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THE TROUBLE WITH CHAPTER 11

LYNN M. LOPUCKI*

The length of time companies remain in bankruptcy reorganization is critically important. During that time, the business is at risk because management incentives are inappropriate, professional fees accrue at a rapid rate, and business uncertainties increase. Creditors may be injured because the reorganizing debtor does not make payments during the case and because some creditors are not entitled to accrue interest during the pendency of the case. In this Article, Professor LoPucki presents data from several studies showing approximately a 150% increase from 1964 to 1987 in the median time companies spend in Chapter 11. Using data from other studies, he shows that the median time large, publicly beld companies spend in Chapter 11 did not increase during that same period. He argues that the increase in the time ordinary companies remain in Chapter 11 resulted from the adoption in 1978 of a reorganization procedure appropriate only to the largest bankruptcy reorganization cases. He advocates a number of procedural changes to remedy the problem; the most important is the adoption of a separate procedure, applicable to the large majority of bankruptcy cases, that is more appropriate to their size. Professor LoPucki discusses current efforts to enact such a procedure and documents resistance to the effort by prominent members of the bankruptcy bar.

Chapter 11 is in trouble. Critics complain that ailing companies languish under the protection of the bankruptcy court for years while the managers who led them to ruin remain in control and continue to make the decisions.[1] Some assert that Chapter 11 serves no purpose.[2] In its

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* Professor of Law, University of Wisconsin. I have benefitted greatly from the comments of Ted Eisenberg, Bob Feidler, Ed Flynn, Kate Heidt, Donald Korobkin, Dan Keating, Bob Martin, Harvey Miller, Bob Rasmussen, Leonard Rosen, David Skeel, Mike Sigal, Tom Small, Elizabeth Warren, and Bill Whitford on earlier drafts of this Article. None is, however, responsible for the views I express. I presented the central ideas in this Article at the Advaneed Bankruptcy Procedures Seminar in Dubuque, Iowa and at a meeting of the Business Bankruptcy Committee of the American Bar Association in San Antonio. I received many helpful comments on each occasion. I am also grateful to Bankruptcy Judge Robert D. Martin, and Bankruptcy Clerk Ann B. Manley of the Western District of Wisconsin and her staff for providing me with access to data on the time cases remained pending in that district.

1. *See, e.g.*, John Greenwald, *The Bankruptcy Game*, TIME, May 18, 1992, at 60 ("Chapter 11 can be a good opportunity for a eompany to cleanse itself of past mistakes . . . . But how do you do that when you have the same managers and employees who created the problems in the first place?"); Michelle Singletary, *Panel Votes to Form Bankruptcy Study Body*, WASH. POST, Mar. 20, 1992, at F1 (diseussing the Bradley and Rosenzweig proposal for repeal of Chapter 11 and quoting Rosenzweig as saying that "[w]hat is working is managers get to keep their jobs and they are the very ones that led the company into trouble"); LAURENCE H. KALLEN, CORPORATE WELFARE: THE MEGABANKRUPTCIES OF THE 80S AND 90S, at ix (1991) ("Chapter 11 permitted megacorporations . . . [and] allowed the men who ran them to escape the consequences

absence, they say, the market would find more efficient solutions to the problems of ailing companies.[3] Increasingly, Chapter 11's critics have lost interest in reform and instead call for repeal.[4]

Much of the criticism is sheer nonsense, spun from misunderstanding of the reorganization process or economists' fantasies of wbat life would be like in a world of perfect markets and zero transaction costs.[5] But it is also clear that something is very wrong with Chapter 11. In this Article, I present the thesis that the seemingly unrelated problems that are now combining to strangle Chapter 11—the burgeoning expense,[6] the

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of their greed and incompetenco.").

2. *See, e.g.*, Edith H. Jones, *Chapter 11: A Death Penalty for Debtor and Creditor Interests*, 77 CORNELL L. REV. 1088 (1992) ("The reason I spoke of it as a death penalty is that, for all practical purposes, Chapter 11 is not facilitating reorganizations.").

3. The idea that the market could substitute for Chapter 11 originated with Professors Baird and Jackson. *See* Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127, 127-28 (1986) ("[T]he entire law of corporate reorganizations is hard to justify under any set of facts and virtually impossible when the debtor is a publicly held corporation."); THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 223 (1986) ("There is no reason why chapter 7 could not be used as the vehicle to sell the firm as a going concern in the same way that companies go public.").

It has bcen repeated numerous times, *e.g.*, Lucian A. Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775, 785 (1988) (proposing to substitute a scheme of reorganization in which shareholdings are canceled without compensation unless shareholders pay thcir pro rata share of all debts of the company within four days after noticc); 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, 2141 (1990) (employing assumptions of porfect markets and other hypothetieal conditions to demonstrate that bankruptcy is unnecessary because debtors will liquidate and distributed their own assets; "The purpose of this study has been to demonstratc that we lack any persuasive theory for why we have or ought to have bankruptcy legislation."); Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439, 489 (1992) ("Congress should repeal bankruptcy's reorganization provisions.").

The idea received a crescendo of publicity with the publication of Michael Bradley & Michael Roscnzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043 (1992) (hereinafter *The Untenable Case*). Post Bradley and Rosenzweig refinements and reiterations can be found in Philippo Aghion et al., *The Economics of Bankruptcy Reform*, 8 J. L., ECON., & ORG. 523 (1992) (employing Bebchuk's new approach as part of a "market-based" proposal that would substitute for Chapter 11) and Barry E. Adler, *A Political Theory of American Corporate Bankruptcy*, 45 STAN. L. REV. (forthcoming 1993).

4. *See* articles cited *supra* note 3.

5. *See* Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosenzweig*, 91 MICH. L. REV. 79 (1992).

6. The direct costs of bankruptcy, primarily professional fees, are cnormous. *See* Lawrence A. Weiss, *Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims*, 27 J. FIN. ECON. 285, 285-89 (1990) (estimating direct costs for publicly held

excessive debtor leverage,[7] the poor performance of the reorganizing companies,[8] and the high rate of recidivism[9]—stem largely from a single source. In its current form, Chapter 11 permits debtors to remain under court protection for an excessive period of time. Bankruptcy reorganization can be effective only when the cases move quickly. Because the cases have slowed, the process has been disintegrating.

In the first part of this Article, I explain why the pace of bankruptcy reorganization matters. In the second, I use data from several empirical studies of the length of bankruptcy reorganizations from 1941 to the present to document my charge that the adoption of Chapter 11 has more than doubled the median length of reorganization cases. As a clue regarding the etiology of this disease, I also show that no such increase in time-in-Chapter-11 occurred among the cases of large, publicly held companies. In the third part, I speculate on how the adoption of Chapter 11 brought about this selective increase in the time ordinary cases remain under Chapter 11. In the fourth, I propose several means for shortening

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firms at three percent of assets); Edward I. Altman, *A Further Empirical Investigation of the Bankruptcy Cost Question*, 39 J. FIN. 1067, 1077 (1984) (average of direct bankruptcy cost to value of the company ratio for publiely held companies was six pereent). To appreeiatc the enormity of these costs, one must realize that a substantial percentage of the assets of most Chapter 11 debtors are pledged to creditors who cannot be compelled to contribute to payment of the debtor's professional fees. Shareholders and unsecured creditors, who must bear the entire burden, experience the fees as a much larger portion of their debtor companies.

The indirect costs may be far greater than the direct costs. *See* Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669, 753 (1993) [hereinafter LoPucki & Whitford, *Corporate Governance*]; Robert H. Mnookin & Robert B. Wilson, *Rational Bargaining and Market Efficiency: Understanding* Pennzoil v. Texaco, 75 VA. L. REV. 295 (1989) (attributing a $3.5 billion decline in the combined trading values of Texaco and Pennzoil stock to the threat of bankruptcy by Texaco and the resulting costs). *See, e.g.*, *Metzenbaum Charges Fees Leave Little for Those System is Supposed to Protect*, Pensions & Benefits Daily (BNA) (Mar. 31, 1992).

7. *See, e.g.*, Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?* (pt. 1), 57 AM. BANKR. L.J. 99 (1983) [hereinafter LoPucki, *The Debtor in Full Control I*]; Jerome R. Kerkman, *The Debtor in Full Control: A Case For Adoption of the Trustee System*, 70 MARQ. L. REV. 159 (1987) [hereinafter Kerkman, *The Debtor in Full Control*].

8. *See, e.g.*, Federal News Service, Sept. 5, 1991 ("Many small businesses cannot survive the trauma of bankruptcy because . . . their suppliers won't supply them, their customers won't buy from them, their employees don't want to stay, and they die of attrition rather than getting reorganized.").

9. *See* Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. (forthcoming 1993) [hereinafter LoPucki & Whitford, *Patterns*] (32% of the companies to emerge from the largest bankruptcy reorganizations refiled within a few years).

the time companies, both small and large, spend in reorganization. In the fifth part, I describe the politics that led Congress to adopt a reorganization procedure so ill-suited to the large majority of cases it governs and explain how those politics may now prevent Congress from correcting its error.

I. WHY TIME IN CHAPTER 11 MATTERS

While a company remains insolvent, powerful economic incentives press its owners and managers toward reckless, high risk, short term investment policies. In earlier work, William Whitford and I developed this point with regard to the owners and managers of large, publicly held companies who typically are not the same people.[10] My discussion here is limited to the far more common case[11] in which the owners themselves manage the business. I will refer to them as "owner-managers."

Creditors are entitled to absolute priority over the owner-managers in the value of a company.[12] For that reason, when a company is insolvent,[13] the value of the owner-managers' interest approaches zero.[14] With their shares already near worthless, owner-managers may

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10. *See* LoPucki & Whitford, *Corporate Governance, supra* note 6.

11. Owner-managers exist in the large majority of all reorganizing companies. *See* Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code?* (pt. 2), 57 AM. BANKR. L.J. 247, 264 (1983) [hereinafter LoPucki, *The Debtor in Full Control II*] (only two of 35 companies filing Chapter 11 (6%) had more than three shareholders and were not family owned). But Whitford and I found that no such group existed in a large majority of the largest publicly held companies that reorganized from 1979 to 1988. *See* LoPucki & Whitford, *Corporate Governance, supra* note 6, at 689. Thus, the arguments I make in this part with regard to owner-managers do not, strictly speaking, apply to most of the largest publicly held companies. In those companies management may be largely free of owner control and sometimes will be captured by creditors. *Id.* The economic incentives are more complex when the owners do not manage the company or control those who do. But the main point I make in this part—that economic incentives propel those in control of the debtor company in directions that are not in the economic interests of the company—remains true in the largest publicly held companies as well. *Id.* at 719-20, 752-53.

