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ONE SIZE FITS SOME: SINGLE ASSET REAL ESTATE BANKRUPTCY CASES†

Kenneth N. Klee††

For several years a debate has raged over whether single asset real estate cases should be singled out for special treatment under the Bankruptcy Code. Under the current \$4 million debt cap, these cases involve apartment houses and small office buildings. But both Houses of Congress have passed legislation that will repeal the \$4 million cap, potentially subjecting large office buildings, shopping centers, and perhaps hotels to expedited discriminatory treatment in Chapter 11 reorganization cases. In this Article, Professor Klee attempts to inform the debate by presenting empirical data gathered from a national questionnaire and cross-checking the data against the case files of a bankruptcy judge in the most active judicial district in the country. The results are striking. Asset values rather than amounts owing stand out as reliable predictors of plan confirmation. Surprisingly, value-to-loan ratios are less reliable than asset values standing alone. The data show that valuable properties have a much greater probability of confirming a plan than less valuable properties. The Article suggests that if Congress desires to discriminate against single asset real estate debtors, it should draw the line at approximately \$7–\$8.2 million in asset value rather than changing current law to discriminate against all single asset real estate debtors.

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INTRODUCTION

Congressional shortcuts can cut short the rights of Chapter 11¹ real property owners and investors.² Shortcuts rely on generalizations that sacrifice accuracy and precision for the sake of expedience.³ In fashioning a shortcut, the guide is usually inductive logic: If a shortcut works for a few cases, it will likely work in many cases. Inductive logic often rests on assumptions based on limited observations, but a shortcut rarely relies on systematic and expensive empirical research.

Absent an emergency, legislators can afford to engage in empirical research, but seldom do.⁴ This Article discusses one piece of federal legislation that could have benefitted from a small amount of empirical research, which would have likely resulted in a more efficient statutory amendment.

¹ See 11 U.S.C. §§ 1101–1174 (2000).

² See, e.g., *infra* Part IV (arguing that the congressional shortcut in removing the \$4 million cap on single asset real estate (SARE) cases will harm property owners and investors).

³ Commentators have analyzed and criticized courts' use of shortcuts to resolve securities law cases. See Stephen M. Bainbridge & G. Mitu Gulati, *How Do Judges Maximize? (The Same Way Everybody Else Does—Boundedly): Rules of Thumb in Securities Fraud Opinions*, 51 EMORY L.J. 83, 87 (2002) (concluding that judges use substantive heuristics to dispose of securities law cases at the motion to dismiss stage); see generally Hillary A. Sale, *Judging Heuristics*, 35 U.C. DAVIS L. REV. 903 (2002).

⁴ It is a matter of conjecture whether legislators are too busy to cause their staffs, the General Accounting Office, or the Congressional Research Service to engage in empirical research or whether legislators prefer to respond to lobbying pressures without the burden of hard data that might undercut the lobbyists' legislative objectives. On some occasions, Congress has commissioned studies before legislating a solution to a perceived problem, and did so with respect to other aspects of the pending Bankruptcy Reform Act of 2001. See U.S. GEN. ACCOUNTING OFFICE, PERSONAL BANKRUPTCY: ANALYSIS OF FOUR REPORTS ON CHAPTER 7 DEBTORS' ABILITY TO PAY, No. GAO/GGO-99-103 (1999), available at <http://www.gao.gov/archive/1999/gg99103.pdf> (last visited Feb. 1, 2002). As a norm, however, policymakers typically have a full legislative agenda that covers a wide range of topics, and have little taste for delving into the kinds of minutiae necessary to produce high-quality empirical research. Moreover, to the extent that legislation responds to interest group lobbying, a friendly legislator sees little to gain from developing data that would suggest that her supporters are pushing for something unwise.

In 2001, each House of Congress passed a so-called "technical amendment"⁵ (hereinafter collectively referred to as the "2001 Amendment") repealing the \$4 million cap in the definition of "single asset real estate" (SARE).⁶ Before the 2001 Amendment, SARE covered most apartment houses, very small office buildings, and strip-mall shopping centers.⁷ If the 2001 Amendment becomes law and eliminates its dollar limitation, SARE will cover large office buildings, such as Rockefeller Plaza, and possibly hotels and casinos.⁸ This technical amendment will subject large real estate projects with complex capital structures and operating problems to the same reorganization process as a five-unit apartment house. Most importantly, the 2001 Amendment eliminates an important protection the Bankruptcy Code offers developers or owners with liquidity problems. In a SARE case, the Bankruptcy Code permits a mortgage holder to obtain relief from the automatic stay by commencing foreclosure a mere ninety days⁹

⁵ Bankruptcy Abuse Prevention and Consumer Protection Act of 2001, H.R. 333, 107th Cong. § 1201(5)(B), *available at* <http://thomas.loc.gov> (amending the definition of "single asset real estate" in 11 U.S.C. § 101(5)(B)); Bankruptcy Reform Act of 2001, S. 420, 107th Cong. § 1201(5)(B), *available at* <http://thomas.loc.gov> (same). The House filed a conference report on H.R. 333 on July 26, 2002. The conference report contains the provisions referenced in this Article. At the time this Article went to press, the prospects for the bill's passage remained unclear.

⁶ The current statutory definition reads as follows:

"[S]ingle asset real estate" means real property constituting a single property or project, other than residential real property with fewer than 4 residential units, which generates substantially all of the gross income of a debtor and on which no substantial business is being conducted by a debtor other than the business of operating the real property and activities incidental thereto having aggregate noncontingent, liquidated secured debts in an amount no more than \$4,000,000.

11 U.S.C. § 101(51B) (2000).

⁷ *See, e.g., In re Syed*, 238 B.R. 133, 140 (Bankr. N.D. Ill. 1999) (noting that "[t]he phrase 'single-asset real estate' was intended in the statute to encompass an apartment building, office building, or strip-mall shopping center"). "We commonly think of a single asset case as one of a debtor with a single apartment house or condo complex or a single piece of real estate." 138 CONG. REC. S8264 (daily ed. June 16, 1992) (statement of Sen. Reid).

⁸ Whether the 2001 Amendment covers shopping complexes, office towers, hotels, and casinos depends on whether courts find those properties to have substantial businesses other than operating the real property and activities incidental thereto. *See, e.g., Centofante v. CBJ Dev., Inc. (In re CBJ Dev., Inc.)*, 202 B.R. 467, 474 (B.A.P. 9th Cir. 1996) (holding that a full-service hotel is not SARE). Some courts will not interpret the SARE definition to include a golf course or a golf and ski facility. *See In re Prairie Hills Golf & Ski Club, Inc.*, 255 B.R. 228, 230 (Bankr. D. Neb. 2000) (holding that a golf and ski facility is not SARE because it involves significant income-producing activities other than income-producing buildings and land); *In re Larry Goodwin Golf, Inc.*, 219 B.R. 391, 393 (Bankr. M.D.N.C. 1997) (holding that a golf club is a "business" rather than SARE).

⁹ The court can extend the ninety-day period for "cause" by an order entered within the ninety-day period. *See* 11 U.S.C. § 362(d)(3) (2000). However, forcing the debtor to seek an extension is costly. Moreover, based on judges' different attitudes toward SARE cases generally, the application of judicial discretion in this context is likely to lead to disparate results in similar cases before different judges. *See infra* note 90 and accompany-

after the order for relief, unless “the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time,”¹⁰ or the debtor in possession¹¹ has commenced monthly payments equivalent to interest¹² to each secured creditor.¹³

If the 2001 Amendment becomes law, however, mortgage holders can prematurely flush out of the bankruptcy system some large real estate developers or owners that have liquidity problems before the latter have a reasonable chance to reorganize.¹⁴ By threatening to do so, mortgage holders can control the Chapter 11 process to their benefit. They can decide whether to seize the property for potential upside gain or leave it in Chapter 11 to serve their other purposes.¹⁵ Their benefit will come at the expense of property owners, general unsecured creditors, and the public that subsidizes the cost of operating the bankruptcy system to achieve a public good.

After testifying before Congress about the forerunner of the 2001 Amendment, I recognized the desirability of gathering empirical data to determine whether large SARE debtors differed from small SARE debtors in their Chapter 11 experiences. I examined the case law and gathered information in unreported cases to determine whether SARE debtors confirmed Chapter 11 plans. By analyzing plan confirmation rates over the past twenty years, this Article tests the wisdom of

ing text (discussing the uncertainty of an extension motion due to judicial hostility toward SARE debtors).

¹⁰ 11 U.S.C. § 362(d)(3)(A).

¹¹ Although the statute refers to a “debtor,” it actually means a “debtor in possession” acting as the legal representative of the bankruptcy estate. *See id.* §§ 323(a), 1107(a).

¹² Some courts and commentators mistakenly characterize the statute as requiring the payment of interest. Rather, the payments are “in an amount equal to interest.” *See id.* § 362(d)(3)(B). Unless the creditor is oversecured or the debtor is solvent, the statute forbids the payment of postpetition interest. *See id.* §§ 502(b)(2), 506(b), 726(a)(5). In fact, if the creditor is oversecured, although postpetition interest will accrue under § 506(b), the statute might forbid the payment of postpetition interest prior to the conclusion of the case as well. *See Orix Credit Alliance, Inc. v. Delta Res., Inc. (In re Delta Res., Inc.)*, 54 F.3d 722, 730 (11th Cir. 1995).

¹³ *See* 11 U.S.C. § 362(d)(3)(B).

¹⁴ *See In re Kkemko, Inc.*, 181 B.R. 47, 49 (Bankr. S.D. Ohio 1995) (noting that the purpose of § 362(d)(3) is to “impose an expedited time frame for filing a [confirmable] plan” in SARE cases); David B. Young, *Automatic Stay Issues: Selected Recent Developments*, in 2 23rd ANNUAL CURRENT DEVELOPMENTS IN BANKRUPTCY AND REORGANIZATION 9, 71 (PLI Commercial Law & Practice Course, Handbook Series No. A-820, 2001) (“11 U.S.C. § 362(d)(3) . . . seeks to place the debtor on a fast track and to permit the mortgage lender to foreclose unless the debtor acts swiftly.”).

¹⁵ That is why mortgage holders financed the lobbying effort to press for this amendment. *See generally Bankruptcy*, at <http://www.opensecrets.org/news/bankruptcy/index.htm> (last visited Mar. 15, 2002) (indicating that during the 1999–2000 lobbying cycle, finance and credit card companies contributed \$9 million, and that during the same cycle, commercial banks contributed \$29 million, and credit unions contributed \$2.1 million—almost two and a half times the amount spent by this industry during the 1996 presidential campaign).

treating large and small SARE debtors alike in a manner different from all other Chapter 11 debtors.

Part I of this Article examines the history and policy behind SARE reorganization and asks a threshold question: Why should SARE debtors have the opportunity to reorganize at all? Compelling policy reasons favor reorganization of SARE debtors, even though theories of allocative efficiency might indicate otherwise. Part II reviews the 2001 Amendment's uniform procedure for all SARE reorganizations by changing the definition of SARE to eliminate the \$4 million cap and analyzes the policies that the amendment implicates. Part III discusses original data analyzing real estate cases to see how they fared in bankruptcy and finds that larger SARE debtors above the \$4 million cap have higher Chapter 11 confirmation rates. In Part IV, this Article argues that these findings do not justify Congress's proposal to repeal the SARE \$4 million cap because Chapter 11 functions well for larger SARE debtors. Congress acted on the basis of a hunch instead of doing its homework.

I

WHY REORGANIZE SARE CASES AT ALL?

The question whether or under what conditions single asset real estate cases should be able to reorganize under the Bankruptcy Code requires an evaluation of the costs and benefits of reorganization as compared to foreclosure under state law. To place the evaluation in context, this Part begins with a brief history of real property reorganizations and describes how Chapter 11 reorganization cases work. It examines the arguments for and against allowing SARE cases access to Chapter 11 at all and focuses on the political motivations that led to the adoption of the 2001 Amendment rather than exclusion of SARE debtors from Chapter 11.

A. The History of Real Property Reorganization Cases

During the 1930s, the deteriorating economic climate in the United States led to massive defaults in the repayment of real property mortgages.¹⁶ Economic disaster threatened not only the debtors who owed mortgage obligations, but also the financial institutions, particularly savings banks, that held the mortgages.¹⁷ As debtors defaulted,

¹⁶ See Homer F. Carey, *Real Property: Post Depression and Future*, J. LEGAL & POL. SOC., Apr. 1943, at 101, 101 ("Foreclosures reached staggering proportions [from 1931 to 1935] and bankruptcies were occurring at an ever accelerating rate.").

¹⁷ See ELMUS WICKER, *THE BANKING PANICS OF THE GREAT DEPRESSION* 16 (1996) ("Real estate lending, primarily nonfarm, . . . was an important source of unsettled banking markets during the Great Depression."); Milton Esbitt, *Bank Portfolios and Bank Failures During the Great Depression: Chicago*, 46 J. ECON. HIST. 455, 457 (1986) ("[F]ully 95% of the bank troubles in Chicago were predicated on real estate." (internal quotation marks omitted));

mortgage holders commenced foreclosure proceedings and financial institutions began to hold record title to enormous amounts of real property.¹⁸ Many of these financial institutions faced the Hobson's choice of holding real estate that generated little income but carried tax, maintenance, and insurance liabilities, or selling the real estate into a thin market with few buyers and distressed prices.¹⁹ Yet in many states, financial institutions could not intervene to protect their interests by foreclosing on mortgaged properties, because the states had imposed moratorium laws to suspend foreclosures.²⁰ As a result, the United States faced the prospect of numerous financial institution insolvencies.²¹ In addition, Congress saw a risk of undermining the U.S. economic system by allowing real property defaults to cause pervasive dispossession of private ownership. Partially to ameliorate this situation, Congress enacted Chapter XII of the Bankruptcy Act to permit individual and partnership debtors who owned real property the opportunity to reorganize.²² By enacting Chapter XII, Congress cre-

Thomas S. Stone, *Mortgage Moratoria*, 11 WIS. L. REV. 203, 206 (1935) ("The wave of foreclosures . . . was of little benefit to creditors."); Current Legislation, *Emergency Mortgage Legislation*, 8 ST. JOHNS L. REV. 204, 206 (1933) ("Savings banks and insurance companies with their millions in mortgages . . . were caught in the deluge of foreclosure and in this time of chaos, President Roosevelt declared the Banking Holiday.")

¹⁸ See Carey, *supra* note 16, at 104 ("[P]roperty passed in great volume to the creditor class during the interval from 1930 to 1937."). Contemporary literature contains the following hyperbole: "When one realizes that approximately 50 per cent of the farm lands in Central and Northern California are controlled by one institution—the Bank of America—the irony of these 'embittered' farmers defending their 'homes' against strikers becomes apparent." CAREY McWILLIAMS, *Factories in the Field: The Story of Migratory Farm Labor in California* 233 (1939).

¹⁹ See, e.g., Stone, *supra* note 17, at 206 ("[T]he past few years have found banks and other lending institutions loaded down with physical properties which they cannot operate."); Arthur E. Sutherland, Jr., *Foreclosure and Sale: Some Suggested Changes in the New York Procedure*, 22 CORNELL L.Q. 216, 217 (1937) ("The great lending institutions are reluctant to load themselves with foreclosed real estate . . .").

²⁰ See, e.g., Robert H. Skilton, *Mortgage Moratoria Since 1933*, 92 U. PA. L. REV. 53, 88 (1943) ("The chief criticism that may be made of the New York moratorium is that it was too inclusive. Commercial properties . . . were protected against the consequences of default in principal."); see also William L. Prosser, *The Minnesota Mortgage Moratorium*, 7 S. CAL. L. REV. 353, 355, 360–63 (1934) (discussing Minnesota's executive and legislative responses to the wave of foreclosures and forced sales); Stone, *supra* note 17, at 219–20 (discussing the Wisconsin Mortgage Moratorium Law of 1933); Current Legislation, *supra* note 17, at 206–09 (discussing New York's mortgage moratorium statutes).

²¹ See Raymond J. Mischler, *After the Mortgage Moratorium—What?*, 19 IOWA L. REV. 560, 561 (1934) ("Foreclosures and forced sales were reaching proportions that threatened state and national stability.")

