inference, also violates that requirement and thus makes ambiguous the extent to which Warren subscribes to LoPucki's standard of observational strictness.

29. Bradley & Rosenzweig, *supra* note 3, at 1056 n.44.

30. Recall that Bradley and Rosenzweig's argument and inference is that the adoption of chapter 11 caused the *market values* of certain claims against bankrupt firms to decline. Market values are direct evidence of the worth placed on rights to assets by actual, living buyers and sellers. There is much in LoPucki's argument, however, to suggest that he deems irrelevant what actual people are willing to take for or pay for rights. Instead, he suggests that the relevant datum is some transcendental sort of pure value. For example, LoPucki suggests that market values might somehow be incorrect, and that markets might "overvalue" corporate shares. LoPucki, *supra* note 2, at 83 n.13. At the same time, however, he also suggests that the problem of determining nonmarket values is intractable. *Id.* at 84 & n.18.

II. MARKETS AND BUREAUCRACIES

A. *Aspirations and Economic Models*

The meat of the Warren and LoPucki commentary on the Bradley and Rosenzweig study is their attack on economic theory, upon which LoPucki and Warren claim Bradley and Rosenzweig's conclusions must have been based.³¹ The problem, LoPucki asserts, is "the economist's hypothetical world of perfect markets and zero transaction costs . . . *the PM-ZTC World*."³² LoPucki and Warren both argue that the distance between this assumed world and the real world in which we live is so great that conclusions about the former are simply irrelevant to the lives of people living in the latter.³³ This argument flies in the face of a long human tradition of insisting that good can come from contemplating heaven, if for no other reason than to better the odds that we can get there.

The LoPucki and Warren dismissal of the observation technique of economic analysis, presumably to be replaced by strict information about the real world, marks them as adherents to what Holmes called "antiquarianism."³⁴ LoPucki and Warren reject, and Bradley and Ro-

31. See *supra* note 19. If the Bradley and Rosenzweig proposals are as unrelated to their empirical work and as dependent upon their economic theory, as LoPucki and Warren argue, one might wonder why they spent so much energy criticizing Bradley and Rosenzweig's empirical technique. If they believe that the Bradley and Rosenzweig theory is required to reach their conclusions and that it is indefensible, their empirical critiques were a waste of time. The empirical critiques also tend, unfortunately, to divert our focus from LoPucki's and Warren's own theoretical contributions to the debate.

32. LoPucki, *supra* note 2, at 99. Actually, his characterization of the hypothetical world economic analysts use is potentially redundant. If the set of costs considered to be transaction costs is defined broadly enough, ZTC alone is all it is necessary to assume. The existence of universal and utterly perfect markets follows from the assumption of ZTC. See generally Guido Calabresi, *Transaction Costs, Resource Allocation and Liability Rules — A Comment*, 11 J.L. & ECON. 67 (1968). If transaction costs are more narrowly defined, recent work in game theory suggests that ZTC may not inevitably lead to perfect market outcomes. See, e.g., Jason S. Johnston, *Opting In and Opting Out: Bargaining for Fiduciary Duties in Cooperative Ventures*, 70 WASH. U. L.Q. 291 (1992).

33. As yet, no one has demonstrated that any relationship at all exists between the way things work in the PM-ZTC World and the way things work in the world in which we live. No basis exists for assuming that, because a proposition is entirely true in the former world, it is even a little bit true in the latter. To prove a necessary premise of an argument false is to defeat the argument. By that standard, all arguments that depend on PM-ZTC assumptions fail, as do all attempts to import conclusions from the PM-ZTC world. LoPucki, *supra* note 2, at 109. "Unfortunately, we live in an imperfect world. Economists have long recognized that solutions proposed for perfect markets may not work in imperfect markets." Warren, *supra* note 2, at 474.