12. The absolute priority rule is reflected in the Bankruptcy Code requirements for confirmation of a plan. 11 U.S.C. § 1129(b)(2) (1988) [hereinafter, Title 11 provisions will be cited as "Bankruptcy Code § __"]. In essence, they prohibit confirmation of a plan that provides for a class of junior claims or interests from participating in the distribution unless the claims of all senior classes are to be paid in full.

13. I use the term here in the "bankruptcy sense" of a debtor having liabilities that exceed the value of its assets. *See* Bankruptcy Code § 101 (definition of "insolvent").

14. The value of the interest will not reach zero until creditors implement the absolute priority rule, typically through some kind of legal action. Until they do so, the owner-managers enjoy a position which they can exploit or "sell" to the creditors. For

have little more to lose.[15] Yet even though the owner-managers' ownership interests may be far "under water," creditors can terminate them only through an event such as the confirmation of a plan of reorganization or a liquidation of the company's assets. Creditors generally find that difficult to accomplish. Chapter 11 permits owner-managers to retain control of their companies and manage them during reorganizations.[16] In practice, Chapter 11 also enables many owner-managers of insolvent companies to retain control of the companies and their own jobs after reorganization.[17] But, at the insistence of creditors, Chapter 11 requires that even owner-managers of such companies surrender the *value* of their interests to creditors at confirmation.[18]

Thus, during reorganization, the owner-managers of an insolvent company remain in a position to benefit from sufficiently large increases in the value of the company. Yet they cannot suffer major financial losses from even the largest decreases in its value. Because they retain the benefits of risk taking without suffering a corresponding share of the losses, it may be in their interests that the company take risks not justified by the expected returns to the company. To illustrate, assume that Debtor Company has assets worth $1 million and liabilities of only a slightly larger amount. It might be in the economic interests of the owner-managers of Debtor Company to bet the $1 million in assets on the flip of a coin if they could. If Debtor Company won, the value of the shares

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the owner-manager, exploitation may include taking a salary from the debtor company during the reorganization case that is greater than the owner-manager would otherwise earn during that period.

15. The point was illustrated dramatically by an exhibit introduced in evidence in the *KenDavis Industries* case. One of the owner-managers had apparently written: "As Barb continues to repeat and everyone agrees there is no shareholder equity—so *we've* got *nothing* to lose. The *banks* have it all on the line now—not us." *In re* KenDavis Indus. Int'l, Inc., 91 B.R. 742, 765 (Bankr. N.D. Tex. 1988).

16. With regard to small cases, see LoPucki, *The Debtor in Full Control II, supra* note 11, at 258-63 (debtors remained in control as long as they chose to in 46 of 48 cases (96%)). With regard to cases of large, publicly held corporations, see LoPucki & Whitford, *Corporate Governance, supra* note 6, at 699-700 (no trustee or quasi trustee was appointed to replace debtors in possession in 38 of 43 cases (88%)).

17. *See* LoPucki, *The Debtor in Full Control II, supra* note 11, at 264 (owner-managers retained control of nine of twelve surviving companies).

18. See, for example, Bankruptcy Code §1129(b)(2)(B), prohibiting shareholders from receiving or retaining any property on account of their shares, unless the plan provides creditors with full payment of their prepetition claims. Owner-managers may nevertheless be able to retain control under a plan by which they purchase control of the emerging company for "new value." *See, e.g.*, Elizabeth Warren, *A Theory of Absolute Priority*, 1991 ANN. SURV. AM. L. 9, 39-42.

would leap from a nominal amount[19] to $1 million;[20] if Debtor Company lost, the shareholders would lose only their shares, which had little value anyway.[21]

Even if the bet on the flip of the coin was a bad bet from the point of view of Debtor Company, it might remain a good one from the point of view of the owner-managers. For example, if no better bet were available, it would be in the interest of the owner-managers that Debtor Company grant ten to one odds on a flip that Debtor Company had a 50% chance of losing. If Debtor Company won $100,000, the owner-manager's stock would increase in value by nearly that amount; if Debtor Company lost $1 million, it would be money that otherwise would have gone to creditors anyway.

In many cases, the financial condition of the company will be so bad that the business cannot be restored to solvency. While that may remove the owner-managers' inappropriate incentive toward high risk investment, it does not substitute appropriate incentives. For the duration of the Chapter 11 case, the owner-managers are likely to remain in control of the business, while both increases and decreases in value accrue almost entirely to creditors. In these circumstances, the incentives of the owner-managers become more rather than less bizarre.[22]

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19. If a company with assets of a value slightly less than the amount of its liabilities is liquidated, the shareholders will receive no distribution. In that sense, the shares are sometimes referred to as "worthless" or "under water." In reality, however, the creditors of such a company will find it difficult to force a liquidation. The owner-managers can seek refuge in Chapter 11. Once there, a variety of factors combine to assure that shareholders will receive at least a nominal share of the distribution, even though they would be entitled to nothing in a cram down. *See* 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, 143-58 (1990) [hereinafter LoPucki & Whitford, *Bargaining Over Equity's Share*]. In the cases of some marginally solvent companies, the distributions to shareholders were substantial. *Id.* at 166.

20. After collecting on the bet, the assets of the company would be $2 million. Its liabilities would continue to be $1 million, leaving a shareholder equity of $1 million.

21. *See supra* note 19.

22. Owner-managers may pursue any of the following objectives during the remainder of the ease: (1) maximize their direct compensation from the company; (2) maneuver the company in a manner that benefits other businesses in which they or their allies have a stake; (3) extort benefits from the creditors, in the form of severance pay or settlement of a claim they have against the company, in return for an earlier end to the Chapter 11 case; or (4) maneuver to purchase the company at a bargain price. *See* LYNN M. LOPUCKI, STRATEGIES FOR CREDITORS IN BANKRUPTCY PROCEEDINGS §11.3.7, §11.11.2 (2d ed. 1991). Of course, they might also abandon their own self interest, and exercise the powers they enjoy as debtor in possession on behalf of their creditors, but to assume this will ordinary be the ease is naive.

From these examples, it should be apparent that the interests of the owner-managers can differ sharply from the interests of Debtor Company. The potential for sharp difference will continue until the owner-managers have a sufficient cushion of equity that they again bear at least the brunt of the risk of Debtor Company's losses and therefore regard the company's money as their own. Arguably, the principal purpose of corporate reorganization is to restore the "cushion of equity"[23] and, along with it, appropriate incentives for the owner-managers.

If the restoration does not occur through increases in the value of the business during the Chapter 11 case, creditors eventually will be able to bring it about by more drastic means. Confirmation of a creditors' plan might extinguish the old equity and convert debt into new equity;[24] conversion to Chapter 7 will lead to a sale of the productive assets to someone who presumably will have an equity in them. Thus, in their attempt to restore the cushion of equity through high risk investment, the owner-managers are working against a deadline. That the deadline is flexible[25] makes it no less real. The investment the owner-managers seek must not only be high risk, it must also have a quick pay out.

The incentives of the owner-managers are similarly perverse with regard to any proposed sale of the company. If Debtor Company must sell its assets, the owner-managers will maximize their own return by insisting on a price well above their $1 million value. It is true that unless a potential buyer made the mistake of paying such a price, the owner-managers' insistence would simply kill the possibility of a sale, leaving the owners with nothing. But that is a risk they cannot escape; if they sold the company for the $1 million it was worth, all of the

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23. Charles W. Adams, *An Economic Justification for Corporate Reorganizations*, 20 HOFSTRA L. REV. 117 (1991). In the cases of large, publicly held companies, the process often fails to achieve this purpose because the plans provide for insufficient reductions in the amounts of debt owing. *See* LoPucki & Whitford, *Patterns, supra* note 9.

24. Extinguishments that transfer control of the company routinely occur in the largest cases. *See* LoPucki & Whitford, *Patterns, supra* note 9. Extinguishments by confirmation of a plan are much less common in small cases because creditors are, as a practical matter, usually unable to operate the emerging company without the help of the owner-managers. *See* LoPucki, *The Debtor in Full Control II, supra* note 11, at 263-66. The principal threat to the owner-managers of small companies is that cash flow will be insufficient for them to continue operations. But the need for cash flow may drive the owner-managers of small companies to reckless risk taking of a nature similar to that described here for the owner-managers of large companies.

25. Time can run out on owner-managers in a variety of ways. Small companies typically exhaust their cash reserves leaving them without the ability to pay expenses necessary to continue to operate. *See* LoPucki, *The Debtor in Full Control II, supra* note 11, at 261. The owner-managers of larger companies may lose control by confirmation of a creditor plan, conversion of the case to Chapter 7, or a lifting of the automatic stay.

proceeds would go to the creditors, leaving the owners with nothing anyway.[26] As a result, owner-managers tend to over estimate the value of their companies' assets, by however much is necessary to leave them with a substantial equity.[27] Their tendency to assert sometimes absurdly high values is one element of the debtor state of mind that bankruptcy lawyers and judges refer to as "terminal euphoria."[28]

In recognition of the differing interests that creditors and owner-managers will have in the event of insolvency, sophisticated creditors of large companies typically contract in advance for the right to draconian remedies as the company approaches insolvency.[29] But by taking the company into Chapter 11, the owner-managers can typically slow or entirely prevent enforcement of such contract provisions.[30]

In place of contractual restraints on the tendencies of the owner-managers to serve their own self interests, bankruptcy law imposes fiduciary duties, a modicum of court oversight, and a norm of prudent investment.[31] Over the short run, these substitutes are generally

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26. That is, if the company in the forgoing example were sold for $1 million in cash, the creditors, who hold $1 million in claims, would have the right under the absolute priority rule to have all of the proceeds paid on their claims. Because the estate had already been reduced te cash, most of the leverage that enables shareholders to win deviations from the absolute priority rule would be absent. *See* LoPucki & Whitford, *Corporate Governance, supra* note 6, at 685-86. Creditors could probably win confirmation of a plan that paid in accord with the absolute priority rule.

27. This problem is less prominent in the cases of large, publicly held companies because creditors often capture control of the company and the sale process. *See* LoPucki & Whitford, *Corporate Governance, supra* note 6, at 702-03. *McLouth Steel* is an example of a case in which that occurred. *Id.* at 702.