²² See Morris W. Macey & M. William Macey, Jr., *The Chapter XII Chrysalis*, 52 AM. BANKR. L.J. 121, 123 (1978) ("Chapter XII was . . . developed principally to meet an emergency situation prevalent in Illinois and, to some extent, Massachusetts."). Congress enacted Chapter XII as part of the Chandler Act of 1938, Pub. L. No. 75-696, ch. XII, 52 Stat. 840, 916–30 (repealed by Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, § 401, 92 Stat. 2549, 2682), and at the same time it passed Chapter X of the Bankruptcy Act to facilitate corporate reorganization of different kinds of businesses, including those owning real property. See *id.* ch. X, 52 Stat. at 883–905 (repealed by Bankruptcy Reform Act of

ated a beneficial legal mechanism to prevent financial institutions from either conducting massive resales of foreclosed real estate into depressed markets or retaining concentrated ownership of real property on their balance sheets. Before the enactment of Chapter XII, SARE debtors either renegotiated consensually with their mortgage holders or liquidated the property under the Bankruptcy Act of 1898 or state mortgage foreclosure laws.

When Congress enacted the Bankruptcy Code in 1978, it continued to permit SARE debtors to reorganize under the same laws and rules as other kinds of Chapter 11 debtors. A property owner was eligible to file for relief under Chapter 11 whether the owner was an individual, partnership, or corporation.²³ The 1978 Bankruptcy Code gave all kinds of SARE debtors a breathing spell to permit them to restructure their property and their mortgage.

In 1994, however, the law changed fundamentally for some SARE property owners when Congress adopted special rules for SARE debtors with secured debts of less than \$4 million ("small" SARE debtors). In those cases, Congress restricted small SARE debtors to an expedited Chapter 11 procedure designed to confirm a plan quickly or force the debtor to pay the mortgage holder. Debtors who could do neither faced losing their property to foreclosure. To protect mortgage lenders in SARE cases having secured debts not greater than \$4 million,²⁴ the 1994 amendments added an additional procedure by which a real property mortgage holder could obtain relief from § 362 of the Bankruptcy Code's automatic stay against lien foreclosure.²⁵

1978, § 401, 92 Stat. at 2682); *see also* *Charlestown Sav. Bank v. Martin (In re Colonial Realty Inv.)*, 516 F.2d 154, 158 (1st Cir. 1975). The court stated:

The power to prevent secured parties from availing of their contractual remedies . . . , and to compel those creditors . . . in possession at the time of filing to return the debtor's property is essential to preserve the possibility of a successful rearrangement of the debtor's affairs. Little hope of resuscitation would remain for the debtor disembowelled just prior to filing.

Id.

²³ Individuals (human beings), partnerships, and corporations are eligible to be Chapter 11 debtors. *See* 11 U.S.C. §§ 101(41), 109(b), (d) (2000); *Toibb v. Radloff*, 501 U.S. 157, 166 (1991) (holding that an individual debtor not engaged in business was eligible to file under Chapter 11). *See generally infra* note 30 (discussing the meaning of the terms "individual" and "corporation" in the Bankruptcy Code). Individual debtors with regular income and noncontingent, liquidated secured debts less than \$871,550 and noncontingent, liquidated unsecured debts less than \$290,525 may file Chapter 13 cases instead of Chapter 11 cases. *See* 11 U.S.C. § 109(e) (2000) (as amended effective April 1, 2001). Generally, Chapter 13 cases are less expensive and more effective than Chapter 11 cases. Thus, an individual SARE debtor who is eligible might choose to file a Chapter 13 case instead of a Chapter 11 case. This Article assumes that the debtor files for relief under Chapter 11.

²⁴ For the Code's definition of "single asset real estate," *see supra* note 6.

²⁵ *See* Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, § 218(b), 108 Stat. 4106, 4128 (codified as amended at 11 U.S.C. § 362(d)(3) (2000)); *see infra* note 26. Lenders with secured loans of at least \$4 million did not receive the benefits of these protections,

Section 362(d)(3) permits a SARE mortgage holder to get relief from the automatic stay to foreclose unless, within ninety days after the order for relief, the debtor files a confirmable plan or begins making monthly payments to the mortgage holder.²⁶ Thus the amendments minimize the mortgage holder's out-of-pocket loss by shortening the Chapter 11 process or forcing the debtor to "pay to play" by making cash payments to the lender. This shifts the risk of delay from the secured lender to the debtor. It also creates a barrier to entry that discourages small real estate owners from filing for Chapter 11 relief.²⁷ Mortgage holders and their lobbyists justified the provision based on an alleged "shared experience" that, in most real estate cases, debtors file solely to delay foreclosure.²⁸ They convinced Con-

although they could seek relief from the automatic stay under § 362(d)(1) or (2). See 11 U.S.C. § 362(d)(1)-(2). Presumably Congress adopted the \$4 million cap in 1994 because it thought that different policy concerns governed larger cases.

²⁶ Section 362(d)(3) provides as follows:

[The court shall grant relief from the automatic stay of § 362(a)] (3) with respect to a stay of an act against single asset real estate under subsection (a), by a creditor whose claim is secured by an interest in such real estate, unless, not later than the date that is 90 days after the entry of the order for relief (or such later date as the court may determine for cause by order entered within that 90-day period)—

- (A) the debtor has filed a plan of reorganization that has a reasonable possibility of being confirmed within a reasonable time; or
- (B) the debtor has commenced monthly payments to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien), which payments are in an amount equal to interest at a current fair market rate on the value of the creditor's interest in the real estate.

11 U.S.C. § 362(d)(3).

²⁷ One commentator believed that the 1994 amendments would cause the bankruptcy courts to experience increased efficiency because the amendments would "minimize filings where no real probability of confirmation exists." See *Commercial and Credit Issues in Bankruptcy: Hearing Before the Subcomm. on Courts & Admin. Practice of the Senate Comm. on the Judiciary*, 102d Cong. 89 (1991) [hereinafter *Commercial and Credit Hearing*] (statement of Mary Jane Flaherty). Although it is obvious that a debtor would prefer a ninety-day delay to immediate foreclosure, as a matter of cost/benefit analysis, the foregoing speculations appear to be sound. Debtors that own small real estate projects will be less inclined to pay a bankruptcy attorney's retainer, a Chapter 11 filing fee, the quarterly U.S. trustee's fees, and the other substantial incremental costs of filing for Chapter 11 when the limitations of § 362(d)(3) operate to compress and restrict their opportunity to reorganize. See 28 U.S.C. § 1930(a)(3), (6) (Supp. V 1999). At the margin, they will walk away and allow lenders to foreclose or give lenders a deed to the property in lieu of foreclosure. Another commentator has speculated that the 1994 amendment would discourage small real estate debtors from filing for Chapter 11 relief, thereby resulting in earlier foreclosures under state law. See John C. Murray, *The Lender's Guide to Single Asset Real Estate Bankruptcies*, 31 REAL PROP. PROB. & TR. J. 393, 448 (1996).

²⁸ See, e.g., *Commercial and Credit Hearing*, *supra* note 27, at 88-89 (statement of Mary Jane Flaherty) ("The problem with single asset cases is that there is usually no reasonable prospect of reorganization. The bankruptcy filing is simply used as a legal method to delay foreclosure. Lenders typically receive relief from the stay, but only after substantial delay and expense.").

gress that these cases seldom result in confirmed plans but instead use the resources of the federal courts for improper dilatory purposes.²⁹

In 2001, once again bowing to pressure from mortgage holders and their lobbyists, each House of Congress introduced and passed bills repealing the \$4 million cap and subjecting all SARE debtors to the expedited procedures that since 1994 had applied only to small SARE debtors.

B. How Chapter 11 Functions for SARE Debtors

Before analyzing the 2001 Amendment, it is useful to understand how Chapter 11 functions for SARE debtors and to consider whether SARE cases should reorganize at all. Continuing the pattern of federal reorganization relief that started during the Great Depression, the Bankruptcy Code allows almost any kind of SARE debtor to initiate a Chapter 11 reorganization case, whether the debtor is an individual, partnership, or corporation.³⁰ After filing a Chapter 11 petition, the debtor ordinarily remains as a debtor in possession³¹ with the

²⁹ See *id.*; *Bankruptcy Reform: Hearing Before the Subcomm. on Econ. & Commercial Law of the House Comm. on the Judiciary*, 103d Cong. 532 (1994) (statement of Warren Lasko, Executive Vice President, Mortgage Bankers Association of America) (“The survey also confirms that Chapter 11 is being used by developers and owners of single asset real property for delay, not for legitimate reorganization of a business.”). The subcommittee manager of the bill in the House of Representatives described the 1994 amendments as “designed to curtail bankruptcy fraud and abuse and reduce the unnecessary costs and delays of the bankruptcy process.” 140 CONG. REC. H10,771 (daily ed. Oct. 4, 1994) (statement of Rep. Synar).

³⁰ The Bankruptcy Code uses the term “individual” to mean a particular human being. See *Farm Fresh Poultry, Inc. v. Hooton Co.* (*In re Hooton Co.*), 43 B.R. 389, 391 (Bankr. N.D. Ala. 1984) (“The term ‘individual’ is not included in the definitions found in 11 U.S.C. § 101; however, it may be said to mean generally a single human being as distinguished from a social group or institution.”); David Swarthout, Note, *When Is an Individual a Corporation?—When the Court Misinterprets a Statute, That’s When!*, 8 AM. BANKR. INST. L. REV. 151, 152 n.9 (2000) (citing *Toibb v. Radloff*, 501 U.S. 157, 160–61 (1991), for the proposition that the Court’s use of the term “individual” excludes “corporate debtors and only refer[s] to human beings.”). The Bankruptcy Code’s definition of “corporation” probably includes limited liability companies, limited liability partnerships, and business trusts, but not true trusts. See 11 U.S.C. § 101(9) (2000) (defining “corporation”); Sally S. Neely, *Partnerships and Partners and Limited Liability Companies and Members in Bankruptcy: Proposals for Reform*, 71 AM. BANKR. L.J. 271, 286 (1997) (stating that a LLC “appears to be a corporation” under the Bankruptcy Code’s definition of “corporation”); Thomas F. Blake-more, *Limited Liability Companies and the Bankruptcy Code: A Technical Review*, AM. BANKR. INST. J. (Am. Bankr. Inst., Wash., D.C.), June 1994, at 12 (stating that “a LLC would appear to qualify as a ‘corporation’ under [Bankruptcy] Code § 101(9)”).

³¹ See 11 U.S.C. § 1101(1) (2000) (defining “debtor in possession” to mean the debtor except when a trustee is serving in the case). It is rare for Chapter 11 trustees to be appointed or elected. See *id.* § 1104(a) (2000) (specifying grounds for the appointment of a Chapter 11 trustee).

power to operate its business,³² sell assets,³³ obtain credit,³⁴ and propose a plan of reorganization.³⁵

For at least the last sixty years, most SARE debtors in bankruptcy have had over-leveraged capital structures where a decline in rents (or inability to rent) produces a cash flow insufficient to service their secured debts. Some debtors have obtained junior mortgages to create additional short-term cash flow, but this strategy often adds more debt without solving the debtor's long-term liquidity crisis. Ultimately, the liquidity crisis escalates to the point where the mortgage holder threatens to foreclose and the debtor walks away from the property, renegotiates with the mortgage holder out of court, or files a Chapter 11 petition. In these Chapter 11 cases, the debtor's plan of reorganization almost always proposes debt relief. Debt relief takes many forms, ranging from a simple extension of the maturity date or an adjustment of the interest rate or of the debt amortization period, to forgiveness of indebtedness or the conversion of debt to either equity or a participating mortgage. Indeed, a principal purpose of bankruptcy is to give the debtor an opportunity to solve its liquidity problems.³⁶

In some SARE cases, the borrower needs to restructure both the secured debt and the business operations. For example, a building might require construction for completion, expansion, retrofitting, repair, or renovation. In this kind of SARE case, the debtor in possession first must obtain additional capital to finance the needed construction in order to prove that its reorganization plan is feasible. If the value of the property is less than the mortgage debt, the debtor in possession probably will not obtain additional financing on an unsecured basis or even with a junior lien for security. Sometimes the debtor in possession obtains debtor in possession financing secured by a senior lien on the property.³⁷ Most lenders, however, will not provide financing to a postpetition debtor in possession unless the debtor in possession secures the new credit with a so-called "priming"

³² See *id.* §§ 1107(a), 1108.

³³ See *id.* § 363.

³⁴ See *id.* § 364.

³⁵ See *id.* § 1121(a) (giving the debtor the right to file a plan).

³⁶ See, e.g., H.R. REP. NO. 95-595, at 221 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6180 ("The purpose of [a] reorganization . . . case is to formulate and have confirmed a plan of reorganization . . . for the debtor."); Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336, 372 (1993) (characterizing Chapter 11 as "creating an opportunity for a business to survive its immediate financial crisis"). But see Kevin A. Kordana & Eric A. Posner, *A Positive Theory of Chapter 11*, 74 N.Y.U. L. REV. 161, 164 (1999) ("We assume that the purpose of Chapter 11 is to minimize the cost of credit").

³⁷ See 11 U.S.C. § 364 (giving the debtor in possession the ability to obtain postpetition financing).

lien with priority ahead of the prepetition mortgages.³⁸ The law permits this to be done only if the court determines that there is adequate protection of the prepetition mortgage holder's interest in the real property.³⁹ Although a value cushion is a common form of adequate protection,⁴⁰ where the amount of prepetition mortgage debt exceeds the value of the property, this method of protection is unavailable. In some SARE cases, however, the value added by new construction will provide a sufficient cushion to cover new postpetition financing and adequately protect the prepetition mortgage holder's interest in property.⁴¹ Even if the debtor in possession cannot obtain debtor-in-possession financing, it may be possible for existing or new equity owners to infuse equity capital under a reorganization plan. Unless the prepetition mortgage holder votes to accept the plan, however, the equity owners may infuse equity only if the debtor uses a market process to determine the value of the new equity.⁴²

While the debtor in possession attempts to obtain debtor-in-possession financing or new equity, the law automatically stays the secured lender from pursuing its foreclosure rights.⁴³ Although it is possible for the debtor to make periodic cash payments to the lender as a form of adequate protection,⁴⁴ not all courts require current payment of postpetition interest on prepetition mortgages.⁴⁵ Under the reorganization plan, unless the debtor is solvent, the undersecured lender's claim will include principal and prepetition interest, but not postpetition interest.⁴⁶ For example, assume that a debtor owes a mortgage holder \$1 million under a note bearing annual interest at 10% and secured by real property worth \$800,000. If the court confirms the reorganization plan and it is effective one year after the

³⁸ See *id.* § 364(d).

³⁹ See *id.* § 361; *id.* § 364(d)(1)(B).

⁴⁰ See, e.g., *Pistole v. Mellor (In re Mellor)*, 734 F.2d 1396, 1400 (9th Cir. 1984); *McCombs Props. VI, Ltd. v. First Tex. Sav. Ass'n (In re McCombs Props. VI, Ltd.)*, 88 B.R. 261, 266 (Bankr. C.D. Cal. 1988).

⁴¹ See, e.g., *In re Ledgemere Land Corp.*, 125 B.R. 58, 63 (Bankr. D. Mass. 1991).

⁴² See *Bank of Am. Nat'l Trust & Sav. Ass'n v. 203 N. LaSalle St. P'ship*, 526 U.S. 434, 445-58 (1999) (holding that if the new value principle exists under the Bankruptcy Code, it requires the equity to be exposed to a market value such as through an auction or the termination of the debtor's plan exclusivity).

⁴³ See 11 U.S.C. § 362(a) (2000).

⁴⁴ See *id.* § 361(1).

⁴⁵ See, e.g., *Orix Credit Alliance v. Delta Res., Inc. (In re Delta Res., Inc.)*, 54 F.3d 722, 729 (11th Cir. 1995) (noting that if the mortgage holder is oversecured, some courts permit postpetition interest to accrue, but do not permit its payment until the conclusion of the case). If the mortgage holder is undersecured, it might not have the right to payment of postpetition interest as long as the value of the real property is not declining. See, e.g., *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 382 (1988) (holding that the undersecured creditor is not entitled to adequate protection for the delay in its foreclosure rights attributable to the automatic stay).

⁴⁶ See 11 U.S.C. §§ 502(b)(2), 726(a)(5) (2000).

bankruptcy filing, the mortgage holder will receive consideration worth \$800,000 on the effective date of the plan but will forgo \$100,000 in postpetition interest. Thus, bankruptcy may reduce the undersecured mortgage lender's recovery on a present value basis compared to what the lender would have received by pursuing its state law rights.

C. Arguments For and Against Reorganization

We now discuss the fundamental question: Why should Congress permit SARE cases to reorganize under Chapter 11?⁴⁷ Some commentators have contended, or have adopted theoretical positions that should lead them to contend, that the Chapter 11 process in SARE cases is inefficient compared to the alternative of mandatory prompt auctions.⁴⁸ Allocative efficiency, they argue, requires swift and inexpensive foreclosure in accordance with state law.⁴⁹ These commentators contend that permitting the borrower to file a Chapter 11 petition inefficiently delays foreclosure, thereby imposing increased costs on secured creditors.⁵⁰ Secured creditors in turn pass these losses on to all borrowers in the form of higher interest rates.