34. See *supra* note 1. Taken together with his insistence that conclusions be based only on strict empirical observation, LoPucki argues that the only sound basis for making policy judgments is valid empirical data. Warren too has fervently insisted that all bankruptcy arguments must be based on solid empirical data. See, e.g., Teresa A. Sullivan et al., *The Use of Empirical Data in Formulating Bankruptcy Policy*, LAW & CONTEMP. PROBS., Spring 1987, at 195. These positions are "antiquarian" because data are always explicitly historical.

senzweig accept, Holmes' call for us to "spend our energy on a study of the ends sought to be attained and the reasons for desiring them."³⁵ The Coase Theorem,³⁶ application of which inaugurated the use of ZTC models, posits the ZTC world as one of aspiration. The ZTC world is the one in which the most is made out of the world's scarce resources. In all other worlds, scarce resources might be wasted while some people are still hungry. In their model Bradley and Rosenzweig propose that the law be altered to mimic more closely the outcomes in a ZTC world. LoPucki and Warren, however, reject as nonsensical the use of a ZTC world even as an aspiration.³⁷ This is particularly ironic because it appears that, upon close examination of their argument, LoPucki and Warren seem devoted to the lowering of transaction costs as justification for their own legal arguments.³⁸ What is significant and important about their analysis, and promising about the Fantastic Wisconsin School of Zero-Bureaucratic-Costs (ZBC), is that defenders of the Bankruptcy Code have, for the first time, offered a coherent principle to justify its existence. If bankruptcy law lowers transaction costs, it has a lot going for it that has never been previously realized.³⁹ Regrettably, neither LoPucki's nor Warren's application of the ZBC model takes serious analytical account of transaction costs.

35. See *supra* note 1.

36. See Ronald H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960).

37. See *supra* note 33. ZTC models are "boring" to LoPucki because, in a world of ZTC, every new proposal *does* maximize wealth. See LoPucki, *supra* note 20. LoPucki's boredom, however, results from a misapplication of the Coase Theorem. The theorem actually suggests that things turn out right *only* when the parties have the right to contract around any imperfections. Inasmuch as he acknowledges that the right to take chapter 11 cannot be contracted around, LoPucki, *supra* note 2, at 107 n.123, an actual world of very low or nonexistent transaction costs ought still to retain some intrinsically interesting legal problems.

38. "Chapter 11 exists solely to deal with transaction costs." LoPucki, *supra* note 2, at 106. "Bradley and Rosenzweig argue that bankruptcy is justifiable only if there are problems generated by 'significant . . . transactions costs' In my view, Chapter 11 was specifically designed to respond to such problems." Warren, *supra* note 2, at 475.

One way of making the world mimic one in which costs are zero is, of course, to alter the existing world in ways that reduce costs as near to zero as is practical.

39. Warren explicitly uses the argument that bankruptcy lowers transaction costs. Warren, *supra* note 2, at 475.

My own work expresses some skepticism that transaction costs can justify or explain the existence of bankruptcy, although I do try to explain the existence and shape of *nonbankruptcy* creditors' remedies as functions of the existence of transaction costs. James W. Bowers, *Groping and Coping in the Shadow of Murphy's Law: Bankruptcy Theory and the Elementary Economics of Failure*, 88 MICH. L. REV. 2097 (1990) (arguing that debtors are the most efficient liquidators of their own declining affairs even in the presence of identified transaction costs); Bowers, *supra* note 21 (arguing that debtors are the most efficient distributors of their own assets, even in the face of identified transaction costs).

B. *The Transaction Costs Avoided by Bankruptcies*

The heart of LoPucki's argument is not a systematic attempt to discredit economic reasoning, but rather an argument by example. He posits that there are four types of transaction costs in the real world which are ignored by Bradley and Rosenzweig's proposal to jettison chapter 11. While he never explicitly says so, it is apparent that, in the end, LoPucki must make his own "economic" analysis and base it firmly on the second classic model which earned Coase the Nobel Prize.⁴⁰ If the market fails to be efficient, Coase argued, a command-type governance structure could be justified, *assuming that the costs imposed by failures inherent in command structures are not more serious than those imposed by failures of the market.*⁴¹ LoPucki never even asks whether, in order to defend bankruptcy law, one must do anything more than assert that the world has transaction costs. Rather than face the question of whether bankruptcy has costs of its own that might exceed the market's transaction costs, he has taken the easier route of assuming that command structures entail zero bureaucratic costs. Thus, if one can demonstrate that markets impose transaction costs on people, one can easily justify chapter 11 because, unlike markets, it operates perfectly and costlessly. *Voilà ZBC!*