28. *See, e.g., In re* Lakeside I. Corp., 104 B.R. 468, 470-71 (Bankr. M. D. Fla. 1989):

> [T]he difficulty with the values stated by [the Debtor's expert] is evident because his opinion is based not on existing facts, on the present condition of the property as it stands today, but on future hopes and expectations wholly unsupported by this record. . . . In light of the past history of this subject property, it is not really an overstatement to characterize this reorganization attempt as something which is based on "terminal euphoria" of the Debtor . . . .

29. The typical contract provision requires that the company maintain a specified equity to debt ratio. As the company approaches insolvency, it will breach the covenant. The breach will constitute a default, entitling the creditor to file suit immediately. *See, e.g.,* Gatx Leasing Corp. v. Capital Bank & Trust Co., 717 F. Supp. 1160 (M.D. La. 1988) (discussing the operation of such a provision). If the creditor is secured, the suit will seek immediate possession of the collateral; otherwise the suit will seek a judgment which will serve as the basis for the seizure of the company's assets.

30. They do so principally through the mechanism of the automatic stay. *See* Bankruptcy Code § 362(a).

31. *See* LoPucki & Whitford, *Corporate Governance*, supra note 6, at 706-10,

sufficient to prevent the owner-managers from taking the company to Las Vegas[32] or looting it. But given enough time, the owner-managers will find subtler ways to capture a substantial portion of the creditors' expectancy. If the company is within reach of solvency, they can gamble on bigh risk strategies to bust a union,[33] to try a new marketing concept,[34] or to bring a new product to the market place.[35] If not, they can serve their personal interests in ways that do not depend on the success of the company.[36]

In the context of large, publicly held companies, Whitford and I considered several means by which the incentives of incumbent managements might be redirected. We concluded that shareholders who benefit from high risk investment strategies by reorganizing companies should be required to transfer a portion of their shares to the creditors disadvantaged by them.[37] But we also concluded that the surest means for controlling reorganization management is to limit the time companies can spend in reorganization.[38]

The poor investment policies fostered by the separation of the risk of loss from the possibility of gain are not the only inefficiencies associated with prolonged insolvency. First, as creditors struggle to protect their investments, both sides incur substantial direct expenses, primarily in the form of professional fees. Bankruptcy professionals work by the hour; the longer the case, the higher the fees. Second, even aside

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716-19, 776-78.

32. See, e.g., *In re* Tri-State Paving, Inc., 32 B.R. 2, 3 (Bankr. W.D. Pa. 1982), in which the owner-managers literally took all of the company's cash to Las Vegas in an attempt to win enough money "to pay the corporate-debtor's creditors and solve the financial problems of all three debtors . . . ."

33. Frank Lorenzo's Texas Air purchased a controlling interest in Continental Airlines cheaply when the latter was already in serious financial difficulty. Continental filed Chapter 11, locked the union out, and attempted to hire a new, non-union labor force while selling tickets to anywhere in the U.S. for $49. Creditors opposed the scheme. Had it been unsuccessful, they would have borne most of the cost.

34. While in Chapter 11, Sambo's Restaurants borrowed against its unencumbered assets and invested the money in changing the name, look, and concept of its restaurants. The gamble failed, the money was lost, and unsecured creditors ended up with only about 11 cents on the dollar.

35. Storage Technology brought a new data-storage device to the market during its Chapter 11 case. The product was so successful that the company was solvent with a substantial cushion of equity by the time it emerged.

36. *See supra* note 22.

37. We refer to such transfers as "risk compensation payments." *See* LoPucki & Whitford, *Corporate Governance*, *supra* note 6, at 788-96. We also suggested, somewhat less forcefully, that risk compensation payment run in the opposite direction to encourage creditor-dominated managements to take higher risks. *Id.* at 795-96.

38. *Id.* at 787-88.

from the problems caused by the tendency toward overly risky investment when owner-managers are in control,[39] insolvent companies generally perform poorly. Customers and suppliers are leery of them because their futures appear uncertain and because cash shortages often disrupt their operations, injuring both the insolvent companies and their trading partners. Their managements spend substantial amounts of time in court and otherwise tending to legal matters, leaving less time to tend to operations. Managers' jobs are often insecure[40] and their duties are unclear.[41]

Third, once a debtor defaults on the debt to its primary lenders the debtor typically has little reason to pay other creditors. The debtor's credit rating is no longer of concern, because credit is unavailable anyway. The lawsuits filed by creditors are similarly unimpressive, because they can be blocked by the filing of a Chapter 11 case. Acceleration of long term debt is no longer a threat; the acceleration can be reversed through the eventual confirmation of a Chapter 11 plan. As a result, a common strategy for a debtor who cannot avoid default is to suspend payments to all its creditors. Chapter 11 not only permits this strategy, it mandates it.[42] These mass suspensions of payments can severely disrupt the businesses and lives of creditors. For example, by filing under Chapter 11, the Manville company was able to entirely avoid making any payment on billions of dollars of unsecured claims for about six years. The claimants who were put off for that period of time included not only commercial creditors, but all of Manville's tens of thousands of asbestos health victims. None got so much as a nickel, even for necessary medical treatment.[43] Such a suspension of payments by

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39. In our study of large, publicly held companies, Whitford and I found that creditors often took control. *See* LoPucki & Whitford, *Corporate Governance*, *supra* note 6, at 742-47. When they did, there may have been a tendency toward inappropriately low risk investment. *Id.* at 778. These conflicting tendencies do not offset one another because typically only one or the other operates at any given time. Id. at 788-96.

40. *See id.* at 737.

41. *Id.* To restrain managers from either the excessively high risk investments that would serve the interests of shareholders or the overly conservative investment policies that would serve the interests of most creditors, bankruptcy law imposes vague fiduciary duties on managers. A norm of bankruptcy practice has arisen that restricts managers to what Whitford and I have termed a "prudent" investment policy. *Id.* at 776-78. Given the sharply conflicting interests of creditors and shareholders in many cases, putting the company in a "holding pattern" during the reorganization case is probably a wise course, but by eliminating investment options that might be optimal, it can put the company at a competitive disadvantage.

42. *See* LOPUCKI, STRATEGIES FOR CREDITORS, *supra* note 22, §§ 10.3.4, 11.3.9.

43. Though *Manville* did not produce a reported opinion on point, another mass tort case did. *See* Official Comm. of Equity Sec. Holders v. Mabey, 832 F.2d 299, 302 (4th Cir. 1987) (Bankruptcy Code prohibits disbursements to tort creditors for emergency

one debtor often forces creditors of that debtor into bankruptcy, creating a domino effect.

Lastly, because of the peculiar rule that undersecured creditors cannot accrue interest on even the secured portions of their claims during bankruptcy cases, Chapter 11 cases result in wealth transfers from undersecured creditors to unsecured creditors and/or the debtor.[44] The rate of this transfer is substantial and the amount increases in direct proportion to the length of the case.[45]

Bankruptcy theorists have been slow to acknowledge the problems that result from extended bankruptcy reorganization cases. In fact, much of the economic literature views "bankruptcy" as a point in time, not even as a proceeding that takes place over a period of time.[46] But the lengthening of the time its takes to reorganize has made the associated problems increasingly difficult to ignore.

II. THE DRAMATIC INCREASE IN TIME IN CHAPTER 11

Figure 1 shows the results of the five all-case empirical studies of the length of bankruptcy reorganization cases that resulted in confirmation of a plan. By "all-case," I mean that the study included all Chapter XI or Chapter 11 cases in a particular district or group of districts.[47] In the

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treatment until a plan is confirmed).

44. *Compare* THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 181-90 (1986) (the payment of interest on secured claims is necessary to give secured creditors the value of their state law rights) *with* United Savings Ass'n of Texas v. Timbers of Inwood Forest Assoc., 484 U.S. 365 (1988) (*see infra* note 45).

45. In its landmark decision in the *Timbers* case, the Supreme Court reinforced the rule denying creditors interest on undersecured debt. To the assertion that as a result of the rule undersecured creditors would face large losses from inordinate and extortionate delay, the Court in essence responded that the bankruptcy courts would not allow the cases to go on for extended periods of time. They filled a footnote with citations to cases aborted in less than a year, *Timbers*, 484 U.S. at 376 n.1, and encouraged the bankruptcy courts to carefully examine cases even in their first four months, *id.* at 376. Apologists for the Court explained that after *Timbers*, Chapter 11 cases would be disposed of more quickly. There is, however, no evidence that has come to pass.

46. *E.g.*, Douglas G. Baird & Thomas H. Jackson, *Bargaining After the Fall and the Contours of the Absolute Priority Rule*, 55 U. CHI. L. REV. 738 (1988); Jeremy I. Bulow & John B. Shoven, *The Bankruptcy Decision*, 9 BELL J. ECON. 437, 454 (1978) ("In contrast with earlier studies, we have treated bankruptcy as a decision of the bank lender where the criterion for bankruptcy is whether or not the coalition of claimants with negotiating power can gain from immediate liquidation.").

47. Neither Chapter XI nor Chapter 11 is synonymous with business bankruptcy reorganization. Stanley and Girth excluded business bankruptcy reorganizations that proceeded under Chapters X and XII. The other four studies excluded business bankruptcy reorganization cases that proceeded under Chapter 13. But the numbers of cases thus excluded are small. *See infra* note 67.

first of these studies, David Stanley and Marjorie Girth found that debtors who successfully reorganized in six districts in 1964 were under Chapter XI for a median time of about eight months.[48] In the second, I found that debtors who successfully reorganized in the Western District of Missouri during the first year after the effective date of the Bankruptcy Code were in Chapter 11 for a median time of about 9.5 months.[49] In the third, Jerome Kerkman found that debtors who successfully reorganized in the Eastern District of Wisconsin during 1982 were in

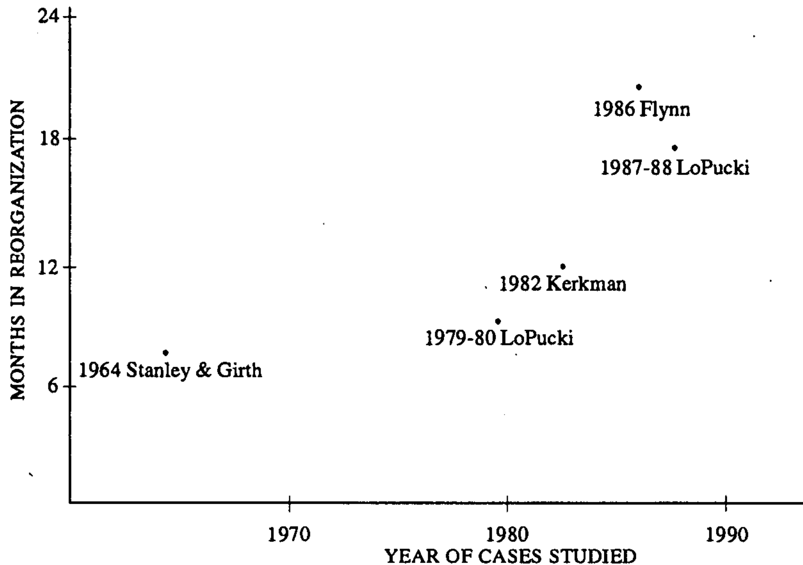

Figure 1. Median time all companies spent in Chapter 11 in the years indicated, according to various studies.