Other commentators argue that bankruptcy law should permit interference with state law only if it solves a "common pool problem."⁵¹ In their view, bankruptcy law is necessary to prevent one creditor from acting in its own self-interest to the detriment of creditors as a whole.⁵² For example, the law properly prevents a creditor with a security interest in valuable machinery of an insolvent manufacturing company from foreclosing on its security interest and causing the liquidation of the debtor to the detriment of all other creditors. These commentators argue that almost all SARE cases are two-party disputes

⁴⁷ See, e.g., Young, *supra* note 14, at 59 ("It is at least arguable that single asset real estate debtors do not belong in a reorganization proceeding at all").

⁴⁸ See, e.g., Douglas G. Baird & Edward R. Morrison, *Bankruptcy Decision Making*, 17 J.L. ECON. & ORG. 356, 371 (2001).

⁴⁹ See Alex M. Johnson, Jr., *Critiquing the Foreclosure Process: An Economic Approach Based on the Paradigmatic Norms of Bankruptcy*, 79 VA. L. REV. 959, 989 (1993). Johnson explains: The ability of a lender to foreclose on a mortgage in an inexpensive and expeditious manner is a key element of the ex ante bargain struck between creditor and debtor, a bargain that allows the debtor to obtain a loan at a very attractive interest rate, at least compared with other forms of debt such as personal loans.

Id.

⁵⁰ Taken to its extreme, this argument supports prompt, strict foreclosure with no right of redemption as the most efficient system. See, e.g., James Geoffrey Durham, *In Defense of Strict Foreclosure: A Legal and Economic Analysis of Mortgage Foreclosure*, 36 S.C. L. REV. 461, 462 (1985) (concluding that "strict foreclosure . . . is the most efficient method of foreclosure, and is equitable and fair in almost every situation").

⁵¹ See, e.g., THOMAS H. JACKSON, *THE LOGIC AND LIMITS OF BANKRUPTCY LAW* 19, 194-95 (1986).

⁵² See *id.*

that involve only a debtor and a mortgage holder; therefore, there is no common pool problem, and there should be no bankruptcy case.⁵³ Permitting a SARE debtor to file for bankruptcy confers no benefits on a pool of other claimants, there being none, they argue, and it only imposes unjustified costs and delays on mortgage holders, resulting in higher interest rates, fewer mortgage loan approvals,⁵⁴ and the “withholding from the marketplace property capable of producing value.”⁵⁵ “The time spent in the Bankruptcy Court is wasteful and without any public benefit.”⁵⁶ Therefore, proponents of this argument support amending the Bankruptcy Code to bar SARE cases from reorganizing under Chapter 11.⁵⁷

Contrary to the claim that the common pool problem is the sole or primary basis for evaluating the desirability of allowing SARE debtors access to Chapter 11, three principal arguments, developed below, powerfully favor giving access to Chapter 11 so that SARE debtors have an opportunity to reorganize. First, Chapter 11 smoothes out market inefficiencies, particularly during massive real estate downturns. Second, federal public policy supports giving property owners a chance to save their investments. Third, macroeconomic and social policies favor reorganization of SARE debtors.

First, during broad-based financial crises, allowing debtors to restructure debts in Chapter 11 smoothes economic turbulence and precludes the downward spiral in real estate prices that can result when mortgage holders simultaneously dump massive amounts of foreclosed properties on the market. In addition, Chapter 11 functions in SARE cases to smooth out market inefficiencies caused by

⁵³ See, e.g., Daniel C. Draper, *Stays of Mortgage Foreclosure—A Proposal for Reform*, 93 BANKING L.J. 133, 135–36 (1976). Draper writes:

Although, in many cases, the insolvent debtor can adjust its financial situation and eventually satisfy creditors, in our experience that is rarely, if ever, the case for a single-project real estate corporation. The presumption that “time will heal” is simply not valid where the debtor has virtually nothing to reorganize except a single mortgaged project Stays against secured creditors of single-project corporations rarely increase the probability of reorganization and consequently cannot further any policy aimed at enhancing all opportunities for success by the debtor.

Id.; *Commercial and Public Sector Issues in Bankruptcy: Hearing Before the Subcomm. on Econ. & Commercial Law of the House Comm. on the Judiciary*, 102d Cong. 250 (1992) (statement of Michael F. Brown) (“When financial problems arise . . . virtually the only creditor is the mortgage holder. Generally there is little or no trade debt or other associated debt.”).

⁵⁴ See *Commercial and Credit Hearing*, *supra* note 27, at 183 (1991) (statement of James W. Nelson) (“The results of lenders’ potential losses from single-asset foreclosure delays are higher mortgage interest rates to compensate for loss, [and] a disincentive for institutional lenders to continue to invest in commercial mortgages”).

⁵⁵ Draper, *supra* note 53, at 138.

⁵⁶ *Id.* at 142.

⁵⁷ See, e.g., 1 NAT’L BANKR. REVIEW COMM’N, BANKRUPTCY: THE NEXT TWENTY YEARS 661 n.1678 (1997) (citing authorities), available at <http://govinfo.library.unt.edu/nbrcreporttitlepg.html>.

state foreclosure systems.⁵⁸ Specifically, some state law foreclosure systems are flawed because they permit lenders to seize property and conduct foreclosure sales without sufficient notice, resulting in artificially depressed prices.⁵⁹ Although the Depression is long gone, "the modern mortgage market is subject to deficiencies that create similar market declines."⁶⁰ These evils exist "[n]ot . . . only in time of emergency."⁶¹ Thus, many foreclosures result in nonconsensual sales at below-market price. By contrast, Chapter 11 gives the property owner the opportunity to sell the property over a reasonable period of time. When debtors sell properties with their lenders' cooperation, the resulting orderly sales can increase value for the lenders and other creditors. Alternatively, Chapter 11 permits the property owner to restructure the mortgage through a consensual valuation under a plan supported by the mortgage holder or through a "market-tested" valuation in a contested plan confirmation.⁶²

Several commentators have endorsed these arguments. Based on his previous writing,⁶³ Judge Bufford testified that real estate reorganization had its roots in the Depression and that Congress enacted it to prevent banks from owning most of the real estate in the nation.⁶⁴

⁵⁸ See, e.g., Lynn M. LoPucki, *Strange Visions in a Strange World: A Reply to Professors Bradley and Rosenzweig*, 91 MICH. L. REV. 79, 100 (1992).

⁵⁹ See Arthur J. Hughes, *Reorganization Under the Amended Bankruptcy Act*, 13 NOTRE DAME LAW. 112, 114 (1937). Hughes writes:

Market values did not properly approximate the real values of the properties. The scarcity of purchasers generally enabled a few buyers to acquire properties at . . . far below the cost of the properties To be forced to sell in such a market, was certain to result in a complete loss to the debtor and a substantial loss to the creditors.

Id.; see also *Armstrong v. Csurilla*, 817 P.2d 1221, 1223 (N.M. 1991) ("When property subject to a mortgage or other lien is sold in foreclosure proceedings, the buyer is usually the mortgagee or other lien creditor and the price for which the property is 'bought in' is sometimes significantly less than the property's fair market value."); cf. *BFP v. Resolution Trust Corp.*, 511 U.S. 531, 539 (1994) (noting that property sold under the strictures of foreclosure is simply worth less than fair market value).

⁶⁰ Robert M. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843, 851-52 & n.48 (1980) (citing *Nat'l Bank v. Equity Investors*, 506 P.2d 20, 43-44 (Wash. 1973) (en banc)); see also Arthur E. Wilmarth, Jr., *The Expansion of State Bank Powers, the Federal Response, and the Case for Preserving the Dual Banking System*, 58 FORDHAM L. REV. 1133, 1244 (1990) ("[During the late 1980s,] bank failures in Texas have been caused primarily by an excessive concentration of bank assets in commercial loans related to real estate and energy ventures.").

⁶¹ D.J. Farage, *Mortgage Deficiency Judgment Acts and Their Constitutionality*, 41 DICK. L. REV. 67, 67 (1937) ("[E]mergencies do expose to the spotlight certain economic malpractices, which, in more prosperous times, flourish unheeded").

⁶² See *Bank of Am. Nat'l Trust & Sav. Ass'n. v. 203 N. LaSalle St. Ltd. P'ship*, 526 U.S. 434 (1999).

⁶³ See Samuel L. Bufford, *What Is Right About Bankruptcy Law and Wrong About Its Critics*, 72 WASH. U. L.Q. 829, 836-38 (1994) (arguing that bankruptcy law "prevents secured creditors from collectively starting a downward spiral of foreclosures and bank failures that could result in the failure of the entire economy").

⁶⁴ See 1 NAT'L BANKR. REVIEW COMM'N, *supra* note 57, at 680.

Former FDIC Chairman William Seidman testified before the House Banking Committee in 1990 that when bank regulators force quick sales of real estate owned after foreclosure, property values decline precipitously.⁶⁵ Thus, when it considered the Bankruptcy Reform Act of 2001, Congress was aware that orderly liquidations leave society better off.

Second, Chapter 11 also implements important federal policies protecting ownership investments in real estate. Contrary to the assertion that SARE cases are two-party disputes, many cases involve the interests of numerous owners who have invested in the real estate project.⁶⁶ As a normative matter, Chapter 11 protects general partners or guarantors who might be liable for foreclosure deficiencies from the risk of an unfair⁶⁷ or inefficient state foreclosure process. As a consequence, partners and guarantors can make efficient decisions *ex ante* whether to invest in real estate projects.⁶⁸ Moreover, minimizing foreclosure deficiencies has a beneficial second-order effect. The efficiencies of Chapter 11 reduce the tax recapture liability of partners in a

⁶⁵ See, e.g., Stuart D. Root, *Bank Capital, Asset Liquidation, and the Credit Crunch*, 1993 COLUM. BUS. L. REV. 169, 182–83 (citing *Federal Home Loan Bank Board 1988 Deals: Hearings Before the House Comm. on Banking, Fin. & Urban Affairs*, 101st Cong. 28 (1990) (testimony of William Seidman, Chairman, FDIC)) (“Congress . . . seemingly ignored . . . estimate[s] that assets lose up to twenty percent of value when they are taken over by the government for disposition. A liquidation program involving hundreds of billions of dollars in assets is thus bound to have an adverse impact on values of assets held by institutions.” (footnotes omitted)).

⁶⁶ Some cases also involve unsecured creditors, such as vendors, property managers, and tenants.

⁶⁷ Although law-and-economics scholarship generally has steered clear of distributional issues, recently economic analysis in the literature has attacked the propriety of making fairness-based assessments. See, e.g., Louis Kaplow & Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 1011 (2001) (criticizing fairness-based assessments on the ground that they depend “exclusively on the effects of legal rules on individuals’ well-being” and, as a consequence, “can make individuals worse off, that is, reduce social welfare”). In this Article, by “unfair,” I refer to a state foreclosure statute that provides insufficient notice or auction procedures to produce a fair market price. See sources cited *supra* note 59 and accompanying text. Some commentators might argue that the state foreclosure system is part of the property owner’s bargain when it obtains the mortgage. Others might reply that the property owner’s right to file for Chapter 11 relief was a risk the mortgage holder took when it made the loan.

⁶⁸ Congress changed the risk/reward ratio for real estate investments in 1986 when it withdrew tax incentives to invest in real estate and enacted passive activity loss rules. See Daniel S. Goldberg, *Tax Subsidies: One-Time vs. Periodic: An Economic Analysis of the Tax Policy Alternatives*, 49 TAX L. REV. 305, 340 (1994). But Chapter 11 remains an important part of the risk/reward ratio by protecting owners from immediate loss of their investments in the event their business faces a liquidity crisis. See, e.g., Warren, *supra* note 36, at 357–58 (describing the policies of Chapter 11 as encouraging risk-taking behavior); LoPucki, *supra* note 58, at 100 (asserting that Chapter 11 offers “the owners, and more importantly the creditors, an alternative to putting the debtor’s assets on the auction block” when the debtor faces a liquidity crisis).

debtor real estate partnership, thus preventing governments from reaping a windfall due to artificially low foreclosure prices.⁶⁹

Third, macroeconomic and social policies also favor reorganization of SARE debtors. Granting SARE debtors meaningful access to Chapter 11 not only makes good economic sense, but it is also good social policy. Generally, mortgage lenders are the successful bidders at foreclosure sales.⁷⁰ Chapter 11 prevents undue concentration of real estate ownership into the hands of large financial institutions during economic downturns by facilitating reorganization and the debtor's retention of ownership.⁷¹ Moreover, some commentators contend that Chapter 11 allows the bankruptcy court to consider equitable, community, and other factors in ruling on a mortgage holder's relief from a stay motion.⁷² For example, a court might consider that

⁶⁹ Federal and state governments impose taxes on depreciation recapture and capital gains arising from loan foreclosures whether or not the loan is recourse. See, e.g., 26 U.S.C. §§ 1231, 1245, 1250 (1994 & Supp. V 1999). The concept of a nonrecourse loan in bankruptcy is described by the Supreme Court in *Johnson v. Home State Bank*, 501 U.S. 78, 86 (1991) (defining nonrecourse loans as "agreements where the creditor's only rights are against property of the debtor, and not against the debtor personally" (citation omitted)). Taxpayers who dispose of property subject to nonrecourse debt in excess of basis typically must pay tax on an amount of gain equal to the excess. See *Comm'r v. Tufts*, 461 U.S. 300, 317 (1983). For a thorough description of how real property foreclosures create taxable gains, see *Interhotel Co. v. Commissioner*, 81 T.C.M. (CCH) 1804 (T.C. 2001). See also Gregory M. Stein, *The Scope of the Borrower's Liability in a Nonrecourse Real Estate Loan*, 55 WASH. & LEE L. REV. 1207, 1220 (1998) (discussing the tax benefits to limited partners when their partnerships borrow on a nonrecourse basis rather than on a recourse basis).

⁷⁰ Basil H. Mattingly, *The Shift from Power to Process: A Functional Approach to Foreclosure Law*, 80 MARQ. L. REV. 77, 101 (1996) (stating that lenders rely on foreclosure "to control their collateral, to cut the borrower out of the title picture" because they "generally anticipate being the purchaser at foreclosure sales"). "Typically, lenders are the successful bidders at foreclosure sales. After buying the property the lenders take the property into their portfolios. . . . [T]hey [then] hire real estate agents to locate prospective purchasers." *Id.* at 101 n.104 (quoting Maury B. Poscover, *A Commercially Reasonable Sale Under Article 9: Commercial, Reasonable, and Fair to All Involved*, 28 LOY. L.A. L. REV. 235, 246 (1994)).

⁷¹ For example, during the 1980s, government regulators seized several savings and loan associations and forced most of them to simultaneously market and sell the real estate they owned. As a result, the market was flooded with real estate inventory and prices plummeted. See Goldberg, *supra* note 68, at 341 ("[P]rices declined further and the market became flooded with available real estate.").

⁷² See, e.g., Raymond T. Nimmer, *Real Estate Creditors and the Automatic Stay: A Study in Behavioral Economics*, 1983 ARIZ. ST. L.J. 281, 281 (1983). Nimmer writes:

A secured creditor who can remove the stay may gain a substantial economic benefit. Depending on the relationship between the secured collateral and the debtor's overall estate, denial or delay of foreclosure may be vital to ultimate completion of a plan for relief. . . . [Economic and financial] factors are not the only considerations that courts apply. . . . The result is a general balancing of equitable factors. . . . that is significantly more complex than the pure economic evaluation often suggested in the literature.

Id.; see also Karen Gross, *Taking Community Interests into Account in Bankruptcy: An Essay*, 72 WASH. U. L.Q. 1031 (1994) (arguing that courts should take community interests into account in bankruptcy).

"[m]any foreclosures occur in inner-city neighborhoods occupied by low-income groups . . . fac[ing] unemployment in an economic downturn . . . [and] are thus more likely to default on their mortgage loans and less able to avoid foreclosure."⁷³

It appears that these three arguments won out over law-and-economics arguments to the contrary. For reasons that were not apparent in congressional debates concerning the 2001 Amendment, neither Congress nor the mortgage holders embraced arguments to exclude SARE debtors from Chapter 11.⁷⁴ Perhaps they were aware that within the realm of economics (in opposition to the efficiency arguments identified at the beginning of this subpart), some commentators believe that Chapter 11 reorganization promotes allocative efficiency as compared with foreclosure under state law.⁷⁵ Or perhaps they accepted the above three arguments in response to the efficiency and common pool problems. State law foreclosure is more efficient than Chapter 11 under most market conditions. When real estate markets are turbulent, however, our experience with the Depression teaches us that state law foreclosure imperils both borrowers and lenders. Moreover, we should not forget that politicians are responsible for legislation. Many politicians consider issues of fairness and equity that generally fall outside the realm of allocative efficiency.⁷⁶ As identified above, these concerns could well support a political decision to allow SARE debtors access to Chapter 11. As discussed below, that is what the politicians did.