Warren's view may not be quite as extreme. She only suggests that bankruptcy provides certain functions at lower cost than state courts or markets.⁴² She gives us nothing except her own unvarnished opinion to support her suggestions, however. Analytically, an undefended assumption of low bureaucratic costs is so nearly the equivalent of a zero-bureaucratic-cost assumption that Warren deserves credit as codiscoverer of ZBC analysis.⁴³

40. Ronald H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937) (explaining the existence of firms by the fact that coordination of activities in markets via contracts incurs excessive transaction costs). The suggestion that bankruptcy could be seen as the mandatory creation of a firm with a management (trustee) and various owners (claimants) is, to my knowledge, originally my thought, not LoPucki's. See Bowers, *supra* note 39, at 2109.

41. Cf. Guido Calabresi, *The Pointlessness of Pareto: Carrying Coase Further*, 100 *YALE L.J.* 1211, 1213-15 (1991) (explaining Coase's view of the symmetry between market and command structures).

42. Warren, *supra* note 2, at 475-77.

43. If either Warren or LoPucki had less disdain for economic theory, they might not have overlooked an obvious and simple *theoretical* argument for the assumption that chapter 11 involves lower transaction costs than market activity would. Debtors always have the option of trying to work out and solve their problems in markets. To the extent that markets are cheaper than chapter 11, then, profit-maximizing debtors will avail themselves of market solutions. Assuming, as is typical in economic argument, that for any input like market restructuring activity the marginal costs are increasing, one might predict that debtors will use markets to solve their illiquidity problems until the marginal cost of additional efforts in the market exceed the marginal costs of employing chapter 11. Thus, voluntary chapter 11s will occur only when they are cheaper than alternative market-based solutions to the debtor's problems. Because the market is

The Bradley and Rosenzweig study is so troubling to LoPucki and Warren because Bradley and Rosenzweig's empirical data tend to call the ZBC assumption into question. Indeed, for publicly listed firms, their data supports the strict empirical observation that chapter 11 does *not* operate with ZBC, at least as far as investors are concerned. LoPucki's transaction cost analysis, on the other hand, is *not* grounded on strict empirical observation, nor even on extended inference, but rather upon casual theorizing about the operation of markets. The transaction costs (market failures) LoPucki identifies which, along with an implicit ZBC assumption, he asserts justify the existence of chapter 11 are discussed in turn below.

1. *The Problem of Illiquidity*

The market-based alternative to chapter 11 proposed by Bradley and Rosenzweig⁴⁴ assumes that debtors in financial trouble can raise new capital in the market either by selling equity claims or by liquidating assets. LoPucki points out that it is costly to identify and assemble all the world's potential buyers, who are ready to make their best deals, at one place and one time so that whatever the debtor sells will bring in its highest values. Instead, it is cheaper to permit bidders to present themselves and assess potential deals with the debtor serially, over time, until a satisfactory bid is received.⁴⁵ A market-based alternative, then, will fail because, in the real world, debtors will not have enough time between default and foreclosure to access the serially appearing buyer market. Auctions tend to bring fire-sale, distressed prices. LoPucki argues that chapter 11 buys time, thus overcoming this market failure, and is therefore economically justifiable.⁴⁶ The ar-

always available as a choice for management, the chapter 11s that actually occur will only be in cases in which command techniques cost less than market techniques; the world should never be troubled with chapter 11s in which the contrary is the case. *But see* Alan Schwartz, *Bankruptcy Workouts and Debt Contracts*, 36 J.L. & ECON. (forthcoming 1993) (arguing that market workouts are likely to fail only when debtor firms or their managements insist on retaining more than the amount of gains resulting from the workout contract; that is, they make offers to creditors that will pay less than the amount to which creditors are legally entitled and can reasonably expect to receive absent a workout agreement; and concluding that commercial firms ought to be permitted to waive the protection of bankruptcy law).