48. DAVID T. STANLEY & MARJORIE GIRTH, BANKRUPTCY: PROBLEM, PROCESS AND REFORM (1971). The eight month figure is an estimate I derived from the data reported by Stanley and Girth. Stanley and Girth did not report an average time in Chapter XI or even a median time for all Chapter XI cases. They did, however, report that 38% of the confirmed plans were one-payment plans and 62% were deferred payment plans, *id.* at 138, and that the median time in Chapter XI for single payment plan cases was six months, while the corresponding time for deferred payment plans was nine months. My estimate is a weighted average of the medians for the two periods.

Stanley and Girth's figures may actually overstate the median times for reorganization in the entire United States at that time. One of the six districts in their study was the Southern District of New York, where cases tended to take considerably longer than elsewhere. Had New York not been included, Stanley and Girth's medians probably would have been less than six months. *See id.* at 143.

49. LoPucki, *The Debtor in Full Control II*, *supra* note 11, at 269. The Bankruptcy Code applied to all cases filed on or after October 1, 1979. My study included all cases filed from October 1, 1979 to September 30, 1980.

Chapter 11 for a median time of about twelve months.[50] In the fourth, Ed Flynn, of the Administrative Office of the U.S. Courts, found that debtors whose cases remained open after confirmation in fifteen districts had been in Chapter 11 for a median time of about 21.6 months before

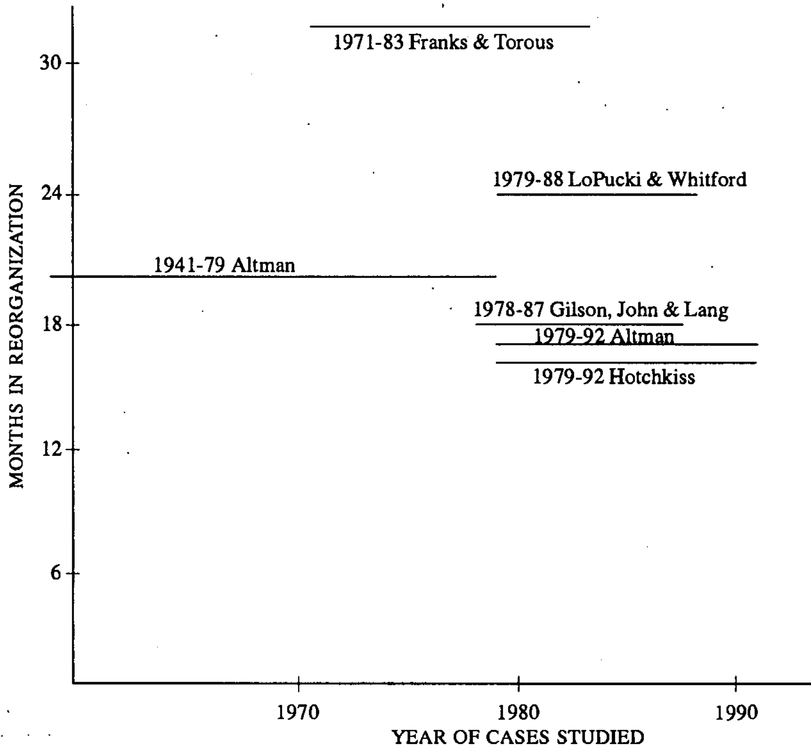

Figure 2. Median time large, publicly held companies spent in Chapter 11 in the years indicated, according to various studies.

their plans were confirmed.[51] In the most recent of these studies, I found that debtors who successfully reorganized in the Madison Division of the Western District of Wisconsin in 1987 and 1988 were in Chapter

50. Kerkman, *The Debtor in Full Control*, *supra* note 7, at 205-06. Kerkman does not report a median, but does report the data from which the median can be derived. I calculated the median from his data.

51. Flynn acknowledges that his methodology tended to exaggerate the time debtors remained in Chapter 11. He used data that had been compiled by Ernst & Young, Inc. on 2400 Chapter 11 cases for other purposes. The sample consisted of all cases that remained open after confirmation of a plan at the time the sample was taken. Flynn reports that "Ernst & Young only reviewed chapter 11 cases filed prior to 1987 which were still pending. It is likely that the cases which were confirmed and closed prior to the study [which were excluded] moved from filing to confirmation faster than the study cases." ED FLYNN, STATISTICAL ANALYSIS OF CHAPTER 11, at 23 (1989).

11 for a median time of 17.5 months.[52] On the face of the data, it appears that the length of bankruptcy reorganization cases has more than doubled since the 1960s.

In evaluating this conclusion, several cautions are in order. First, these studies were not conducted in the same districts. The differences shown may be wholly or partly attributable to differences among districts rather than differences over time.[53] Second, even though the LoPucki and Kerkman studies included all Chapter 11 cases in the district or division, the numbers of cases were small. Third, even though bankruptcy is governed by Federal law, the bankruptcy system operates differently from district to district. A study in one district does not necessarily indicate what is occurring at the same time in other districts.[54] For these reasons, further study may be necessary to ascertain the magnitude of the increase in the time debtors spend in successful reorganizations. But the data leave little doubt that an increase of substantial magnitude has occurred.

Figure 2 shows the results of several studies of the length of the bankruptcy reorganization cases of large, publicly held companies.[55] The companies included in these studies were much larger than those included in the all-case studies shown in Figure 1. That the value of the assets of the *smallest* company included in the LoPucki-Whitford study ($100 million) was about 300 to 500 times the value of the assets of the *median* company proceeding in Chapter 11 during the same period[56]

52. I conducted this study in October of 1992, using the computerized and noncomputerized docket sheets of the Bankruptcy Court. A list of the cases that resulted in confirmation of a plan appears in the Appendix at the end of this Article. During the period covered by this study, the Madison Bankruptcy Court had a relatively light case load and relatively clear dockets. Many other Bankruptcy Courts had high caseloads and lengthy dockets during this period, suggesting that the medians in other districts will be higher rather than lower than that in Madison.

53. The two multi-district studies both included the Southern District of New York, as well as smaller districts, suggesting that the districts studied will prove to have been comparable. My thesis that there has been a dramatic increase in the median time for Chapter 11 reorganization is borne out in the comparison of the New York data from the two studies. *See infra* note 86.

54. The three one-district studies were in districts where the dockets were relatively uncrowded during the periods studied, suggesting that any error will be in the direction of under estimating rather than over estimating time in Chapter 11.

55. These studies, like the all-case studies, include only companies that completed their reorganizations by obtaining confirmation of a plan of reorganization.

56. UNITED STATES DEP'T OF JUSTICE, EXECUTIVE OFFICE FOR U.S. TRUSTEE, AN EVALUATION OF THE U.S. TRUSTEE PILOT PROGRAM FOR BANKRUPTCY ADMINISTRATION 47 (1983) [hereinafter ABT STUDY] (reporting a median asset size for all cases in nonpilot districts of $205,000 and in pilot districts of $313,000; the median for all cases was not given).

demonstrates the magnitude of the difference.

In the earliest of these large case studies, Edward Altman found that ninety large companies that filed under Chapters X or XI of the Bankruptcy Act from 1941 to 1979, were in reorganization for a median time of twenty months.[57] In a study that overlapped the periods of the Act and the Code,[58] Julian Franks and Walter Torous collected data showing that the median time twenty-seven large, publicly held companies spent in bankruptcy reorganization was thirty-two months.[59] In a later study of eighty-nine publicly held companies, Stuart Gilson, Kose John, and Larry Lang found that the median time in Chapter 11 was eighteen months.[60] In studies of the largest, publicly held companies to reorganize since the effective date of the Bankruptcy Code in 1979, Whitford and I found a median time of twenty-four months,[61] Altman found a median time of 17.1 months,[62] and Edie Hotchkiss found a median time of 16.2 months.[63]

As shown in Figure 2, several of these studies overlap as to the time periods covered but show substantially different lengths of time in reorganization. Most of the differences can be reconciled through the

57. EDWARD I. ALTMAN, CORPORATE FINANCIAL DISTRESS 26 (1983).

58. The nonrandom sample was of companies that filed for bankruptcy reorganization from 1971 to 1983. Sample selection was biased toward large, publicly traded firms. Julian R. Franks & Walter N. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. FIN. 747, 752 (1989).

59. *Id.* at 753. Before calculating the median, I removed from the sample the three railroad reorganizations that averaged over 10 years in length. With the railroad reorganizations included, the median for the 30 firms would have been 34 months.

60. *See* Stuart C. Gilson et al., *Troubled Debt Restructurings: An Empirical Study of Private Reorganizations of Firms in Default*, 27 J. FIN. ECON. 315, 336 (1990).

61. We included only publicly held companies with assets of $100 million or more, that reorganized between October of 1979 and March of 1988. There were 43 such companies. The data is reported in Lynn M. LoPucki & William C. Whitford, *Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 1991 WIS. L. REV. 11 [hereinafter LoPucki & Whitford, *Venue Choice*].

Our methodology tended to understate the time spent under Chapter 11 because we included cases only if they resulted in confirmation of a plan by March 15, 1988. Longer cases filed during the period covered had less chance of inclusion than shorter cases, because plan confirmation was more likely to take place only after our closing date.

62. Altman included 284 of the largest companies to reorganize under Chapter 11 from 1979 to 1991. Edward I. Altman, Evaluating the Chapter 11 Bankruptcy-Reorganization Process (Jan. 1993) (unpublished manuscript, on file with Author). Based on the data he collected in the two studies, Altman concluded that the average time in Chapter 11 for large, publicly held companies "has been shortened somewhat under the [1978] Code . . . ."