⁷³ Washburn, *supra* note 60, at 853.

⁷⁴ Some witnesses made arguments based on efficiency to urge repeal of the \$4 million cap, but not to support an outright ban on SARE debtors' access to Chapter 11. See *Bankruptcy Amendments of 1997; and Bankruptcy Law Technical Corrections Act of 1997: Hearing on H.R. 764 and H.R. 120 Before the Subcomm. on Commercial & Admin. Law of the House Comm. on the Judiciary*, 105th Cong. 106-09 (1997) [hereinafter *Bankruptcy Amendments Hearing*] (statement of Donald R. Ennis) (asserting that repeal of the \$4 million cap is necessary "to permit the efficient operation of the single asset provisions and the fulfillment of their purpose").

⁷⁵ Contrary to the argument that allocative efficiency requires strict foreclosure without redemption, economic data demonstrate that mortgagor protection laws "may indeed promote economic efficiency." Michael H. Schill, *An Economic Analysis of Mortgagor Protection Laws*, 77 VA. L. REV. 489, 491 (1991). According to Schill, "[V]iewed from an ex ante perspective, mortgagor protections may promote, rather than impede, economic efficiency by functioning as a form of insurance against the adverse effects of default and foreclosure." *Id.* at 538. This Article does not attempt to resolve which commentators are correct, whether state law foreclosure systems are preferable to Chapter 11, or which group has the burden of proof in evaluating comparative economic efficiencies. Rather, it is based on the assumption that Congress has adopted Chapter 11 as a federal alternative to state law foreclosure.

⁷⁶ See Kaplow & Shavell, *supra* note 67, at 1011 (arguing that economic analysis should give no weight to notions of fairness).

D. The Politics

Those interest groups that pushed for special treatment of SARE debtors could have instead called for their exclusion. Since arguments for the complete exclusion of two-party disputes were made at the time of both the 1994 and 2001 amendments, why did the lending industry not push for an outright exclusion of SARE cases from bankruptcy? Perhaps their lobbyists counseled against trying to overturn a federal policy that is over sixty years old. Alternatively, it is possible that mortgage holders wanted their borrowers, in some cases, to have access to Chapter 11.

In cases in which title to the property is clouded or the property contains toxic waste, for example, mortgage holders prefer to use the bankruptcy court to their own advantage.⁷⁷ Chapter 11 fully constrains the property owner's activities, and the property may be cleaned while the mortgage holder avoids any liability arising out of ownership resulting from foreclosure. By permitting property owners to reorganize under Chapter 11, mortgage holders get the best of both worlds.

However, the lenders' attraction to Chapter 11 is narrow: They want all of the benefits of bankruptcy and also control over the process. For example, they do not want the debtor to be able to restructure secured debt without the lender's consent. Moreover, lenders are not content to receive these benefits in small SARE cases; they want them in all SARE cases.⁷⁸ Thus, they influenced the National Bankruptcy Review Commission to make a recommendation to Con-

⁷⁷ Lenders may realize another subtle benefit of Chapter 11. Mortgage holders who do not want to foreclose on defaulted real properties may use the automatic stay of borrowers' Chapter 11 filings to accomplish that objective, even if the mortgage holders' government regulators would prefer immediate foreclosure. During a borrower's Chapter 11 case, the automatic stay legally prevents foreclosure unless the lender obtains relief from the stay. Lenders who do not want real estate assets on their books can fail to seek relief from the automatic stay or delay the process. See Sutherland, *supra* note 19, at 217 ("The mortgagee has ordinarily used every resource to encourage the debtor to keep up his interest and taxes, and comes to foreclosure only when the case is hopeless. The great lending institutions are reluctant to load themselves with foreclosed real estate . . .").

⁷⁸ See, e.g., *Bankruptcy Amendments Hearing*, *supra* note 74, at 118, 121–22 (statement of Jill M. Sturtevant, Assistant General Counsel, Bank of America) ("[The American Bankers Association] strongly supports the . . . provision . . . strik[ing] the \$4 million debt cap . . . contained in the definition [of] 'single asset real estate.'" (emphasis omitted)); *Oversight of the National Bankruptcy Review Commission Report: Hearing Before the Subcomm. on Admin. Oversight & the Courts of the S. Comm. on the Judiciary*, 105th Cong. (1997) (statement of John A. Gose) [hereinafter Gose Testimony] ("No rational correlation exists between the size of a single asset real estate bankruptcy and the complexity of that transaction. A cap, which presently exists in the Bankruptcy Code, is purely arbitrary."), at 1997 WL 659242.

gress to amend the law,⁷⁹ and they financed lobbyists to shepherd that amendment into law.⁸⁰

It is not surprising, therefore, that in passing the 2001 Amendment, Congress nominally retained access to Chapter 11 for SARE debtors while sharply reducing the meaningfulness of that access. The result is a proposed law that permits debtors access to Chapter 11, but under such tight time restrictions that, after ninety days, the debtor's functional ability to remain in Chapter 11 usually will be at the complete discretion of the mortgage holder. Moreover, unlike current law, the restrictive procedures of the 2001 Amendment would apply to single asset real property projects of all sizes without regard to the dollar amount of the mortgage. With this background, we are prepared to examine closely the 2001 Amendment as a prelude to determining whether Congress made the right choice in eliminating the cap.

II

THE 2001 AMENDMENT EXPLODES THE CAP

A. The Rationale for Congressional Action

The Bankruptcy Reform Act of 2001 proposes to abolish the \$4 million cap in the definition of SARE based on arguments made at congressional hearings that a one-size reorganization procedure could fit all SARE bankruptcy cases.⁸¹ It is the author's experience that lob-

⁷⁹ At the instigation of the author, a majority of the bankruptcy commissioners also supported an alternative recommendation that would have raised the SARE cap but not eliminated it. See 1 NAT'L BANKR. REVIEW COMM., *supra* note 57, at 684.

⁸⁰ See, e.g., *Bankruptcy Reform Act of 1999 (Part II): Hearing on H.R. 833 Before the Subcomm. on Commercial & Admin. Law of the House Comm. on the Judiciary*, 106th Cong. 5-14 (1999) (statement of George J. Wallace, on behalf of the Consumer Bankruptcy Reform Coalition); *Bankruptcy Reform Act of 1998 Part I: Hearing on H.R. 3150 Before the Subcomm. on Commercial & Admin. Law of the House Comm. on the Judiciary*, 105th Cong. 25-28, 38-40 (1998) (statement of Lloyd N. Cutler, on behalf of the Bankruptcy Issues Council); *Bankruptcy Reform Act of 1998; Responsible Borrower Protection Act; and Consumer Lenders and Borrowers Bankruptcy Accountability Act of 1998 Part II: Hearing on H.R. 3150, H.R. 2500, and H.R. 3146 Before the Subcomm. on Commercial & Admin. Law of the House Comm. on the Judiciary*, 105th Cong. 56-63 (1998) (statement of George J. Wallace, on behalf of the American Financial Services Association).

⁸¹ See sources cited *supra* note 78 and accompanying text. One congressman characterized the repeal of the \$4 million cap as necessary to cure an "injustice" stemming "from a last-minute decision that was made in the 103rd Congress, which placed an arbitrary \$4 million ceiling on the single asset provisions of the bankruptcy reform bill. The effect has been to render investors helpless in foreclosure on single assets valued at over \$4 million." See 145 CONG. REC. H2713 (daily ed. May 5, 1999) (statement of Rep. Knollenberg). Inexplicably, in the pending Bankruptcy Reform Act of 2001, Congress adopted exactly the opposite rationale in expanding the debt threshold from \$2 million to \$3 million in the definition of small business debtors for the purpose of segregating small businesses from larger businesses. See Bankruptcy Reform Act of 2001, H.R. 333, 107th Cong. § 432(a) (2001) (proposing to amend the definition of "small business debtor" in § 101(51)(D) of the Bankruptcy Code to cover businesses that have "aggregate noncontingent, liquidated

byists for lenders convinced Congress that a real estate case is a real estate case, whether it is an apartment house or the Waldorf Astoria Hotel.⁸² Some witnesses told Congress that it should repeal the \$4 million cap because large properties have the same maintenance, tax, and recapitalization problems as small properties.⁸³ They also stated that repeal of the \$4 million cap was necessary "to permit the efficient operation of the single asset provisions and the fulfillment of their purpose."⁸⁴ Other witnesses and commentators took the position that some form of a cap was appropriate, but had no hard data to support their claims.⁸⁵ Although a few witnesses suggested banning SARE cases from Chapter 11 altogether, others said Chapter 11 played an important role in SARE cases.

Some witnesses unsuccessfully argued in support of retaining the \$4 million cap and treating large SARE debtors the same as other Chapter 11 debtors.⁸⁶ They argued that separate treatment of all SARE debtors from other debtors would induce lenders to force borrowers to incur transaction costs to form new single asset entities in order to finance each property, even if the same real party in interest owned the properties. Thus, if a manufacturer seeks financing for construction of a \$50 million plant, a rational lender will require the manufacturer to form a single asset company to hold title to the real estate and become the borrower. The lender may force the manufacturer to guarantee the debt. As a result, the manufacturer will not avoid liability on the loan, and will incur the transaction costs of forming the single asset company and maintaining separate tax, accounting, and legal records. Moreover, in the event of insolvency of several

secured and unsecured debts . . . in an amount not more than \$3,000,000"), available at <http://thomas.loc.gov>; Bankruptcy Reform Act of 2001, S. 420, 107th Cong. § 432(a) (2001) (same), available at <http://thomas.loc.gov>.

⁸² See *In re Penn Cent. Transp. Co.*, 354 F. Supp. 717 (E.D. Pa. 1972). After the 2001 Amendment, if the ground leased was real property held by a SARE debtor, 11 U.S.C. § 362(d)(3) would apply.

⁸³ See sources cited *supra* note 78.

⁸⁴ *Bankruptcy Amendments Hearing*, *supra* note 74, at 107 (statement of Donald R. Ennis).

⁸⁵ See, e.g., *id.* at 46 (statement of Kenneth N. Klee, Chairman, Committee on Legislation, National Bankruptcy Conference) ("I would have to think a \$10 million limit would bring in the lion's share of the projects . . ."); Lawrence Ponoroff, *The Dubious Role of Precedent in the Quest for First Principles in the Reform of the Bankruptcy Code: Some Lessons from the Civil Law and Realist Traditions*, 74 AM. BANKR. L.J. 173, 195 (2000) ("Wisely, until now, the definition of 'single asset real estate' has been limited to debtors with below a certain maximum level of secured debt . . ."). After the congressional hearings, Professors Warren and Westbrook analyzed hard data and concluded that the \$4 million cap already covers 72% of the SARE cases and raising the cap to \$15 million would capture 94% of the cases. See Elizabeth Warren & Jay Lawrence Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L.J. 499, 542-43 (1999).

⁸⁶ See, e.g., *Bankruptcy Amendments Hearing*, *supra* note 74, at 37, 46 (statement and testimony of Kenneth N. Klee, Chairman, Committee on Legislation, National Bankruptcy Conference).

related projects, instead of the manufacturer filing for bankruptcy for one company that owns several properties, the manufacturer will file a separate bankruptcy petition for each company that holds a troubled project, thereby paying multiple filing fees and incurring the costs of multiple bankruptcy administrations.⁸⁷

In this light, it is reasonable to question why Congress abandoned the line it drew in 1994. Was the change occasioned by lobbying pressure from secured lenders, or did circumstances change after 1994? Was Congress wrong in enacting the cap in the first place in 1994? Certainly the shared experience that led Congress to adopt the \$4 million cap in 1994 suggested that the group of larger SARE cases had more complex debt structures, greater capacity to service Chapter 11 administrative expenses, and a greater likelihood of confirming a plan.⁸⁸ That is why Congress enacted special rules only for smaller SARE debtors. Anecdotal testimony led Congress to believe that smaller debtors, for the most part, had simple debt structures, little capacity to service Chapter 11 administrative expenses, and no reasonable likelihood of confirming a plan. For the small SARE debtors, it made sense for Congress to pretermite the Chapter 11 process.

The same was not true, however, for larger SARE debtors in 1994, and it remains untrue in 2002. If there is a reasonable likelihood that, as a group, large SARE debtors will be able to confirm Chapter 11 plans, what rationale justifies subjecting these debtors to the strictures of § 362(d)(3) of the Bankruptcy Code? Indeed, if the data show that most large SARE cases have a reasonable possibility of confirming a Chapter 11 plan, it makes more sense for Congress to raise the \$4 million cap to a specific dollar sum than to abandon it altogether. Perhaps Congress believed that if the cap functioned well for small SARE debtors, it should extend it to all SARE debtors.

⁸⁷ This strategic behavior certainly is one downside of the pending Bankruptcy Reform Act of 2001, which allows lenders to opt out of the regular Chapter 11 rules by requiring borrowers to compartmentalize real property assets. Another theoretical by-product of the proposed Act is that it should reduce monitoring by unsecured creditors. Unsecured creditors will not likely pay attention to SARE cases if secured lenders will dominate and quickly foreclose or receive assets as interest payments. In the author's experience, however, unsecured creditors seldom monitored SARE cases even before the Act was proposed, because they had little at stake individually.

⁸⁸ See, e.g., Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a "Race to the Bottom"*, 54 VAND. L. REV. 231, 256 (2001) (showing an extremely high confirmation rate for large public companies from 1989 until 1997); Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597, 600 (1993) (reporting a 96% confirmation rate for large, public companies).

B. Predicted Effects of Blowing Up the Cap

Whether or not Congress justifiably proposed to explode the \$4 million cap, if the proposal becomes law, parties in SARE cases will have to adapt to those changes. The new reality for large SARE debtors will be that they will be subject to lenders' threats to bring, and actually file, motions for relief from the automatic stay under § 362(d)(3). How will this change in leverage affect the way Chapter 11 functions for large SARE debtors? Certainly it will be unreasonable for many large SARE debtors to file a plan within ninety days after the order for relief. To be sure, the court can extend this time for "cause,"⁸⁹ but why should the large SARE debtor have to bear the cost, burden, and uncertainty of bringing such a motion? The cost of bringing a motion is inevitable and not recoupable. The burden of proving the "cause" for an extension is on the large SARE debtor, unlike all the other large debtors who have a minimum 120-day exclusivity period within which to file a plan and do not face automatic foreclosure if they fail to file within that period. The uncertainty about whether the judge will grant the extension motion is obvious. Many judges have displayed open hostility toward SARE debtors.⁹⁰

Of course, the debtor has the theoretical option of commencing payments to the mortgage holder. But many SARE debtors are illiquid.⁹¹ The SARE debtor might be cash poor because the debtor has not completed the real estate project, because the debtor needs money for repairs, maintenance, or renovation, or because a down market has created large vacancy rates. Moreover, in most SARE cases, the mortgage holder has a lien on the rents.⁹² Under current

⁸⁹ See sources cited *supra* note 9.

⁹⁰ Generally, judicial hostility is evident when a judge characterizes the SARE debtor as having filed its bankruptcy petition "in bad faith." See, e.g., *Pac. First Bank ex rel. R.T. Capital Corp. v. Boulders on the River, Inc.* (*In re Boulders on the River, Inc.*), 164 B.R. 99, 103 (B.A.P. 9th Cir. 1994) ("Bad faith exists if there is no realistic possibility of reorganization and the debtor seeks merely to delay or frustrate efforts of secured creditors."); *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.* (*In re Timbers of Inwood Forest Assocs., Ltd.*), 808 F.2d 363, 384 (5th Cir. 1987) ("To the extent that the debtor in bankruptcy can prevent the secured creditor from enforcing its rights against collateral while the debtor benefits from the creditor's money, the debtor and his unsecured creditors receive a windfall at the expense of the secured creditor."), *aff'd*, 484 U.S. 365 (1988). Courts often dismiss debtors' Chapter 11 petitions when they are filed in "bad faith." See, e.g., *Albany Partners, Ltd. v. Westbrook* (*In re Albany Partners, Ltd.*), 749 F.2d 670, 676 (11th Cir. 1984) (affirming a lower court's annulment of a stay); *Singer Furniture Acquisition Corp. v. SSMC Inc. N.V.*, 254 B.R. 46, 60 (M.D. Fla. 2000); see also *In re Pac. Rim Invs., LLP*, 243 B.R. 768, 773 (D. Colo. 2000) (rejecting "the argument that the ability to reorganize precludes dismissal for bad faith.").