44. And the optimal liquidation scheme proposed by me as well. *See* Bowers, *supra* note 39.

45. A transaction-cost analysis of this type may explain why, for example, people typically list real estate with brokers and sell it over a period of a few months rather than holding auctions. LoPucki does not give us any information about whether debtors-in-possession (DIPs) under chapter 11 ever decide either to list with brokers or to hold auctions, however. He simply assumes that these two costly "market-based" techniques, used by all of us outside bankruptcy, are somehow cheaper or even costless when employed within a bankruptcy proceeding by a trustee or DIP.

46. LoPucki, *supra* note 2, at 100-01. Warren seems to agree that she argues that, to the extent the acts necessary to obtain liquidity are out of the "ordinary," bankruptcy is intended to see that such acts be taken only under close court and creditor supervision. Warren, *supra* note

gument is valid, however, only if one assumes that the command structure proceedings which replace these otherwise costly market transactions are themselves costless, or, as Warren is more explicit in suggesting, less costly than the market alternative. Thus, by making this argument, LoPucki implicitly adopts the Zero-Bureaucratic-Cost assumption.

His analysis makes some other illegitimate, implicit assumptions about the market-based proposal offered by Bradley and Rosenzweig. LoPucki implicitly assumes that the techniques required for dealing with financial distress must all be employed over a very tight timeframe.⁴⁷ In Bradley and Rosenzweig's view, on the other hand, financial distress is endogenous — chosen by management. It would be avoidable if management constantly accessed the market, perhaps years in advance of any financial downturn in the firm's fortunes, so that fire-sale time constraints would never have to be faced.⁴⁸ If corporate managers carry out that function, they could buy and hold puts covering the firm's assets years before any financial crisis created illiquidity.⁴⁹ Managers offered chapter 11 as an alternative to buying puts on the firm's assets may not buy them, however. Thus, the managers themselves create the crises that require auctions instead of serially appearing buyer-market sales.

One might object that puts for corporate assets are nearly as illiq-

2, at 475. There is some theoretical reason to conclude that illiquidity problems are not based exclusively on transaction costs, however. Bruce A. Markell, *The Case Against Breakup Fees in Bankruptcy*, 66 AM. BANKR. L.J. 349, 367-68 (1992), argues that the desire to maximize revenues can also explain the choice of an auction technique, so that illiquidity need not result exclusively from market failure.

47. LoPucki, *supra* note 2, at 100.

48. Bradley & Rosenzweig, *supra* note 3, at 1047, 1087-88.

49. Buying puts is not, of course, the only management strategy available in a market-based alternative regime to chapter 11. Management could obtain similar protection by lining up long-term contingent lines of credit or simply by holding much of the firm's asset base in the form of liquid assets. In some markets, such as the market for cash, the hypothesis that transactions are costless is nearly true. In fact, the existence of one well-functioning market, like the market for cash, makes it possible for debtors to minimize their losses even when the remainder of their assets are traded only in costly markets. See Bowers, *supra* note 39, at 2129.

Still another alternative way in which a market might deal with this problem is in the negotiation of the debt contract *ab initio*. If the essential justification for chapter 11 is the need for a grace period for all debtors so that they can use the time-accessed market, debtors could bargain for grace periods in their debt contracts. Bankruptcy treats all debtors as if they need grace, and probably similar periods of it. The market, however, is likely to discriminate between those borrowers who need a lot of grace — and who would therefore offer to pay for the right to grace — and those whose assets would ordinarily be liquid anyway — and who do not have such critical needs for grace or whose needs are likely to be for shorter periods. The latter group is likely to bargain and pay for somewhat less grace. The bureaucratic chapter 11 solution, however, is likely to treat all these borrowers alike and thus to require some to pay for more grace than they really need while delivering less than they really need and are willing to pay for to others. That is a bureaucratic cost whose existence the Wisconsin school apparently denies or assumes to be trivially minimal.