63. Hotchkiss included all publicly held companies that reorganized from 1979 to 1991. There were 693 such companies. Telephone interview with Edie Hotchkiss (Nov. 1992).

realization that among large companies, unlike among those of ordinary size,[64] the time it takes to reorganize is a function of company size. The studies finding the longest times in reorganization for large companies were those that studied the largest cases.[65]

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64. *See* FLYNN, *supra* note 51, at 27 ("The amount of assets listed by the debtor seems to have very little impact on the length of time it takes for the case to get from filing to confirmation. . . . Cases with assets between $100,000 and $100,000,000 all seem to proceed to confirmation at about the same pace. [Presenting data]").

65. Only a few of these studies indicate the sizes of the companies in their samples. But it is very likely that the sizes of the companies studied are inverse to the sample sizes. The number of publicly held companies filing under Chapter 11 is small. The samples in all of these studies were drawn from the same small pool. Researchers who have studied fewer than all of them have generally concentrated on the largest. For example, Whitford and I studied all companies with assets exceeding $100 million in value. Altman included most of our companies, along with additional ones that enabled him to achieve a sample size of 284 companies. While his sample was not drawn systematically, he concentrated on larger companies. Hotchkiss included all publicly held companies filing for reorganization, thus including many that were too small to be of interest to Altman.

A second factor may account for some of the difference in results. Whitford and I had an earlier cut off date for our study than did the Altman and Hotchkiss studies. Only two of 43 cases in our study (5%) were prepackaged. Prepackaged cases probably became more common in later years, with the result that the Altman and Hotchkiss studies may have included larger proportions of them. The effect would be to shorten the median time in Chapter 11 for the cases they studied, without necessarily indicating that the problems discussed in Part I of this Article have been alleviated. Whatever the cause, the effect is that the larger the number of cases studied, the lower the median time they generally spent in Chapter 11.

Table 1

Median time in Chapter 11 as a function of the size of the large, publicly held companies included in the study.

	Number of cases	Median time in Chapter 11
Franks & Torous	27	32 months
LoPucki & Whitford	43	24 months
Altman (before 1979)	90	20 months
Gilson	89	18 months
Altman (after 1979)	284	17.1 months
Hotchkiss	693	16.2 months

The apparent anomaly in Table 1 is that Gilson's number of cases (89) was smaller than Altman's (90) but yielded a shorter median time in reorganization. The explanation

From the studies described in this part, I conclude that the effect on time-in-reorganization of the adoption of Chapter 11 in 1978 was very different for large and small companies. For the largest companies, which were already taking a median time of twenty months or more to reorganize under Chapter X or Chapter XI of the old law, the adoption of Chapter 11 had little impact. But for the smaller companies, that were taking a median time of only about eight months to reorganize, the change from Chapter XI to Chapter 11 was a disaster. The time it took these companies to reorganize more than doubled.[66]

III. How the Adoption of Chapter 11 Slowed Reorganization

Why did the adoption of Chapter 11 have such a different effect on large and small cases? In this part, I will argue that the procedures of Chapter 11 were designed for the cases of large, publicly held companies. When these large-case procedures were applied to ordinary reorganization cases, the dynamics of ordinary cases became more like the dynamics of large cases. Time in Chapter 11 for the two kinds of cases simply converged.

Chapter 11 replaced three chapters of the former law under which business debtors had been able to reorganize. Chapter X had served small numbers of large, publicly held companies; Chapter XI had processed the large bulk of business reorganization cases; and Chapter XII had served a relatively small number of individual debtors with real estate

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may be that Altman studied the largest companies; Gilson limited his study to companies listed on a stock exchange, which would have excluded some of the largest. *See* Gilson et al., *supra* note 60, at 326. Thus Altman's cases may have been larger than Gilson's.

Flynn found a relationship between size and time to confirmation for companies with assets of $100 million or more, but found no such relationship for smaller companies. *See supra* note 64. The hypothesis I present here suggests that, at least for publicly held companies, the relationship between size and time to confirmation holds for companies with assets in excess of about $10 million. Those cases still represent only a tiny fraction of all cases filed under Chapter 11.

66. Some increase in the time companies spend in reorganization is perhaps to be expected. One might suppose that the median size business reorganizing in Chapter 11 today is both larger and more complex than the median size business reorganizing in 1964. But caution is warranted. First, there is no data on which to base a comparison of the size and complexity of the two groups of businesses. Measured in dollars, the difference would certainly be great, but that difference would be principally the product of inflation, which should have no effect on time in Chapter 11. Second, Flynn found that among all but the largest companies, the effect of size on time in Chapter 11 is small. *See supra* notes 51, 64, 65. Third, that aggressive case management reduces time in Chapter 11 to roughly what it was in 1964 suggests that procedures, rather than changes in the nature of the companies reorganizing, account for the bulk of the change of time in Chapter 11. *See infra* text accompanying notes 87-95.

holdings.[67] The new Chapter 11 combined elements of all three procedures and made some innovations. The large bulk of the cases that would go through Chapter 11 were cases that, under the former law, would have been filed under Chapter XI.

An argument can be made that the slowing of these cases resulted in part from an expansion of relief available under Chapter 11 over what had been available under Chapter XI. Based on the data presented in this Article and my experience as a bankruptcy practitioner during the transition from Chapter XI to Chapter 11, that seems less plausible than the procedural cause theory that I will now elaborate.[68]

Under Chapter XI, the first consideration of the time it would take to reorganize typically occurred at a "meeting of creditors" held only about thirty days into the case. The bankruptcy judge presided at the meeting and frequently used it as an opportunity to speed the cases along. Because the debtor also attended the meeting and gave testimony, the judge could consider the size, complexity, and nature of the case in determining how much time to allow the debtor to formulate and file its plan. In the districts where I practiced, the deadlines for filing plans in ordinary cases were fixed at thirty days after the first meeting of creditors, and the deadlines for larger debtors typically were fixed at sixty. Few extensions were granted.

One of the key concepts behind Chapter 11 was to remove bankruptcy judges from the administration of bankruptcy cases and permit them to act solely in a judicial capacity. Some of the drafters, probably those most familiar with large cases, thought that creditors and their

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67. For example, the number of cases in each chapter during the last year of the Act were as follows: 55 cases in Chapter X; 3339 cases in Chapter XI; and 720 cases in Chapter XII. ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, FEDERAL JUDICIAL WORKLOAD STATISTICS DURING THE TWELVE MONTH PERIOD OCTOBER, 1978-SEPTEMBER, 1979, at 70.

68. Under Chapter XI of the former law, a plan of reorganization could not affect secured debts. Chapter 11 permits plans to affect secured debt. The change enables many companies that could not have reorganized effectively under the old law to do so under the new law. It has certainly strengthened the hands of debtors in negotiations with secured creditors. But there is little reason that this more effective relief should take significantly longer to administer. In fact, one might expect negotiations with secured creditors to be concluded more quickly in a system where the debtor has an alternative to negotiations for dealing with its secured creditors.

When a debtor seeks to cram down a plan against secured creditors under Chapter 11, it may be necessary to litigate over the value of the collateral. That kind of litigation does not necessarily delay the ease. *See* LoPucki & Whitford, *Bargaining Over Equity's Share*, *supra* note 19, at 144-46 (trials of the values of the assets of three of the largest reerganizing companies each concluded in a single day). Nevertheless, it remains possible that the parties' *expectation* that valuation litigation will be long and costly would result in some slowing of the cases. *Id.* at 148.

committees would assume the case management function. Others, probably those who had experience with smaller cases, thought that an administrative agency would be needed to replace the judge as case manager.[69] A compromise was struck in which the judges were relieved of administrative tasks such as monitoring cases and keeping them moving, the committee system was strengthened in the hope that creditors would assume that task, and a U.S. Trustee program was established in pilot districts to be ready for nationwide implementation if they did not.

Consistent with the new, entirely judicial role of bankruptcy judges, Chapter 11 prohibits judges from attending the meeting of creditors.[70] Though technically the judges continued to have the authority to fix the time for filing a plan,[71] the provisions of the new law removed them from the occasion. Moreover, other provisions of Chapter 11 that gave the debtor in possession the exclusive right to file a plan within the first 120 days of the case[72] seemed to suggest that the routine fixing of times was no longer appropriate. The establishment of the 120 day "period of exclusivity" was accepted by the bankruptcy courts as a congressional determination that Chapter 11 debtors should be given a longer time in which to reorganize.

The immediate effect of the change was apparent from data I gathered on the first Chapter 11 cases filed in the Western District of Missouri. For the first few months, the bankruptcy judges continued to fix the debtor's time for filing a plan at sixty days.[73] But they soon accepted the philosophy of Chapter 11 expounded by the Advisory Committee on Bankruptcy Rules, that "[t]he debtor in possession may file a plan within 120 days after the order for relief."[74] Debtors quickly took advantage of the additional time allowed them. During the first year after adoption of Chapter 11, the *median* time within which plans were filed in the Western District of Missouri rose to 120 days.[75] The new attitude was captured in a debtor's prefiling threat to a creditor that once his company filed under Chapter 11 "you can't touch us for four months."[76]

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69. *See, e.g.*, H.R. REP. NO. 137, 93d Cong., 1st Sess., pt. 1, at 5-8 (1973).

70. Bankruptcy Code § 341(c).

71. Bankruptcy Code § 1112(b)(4) authorizes the court to dismiss a Chapter 11 case or convert it to Chapter 7 for "failure to propose a plan . . . within any time fixed by the court."

72. Bankruptcy Code § 1121(b).

73. *See* LoPucki, *The Debtor in Full Control II*, *supra* note 11, at 270.

74. *Id.* This statement of the "philosophy" comes from the Advisory Committee on Bankruptcy Rules of the Judicial Conference of the United States, Suggested Interim Rules, Rule 3006(a) cmt.

75. *See* LoPucki, *The Debtor in Full Control II*, *supra* note 11, at 271.

76. *Id.*

The 120 day limit proved not to be much of a limit. Many of the bankruptcy courts adopted lenient policies on the granting of extensions, particularly when the motions seeking them were unopposed. Debtors who failed to meet the 120 day deadline or obtain an extension usually suffered no consequences.[77] In his study of cases filed three to four years after the effective date of the Code, Kerkman found that the median time from the filing of the case to filing of a plan in the Eastern District of Wisconsin was 193 days.[78] The dramatic increase in the length of ordinary Chapter 11 cases was well under way.