⁹¹ See LoPucki, *supra* note 58, at 100; sources cited *supra* note 36.

⁹² In some SARE cases, the mortgage holder has an "absolute assignment" of the rents whereby the mortgage holder owns the rents until the mortgage is paid. See, e.g., *Great W. Life Assurance Co. v. Rothman* (*In re Ventura-Louise Props.*), 490 F.2d 1141, 1143-44 (9th Cir. 1974) ("[A]n agreement can provide for an absolute assignment of rents upon default.

law, mortgage holders have persuaded some courts that rents are additional collateral that the law must protect separately, and that they are unavailable to protect a mortgage holder's lien on a real property project.⁹³ One beneficial provision of the proposed Bankruptcy Reform Act of 2001 makes rents available to satisfy the debtor's payment obligation under § 362(d)(3) of the Bankruptcy Code.⁹⁴ But in many cases, the net rents will be insufficient to service the debtor's payment

'It has been held that such a provision, rather than pledging the rents as additional security, operates to transfer to the mortgagee, the mortgagor's right to the rentals upon the happening of a specified condition.'" (quoting *Kinnison v. Guar. Liquidating Corp.*, 115 P.2d 450, 453 (Cal. 1941)). Although beyond the scope of this Article, discussion of rents has created a large body of literature. Not less than sixty-four law review articles contain the word "rents" in their titles. Of these, no fewer than seventeen also mention *In re Ventura-Louise*. See, e.g., David Gray Carlson, *Rents in Bankruptcy*, 46 S.C. L. REV. 1075, 1104 (1995) (discussing *In re Ventura-Louise* for the proposition that judges routinely authorize forfeitures upon default and allow secured parties to collect rent); Julia Patterson Forrester, *A Uniform and More Rational Approach to Rents as Security for the Mortgage Loan*, 46 RUTGERS L. REV. 349, 379-82 (1993) (discussing the trend in the treatment of absolute assignment of rents cases); Patrick A. Randolph, Jr., *When Should Bankruptcy Courts Recognize Lenders' Rents Interests?*, 23 U.C. DAVIS L. REV. 833, 841-45 (1990) (discussing the conditional present assignment theory as adopted in *In re Ventura-Louise*); John C. Siemers, *The Mortgagee's Lien Against Rents*, 25 TEX. TECH L. REV. 873, 892 n.70 (1994) (acknowledging *In re Ventura-Louise* in a footnote); Joanne N. Davies, Note, *FNMA v. Bugna: California Assignment of Rents Provision and the Impact of the Bankruptcy Reform Act of 1994*, 31 LOY. L.A. L. REV. 1453, 1466 (1998) (discussing the "contradictory and confusing" case law surrounding the protection of a lender's security interest in postpetition rents); Sandra Elzerman, Comment, *Interests in Collaterally Assigned Rents and Profits Under the Bankruptcy Code*, 22 HOUS. L. REV. 1251, 1265 n.101 (1985) (acknowledging *In re Ventura-Louise* in a footnote).

⁹³ See, e.g., *In re* 499 W. Warren St. Assocs., Ltd. P'ship, 142 B.R. 53, 56 (Bankr. N.D.N.Y. 1992) (stating that "a secured creditor holding both a mortgage securing a debt on a parcel of real property, and a perfected security interest in rents derived therefrom, holds two distinct interests," and discussing cases laying out the contours of this approach); see also *John Hancock Mut. Life Ins. Co. v. Madera Farms P'ship* (*In re* Madera Farms P'ship), 66 B.R. 100, 103 (B.A.P. 9th Cir. 1986) ("It is clear that the rents are additional collateral."); *In re* Landing Assocs., Ltd., 122 B.R. 288, 296 (Bankr. W.D. Tex. 1990) (considering the value of the mortgage securing a debt on a parcel of land as separate from the security interest in the rents derived from it); *Mortgage Guarantee Co. v. Sampsell*, 124 P.2d 353, 356 (Cal. Ct. App. 1942) ("There can be no question but that the assignment of rentals in the deed of trust constituted additional primary security with the real property described in the deed of trust and the personal property described in the chattel mortgage." (citation omitted)).

⁹⁴ See Bankruptcy Reform Act of 2001, H.R. 333, 107th Cong., § 444(2) (2001); Bankruptcy Reform Act of 2001, S. 420, 107th Cong., § 444(2) (2001). Section 444(2) would amend 11 U.S.C. § 362(d)(3)(B) to preclude relief from the stay under § 362(d)(3) if:

(B) the debtor has commenced monthly payments that—

- (i) may, in the debtor's sole discretion, notwithstanding section 363(c)(2), be made from rents or other income generated before or after the commencement of the case by or from the property to each creditor whose claim is secured by such real estate (other than a claim secured by a judgment lien or by an unmatured statutory lien); and
- (ii) are in an amount equal to interest at the then applicable nondefault contract rate of interest on the value of the creditor's interest in the real estate; . . .

H.R. 333, § 444(2); S. 420, § 444(2).

obligation in full. Thus, in many SARE cases, the debtor's option to commence making payments will be unrealistic.

If the debtor cannot file a confirmable plan within the fast track of § 362(d)(3), commence making payments to the mortgage holder, or persuade the court to grant an extension of time, then the mortgage holder is effectively in complete control of the Chapter 11 process. If the property has a feature, for example environmental waste, such that the mortgage holder might benefit by leaving the property in Chapter 11, the mortgage holder can grant an extension of time or fail to foreclose following relief from the stay. Alternatively, if the borrower faces tax problems in the event of foreclosure, the lender can threaten foreclosure to extract a contribution of new equity into the project to reinstate the loan and restore it to a performing asset on the lender's books. On the other hand, if the property has potential upside and the mortgage holder desires to capture this upside for its own benefit, then the mortgage holder gets relief from the automatic stay and the right to foreclose on the property. In essence, the Chapter 11 case is over. Although this might be good news for the mortgage holder, it is bad news for the property owner who loses the opportunity to reorganize.

III

DATA FROM SARE CHAPTER 11 CASES

A. Methodology

Talk is cheap. It is easy to criticize Congress for failing to develop data concerning the operation of SARE cases before it proposed significant changes, but it is much harder to develop those data than to criticize Congress for failing to do so. This is especially true for scholars and others who work with limited access to the underlying data and limited means to fund the needed research. Given the importance of bankruptcy law and the constitutional requirement that any federal bankruptcy law be uniform,⁹⁵ it is astounding that Congress has not developed better bankruptcy data on which to base its legislative decisions. For example, there is no national database of bankruptcy court records; bankruptcy courts compile and store their records locally. Furthermore, the Administrative Office of the U.S. Courts does not collect separately-recorded data on SARE cases. This means that the resources necessary to draw a national sample of SARE cases would be beyond the reach of a single researcher.

Faced with the prospect of cursing the darkness or lighting a very small candle, however, I decided to study what I could. I drew two samples of data: The first was a national sample of all reported SARE

⁹⁵ See U.S. CONST. art. I, § 8, cl. 4.

decisions augmented by data on unreported SARE cases sent to me by lawyers in response to a questionnaire. The second extracted SARE data from the files of all Chapter 11 cases administered by a single bankruptcy judge in Los Angeles. I refer to the first sample as the "National" data set and the second sample as the "L.A." data set. I also combined the National and L.A. data sets into a "Combined" data set.

I began this research by collecting every published bankruptcy court opinion dealing with a SARE Chapter 11 case under the Bankruptcy Code, despite the shortcomings of such a database. Published opinions may be grist for law school classes, but they are not random samples of all the cases decided. Indeed, the fact that an opinion is published is a fair indication that something is aberrational in the case. This defect afflicts any study of published opinions, although in the bankruptcy area it is ameliorated by the fact that trial courts—not just appellate courts—publish their decisions. That difference makes a database drawn from bankruptcy court opinions somewhat closer to a representative sample and the underlying reality, although the cases in which there was a sufficient dispute to prompt a published opinion are obviously somewhat different from a perfect cross-section of all the underlying cases. The cases that result in a written opinion may involve more money, more contentious creditors, or more aggressive lawyers. Despite these limitations, however, a database consisting of all published SARE cases, dominated by cases from the bankruptcy trial courts themselves, can shed some light on the operation of real estate Chapter 11 cases.

Therefore, in order to test the reasonableness of abolishing the \$4 million cap, I studied every reported SARE Chapter 11 case from October 1, 1979 through December 31, 1997 to extract the following data, among others:⁹⁶

⁹⁶ Because I am not recommending a specific debt limit for Congress to adopt, I did not develop a specific dollar value or adjust debts and property values for the data set to constant dollars for a specific base year. My hypothesis is that adjusting the data over time is an appropriate fine-tuning of my methodology, but unnecessary to support the trends identified in this Article. To make certain, however, that the data are not distorted by inflationary differences, the debts and property values were recomputed using an inflation adjustment based on the year of the bankruptcy filing. It is possible, of course, that the mortgage debt or property valuation was made a year or two after the filing, but this adjustment helps to eliminate most of the inflationary effects. Of the forty-five cases in the National data set, only thirty-two have information on the year in which the Chapter 11 petition was filed. It appears, however, that most of the remaining thirteen cases were filed between 1987 and 1993. I used 1990 as a proxy-valuation year for these data and used actual filing years for the thirty-two cases in which I had filing data. I adjusted the values using the Consumer Price Index, and re-ran the regression. The resulting Nagelkerke R^2 (*see infra* note 154) is very similar (.44) compared with the pre-adjustment Nagelkerke R^2 (.42): the coefficients are almost identical, and the significance levels improve. The p -value for property value is .0043 (compared with <.01) and for the value-to-loan ratio is .0184. In sum, inflation does not appear to have a measurable effect on the statistical analysis.

- type of property;
- valuation range of the property;
- whether there was an out-of-court settlement, cram down, or consensual plan;
- whether maintenance and taxes were current pre-workout or prepetition;
- the terms of the senior and any junior indebtedness pre- and post-restructuring or plan confirmation; and
- any treatment of the old equity under the plan.

In total, the database contains sixteen categories of information pertaining to various factual aspects of the cases.

To gather some information about a cross-section of SARE cases that did not result in a published opinion, I developed and circulated a questionnaire to 302 bankruptcy lawyers. Of the bankruptcy specialists selected, I chose ninety based on my own experience and 212 from a bar association's membership list.⁹⁷ The questionnaire asked each lawyer to provide the same kinds of information on all SARE cases in which they participated since October 1, 1979.⁹⁸ As described below, this permitted expansion of the initial thirty usable cases⁹⁹ in the database by another fifteen cases.¹⁰⁰

Many of the reported decisions and a few of the questionnaires did not contain complete data in every category. To fill gaps in the data, I asked attorneys involved in the cases to provide additional information.¹⁰¹ The database included 152 cases with sufficiently complete information for an extended analysis. Those 152 cases included 120 bankruptcy court decisions, thirteen appellate court decisions, and nineteen cases generated from the questionnaires, representing

⁹⁷ Specifically, I sent eighty-nine letters on February 5, 1998, fifty-three letters on April 9, 1998, sixty-four letters on April 16, 1998, and ninety-five letters on April 28, 1998 to bankruptcy specialists known to me and to members of the ABA Business Bankruptcy Committee. I also sent one specialist the questionnaire via e-mail. In response, I received questionnaires describing sixteen SARE cases. The response rate is low probably due to the time and expense required of respondents to assemble the requested information.

⁹⁸ I extracted the data from the case law and questionnaires and entered it into a Microsoft Excel spreadsheet. I have reproduced a sample questionnaire *infra* in Appendix B.

⁹⁹ I define the term "usable case" to mean a case with sufficiently complete information for an extended statistical analysis.

¹⁰⁰ It is possible that the low response rate producing these fifteen cases could lead to sample bias. Confirmation rates for these cases are significantly higher than the reported decisions. This disparity may reflect a judicial bias to write and publish opinions denying confirmation, or it may reflect a bias on the part of attorneys in submitting data on confirmed cases in response to my questionnaire. Additional research would be necessary to resolve these issues.

¹⁰¹ I used printed versions of each published case listed in the database. It was necessary to read the case, highlight the pertinent information, and then transfer it to the database. I have retained for the file these marked-up versions that contained data included in the study.

unpublished cases. Many of the 152 entries in the database, however, involved the same SARE reorganization case due to multiple-reported decisions on the same property by the bankruptcy and appellate courts. I deleted duplicate entries from the database, but augmented individual entries on particular SARE projects with data derived from related reports.¹⁰² The resulting National data set comprised forty-five usable cases. Because of the relatively small number of observations in the data set and the lack of randomness in the sample selection, I developed another database to test the robustness of my findings.

While I was collecting my initial database on SARE cases, a unique opportunity to examine detailed court records came my way. When Judge Lisa Hill Fenning decided to leave the bench in February 2000, she gave me nine boxes of court documents she had collected on her cases in the Bankruptcy Court for the Central District of California. Judge Fenning had compiled files on each business bankruptcy case over which she had presided from 1987 through 1995 during her tenure on the bench. She collected case files on all kinds of Chapter 11 cases she had heard, not only on the handful for which she wrote published opinions.

A few words about her cases are in order. First, Chapter 11 case assignment in the Bankruptcy Court for the Central District of California is random; SARE cases were only remotely assigned to a particular judge. Thus, all judges presumably had an equal likelihood of hearing a SARE case. Although it is one of ninety-four judicial districts around the country and its territories, through the mid-1990s the Central District of California was the largest in terms of number of Chapter 11 business bankruptcy cases filed.¹⁰³ From 1987 through 1995,

¹⁰² None of the cases included in the database involved repeat filings in which the same debtor or project was in Chapter 11 on more than one occasion. Some commentators view continuation of the business or the lack of a repeat filing as an essential measure of success. 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, 106–08 (1983) (defining the survival of a business as a measure of success). For purposes of this Article, however, I measured the initial confirmation of a Chapter 11 plan without regard to repeat filings. This is the goal Congress has established for Chapter 11 cases. The Bankruptcy Code permits a court to confirm a Chapter 11 plan based on a reasonable likelihood, rather than certainty or a strong probability, that confirmation will not precede liquidation or further financial reorganization of the debtor. See 11 U.S.C. § 1129(a)(11) (2000).

¹⁰³ See, e.g., THE 1993 BANKRUPTCY YEARBOOK & ALMANAC 14–16 (Christopher M. McHugh ed., 3d ed. 1993) (showing that Chapter 11 business case filings in the Bankruptcy Court for the Central District of California constituted about 9% of all Chapter 11 business cases filed nationally). Based on data compiled by the Administrative Office of the U.S. Courts, during 1987–1995, the Central District of California was the venue for 12,088 Chapter 11 business bankruptcy cases, representing 8.18% of the 147,849 business bankruptcy Chapter 11 cases filed nationwide during those years. The next largest district was the Southern District of New York, which hosted 7,471 or 5.05% of the business bankruptcy Chapter 11 cases. See ADMIN. SERV. OF THE U.S. COURTS, 1995 JUDICIAL BUSINESS OF

12,088 Chapter 11 business cases were filed in the Bankruptcy Court for the Central District of California, constituting over 8% of all business bankruptcy cases filed nationally.¹⁰⁴ Although it is not possible to say whether Judge Fenning's cases were a representative cross-section of cases filed across the country, her cases represent a sample of one of the most active bankruptcy courts in the country. Furthermore, even though these cases reflect the administration of only one judge in only one district, they provided a cross-check against which I tested my findings from my initial broader-based data set.

I extracted every SARE Chapter 11 case from Judge Fenning's boxes. In some instances, the case file documents were incomplete or merely face-page filings with no supporting data; however, there were far more records of SARE cases than appeared in reported opinions. Fortunately, many of the SARE cases had detailed records. The documents typically included bankruptcy petitions, schedules, and statements of financial affairs. If the case resulted in a confirmed plan, I also extracted data from that document.

I extracted only those SARE cases with sufficient information to identify and research the matter further. Where the data were incomplete, in order to expand the usefulness of these data, I reviewed each complete case file and recorded additional information pertinent to the study. I extracted the values in my L.A. database from the debtor's bankruptcy petition, schedules, and statement of financial affairs, all of which were filed under penalty of perjury. If the debtor amended the schedules, I used the amended values. When there was an undisputed and a better source of information in the case file than the data provided in the schedules, I included that source in the L.A. database. Examples of better sources included undisputed appraisals of real property value, undisputed declarations of creditors detailing indebtedness and arrearages, Internal Revenue Service statements of tax arrearages, and court findings.