uid as the assets themselves, thus necessitating a bureaucratic solution such as chapter 11. However, the fact that there is no established market for puts for lots of corporate assets may be a result of the existence of chapter 11 rather than a justification for it. Markets tend to arise when there are needs to be served and money can be made in serving them.⁵⁰ There is thus reason to believe that repeal of chapter 11 would create markets through which the transaction cost of illiquidity could potentially be avoided. Similarly, established markets for options on many firms' securities already exist. Repeal of chapter 11 might cause them to function somewhat more actively than they do now.

Nevertheless, LoPucki would undoubtedly say, the investment in puts would divert corporate resources from their current uses, and thus would not be costless, transactionally speaking. He would, of course, be correct, but the argument would not end there. The issue then would be: Is chapter 11 cheaper than the cost of buying the puts? If it were, then management would not buy them, opting instead for chapter 11. The key defect in the current Bankruptcy Code is that, if the converse is true, the debtor cannot contract out of the chapter 11 method of dealing with the timing problem and into the cheaper put-buying technique for doing so. Of course, this is not a serious argument to a believer in the Fantastic Wisconsin School, which assumes that chapter 11 is *always* the low-cost alternative.

The point here is that both Bradley and Rosenzweig *and* Warren and LoPucki can be right. They differ only in their estimation of the costs of reorganizing businesses. To the extent that neither markets nor bureaucracies function costlessly, both Bradley and Rosenzweig and Warren and LoPucki carry their arguments too far. In cases of doubt, probably the best solution is to permit firms to choose which regime they feel is least costly. Firms that believe LoPucki and Warren will then opt for bankruptcies; firms that believe Bradley and Rosenzweig will choose the market-based solution. LoPucki and Warren are thus right that there is no need to adopt Bradley and Rosenzweig's solution of repealing chapter 11. All that is necessary is to amend chapter 11 so that debtors can contract out of its provisions.⁵¹

50. Indeed, chapter 11 itself spawned new markets for interests in distressed firms. See, e.g., Scott K. Charles, *Trading Claims in Chapter 11 Cases: Legal Issues Confronting the Postpetition Investor*, 1991 ANN. SURV. OF AM. L. 261, 261-63.

51. For such a proposal, see Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEXAS L. REV. 51 (1992).

2. Communication and Coordination

a. *Communications among a multitude of parties.* LoPucki's second identified market failure is that, because there are likely to be many thousands of claimants with rights against the firm, transaction costs to adjust the affairs of all these claimants are likely to be high unless one assumes them away by positing a zero-transaction-cost world.⁵² Furthermore, even worse than having too many claimants might be having too few. When as few as two parties must get together and negotiate, bilateral monopoly problems impose still more transaction costs. To avoid these difficulties, chapter 11 is justifiable, LoPucki argues.⁵³

It is a common belief at the bar that one purpose of chapter 11 is to force negotiations among the throngs of people in a doomsday setting.⁵⁴ It is not obvious, however, why suddenly placing all this bargaining under the mantle of chapter 11 suddenly renders it costless.⁵⁵ If management remained liquid enough, which could be done in markets as suggested above, the hundreds of simultaneous negotiations would not have to take place in the expensive fashion that LoPucki suggests the market imposes. Everybody's property rights would not have to be redetermined at once. Instead, only the property rights of those involved in the lowest priority at any time need be involved in the renegotiations.⁵⁶

There are additional reasons to believe that the market offers managements techniques for lowering coordination costs. For example, lender syndicates who offer to deal through a single representative

52. "Direct negotiations among so many parties are unthinkable." LoPucki, *supra* note 2, at 101-02. "[Chapter 11] provides a forum for negotiating deals . . . [which] help[s] to reduce transaction costs . . . that exist in the real world between a troubled company and the thousands of entities with which it conducts its business." Warren, *supra* note 2, at 475.