The new Chapter 11 procedures added other delays. Once a plan was filed under Chapter XI, the court had been able to set a hearing on confirmation and send the plan out for a vote of the creditors. Chapter 11 added an additional step. A disclosure statement had to be filed along with the plan and then approved by the court on at least twenty-five days notice.[79] Votes for or against the plan could be solicited only on the basis of an approved disclosure statement.[80] Thus, once a plan was filed in the Chapter 11 case, the next step was to schedule a hearing on disclosure. Only after the disclosure statement was approved could the court set a hearing on confirmation and send the plan out for a vote.

In theory, each of these procedural obstacles could have been overcome. The courts could have held status conferences and used them as the occasion for fixing early dates for the filing of plans in small

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77. Their failure violated no rule. Legally, the only consequence of expiration of exclusivity was that other parties in interest could file a plan. Particularly in small cases, expiration makes little difference because continued operation of the business ordinarily requires the cooperation of the owner-managers, while liquidation leads to so much poorer a result that the courts are reluctant to permit it. *See, e.g.*, *id.* (counsel failed to obtain extensions of exclusivity in 31% of cases in which debtor did not file a plan within period of exclusivity; none of the failures resulted in any adverse consequences to the debtor). In our study of large cases, Whitford and I found that the lawyers who participated considered exclusivity very important. LoPucki & Whitford, *Venue Choice*, *supra* note 61. *See also* Harvey R. Miller & Jacqueline Marcus, *The Crumbling Debtor Leverage in Chapter 11 Cases—An Implementation or Perversion of the Bankruptcy Reform Act of 1978*, *in* THE WILLIAMSBURG CONFERENCE ON BANKRUPTCY, CRITIQUE OF THE FIRST DECADE UNDER THE BANKRUPTCY CODE AND AGENDA FOR REFORM 445 (1988) (stressing importanco of exclusivity). Paradoxically, not much seemed to change when it was allowed to expire. Among the nine cases in which that occurred in the cases Whitford and I studied, most resulted in the confirmation of plans jointly proposed by the debtor and the unsecured creditors' committee. Only in the *Evans Products* case were creditors able to capitalize on the expiration of exclusivity. Even in that case, months elapsed before they decided to do so. *See* LoPucki & Whitford, *Venue Choice*, *supra* note 61, at 36 n.85.

78. Kerkman, *The Debtor in Full Control*, *supra* note 7, at 181.

79. Bankruptcy Rule 2002(b).

80. Bankruptcy Code § 1125(b).

Chapter 11 cases. Creditors could have pressed for shortening the period of exclusivity.[81] An innovative bankruptcy judge has demonstrated that it is linguistically possible to construe Bankruptcy Code § 1125 as permitting the hearing on the disclosure statement to take place after the statement has been used to solicit votes.[82] But the data presented in Figure 1 show that the obstacles were not in fact overcome. The more cumbersome procedure of Chapter 11 greatly increased the time in bankruptcy reorganization for routine cases.

IV. CONTROLLING TIME IN CHAPTER 11

A. Small Cases

While the pre-1979 Bankruptcy Act had many shortcomings, its saving grace was that it had separate procedures for large and small cases. Though the separation could not always be made effectively, the cases of large, publicly held companies were supposed to proceed under Chapter X, while Chapter XI was designed for the needs of smaller companies. Under that statutory scheme, ordinary cases proceeded at more than twice the speed of the cases of large, publicly held companies. As I demonstrated in Part II, eight years after Chapter 11 became effective, the two groups of cases were proceeding at virtually the same pace. The lesson to be learned from this case management disaster is that when small cases are processed in a procedure designed for large cases, the small cases will tend to take just as long as the large ones.

The disaster did not go unnoticed. Studies of routine Chapter 11 cases conducted shortly after adoption of the Bankruptcy Code showed that many cases remained stalled in Chapter 11 because it was not in the interests of the debtors to move them forward and because the creditors were unrepresented.[83] The committee system that had been successful in the context of large Chapter 11 cases failed in the context of routine

81. The court has the authority to reduce for cause the period during which the debtor has the exclusive right to file a plan. Bankruptcy Code § 1121(d).

82. *See infra* notes 89-90 and accompanying text.

83. The principal such study was conducted by a consulting firm retained by the U.S. Department of Justice. ABT STUDY, *supra* note 56. The Abt Study did not determine the total time companies remained in Chapter 11. Instead, its focus was on periods of inactivity that occurred while the companies remained in Chapter 11. It found, for example, that even in pilot districts in which the U.S. Trustee system was in operation, 46% of Chapter 11 cases had "periods of inactivity." *Id.* at 80. A period of inactivity was defined as a period for which the court file contained "no evidence of any activity (e.g., motions, hearing, filing of a plan) by the creditors, debtors, [or] a case administrator." *Id.* at 79. The median period of inactivity in pilot districts was 134 days. *Id.* at 80.

Chapter 11 cases.[84] In large part to remedy this problem, the U.S. Trustee system was expanded nationwide and its attorneys were charged with "monitoring the progress of cases under title 11 and taking such actions as the United States trustee deems to be appropriate to prevent undue delay in such progress."[85] As yet, there is no evidence that the system has had a significant effect in this regard.[86]

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84. The assumption initially was that creditors would form committees and provide the needed checks on management. Essentially that occurred in large cases. *See* LoPucki & Whitford, *Bargaining Over Equity's Share, supra* note 19, at 137-41; LoPucki & Whitford, *Corporate Governance, supra* note 6, at 681. But in small cases, the system for forming and representing committees broke down. Committees were formed in less than half of the cases. *See, e.g.*, LoPucki, *The Debtor in Full Control II, supra* note 11, at 250 (committees formed in 40% of the cases).

The drafters assumed that members of the committees would be personally active in the Chapter 11 cases, even though they could not be compensated. In large cases, where committee members may have millions of dollars at stake, the drafters' assumption is largely justified. But for creditors whose debts are measured in the thousands of dollars, uncompensated service on a creditor's committee is not cost effective.

As I have discussed at length elsewhere, the only way to make the committee system work in small cases is essentially to abuse it. *See* LOPUCKI, STRATEGIES FOR CREDITORS, *supra* note 22, § 10.5. The committee hires an attorney (who can be compensated for his or her legal work). The attorney performs the work of the committee and bills it to the estate as legal work. *Id.* § 10.8.3. Most of the committees that were formed in small cases did not even retain counsel. *See, e.g.*, ABT STUDY, *supra* note 56, at 58. The result was that small case debtors completely dominated their Chapter 11 cases, to the complete frustration of their creditors. *See* LoPucki, *The Debtor in Full Control II, supra* note 11.

85. 28 U.S.C. § 586(a)(3)(G) (1988).

86. The legislation expanding the U.S. trustee system nationwide was adopted in 1986 and implementation began immediately. The first phase of expansion of the system was completed some time prior to April, 1988. *See* LYNN M. LOPUCKI, LAW & BUSINESS DIRECTORY OF BANKRUPTCY ATTORNEYS 1989, xv, xvi (1989) (statement of John E. Logan, General Counsel, Executive Office for United States Trustees in April, 1988 describing the first phase of the expansion as "already complete"). The sample of cases studied by Ed Flynn, of the Administrative Office of the U.S. Courts, was drawn from cases that remained pending in 1987. While the sample showed longer times under Chapter 11 than prior studies, the U.S. Trustee program was still too new to be held responsible on that basis alone.

There are two indications, however, that implementation of the U.S. Trustee system has not had much impact on the time companies spend under Chapter 11. First, the expansion of the U.S. Trustee system into Wisconsin was complete no later than April of 1988. My study in the Western District of Wisconsin examined cases filed in 1987 and 1988; those cases remained pending for a median time of 17.5 months. *See supra* note 52. Second, the U.S. Trustee system had been operating in 18 pilot districts, including the Southern District of New York, for several years before Flynn's study. The median times in reorganization in that district under the Act had been eight months (single payment cases) and 11 months (multiple payment cases). *See* STANLEY & GIRTH, *supra* note 48, at 143. Eight years after the Code took effect and established the U.S. Trustee

Bankruptcy Judge Thomas Small conceived of a bolder solution. In 1987, he implemented a procedure to shorten the time Chapter 11 cases remained pending in his court.[87] After various adjustments over the years, the procedure remains in effect. In "small business" cases[88] filed in his court, Judge Small orders the debtor to file a plan and disclosure statement within sixty or ninety days of the commencement of the case. Shortly after the debtor does so, Judge Small "conditionally" approves the disclosure statement[89] and sets a hearing on confirmation. By doing so, Judge Small eliminates what most judges had thought was a mandatory delay necessary to give notice and conduct a hearing on approval of the disclosure statement. Instead, Judge Small permits debtors to use conditionally approved disclosure statements to solicit votes on the plan. He considers whether to finally approve the disclosure statements at the hearings on confirmation of the plans. While Judge Small's procedural innovation is legally questionable,[90] his "fast track" has been successful in reducing the time companies spend under Chapter 11 in his district. It was received favorably by most of the bankruptcy community[91] and the national media,[92] and has inspired other experiments.[93]

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system in that district, the median time in Chapter 11 was 20 months. FLYNN, *supra* note 51, at 12.

87. *See* John Greenwald, *The Bankruptcy Game*, TIME, May 18, 1992, at 60 ("Under a fast track that U.S. bankruptcy Judge A. Thomas Small installed in 1987, firms file their reorganization plans within 90 days and average just six months in court."); Mary Graham, *Bankrupt and Bullish*, THE ATLANTIC, Mar. 1992, at 24, 40 ("Plans have to be filed quickly, paperwork is simplified, and cases take an average of seven months.")

88. As the program currently operates, Judge Small reviews each Chapter 11 case as soon as it is filed. Based on the sizes of the debts shown in the lists of the 20 largest creditors and other available information, he orders that about 50% to 70% of the cases proceed as small business cases. Telephone interview with Judge A. Thomas Small (Oct. 20, 1992).

89. Judge Small conditionally approves the disclosure statements based on his reading of them, without either notice or a hearing. If he does not approve a particular statement, he enters an order that explains the reasons and gives the debtor an oppertunity to cure the defect. Final approval of the disclosure statement is made after notice and a hearing, typically at the same time as the confirmation hearing. *Id.*

90. The Bankruptcy Code provides that "[a]n acceptance or rejection of a plan may not be solicited . . . unless . . . before such solicitation, there is transmitted to such holder . . . a written disclosure statement approved, after notice and a hearing, by the court. . . ." Bankruptcy Code § 1125(b). The text does not explicitly provide that the approval must occur before the transmission, but there can be little doubt that was the intent.