THE UNITED STATES COURTS—1995 REPORT OF THE DIRECTOR 268 tbl.F-2 (1995); ADMIN. SERV. OF THE U.S. COURTS, JUDICIAL BUSINESS OF THE UNITED STATES COURTS, at A1-186 tbl.F-2 (1994); ADMIN. SERV. OF THE U.S. COURTS, 1993 JUDICIAL BUSINESS OF THE UNITED STATES COURTS—ANNUAL REPORT OF THE DIRECTOR, at A1-190 tbl.F-2 (1993); ADMIN. SERV. OF THE U.S. COURTS, 1992 ANNUAL REPORT OF THE DIRECTOR—ACTIVITIES OF THE ADMINISTRATIVE OFFICE: JUDICIAL BUSINESS OF THE UNITED STATES COURTS 316 tbl.F-2 (1992); ADMIN. SERV. OF THE U.S. COURTS, 1991 ANNUAL REPORT OF THE DIRECTOR—ACTIVITIES OF THE ADMINISTRATIVE OFFICE: JUDICIAL BUSINESS OF THE UNITED STATES COURTS 296 tbl.F-2 (1991); ADMIN. SERV. OF THE U.S. COURTS, ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS 240 tbl.F-2 (1990); ADMIN. SERV. OF THE U.S. COURTS, ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS 362 tbl.F-2 (1989); ADMIN. SERV. OF THE U.S. COURTS, ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS 364 tbl.F-2 (1988); ADMIN. SERV. OF THE U.S. COURTS, ANNUAL REPORT OF THE DIRECTOR OF THE ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS 351 tbl.F-2 (1987).

¹⁰⁴ See sources cited *supra* note 103.

The L.A. database yielded eighty-three single asset bankruptcy cases that contained twenty-three submitted plans of reorganization. Of the twenty-three submitted plans, the bankruptcy court confirmed thirteen of them. The two databases—one comprising national reported decisions and lawyer reports and a second comprising the Los Angeles cases—offer two approaches to understanding SARE cases. I also combined the databases to conduct additional analysis, but focused primarily on the National data set to avoid allegations that including the L.A. data set in the sample would result in improper distortion.¹⁰⁵ Both the National and L.A. data sets include cases filed after the effective date of the 1994 amendments. Although it is possible that the 1994 amendments caused a higher percentage of small cases to fail to confirm plans, I did not segregate the data to test this hypothesis. I chose to use the National data set to test my hypotheses initially and the L.A. and Combined data sets to test the robustness of my findings.

B. The Findings

The overriding question concerning SARE cases is whether the game is worth the candle; does the debtor's opportunity to reorganize bear fruit or does it simply impose cost and delay on the mortgage holder as some law-and-economics theorists suggest? The answer to this question necessarily sets the parameters for every other discussion about the SARE process.

To answer this question, I analyzed the data to determine the frequency with which SARE debtors confirmed Chapter 11 plans.¹⁰⁶ Out of the forty-five cases in the National database, seventeen debtors (38%) confirmed plans. Some plans resulted in restructuring the secured debt while the debtor retained ownership of the property. Other plans resulted in the sale of the property. Still others were hybrid plans; the debtor retained the property for a specified time while committing to sell it or permit foreclosure if it did not repay the mortgage holder's restructured debt within that time.

When Congress enacted Chapter 11, it noted that "[t]he purpose of [a] reorganization . . . case is to formulate and have confirmed a plan of reorganization . . . for the debtor."¹⁰⁷ Although confirmation

¹⁰⁵ The author knows of no reason why Judge Fenning would treat SARE cases in Los Angeles any differently than would bankruptcy judges in other judicial districts.

¹⁰⁶ Previous studies have analyzed the success that real property debtors had in liquidating properties and concluded that only one in seven (about 14%) were successful. See LoPucki, *supra* note 102, at 109 & nn.47-49; see also Jerome R. Kerkman, *The Debtor in Full Control: A Case for Adoption of the Trustee System*, 70 MARQ. L. REV. 159, 167 (1987) (finding that "in Kansas City and Milwaukee . . . 74% and 76%, respectively, of the operating businesses entering Chapter 11 proceedings were destined to fail" (footnotes omitted)).

¹⁰⁷ H.R. REP. NO. 95-595, at 221 (1977), reprinted in 1978 U.S.C.C.A.N. 5963, 6180.

of a SARE plan is not a foolproof surrogate for positive social value,¹⁰⁸ it is the recognized hallmark of a successful Chapter 11 case,¹⁰⁹ even if some commentators regard it as underinclusive¹¹⁰ or overinclusive¹¹¹

¹⁰⁸ See, e.g., Douglas G. Baird, *Bankruptcy's Uncontested Axioms*, 108 YALE L.J. 573, 584 (1998) ("Chapter 11 cannot be judged merely by counting the number of firms that reorganize successfully. . . . [T]he rehabilitation goal must be balanced against other interests, including the need to recognize the rights of creditors.").

¹⁰⁹ See, e.g., Samuel L. Bufford, *Chapter 11 Case Management and Delay Reduction: An Empirical Study*, 4 AM. BANKR. INST. L. REV. 85, 103 (1996) ("The traditionally recognized purpose of filing a chapter 11 case is to reorganize the finances of the debtor by means of a chapter 11 plan."); *id.* at 103 n.82 ("By the traditional measure, the confirmation of a chapter 11 plan constitutes success under chapter 11."); LoPucki & Whitford, *supra* note 88, at 599 ("Bankruptcy lawyers and commentators sometimes consider a reorganization case to be successful if a plan of reorganization has been confirmed."); David P. Bart & Scott Peltz, *Rethinking the Concept of "Success" in Bankruptcy and Corporate Recovery*, AM. BANKR. INST. J. (Am. Bankr. Inst., Wash. D.C.), May 1998, at 1, 37 ("The emerging data suggests a far greater chance of 'success,' as narrowly defined by chapter 11 confirmations, than was suggested in previous studies."); Lisa Hill Fenning, *Mediation, Not Litigation*, AM. BANKR. INST. J. (Am. Bankr. Inst., Wash. D.C.), July/Aug. 1996, at 35, 36 ("Success in chapter 11 is . . . typically defined as a confirmed consensual plan of reorganization."). Moreover, both Congress and the Supreme Court have adopted triggers within Chapter 11 based on the reasonable likelihood that a court will confirm a Chapter 11 plan within a reasonable time. See 11 U.S.C. § 362(d)(2)-(3) (2000); *United Sav. Ass'n v. Timbers of Inwood Forest Assocs., Ltd.*, 484 U.S. 365, 376 (1988).

¹¹⁰ Judge Bufford is among these commentators. In his 1994 article, he writes:

There is a basic misconception about the success rate of Chapter 11 cases . . . [because of] a perversely narrow view of the nature of Chapter 11 success.

Defining success in Chapter 11 requires much more analysis and debate than it has heretofore received. As a first approximation, I propose that success be defined as the achievement of the results sought, or the avoidance of the results unwanted, by the debtor at the time of filing. For example, the debtor may want to sell the business, because the debtor cannot make it profitable. After the filing, a sale is arranged and the case is dismissed. Alternatively, the debtor may be attempting to avoid foreclosure by the principal secured creditor on the principal real estate asset in the bankruptcy estate. The loan is restructured, or a sale is arranged to a better-financed purchaser, and the case is dismissed.

Results of this kind are common in Chapter 11 cases, and frequently occur in single-asset real estate cases, even though they do not comply with bankruptcy theory. However, such cases are all excluded from the tally of successful Chapter 11 cases, according to the conventional counting method.

The real success rate for Chapter 11 cases is probably in the range of 40%. This estimate is based on my experience with nearly 2000 Chapter 11 cases that have been on my docket: no data have been collected on this subject.

Bufford, *supra* note 63, at 833-34 (footnotes omitted); see also Warren, *supra* note 36, at 377 (noting that a high proportion of Chapter 11 case liquidations does not indicate that the bankruptcy system is failing).

¹¹¹ Some commentators contend that "success" should only apply to those cases in which the debtor obtained confirmation of a plan and continued in business. See, e.g., LoPucki, *supra* note 102, at 107 ("[T]he term 'success' will be applied only to proceedings in which the debtor both obtained confirmation of a plan and was able to continue in business . . ."); LoPucki & Whitford, *supra* note 88, at 600 ("One measure of this kind of success is whether the surviving entity remained out of bankruptcy after confirmation.").

of all successful Chapter 11 cases. These commentators might contend that my data counts many failures as successes if the refiling rate is high for the SARE debtors in my data sets.¹¹² Other commentators might counter that the Bankruptcy Code favors confirmation of a plan and does not condemn refilings such that the refiling data are peripheral to my study.¹¹³ This Article does not engage in the debate over defining “success” in Chapter 11 bankruptcies. Instead, it measures confirmation of plans in Chapter 11, which is the benchmark adopted by Congress.

Most Chapter 11 debtors file for relief under Chapter 11 with the objective of confirming a Chapter 11 plan. A confirmed plan can restructure secured and unsecured indebtedness, provide for sale or rehabilitation of the property, or permit the secured lender to foreclose. The outcome is usually consensual, reflecting the will of the parties to preserve value for each particular SARE project. Occasionally, the parties cannot agree on a consensual plan and the court grants the mortgage holder’s request for relief from a stay,¹¹⁴ dismisses the case, or converts it to a Chapter 7 case.¹¹⁵ Very rarely, the court confirms a “cramdown” plan over the dissent of the mortgage holder following a determination that the plan is “fair and equitable.”¹¹⁶ For the most part, the universe of SARE cases with confirmed Chapter 11 plans will reflect a conservative measure of success.¹¹⁷

Thus, these commentators would exclude liquidating plans or plans that result in the debtor refiling for bankruptcy from the category of successful Chapter 11 cases.

¹¹² See LoPucki & Kalin, *supra* note 88, at 235 (“Refiling constitutes a failure of the bankruptcy process.”).

¹¹³ See Robert K. Rasmussen & Randall S. Thomas, *Whither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations*, 54 VAND. L. REV. 283, 293–95 (2001) (arguing that the Bankruptcy Code does not condemn refilings and that they are not costly). See generally *What Other Scholars Think of the LoPucki/Kalin Study*, BANKR. CT. DECISIONS WKLY. NEWS & COMMENT, Aug. 8, 2000, at A7 (reviewing academic reactions to the study).

¹¹⁴ See 11 U.S.C. § 362(d)–(f) (2000).

¹¹⁵ See *id.* § 1112(b).

¹¹⁶ See *id.* § 1129(b). See generally Kenneth N. Klee, *All You Ever Wanted to Know About Cram Down Under the New Bankruptcy Code*, 53 AM. BANKR. L.J. 133 (1979) (discussing the process by which courts confirm cramdown plans). Some might argue that a nonconsensual plan is unsuccessful because it diverts value from secured creditors. See *supra* note 50 and accompanying text. It also is possible in some cases for a creditor to propose a confirmable Chapter 11 plan. See, e.g., *In re Holley Garden Apartments, Ltd.*, 238 B.R. 488, 492 (Bankr. M.D. Fla. 1999) (noting that both the debtor’s and creditor’s plans were confirmable). Therefore in some respects confirmation of a SARE plan could be overinclusive of “success.”

¹¹⁷ But see sources cited *supra* note 111 (contending that some commentators measure confirmation success by whether the debtor survives and does not refile for bankruptcy, and that even if confirmation is not dispositive of success, it is certainly relevant to assessing success). Some commentators, however, adopt the view that state law foreclosure, with all of its shortcomings, is preferable to any bankruptcy reorganization. See, e.g., *supra* notes 47–50 and accompanying text.

If SARE cases were not likely to result in confirmed plans, then Congress should have barred them entirely from the Chapter 11 system instead of allowing debtors to file subject to an expedited procedure. On the other hand, if there was a reasonable likelihood¹¹⁸ that SARE cases would produce confirmed plans, there would not appear to be any principled reason to subject them to rules different from those governing other kinds of Chapter 11 cases. The key is to identify those characteristics of SARE debtors that are good predictors of confirmed plans. Then Congress would have an informed basis on which to draw a line.

Based on my practical experience with SARE cases, I had hypothesized that properties with larger property values and value-to-loan ratios have a greater likelihood of confirmation.¹¹⁹ To test these hypotheses, I examined the National data to determine whether certain variables were indicative of increased likelihood of confirmation, including the property value, the property value natural log, the value-to-loan ratio (difference of natural logs)¹²⁰ and the like. The findings regarding these variables were meaningful with a Pseudo R^2 (Greene) of .28,¹²¹ but I needed additional analysis of all data to determine the validity of my hypotheses.

Analysis of the data reveals interesting patterns in SARE cases. The National data reveal a strong relationship between property value and confirmation of a Chapter 11 plan, a finding that the L.A. and Combined data echo. This means that a judge is more likely to confirm a plan in a case with a very valuable property than in a case with low-valued property. In fact, the observed data are consistent with this prediction. Of the seventeen cases in the National data set that resulted in confirmed plans, ten involved properties worth \$8.2 million or more.¹²² On the other hand, only seven cases involved properties worth less than \$8.2 million. Stated another way, of the eighteen cases in the upper 40th percentile of property value (valued at \$7 million or more), ten (56%) resulted in confirmed plans. Of the twenty-seven cases in the lower 60th percentile (valued at \$7 million or less), only

¹¹⁸ Reasonable minds can differ on the level of probability of confirmation that would support fast-track rules that disadvantage SARE debtors. Congress is well situated to engage in this kind of line-drawing. Figure 1, *infra*, presents the kind of data that gives Congress an informed basis to do so.

¹¹⁹ In my experience, properties with larger values are also better maintained and more current in payment of real property taxes than properties with smaller values. I tested the data for these effects as well.

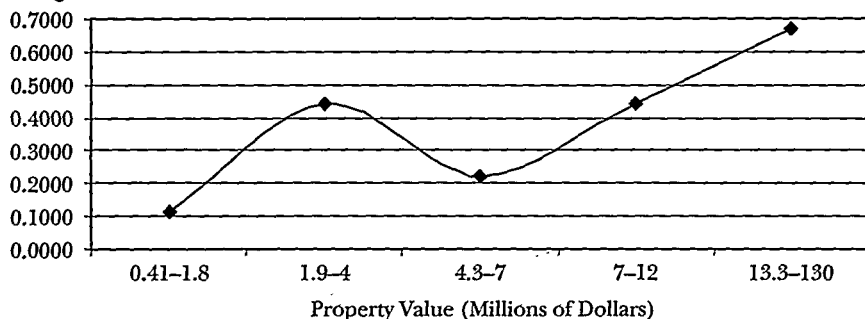
¹²⁰ One can calculate a value-to-loan ratio by dividing the property value by the unpaid loan balance. For example, a property worth \$10 million subject to a \$5 million loan balance will have a value-to-loan ratio of 2:1.

¹²¹ See WILLIAM H. GREENE, *ECONOMETRIC ANALYSIS* 651 (2d ed. 1993). For a general explanation of pseudo R^2 and other statistical measures, see *infra* note 154.

¹²² See *infra* Figure 2.

seven (26%) resulted in confirmed plans.¹²³ At the extremes, the data are even more striking: Chart 1 shows that of the nine cases in the lowest quintile, only one (11%) resulted in a confirmed plan, whereas of the nine cases in the highest quintile, six (67%) resulted in confirmed plans. Thus, based on the raw data, it appears that somewhere between \$7 million and \$8.2 million in property value there is a flexion point above which the likelihood of confirmation increases substantially.

CHART 1
NATIONAL DATA SET PERCENT CONFIRMED CHAPTER 11 PLANS BY
QUINTILE BASED ON PROPERTY VALUE IN MILLIONS OF DOLLARS



The L.A. data, shown in Chart 2, involve more properties with lower property values. Of the sixteen cases in the lowest quintile, only one (6%) resulted in a confirmed plan, whereas six (38%) of the sixteen cases in the highest quintile resulted in a confirmed plan. The second through fourth quintiles show no clear pattern with confirmation rates of 20%, 7%, and 13% respectively.