53. See LoPucki, *supra* note 2, at 102 n.87: "Chapter 11 would be necessary to impose on irrational parties the deals they should have made."

54. See, e.g., J. Bradley Johnston, *The Bankruptcy Bargain*, 65 AM. BANKR. L.J. 213, 229-41 (1991); Donald R. Korobkin, *Rehabilitating Values: A Jurisprudence of Bankruptcy*, 91 COLUM. L. REV. 717, 775 (1991).

55. LoPucki explains that, under chapter 11, bargainers are forced to bargain in large, intermediated groups. LoPucki, *supra* note 2, at 101. This cuts down the number of bargains that must be struck, but it still remains unclear why or to what extent it is cheaper to make people bargain through agents they did not want to appoint than to let the market mediate. If increasing the amount of bargaining was a goal of the 1978 Bankruptcy Act revisions, then Bradley and Rosenzweig's data allows us to make the strict empirical observation that bargaining through involuntary agents is not the least costly way to do it as far as investors are concerned.

56. LoPucki has recently argued that uncertainty about the value of the insolvent firm is normally sufficiently large to cut across more than one legal priority level. Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669, 771-76 (1993). If the value uncertainties cannot be resolved in debt contracts, it would follow that renegotiation might have to occur with the bottom priorities rather than the bottom priority.

would offer competitive advantages to syndicate members over other lenders who insisted on dealing individually. Debt contracts could then be struck in a market-based alternative to chapter 11 in ways that minimize these coordination costs.

In a world that still has a nonwaivable chapter 11, however, the competitive advantage of lenders who join in syndicates is nullified. Lenders in such a world will deal with debtors on an individual basis; thus, individual lenders, not syndicates, will be found in whatever chapter 11s are brought. If lenders deal individually, the costs of negotiation are raised in the chapter 11s by the costs of forcing the individual claimants to deal through representatives different from those they would have contractually selected. The existence of loan participations and indenture trustees for bond issues is some evidence that the market is sensitive to, and capable of taking steps to reduce, coordination and negotiation costs. The existence of such costs does not imply that the market solution is inferior to the bureaucratic solution unless the ZBC assumption is somehow more justifiable than the ZTC assumption.

b. Coordination among a multitude of substantive rights. Perhaps, as LoPucki suggests, property rights might arise by contract with debtor firms which conflict with each other. I suppose it also sometimes happens that the descriptions of dairy farm boundaries get fouled up in Wisconsin so that occasionally two farmers both believe they own that same strip along the back road. By and large, it is probably a fair guess that the market contract system, under which farms are bought, sold, mortgaged, and so forth, does a pretty good job of coordinating old MacDonald's boundary line with Farmer Brown's. It is far from obvious, however, whether a chapter 11, which brings the two farmers and all their uncles and cousins into litigation with each other, is necessary to resolve boundary disputes, something nonbankruptcy courts have been doing for some time now. On the other hand, if bankruptcy courts can resolve boundary disputes at zero costs, perhaps they ought to be reconstituted into central economic planning agencies. Because they operate costlessly, by LoPucki's and Warren's lights, they might be justified as necessary to coordinate everybody's property rights all of the time.

3. *Relief from Contractual Default Provisions*

Unlike the problem of serially time-accessed markets and the problem of coordination and negotiation, this function supposedly served

by chapter 11⁵⁷ does not involve avoidance of transaction costs. Rather, the blurring of rights that occurs when courts do not decide in advance which contract clauses to enforce and which not to enforce *creates* transaction costs. However, if there are weaknesses in the common law of contract that lead us to believe that the courts should not enforce draconian default clauses, the solution is not to add to the number of preexisting transaction costs out there in the world. Rather, it is to propose and adopt a federal law of contract that will override the inefficient state doctrines that enforce those draconian clauses. Achieving this solution, however, requires a theory to distinguish between worthwhile default clauses and objectionable ones.