91. *See, e.g.*, George W. Hay, *Lawyers Overwhelmingly Endorse Judge Small's "Fast Track" 11s*, TURNAROUNDS & WORKOUTS, July 15, 1989, at 1. *See also* the comment of Kenneth Klee, *infra* note 123.

92. *See* articles cited *supra* note 87.

Ironically, the procedure that has evolved under Judge Small's fast track looks much like that under former Chapter XI. The results too are much the same. Ignoring the Southern District of New York, where cases were generally larger, reorganization under Chapter XI had taken a median time of about six months;[94] reorganization under Judge Small's fast track has been taking an average of about six or seven months.[95]

Based largely on the success of Judge Small's experiment, legislation that would create a pilot program for a small business reorganization chapter of the Bankruptcy Code (Chapter 10), was introduced in Congress in 1992. The legislation incorporated both of the key elements of Judge Small's fast track. Under it, plans would have had to be filed within ninety days of the commencement of the case, and plans could have been set for confirmation hearing as soon as they were filed.[96] The proposed Chapter 10 was not included in the legislation as it was passed by the House, and the legislation ultimately died at the end of the session. The legislation has been reintroduced this year.[97]

The current proposal for a new Chapter 10 bas a number of serious flaws, which may prevent its enactment. But the adoption of a separate set of reorganization procedures for small business bankruptcy is a critical step toward reducing the length of time small companies spend under the protection of the bankruptcy court.

B. Large Cases

The problem of delay in large reorganization cases is long standing and probably less tractable. It is certainly intuitively plausible that large complex cases inherently require more time than small, simple ones. But there is also reason to believe that even large cases can move considerably faster than they now do.

In our recent study of the bankruptcy reorganization of large, publicly beld companies, Whitford and I discovered that many, if not most, such companies sougbt to complete their reorganization cases as quickly as possible.[98] In order to minimize the time they would spend under Chapter 11, a few even formulated their plans and obtained the

93. *See, e.g.*, Lisa Hill Fenning, *The Future of Chapter 11: One View from the Bench*, 1993 ANN. SURV. BANKR. LAW (forthcoming) (advocating an active role for judges in Chapter 11 case management).

94. *See supra* note 48.

95. *See supra* note 87.

96. S. 1985, 102d Cong., 2d Sess. § 205(c) (1992).

97. S. 540, 103d Cong., 1st Sess. (1993).

98. LoPucki & Whitford, *Corporate Governance*, *supra* note 6, at 729 n.256.

acceptance of key classes of creditors before filing. Such "prepackaged" cases were sometimes completed in two or three months.

At the other extreme, there were companies that found direct economic advantage in remaining in Chapter 11 for as long as possible.[99] Fortunately, the number of these companies was small.[100] Between the extremes were companies in such turmoil that they found it difficult or impossible to formulate a plan,[101] companies that sought delay because they did not have the cash necessary to begin making payments under the plan, and companies that believed they could not formulate a plan until some major piece of litigation was resolved.[102]

One of the most important causes of delay was impasse in bargaining over the plan. This kind of delay is largely caused by Chapter 11 procedure and is therefore capable of reduction. The pathology is as follows. The Bankruptcy Code permits Chapter 11 debtors initially to remain in possession of their assets. It gives them the exclusive right to file a plan during the first 120 days of the case, with such extensions as the court may allow.[103] So long as the debtor retains the right of exclusivity, the case can go forward only on terms proposed by the debtor. In thirty-four of the forty-three cases Whitford and I studied (79%), exclusivity was continued throughout the case.[104] The debtors

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99. For example, during its stay in Chapter 11, Itel Corporation had hundreds of millions of dollars in cash, invested at interest rates as high as 23% per year. Because the company was insolvent and the creditors' claims were nearly all unsecured, no interest was accruing on them. The longer Itel could remain in bankruptcy, the more cash it would have and the closer to solvent it would be. Both effects tended to strengthen the hand of management.

100. The other companies that sought direct economic advantage through delay were principally oil and gas companies that were trying to hold off creditors until the market for their properties improved.

101. A company need not solve all of its business problems before proposing a plan. All that is necessary is that the company have a business plan for the future (so it knows which assets to sell or abandon) and that it be sufficiently stable that one can make at least a rough estimate of its value. Turmoil at such a level that the company could not propose a plan usually lasted no more than a few months and rarely lasted as much as a year.

102. For example, the Internal Revenue Service assessed taxes against Storage Technology that the company could neither discharge nor pay. Storage Technology disputed the taxes and asserted that until the dispute was resolved, no plan it might propose could meet the feasibility test of Bankruptcy Code § 1129(a)(11). Debtors should not be permitted to win delays based on this argument. To reduce the time companies spend under Chapter 11, debtors should be required to propose plans that expressly provide for the possibility that the litigation will be resolved adversely to the debtor. Those plans might specify the circumstances under which the emerging companies may have to be reorganized again or liquidated. *See id.*

103. Bankruptcy Code § 1121.

104. LoPucki & Whitford, *Venue Choice*, *supra* note 61, at 31 n.67.

in many of these cases were suffering from delay, but the key to understanding the bargaining leverages was to realize that their creditors were suffering much more. For many debtors, the difference was great enough that they could trade movement of the case for substantive concessions from other parties. But persuading the creditors that they could not move the case without the debtor's cooperation frequently required demonstration. Hence, the delay.

For a debtor to demonstrate this kind of control over the movement of the case, the debtor must have the cooperation of the bankruptcy judge in the form of extensions of exclusivity. In a few cases we studied, the debtor did not have that cooperation.[105] But in the large majority, it did.

Why would so many judges cooperate in such a dubious show of power? After studying the pattern of venue choice in these cases, Whitford and I concluded that a combination of active forum shopping and a desire on the part of many bankruptcy judges to participate in these large and glamorous cases provides a substantial part of the explanation.[106] In short, debtors sought out judges inclined to extend exclusivity, and judges who wanted large cases exhibited a bias in favor of extensions. Those who demonstrated a proclivity to lift exclusivity early never got the chance to do it. The cases went elsewhere.[107] The respectability of these otherwise dubious practices was enhanced by the public support of the most prominent members of the bankruptcy bar for a policy of liberal extensions of exclusivity.[108] Exclusivity favored the interests of those attorneys perceived as "insiders" because it put an emphasis on negotiations.[109]

Other factors combined with extensions of exclusivity to place a destructive and unwarranted emphasis on negotiation as the only reasonable means of resolving large reorganization cases. The first was the myth, frequently repeated and almost universally accepted among

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105. The most obvious example was Evans Products, which was owned by notorious corporate raider Victor Posner. Miami bankruptcy judge Thomas Britton refused to grant even a single extension of exclusivity. After withdrawing an offer to equity holders worth more than $18 million, creditors were successful in cramming down a plan that paid nothing to equity. Despite considerable delays in the bargaining process, the entire case took only a little more than one year to complete. *See id.* at 36 n.85.

106. *Id.*

107. In the period covered by our study, large, publicly held debtors were avoiding the bankruptcy courts in Philadelphia, Boston, and Miami. The most popular destination was New York City. *Id.* at 29-33. Since that time, Delaware has become the most popular destination for cases of large, publicly held companies.

108. *See, e.g.*, Miller & Marcus, *supra* note 77.

109. LoPucki & Whitford, *Bargaining Over Equity's Share*, *supra* note 19, at 154-57.

bankruptcy experts, that cram downs against underwater interests were not feasible in large Chapter 11 cases. "Responsible" lawyers, the myth maintains, agree to consensual plans in which everybody gets something.[110] Indeed, the myth is so widely believed that it has in large part become self-fulfilling. Judges who think adjudication is impractical are reluctant to terminate exclusivity because termination cannot accomplish anything. By refusing to terminate, they prevent it from accomplishing anything.[111] Instead, these judges pressure the parties' representatives to reach agreement. In the cases Whitford and I studied, judges applied such pressure by holding oversight hearings at which they reviewed the progress of negotiations, withholding approval of attorneys fees, and even changing the membership of recalcitrant committees.[112] Negotiations are desirable, but to rely on them to the exclusion of adjudication is a recipe for disaster. In the case of large reorganization cases, the disaster comes in the form of extensions of exclusivity that cause cases to drag on for years.

Whitford and I have proposed two reforms to speed the resolution of large reorganization cases. The first is what we call "preemptive cram down." Early in the case, after notice and a hearing, the court "extinguishes the interests of the shareholders of clearly insolvent debtors. The purpose [is] to prevent shareholders who have no plausible claim to share in the distribution under the absolute priority rule from disrupting the reorganization process in the hopes of obtaining such a share through negotiations."[113] Preemptive cram down can be used to eliminate the interests of creditors as well, although there are probably many fewer cases in which that is appropriate.[114] We think the elimination from the bargaining process of parties who have no legal right[115] to sbare in the

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110. *Id.* at 156-58.

111. *Id.* at 157.

112. For example, when the equity committee in the *Manville* case refused to agree to a plan, the court dissolved the committee and refused to appoint a new one. Counsel for the committee withdrew, and the plan was crammed down against the unrepresented shareholders. *Id.* at 145.

113. Lynn M. LoPucki & William C. Whitford, *Preemptive Cram Down*, 65 AM. BANKR. L.J. 625, 625 (1991).

114. *Id.* at 643-44.

115. Arguably, under the "new value exception" to the absolute priority rule, the underwater shareholders of a reorganizing company have the right to retain ownership of the company by, in essence, purchasing the company under the plan. The argument should not prevent preemptive cram downs from occurring. First, the new value exception may not exist. *See In re* Route 37 Business Park Assocs., 146 B.R. 640, 645-48 (Bankr. D.N.J. 1992) (holding that the new value exception exists, but citing numerous cases contra). Second, even if it does exist, the new value exception confers no rights that would be violated by preemptive cram down against underwater interests. *See*

distribution can eliminate a good deal of unnecessary threats, litigation, posturing, and negotiating.