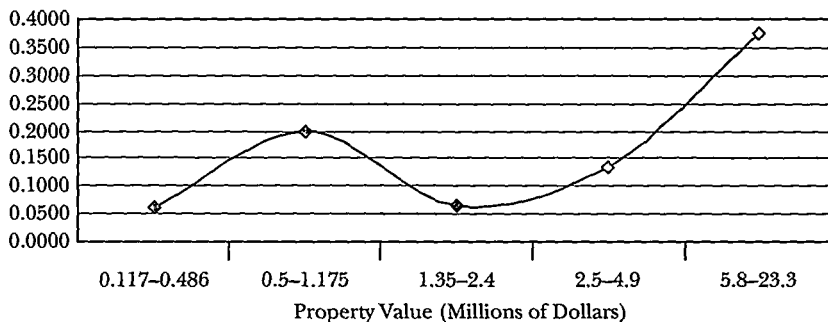
Dissecting the highest quintile of the L.A. data, however, reveals a flexion point similar to that reflected in the National data. Chart 3 shows that of the seven cases with property values between \$5.8 million and \$7.0 million, only one (14%) resulted in a confirmed plan, whereas five (56%) of the nine cases with property values of at least \$8.5 million resulted in confirmed plans. Thus the L.A. data also support the inference that somewhere between \$7 million and \$8.2 million in property value there is a flexion point above which the likelihood of confirmation increases substantially.

The finding with respect to SARE Chapter 11 cases is consistent with the understanding of Chapter 11 generally. Larger companies are more likely to end their Chapter 11 cases with a successful reor-

¹²³ See *id.* I have included properties valued at \$7 million in both the lower 60th percentile and in the upper 40th percentile.

CHART 2

L.A. DATA SET PERCENT CONFIRMED CHAPTER 11 PLANS BY QUINTILE
BASED ON PROPERTY VALUE IN MILLIONS OF DOLLARS



ganization.¹²⁴ This finding may reflect the relatively high expenses of a Chapter 11 reorganization. In effect, only larger cases can afford the expenses of a reorganization in addition to the expenses of operating the property. Smaller cases may be as complex as larger ones,¹²⁵ but if they cannot afford to continue operations¹²⁶ and bear the administrative costs of the Chapter 11 process,¹²⁷ they may not survive.

The National data also reflect a strong relationship between the value-to-loan ratio and the likelihood of confirmation of a Chapter 11 plan, a finding on which the L.A. and Combined data are inconclusive. The National data suggest, consistent with my experience and hypothesis, that cases with less leveraged capital structures are more likely to confirm Chapter 11 plans. But the L.A. and Combined data's inconclusive support for this proposition demonstrates the danger of drawing conclusions based on shared experience and anecdotal testimony without adequate empirical research.

Examining raw historical data is only a beginning. This Article presents a model that forecasts the likelihood of confirmation based on historical relationships embedded in the data set. I selected property values and value-to-loan ratios as key independent variables

¹²⁴ See Warren & Westbrook, *supra* note 85, at 500 ("Because the complex structural apparatus of Chapter 11 . . . is based on a prototype of a business with sufficiently large assets and debt to support an expensive restructuring, the businesses in Chapter 11 should be relatively large."); see also LoPucki & Kalin, *supra* note 88, at 255 (noting the extremely high confirmation rate for large public companies from 1989 until 1997); LoPucki & Whitford, *supra* note 88, at 600 (reporting a 96% confirmation rate for large public companies).

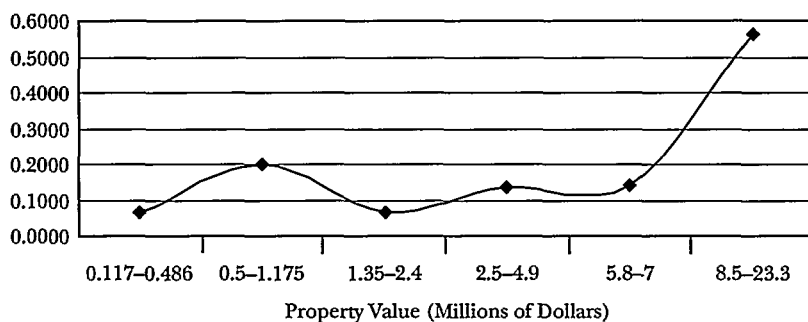
¹²⁵ See Gose Testimony, *supra* note 78 ("I can state categorically that size does not bear any relation to complexity. In fact, it is not unusual for a smaller transaction to be more complex than a larger; with less to fight over, more wrinkles may arise.")

¹²⁶ See LoPucki, *supra* note 102, at 107 & n.32; see also Kerkman, *supra* note 106, at 167 ("[Between 74% and 76%] of the operating businesses entering Chapter 11 proceedings were destined to fail . . .").

¹²⁷ Chapter 11 administrative costs include attorney's fees, accountant's fees, appraiser's fees, court fees, postpetition taxes, and the like. See 11 U.S.C. § 503(b) (2000).

CHART 3

L.A. DATA SET PERCENT CONFIRMED CHAPTER 11 PLANS: GROUPINGS
BASED ON PROPERTY VALUE IN MILLIONS OF DOLLARS



against which I could predict the likelihood of a plan's confirmation. Because confirmation is a dichotomous variable—in that it either occurs or does not occur—I assigned the value “1” to a case with a plan that was confirmed and “0” to a case where a plan was not confirmed. To understand more clearly the relationship between value-to-loan ratios, property values, and probability of confirmation, I first plotted value-to-loan ratios and property values against probability of confirmation. No clear relationship emerged; it was not possible to find a meaningful line around which the data would cluster. By using a logistic regression,¹²⁸ however, the relationships crystallized in a model that predicts the likelihood of confirmation.¹²⁹ That is, given a particular property value and value-to-loan ratio, the model illustrated in Figure 1 forecasts this likelihood of confirmation.¹³⁰

The National data model reflected in Figure 1 shows that both property value and value-to-loan ratios are good predictors of confirmation.¹³¹ For example, although the National model predicts that courts will confirm plans involving properties with a value of \$1 million and loans that are twice the property value (1:2) about 2% of the time, it shows that courts are twenty times more likely to confirm expensive (\$20 million) properties with the same loan ratio (40%).¹³²

¹²⁸ Logistic regression is a statistical procedure that is useful for predicting dichotomous outcomes, in which the dependent variable can have only two possible values (typically 0 or 1); the predictors can be either continuous or categorical. The relationship between these variables is more clearly understood if we view the distribution of predicted confirmations in a two-way table. See *infra* Appendix Table 1. It appears that both property value and value-to-loan ratios are good predictors of which cases courts will confirm, but that property value may be more sensitive to which cases courts will eventually confirm.

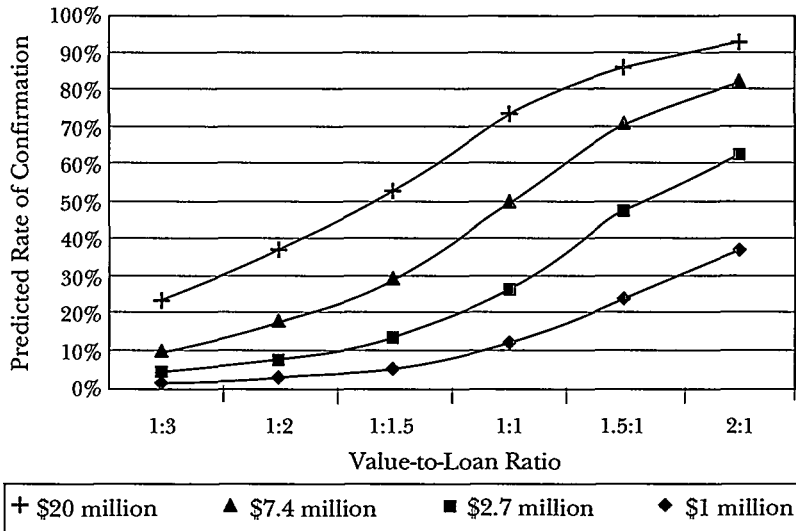
¹²⁹ See *infra* Figure 1; *infra* Appendix Table 1.

¹³⁰ Figure 1, *infra*, suggests more precision in the relationships than a data set with forty-five observations warrants. Nevertheless, it properly illustrates the direction of the relationships.

¹³¹ See *infra* Appendix Table 2.

¹³² See *supra* Figure 1; *infra* Appendix Table 1.

FIGURE 1
NATIONAL MODEL: PREDICTED RATE OF CONFIRMATION BY
PROPERTY VALUE AND VALUE-TO-LOAN RATIO



Those with both a high value and a high value-to-loan ratio are almost certainly confirmed (95%).¹³³ The National model indicates that both the property value and value-to-loan ratio are good predictors of confirmation.

The L.A. and Combined data provide strong support for the relationship generated from the National data between property value and probability of plan confirmation.¹³⁴ But the L.A. and Combined data are inconclusive regarding the relationship between the value-to-loan ratio and the probability of plan confirmation.¹³⁵ The L.A. and Combined data suggest that property value may be more sensitive than the value-to-loan ratio in predicting confirmation.¹³⁶ As a result, I focused on the property value data alone as a predictor of confirmation.

The National model and data strongly suggest that property value is predictive of confirmation in SARE Chapter 11 cases. Thus, property value is a particularly good predictor of the probability that a court will confirm a Chapter 11 plan in a SARE case.¹³⁷ Figure 2 dem-

¹³³ See *supra* Figure 1; *infra* Appendix Table 1.

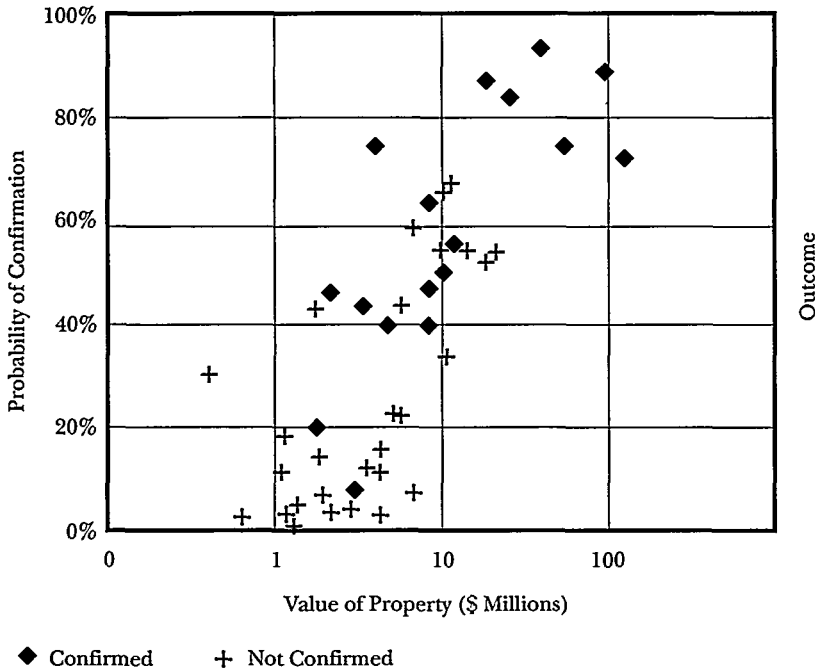
¹³⁴ See *infra* Appendix Table 2.

¹³⁵ See *id.*

¹³⁶ See *id.*

¹³⁷ The Wald statistics are set forth in Appendix Table 2, *infra*. For a more thorough discussion of the statistical methods, see *infra* Appendix A.

FIGURE 2
 NATIONAL MODEL: PROBABILITY OF SARE PLAN
 CONFIRMATION BY VALUE OF PROPERTY



onstrates the fit for the National data using a logarithmic axis for property value and symbols to indicate confirmation.

These data may also be tabulated as in Chart 4:

CHART 4
 NATIONAL MODEL: PREDICTED PROBABILITY OF CONFIRMATION
 BASED ON PROPERTY VALUE

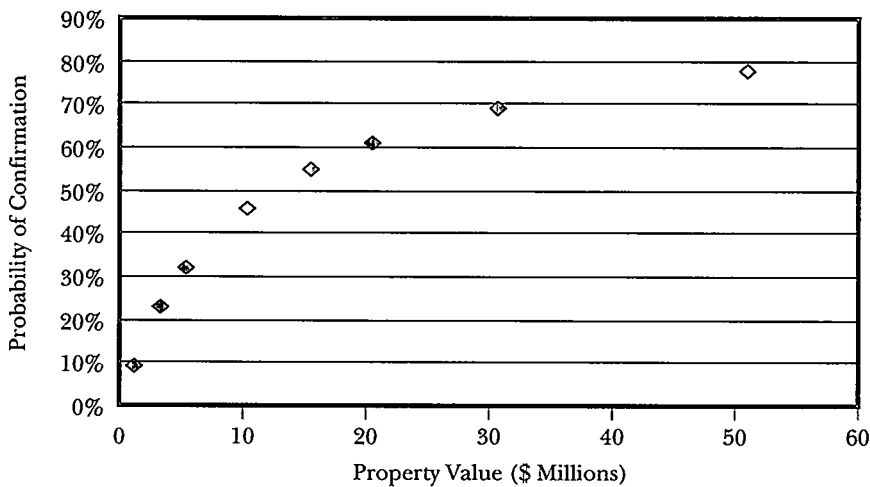
Property Value (\$ Millions)	1	3	5	10	15	20	30	50
Probability of Confirmation	9%	23%	32%	46%	55%	61%	69%	78%

These data justify raising the SARE cap to a property value of about \$10 million. At that level, confirmation is almost an even bet. At the \$20 million level, the likelihood of confirmation is about 60%.

Figure 3 reflects the relationship between property value and probability of confirmation without using a logarithmic scale or including symbolic representation of confirmation.

These figures illustrating the National model support my hypothesis that SARE cases with larger properties have a good chance of hav-

FIGURE 3
NATIONAL MODEL: PROBABILITY OF PLAN CONFIRMATION
BY PROPERTY VALUE



ing a Chapter 11 plan confirmed.¹³⁸ More importantly, they clearly show that a “one-size” Chapter 11 process does not fit all SARE cases, at least where the one-size procedure does not afford all debtors a reasonable opportunity to reorganize.¹³⁹

Not having made a similar investigation, Congress engaged in its process unaware of such information. Congress listened to the lenders who lobbied for the bill and the House and Senate each passed bills blowing up the \$4 million cap. The resulting decision reflected in the 2001 Amendment was a shot in the dark that missed the mark.

IV

LESSONS FROM APPLYING THE DATA TO THE 2001 AMENDMENT

As a policy matter, Congress blundered when it proposed to repeal the \$4 million cap in the definition of SARE debtors. The 2001 Amendment would expose larger SARE debtors to the strictures of the newly expanded § 362(d)(3) of the Bankruptcy Code. To survive the Chapter 11 process, they would have to file a confirmable Chapter 11 plan within ninety days of the order for relief, persuade the court to extend that time, or start making payments to their mortgage holders

¹³⁸ The L.A. and Combined data generally reinforce this hypothesis.

¹³⁹ Before 1994, under the Bankruptcy Code, one size fit all SARE cases precisely because the one size was the general, flexible reorganization rule applicable to almost all Chapter 11 debtors.

based on nondefault interest under the contract.¹⁴⁰ This recipe would give secured mortgage holders effective control of the SARE Chapter 11 case. These lenders will have obtained what they paid for to the detriment of the property owners, the unsecured creditors, and the general public. Congress should have proposed a less restrictive alternative that would have better served and harmonized the competing interests in SARE Chapter 11 cases.

Congress could have adopted the position of law-and-economics critics that Chapter 11 is inefficient and should be replaced by an auction system¹⁴¹ or abolished altogether.¹⁴² But Congress has elected to retain the Chapter 11 system for most debtors, including SARE debtors. By most accounts, the mark of success under the Chapter 11 system is, at the very least, confirmation of a Chapter 11 plan.¹⁴³ Thus,

¹⁴⁰ See Bankruptcy Reform Act of 2001, H.R. 333, 107th Cong. § 444, available at <http://thomas.loc.gov>; Bankruptcy Reform Act of 2001, S. 420, 107th Cong. § 444, available at <http://thomas.loc.gov>.

¹⁴¹ See Baird & Morrison, *supra* note 48, at 369, 371. Baird and Morrison advocate for such a system:

In a mandatory auction regime, managers of firms that have value as going concerns will do everything they can to make this information readily available at the start of the case. They will keep their jobs only if a single buyer of the assets can be found, and the chances of finding such a buyer go up the more such information is available. . . .

. . . .
 . . . Only a system of mandatory auctions both limits the amount of time an inexperienced decision maker handles the shutdown option and forces insiders to give that decision maker sufficient information to exercise the option well while it is in her hands.

Id.; see also Douglas G. Baird, *The Uneasy Case for Corporate Reorganizations*, 15 J. LEGAL STUD. 127, 145 (1986) (criticizing bankruptcy law as not reflective of market preferences); Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775, 778–81 (1988) (noting same).