It is questionable whether bankruptcy law is a rational response to an imperfection in a small part of the common law of contract that permits objectionable default clauses to be enforced. LoPucki has not even suggested that a theory which sorts good default clauses from bad ones has emerged in the bankruptcy process. Since the theory has not yet even been identified, it has not yet been defended. It is premature, in the absence of such a theory and its defense, to conclude that contracts should not be enforced as they are negotiated, much less that the adoption of chapter 11 is the best technique for applying the social decision not to enforce them.

4. *Soft Landings for Managers and Shareholders*

LoPucki's final apology for chapter 11 is that it is needed to eliminate managers who are unwilling to be fired and shareholders who will not admit that their interest in bankrupt firms has evaporated. In making this assertion he does not identify what transaction costs prevent market adjustment of these contractual relationships, nor does he specify the alternative sorts of extra costs that might be incurred if the enforcement of market contracts replaced chapter 11 as a mechanism for the removal of management and shareholders.⁵⁸ Because LoPucki does not indicate the particular transaction costs that dictate a bureaucratic rather than a market-based solution to these problems, it is hard to believe that he offers this argument seriously.⁵⁹

57. LoPucki, *supra* note 2, at 103-04.

58. Nor does he deal with the cases in which firms have actually contracted for changes of management control in the real world and have honored those contracts outside of bankruptcy. See, e.g., *Baron v. Allied Artists Pictures Corp.*, 337 A.2d 653 (Del. Ch. 1975).

59. It may be, for example, that the current state-created common law of contract is deficient in the remedies it provides against recalcitrant managers and shareholders. It remains to be explained, however, why revision of the contract law is not likely to bring about a cheaper solution than is the adoption of a bankruptcy code.

III. SEARCHING UNDER THE STREETLAMP

Were Bradley and Rosenzweig satisfied that bureaucratic solutions to commercial problems were indeed costless, they probably would also agree with LoPucki and Warren that chapter 11, in concept at least, is a monument to human aspirations.⁶⁰ LoPucki, on the other hand, extravagantly concedes that, in a world of zero market costs, chapter 11 would be a colossal mistake.⁶¹ If I am right, the issue between those of us who rely on economic analysis to criticize bankruptcy law and those who, like LoPucki, think our work is screwball is, as Bradley and Rosenzweig concede,⁶² a question of how well our real markets actually work.⁶³ The symmetrical question would be, "Well, how well do those bureaucrats really function?" That is the question Bradley and Rosenzweig sought to answer, and their answer is that the bureaucrats impose a lot of costs on corporate investors.⁶⁴

Is there any reason to believe that real market costs are sufficiently low to make them an attractive solution to the creditors' remedy problem? I believe there is. LoPucki is scathingly critical of Bradley and Rosenzweig for their use of stock and bond market data. He accuses them of warping the questions they study by reason of the availability of the data, much like the person who lost his key somewhere else on the block but conducts his search under the streetlamp because the light is better there.⁶⁵

His critique is telling because the best evidence about whether market transaction costs are lower or higher than bankruptcy bureaucratic costs would be whether and when firms choose one or the other route.

60. Indeed, if the world had perfect bureaucrats, the common law of property, contract, and tort would be unnecessary. The perfect bureaucrats would simply appropriately parcel out the world's resources to whomever would hold and use them most efficiently. There would thus never be any need for any markets, and talking about market-based solutions to problems would be nonsensical.

61. "It should be apparent by now that Bradley and Rosenzweig are correct in their conclusion that there is no need for court-supervised reorganization in a world without transaction costs. A perfect market would be a perfect substitute for chapter 11; in a PM-ZTC world, chapter 11 *should* be repealed." LoPucki, *supra* note 2, at 106.

62. "The relevance or applicability of the perfect markets solution to the real world depends on the efficiency of the pertinent real-world markets." Bradley & Rosenzweig, *supra* note 3, at 1054.

63. LoPucki seems willing to assume that markets actually work pretty well if doing so will help him score a debating point. For example, LoPucki posits certain facts about how highly leveraged the firms that Bradley and Rosenzweig studied were, and then he uses the assumption of a well-functioning market to reinterpret their findings in a way contrary to their interpretation of the same data. If a belief in the efficiency of the market was necessary in order to argue that the Bradley and Rosenzweig findings were in error, LoPucki seems to have no trouble holding the belief. See LoPucki, *supra* note 2, at 89.