The second reform we have proposed is to reduce the discretion of bankruptcy judges with regard to extensions of exclusivity. "The reduction might be accomplished by promulgating reviewable standards for granting extensions, limiting extensions to fixed periods of time, perhaps one year,[116] requiring that applications for extensions be heard by a district judge, or some combination of these proposals."[117]

Our theory is that the knowledge that exclusivity will be lifted early in the case will motivate debtors to strike their bargains as early as possible, before the leverage conferred on them by exclusivity begins to dissipate. That large reorganization cases took considerably longer in the Southern District of New York where exclusivity was rarely lifted[118] suggests that assuring debtors of lengthy extensions in fact leads to delay. Our observations of cases in which exclusivity was lifted suggest that there are no dire consequences.[119]

V. Does Chapter 11 Have a Future?

In the 1970s, when the National Bankruptcy Commission and congressional aides set about designing what eventually became Chapter 11, they turned, not surprisingly, to the most prestigious members of the bankruptcy bar for guidance. The experience of those lawyers was primarily in large cases. They conceived a procedure that addressed the realities of corporate reorganization as they knew them. The procedure, as I have demonstrated here, was unsuited to small cases.

The requirement that both multi-national corporations and corner grocery stores reorganize by the same procedures more than doubled the time ordinary companies spend in reorganization. That more than doubling has exacerbated a variety of other problems, discredited the rcorganization process, and made the repeal of Chapter 11 no longer unthinkable.

As mentioned, legislation that would create a new Chapter 10 of the Bankruptcy Code to address the source of these problems is currently pending before Congress.[120] The legislation has a number of flaws. It

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LoPucki & Whitford, *Preemptive Cram Down*, *supra* note 113. The purpose of the exception is to benefit creditors, not debtors. Warren, *supra* note 18, at 39-42.

116. The current bill pending before Congress would implement this proposal. *See* S. 540, 103d Cong., 1st Sess. § 102 (1993).

117. LoPucki & Whitford, *Venue Choice*, *supra* note 61, at 48.

118. *Id.* at 31 n.67.

119. *See supra* note 77.

120. S. 540, 103d Cong., 1st Sess. § 102 (1993).

is not my intent here to endorse Chapter 10, but only the general concept of separate procedures for small and large reorganization cases. Congress could implement that concept in a number of different ways.[121] Whether Congress corrects its mistake is more important than how it does so.

Unfortunately, the same interests that led Congress to combine large and small cases in a single chapter in 1978 stand ready to oppose their separation now. The most influential group has been the National Bankruptcy Conference, a private organization whose members dominated the National Bankruptcy Commission during the 1970s and shaped the 1978 legislation. The National Bankruptcy Conference has drafted, and is expected soon to release, a report containing its own analysis of the shortcomings of Chapter 11. The report contains no proposals aimed at reducing the time that companies, large or small, remain in reorganization.[122]

Individual members of the Conference have been outspoken in their opposition to the proposed Chapter 10.[123] In a recently published article,[124] Conference chairman Leonard Rosen argued that "[a]lthough some changes in Chapter 11 are needed, its basic structure is solid and should be left alone."[125] He states his opposition to the proposed creation of a new Bankruptcy Commission that might revisit the decisions

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121. Though no legislation has been introduced, members of the bankruptcy community have discussed for some time the possibility of permitting the smallest incorporated businesses to file under already existing Chapter 13. *See, e.g.*, John C. Akard, *Chapter 13 for Small Business?*, AM. BANKR. INST. J., Sept. 1992, at 17. The effect would be much the same as the adoption of Chapter 10.

122. *See* National Bankruptcy Conference Code Review Project (working draft) (Sept. 1, 1992) (on file with Author).

123. For example, The National Law Journal reported the following comment by a prominent member of the National Bankruptcy Conference:

> Bankruptcy lawyer Kenneth N. Klee, a principal draftsman of the 1979 Bankruptcy Code, said the Chapter 10 issue was debated at length in the mid-1970s and rejected. He said he saw no merit in reviving it.
>
> "We went through this, and it was very wasteful," said Mr. Klee . . . "There is no reason why Chapter 11 can't work [on a fast track basis] if the lawyers know what they are doing and the judges are accommodating," he said.

Fred Strasser et al., *Bankruptcy Bill*, NAT. L.J., Sept. 16, 1991, at 29.

The idea that judges can solve the problem of time in Chapter 11 through better case management techniques has been echoed elsewhere. *E.g.*, Fenning, *supra* note 93. Some judges have adopted case management techniques that ameliorate the problem. But the data reviewed and reported in Part II of this Article demonstrate that they have not been suceessful.

124. Leonard M. Rosen, *Book, Chapter and Worse, Chapter 11 Needs a Rewrite*, BUS. L. TODAY, July/Aug. 1992, at 47 [hereinafter Rosen, *Book, Chapter and Worse*].

125. *Id.* at 47.

made in the mid-1970s.[126] Among the minor changes he advocates, none is expressly addressed to the length of time cases remain in Chapter 11. He mentions a proposal by turnaround manager Jeffrey Chanin to limit extensions of the debtor's exclusive right to file a plan to one year, but rejects it as "too rigid."[127] He mentions that Chapter 10 has been proposed, but says no more about it. From the reforms he does tout, it is clear that his focus is on the large cases he litigates. Apparently, in Rosen's view the length of Chapter 11 cases is not a problem.

If the leaders of the bankruptcy bar proceed with their heads in the sand (or perhaps the metaphor should be with their heads in the kinds of cases they litigate) they will miss the opportunity to make the necessary correction. Rosen is correct[128] in dismissing Michael Bradley and Michael Rosenzweig's proposal as "just not workable."[129] But Douglas Baird's earlier proposal does not suffer the same impracticality.[130] Congress could repeal Chapter 11 and force the sale of all ailing companies through Chapter 7. There is precedent. The current, regulatory scheme for corporate reorganization dates back only to the 1930s. Before that time, sale of companies through equity receiverships was a common form of reorganization.[131] The "market" could resume its performance of the reorganization function by transferring those companies to new owners just as it did in the 1930s.

The change would not be efficient.[132] The market for small companies is virtually nonexistent. Without their owner-managers, most have no value at all. Threatening to sell their business in a market that does not exist might frighten the owner-managers into dealing with the company's financial problems earlier. But so would a threat to blow them up; demolition is considerably cheaper than bankruptcy proceedings.

Whitford and I have argued from our data that, although a market for large companies exists, it remains too thin to support auction sales in all cases.[133] Without sufficient numbers of bidders, some of the companies

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126. His expressed opposition was to provisions of S. 1985, 102d Cong., 2d Sess. (1992), which passed the Senate by a vote of 97-0 but died at the end of the session.

127. Rosen, *Book, Chapter and Worse*, *supra* note 124, at 48.

128. *See* LoPucki, *Strange Visions*, *supra* note 5.

129. Rosen, *Book, Chapter and Worse*, *supra* note 124, at 47.

130. *See* Douglas G. Baird, *The Uneasy Case for Chapter 11*, 15 J. LEGAL STUD. 127 (1986) (suggesting that if Chapter 11 were repealed, ailing companies could be reorganized by selling them to the highest bidder in proceedings under Chapter 7).

131. For an excellent exposition of the equity receiverships and their relevance to the current controversy over Chapter 11, see Theodore Eisenberg, Baseline Problems in Assessing Chapter 11 (June 10, 1992) (unpublished manuscript, on file with Author).

132. *See* LoPucki & Whitford, *Corporate Governance*, *supra* note 6, at 753-67.

133. *See id.* at 764.

would go at fire sale prices.[134] Insiders might use their knowledge and their positions to acquire their own companies, as they did in the days of the equity receiverships[135] and as they frequently do in the liquidations of closely held companies today.[136] The buyers' windfalls would come at the expense of former shareholders and creditors. The principal buyers would be investment bankers whose fees and profits on resale would replace the direct costs of bankruptcy that under the current scheme are paid primarily to lawyers.

Which institution—the market or the current regulatory scheme—can best reorganize companies ultimately depends not on how efficiently each works in theoretical abstraction, but on how efficiently each theory can be made to work in practice. That brings us back to our starting point. Because the cases move so slowly, Chapter 11 destroys companies that could have been saved, provides a breeding ground for counterproductive, strategic behavior, and multiplies the cost of reorganization. If all of this trouble over Chapter 11 does not lead to meaningful reform, repeal may be the most reasonable course. Even the market might be better than this.

134. In all probability, a market would quickly form to avail itself of these fire sale prices. The bidders in this market, however, would not be ultimate users who would pay fair market value for the assets. They would be intermediaries who would purchase intending to reap substantial profits by reselling in a commercially reasonable manner.

135. *See* Eisenberg, *supra* note 131.

136. *See* LOPUCKI, STRATEGIES FOR CREDITORS, *supra* note 22, § 11.11.2.

APPENDIX

Length of time in Chapter 11 for all cases filed in Madison Division of the Western District of Wisconsin during 1987 and 1988.

	Name of Case	Date Filed	Date Confirmed	Months in Chapter 11
1.	Galvez, Timoteo L.	09/23/88	02/28/89	5.2
2.	Lane, Linda, M.D. S.C.	02/02/87	09/28/87	7.8
3.	Thompson, James F.	02/02/87	09/28/87	7.8
4.	Cox, Thomas L.	04/29/88	02/07/89	9.3
5.	Great Lakes Cable TV Installer, Inc.	04/05/88	02/07/89	10.1
6.	Sand Prairie Construction Co.	05/03/88	04/10/89	11.2
7.	Abner Boiling & Heating Co.	08/22/88	08/08/89	11.5
8.	Gessler, Lawrence R.	10/31/88	01/11/90	14.4
9.	Hanson, John D.	10/13/87	02/03/89	15.7
10.	Andrews, Floyd D.	10/15/87	02/14/89	16.0
11.	Becker, Richard A.	02/20/87	07/11/88	16.7
12.	Lazo's White House, Inc.	01/29/88	07/13/89	17.5
13.	Rasmussen & Assoc. of Lodi, Inc.	09/27/88	03/29/90	18.0
14.	Vectors of Madison, Inc.	12/18/87	08/29/89	20.4
15.	Foulke Rubber Products	06/10/88	03/22/90	21.4
16.	Foulke, Donald N.	06/10/88	03/29/90	21.6
17.	Arabesque, a limited partnership	01/13/88	02/09/90	24.9
18.	The Klay Kettle Inc.	10/05/87	11/08/89	25.2
19.	Foulke, Billie J.	06/10/88	08/20/90	26.3
20.	Campbell, Susan A.	09/30/88	12/10/90	26.3
21.	Houseworks	03/04/87	05/22/89	26.6
22.	Marcus, Marvin S.	05/20/87	05/15/90	35.9
23.	FPI Inc. f/k/a Freedom Plastics, Inc.	05/18/87	01/27/92	56.4
24.	Batz Sanitation, Inc.	02/16/88	Still pending	