64. This assumes that the reader is willing to accept that extended inferences are valid. See *supra* Part I.A.

65. See LoPucki, *supra* note 2, at 85-86.

There may be many firms which have reorganized or liquidated by using the market, and these firms might have different characteristics from those choosing chapter 11. Accordingly, the worthwhile cases to study might be the cases of those firms who suffered economic hardships or serious business downturns and yet relied on their market-based options to weather the storm. Bradley and Rosenzweig instead limit their study to firms which chose bankruptcy because they were easy to identify.

The firms which used the market-based techniques are hard to identify, so I believe that LoPucki is right in charging Bradley and Rosenzweig with looking only under the lamp. The interesting issue is that LoPucki himself, although presumably funded by a substantial government grant,⁶⁶ chose to search only under the same lamp. His own empirical studies are limited to firms which chose the bureaucratic alternative.⁶⁷ It is rather remarkable that purportedly believing only in conclusions reached through strict empirical observation, and having studied only the bureaucratic alternative, LoPucki holds such strong opinions about the impracticality of the other options. LoPucki's conclusions are the inevitable consequence of his uncritical acceptance of his Fantastic Wisconsin Zero-Bureaucratic-Cost assumption.⁶⁸

My empirical hunch is that the claimholders of the firms who chose to cope with difficulty by using the market are better off than the claimholders of the firms that did not. I defend this hunch by observing that even believers in the ZBC hypothesis like LoPucki and Warren are not yet advocating a bureaucratic alternative to the problems of those businesses that face the same transaction costs faced by declining businesses. People who put businesses together and make them grow, for example, have to enter the same serially accessed markets LoPucki and Warren decry as expensive in order to build their busi-

66. *See id.* at 86 n.22.

67. *Cf.* LoPucki & Whitford, *supra* note 20.

68. It is even plausible to suggest that the first response of firms to incipient insolvency might not be to file a chapter 11 petition, but rather to resort to some market-based type of response to the potential trouble, perhaps by partially liquidating their most liquid assets. Indeed, were he not to disdain theory so strongly, LoPucki could have cited a model which suggests that the only assets left to be liquidated and distributed for firms undergoing financial crises are likely to be those which trade only in markets with high transaction costs or which are highly specialized, and thus have a lot more value to the debtor than to the markets. *See* Bowers, *supra* note 39, at 2120-28, for such a theoretical model. LoPucki dismisses that analysis as just another of those studies using economic reasoning which are not worth examining closely, however. *See* LoPucki, *supra* note 2, at 79 n.2. He does not point out any findings from his own studies that indicate what managements' prebankruptcy responses were to their financial crises. Such suggestions, even if they might have advanced his argument, would nevertheless seem unimportant to a believer in the existence of a perfect bureaucratic solution.

nesses. How much better would be a costlessly operating central planning agency that forced all resources to be registered in a central data bank so that the planners could direct, by fiat, those possessing assets to deliver them to the business-builders! All those millions of contracts, which require individual negotiation and coordination and which LoPucki and Warren say raise prospects of hopelessly high transaction costs, have been initially negotiated and coordinated in markets in the case of every firm ever entering chapter 11. If bureaucratic solutions are costless, it is surprising that there is no apparent demand that they be used to replace the costly markets people use for *building* businesses. No obvious a priori reason exists to believe that there would be bureaucratic costs of putting businesses together that are unavoidable when the bureaucratic costs of taking the structures of businesses apart and reorganizing them are nil.

During the past seventy-five years, the efficiency of bureaucratic solutions to the problems posed by transaction costs was extensively experimented with throughout Eastern Europe. That experience validates hunches like mine: bureaucratic solutions are far from costless. Markets seem to work well enough, despite their imperfections, to put businesses together. That, it seems to me, is enough to justify my belief that markets also ought to be permitted to take them apart.