¹⁴² See, e.g., Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1078 (1992) (“Chapter 11 should be repealed, abolishing court-supervised corporate reorganizations and, in effect, precluding residual claimants from participating in any reorganization of the firm. . . . [W]e propose a federal law repealing Chapter 11 . . . and providing for automatic cancellation of residual claims in the event of default.” (emphasis in original)).

¹⁴³ See sources cited *supra* note 109. *But see*, e.g., Douglas G. Baird, *Bankruptcy’s Uncontested Axioms*, 108 YALE L.J. 573, 584 (1998) (“Chapter 11 cannot be judged merely by counting the number of firms that reorganize successfully. . . . [T]he rehabilitation goal must be balanced against other interests, including the need to recognize the rights of creditors.”); Bufford, *supra* note 63, at 833. Judge Bufford writes:

As a first approximation, I propose that success be defined as the achievement of the results sought, or the avoidance of the results unwanted, by the debtor at the time of filing. For example, the debtor may want to sell the business, because the debtor cannot make it profitable. After the filing, a sale is arranged and the case is dismissed. . . .

. . . However, such cases are all excluded from the tally of successful Chapter 11 cases, according to the conventional counting method.

Id.; Steven H. Ancel & Bruce A. Markell, *Hope in the Heartland: Chapter 11 Dispositions in Indiana and Southern Illinois, 1990–1996*, 50 S.C. L. REV. 343, 357 (1999) (“The consequences outlined above hint at a definition of success . . . that is broader than simply

the question addressed in this Article is not whether the law should permit SARE debtors to reorganize under Chapter 11, but under what conditions SARE debtors may reorganize.

In 1994, Congress established a separate procedure for small SARE debtors with secured debts not exceeding \$4 million. Since then, nothing has happened to warrant applying the separate SARE procedure to larger cases. In fact, instead of conducting diligent legislative factfinding as it had done on other occasions, Congress gathered no empirical data to analyze larger SARE cases. Instead, it chose to receive anecdotal testimony¹⁴⁴ and money from mortgage holders' lobbyists.¹⁴⁵ As this Article demonstrates, the data strongly support the proposition that larger SARE cases have a high likelihood of confirming Chapter 11 plans. The same may be true of cases with high value-to-loan ratios. Repealing the \$4 million cap so as to subject all SARE debtors to the requirements of § 362(d)(3) of the Bankruptcy Code probably will reduce the likelihood of confirmation for several large SARE debtors. By some standards, this will diminish the success of Chapter 11, thereby adding fuel to the fire of the commentators who call for Chapter 11's repeal.

By drawing a reasonable line to differentiate small SARE debtors from large SARE debtors, Congress could have preserved the economic braking function of Chapter 11 in preventing uncontrolled downward spirals in real estate prices when mortgage holders simultaneously dump numerous foreclosed properties on the market.¹⁴⁶ It is important to recall that this system benefits society by guarding the economic health of institutions that finance real property, in addition to the financial well-being of the property owners.¹⁴⁷ In fact, instead of drawing a line based on the amount of secured debt, Congress might have done better to consider property value and the value-to-loan ratio instead. As Appendix Table 1 illustrates, even SARE cases with \$1 million in property value have a 39% chance of confirmation when the value-to-loan ratio is 2:1.¹⁴⁸ Quite clearly, the data support a more textured look at these cases. Indeed, the data raise the question

confirming a Chapter 11 plan. . . . [T]he authors believe a rough definition of a successful Chapter 11 is one in which all participants receive more than they would have if liquidation had been initiated.”)

¹⁴⁴ See sources cited *supra* notes 78, 80.

¹⁴⁵ See *Bankruptcy*, *supra* note 15.

¹⁴⁶ If dumping small SARE properties on the market causes a downward spiral, then drawing a line to insulate large SARE debtors from the restrictions of § 362(d)(3) will not suffice. To prevent the spiral, Congress would need to repeal § 362(d)(3).

¹⁴⁷ See *supra* notes 67–68, 71 and accompanying text.

¹⁴⁸ See *infra* Appendix Table 1. Although the National data support using value-to-loan ratios as indicative of the probability of confirming a SARE plan, the L.A. and Combined data are inconclusive on this point. See *infra* Appendix Table 2.

whether the law should use debt levels alone as an eligibility limitation for any purpose under the Bankruptcy Code.

Moreover, the case in favor of drawing a reasonable line is compelling. As noted above, the National model uses confirmation of a Chapter 11 plan as a surrogate for success.¹⁴⁹ However, many commentators acknowledge that confirmation is only part of the measure of success.¹⁵⁰ Some SARE Chapter 11 cases that resulted in dismissals were undoubtedly the product of negotiated settlements. If the 2001 Amendment is enacted into law, however, as it becomes more difficult to confirm plans, there will be less reason for a mortgage lender to negotiate a reasonable settlement. Hence, with this change in the law, both the visible and the invisible successes in SARE Chapter 11 cases will be less likely to occur.

CONCLUSION

The data strongly support the application of the more relaxed current Chapter 11 procedures in larger SARE cases where the probability of confirmation is high. There is no rational justification for stuffing valuable properties with high values (or possibly high value-to-loan ratios)¹⁵¹ into an expedited SARE procedure that will almost surely decrease the confirmation rate.¹⁵² Policymakers reasonably can disagree about whether they should draw a line at a property value of \$5 million, where the probability of confirmation is 32%, \$10 million, where the probability of confirmation climbs to 46%, or \$15

¹⁴⁹ See *supra* note 109.

¹⁵⁰ See LoPucki & Kalin, *supra* note 88, at 235.

¹⁵¹ Based on the lack of statistical significance in the L.A. and Combined data sets, I would require more data to determine definitively the relationship between value-to-loan ratios and the likelihood of confirmation.

¹⁵² I did not elicit comprehensive data regarding the length of time it took debtors to confirm Chapter 11 plans in large SARE cases. Based on my experience, however, most large SARE cases require more than ninety days to confirm a plan of reorganization. Some of these cases have operating problems that parties in interest must fix before they reasonably can predict the earning potential of the reorganized debtor and use it to negotiate a plan. Other cases involve debtors with complex capital structures, tax issues, foreign lenders, and the like, which delay the plan negotiation and confirmation process. If the 2001 Amendment becomes law, some SARE debtors will fail to reorganize as a result of exposure to the expedited procedures. Others will reorganize on a different basis than they would have before the adoption of the 2001 Amendment as a result of value being shifted from owners and unsecured creditors to secured lenders. A few large SARE debtors may reorganize in a more expeditious fashion than they would have before the adoption of the 2001 Amendment. Indeed, based on their previous writings, some commentators might argue that expedition would lead to higher confirmation rates and no lower rate of business survival. See, e.g., LoPucki, *supra* note 102, at 100-01 (noting that under Chapter XI of the Bankruptcy Act, shorter proceedings probably resulted in a higher confirmation rate than under Chapter 11 of the Bankruptcy Code and no lower rate of business survival); 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, 269-71 (1983). One would need to conduct additional empirical research to quantify the results.

million, where the probability of confirmation is even better, at 55%. But it is plain that any line should be drawn based on consideration of actual data, not on a shortcut rule that treats all SARE debtors less favorably than other Chapter 11 debtors. If a \$50 million property has a 78% chance of confirming a plan under existing law, what policy possibly justifies jamming it into an expedited procedure that might jeopardize this result?¹⁵³ Whether Congress should draw that line at \$4 million in secured debt, or at \$7.4 million, \$20 million, or some different amount of property value, is an issue about which reasonable people can disagree, but it is clear that a line should be drawn.

Congress used a meat axe when it should have used a scalpel. Perhaps before Congress completes its deliberations on bankruptcy reform legislation, it will reinstitute a reasonable SARE cap. This Article and similar studies should serve to sharpen the debate.

¹⁵³ Commentators disagree whether expedition of the Chapter 11 process will reduce the plan confirmation rate. See *supra* note 152.

APPENDIX A: STATISTICAL METHODS

As noted above, logistic regression is a statistical procedure that is useful for predicting dichotomous outcomes, in which the dependent variable can have only two possible values (typically 0 or 1); the predictors can be either continuous or categorical. In this study, the dependent variable is whether the court confirmed the plan. It is coded "1" if there was confirmation, and "0" if there was no confirmation. Both of the independent variables (Value of Property and Value-to-Loan ratio) are continuous.

The logistic regression coefficients reported in Appendix Table 2 are exponents, the natural logs of the odds ratio ($\ln(p/1-p)$). Unlike ordinary least-squares coefficients, one cannot interpret logistic coefficients independently of the model within which they are nested.¹⁵⁴ That is, the entire model is a function that one must calculate in order to determine the effect of an individual independent variable. For this purpose, we can restate the regression as follows:

$$\text{Log Odds of Confirmation} = -2.10 + (\text{Value of Property} \times 1.11) + (\text{Value-to-Loan ratio} \times 2.37).$$

¹⁵⁴ G. David Garson describes R^2 and pseudo R^2 statistics as follows:

- R-squared. There is no widely-accepted direct analog to OLS regression's R^2 . This is because an R^2 measure seeks to make a statement about the "percent of variance explained," but the variance of a dichotomous or categorical dependent variable depends on the frequency distribution of that variable. For a dichotomous dependent variable, for instance, variance is at a maximum for a 50-50 split and the more lopsided the split, the lower the variance. This means that R-squared measures for logistic regressions with differing marginal distributions of their respective dependent variables cannot be compared directly, and comparison of logistic R-squared measures with R^2 from OLS regression is also problematic. Nonetheless, a number of logistic R-squared measures have been proposed. Note that R^2 -like measures below are *not* goodness-of-fit tests but rather attempt to measure strength [sic] of association. For small samples, for instance, an R^2 -like measure might be high when goodness of fit was unacceptable by model chi-square or some other test.

.....

- [•] Cox and Snell's R-Square is an attempt to imitate the interpretation of multiple R-Square based on the likelihood, but its maximum can be (and usually is) less than 1.0, making it difficult to interpret. It is part of SPSS output.

- [•] Nagelkerke's R-Square is a further modification of the Cox and Snell coefficient to assure that it can vary from 0 to 1. That is, Nagelkerke's R^2 divides Cox and Snell's R^2 by its maximum in order to achieve a measure that ranges from 0 to 1. Therefore Nagelkerke's R-Square will normally be higher than the Cox and Snell measure. It is part of SPSS output.

- [•] Pseudo-R-square is a [sic] Aldrich and Nelson's coefficient which serves as an analog to the squared contingency coefficient, with an interpretation like R-square. Its maximum is less than 1. It may be used in either dichotomous or multinomial logistic regression.

See G. DAVID GARSON, *Logistic Regression*, in PA 765 STATNOTES: AN ONLINE TEXTBOOK, at <http://www2.chass.ncsu.edu/garson/pa765/logistic.htm> (last visited Mar. 22, 2002) (citation omitted).

In order to recover the probability of confirmation for a given property or type of property, one would add the values into the equation above, raise Euler's constant (e) to the resulting value, and then calculate the odds.

For example, assume that the property is fully mortgaged; the value-to-loan ratio (which is the difference between the logged values) is equal to 0. This allows us to see what happens as the value of property varies. The value-of-property variable comprises the logged values of the properties, in millions of dollars, so that a value of 1 in the variable is equal to \$2.72 million in the real world; a value of 2 is equal to \$7.39 million, and so on. If we use the National data set and select 1 as the value of property, we would get the following equation:

$$\text{Log Odds of Confirmation} = -2.10 + 1 \times 1.11 = -0.99$$

$$\text{Odds} = E^{-0.99} = .37:1.$$

Once we compute the odds, we generate probability by dividing the odds by one plus the odds:

$$\text{Probability of confirmation} = .37 / 1.37 = .27 \text{ or } 27\%.$$

Now let us assume a property with the same value-to-loan ratio of 0, but a value of property variable value of 2 (an actual property value of \$7.39 million). We would state the equation for the National data set as follows:

$$\text{Log Odds of Confirmation} = -2.10 + 2 \times 1.11 = .12$$

$$\text{Odds} = E^{.12} = 1.13:1$$

$$\text{Probability of Confirmation} = 1.13 / 2.13 = .53 \text{ or } 53\%.$$

We understand more clearly the relationship between these property value and value-to-loan ratio variables if we view the distribution of predicted confirmations in a two-way table (Appendix Table 1). The numbers illustrate how both the property value and the value-to-loan ratio appear to be important factors underlying the confirmation decisions of bankruptcy courts. The model predicts confirmation about 2% of the time of plans involving properties with a value of \$1 million and loans that are twice the property value (1:2); and predicts confirmation of plans for expensive (\$20 million) properties with the same debt ratio as twenty times more likely (40%). Confirmation of plans involving properties with both a high value and a high value-to-loan ratio is almost certain (95%). Therefore it appears that both value and loan ratios are good predictors of confirmation failure, but that value may be more sensitive for predicting confirmation.

To understand the relationship between the property value, the value-to-loan ratio, and the probability of confirmation from a different perspective, consider Figure 1 above. This figure clearly shows a substantial likelihood of confirmation when the property value is at least \$7.4 million and the value-to-loan ratio exceeds 1:1.5. In fact,

APPENDIX TABLE 1
 NATIONAL MODEL: PREDICTED RATE OF CONFIRMATION BY PROPERTY
 VALUE AND VALUE-TO-LOAN RATIO

Property Value	Ratio of Property Value-to-Loan Principal				
	1:2	1:1.5	1:1	1.5:1	2:1
\$1 million	2%	4%	11%	24%	39%
\$2.7 million	7%	12%	27%	50%	66%
\$7.4 million	18%	30%	53%	75%	85%
\$20 million	40%	56%	77%	90%	95%

Note: Entries are the percentage of cases within the cell that are predicted to be confirmed.

using that value-to-loan ratio, if the property value exceeds \$20 million, confirmation is more probable than not.

APPENDIX TABLE 2
 FACTORS OF BANKRUPTCY PLAN CONFIRMATION IN SARE CASES

	Data Source		
	National	L.A.	Combined
Property Value†	1.11** (8.53) (mean 1.72, sd 1.26)	.52* (3.55) (mean .51, sd 1.20)	.73** (13.60) (mean .95, sd 1.35)
Value-to-Loan Ratio†	2.37* (5.28) (mean -.27, sd .51)	-.68 (1.84) (mean .31, sd .77)	-.09 (.08) (mean .10, sd .74)
Constant	-2.10** (7.40)	-1.82** (19.58)	-2.02** (29.46)
Pseudo-R ²	.42	.13	.20
N	45	76	121

* $p < .05$, ** $p < .01$

† Property value is the natural log of the assessed value in millions of dollars. Value-to-loan ratio is the difference in the natural logs of the property value and the outstanding loan amount in millions of dollars.

Note: Cell entries are logistic regression coefficients. Wald statistics are in parentheses.

As noted above, the National data predict the probability of confirmation both as a function of property value and value-to-loan ratio. By contrast, as illustrated by Appendix Table 2, the L.A. and Combined data support the relationship only for property value, but not for value-to-loan ratio. The L.A. data thus make the National data on property value more robust despite the lack of a random sample and a small number of cases, but undermine the National data's implications for value-to-loan ratio. Appendix Table 2 also uses Wald statistics¹⁵⁵ to show the tighter fit for property value data versus value-to-loan data. Note that Appendix Table 2 uses Wald statistics instead of

¹⁵⁵ *Id.* ("Computationally, the Wald statistic = b^2 / ASE_b^2 where ASE_b^2 is the asymptotic variance of the logistic regression coefficient."). Garson further explains the Wald statistic:

standard errors, but Wald statistics derive from standard errors and take into account the number of cases, making them as good or better than standard errors for measuring goodness of fit.

Figures 2 and 3, above, demonstrate the effect of isolating the analysis of the National data set to focus on probability of confirmation based on property value alone.

The Wald statistic is commonly used to test the significance of individual logistic regression coefficients for each independent variable (that is, to test the null hypothesis in logistic regression that a particular logit (effect) coefficient is zero). It is the ratio of the unstandardized logit coefficient to its standard error. The Wald statistic is part of SPSS output in the section "Variables in the Equation." Of course, one looks at the corresponding significance level rather than the Wald statistic itself. . . .

. . . Also note that the Wald statistic is sensitive to violations of the large-sample assumption of logistic regression.

Id.

APPENDIX B: SINGLE ASSET REAL ESTATE (SARE) QUESTIONNAIRE

Please duplicate this Questionnaire and fill out a copy for each single asset real estate deal you have done since October 1, 1979. Please return the completed questionnaires to Professor Ken Klee, UCLA Law School, P.O. Box 951476, Los Angeles, CA 90095-1476 as soon as possible but in no event later than March 13, 1998.

1. Type of Property (Apartment Building, Raw Land, etc.) _____

2. Valuation Range of Property _____

3. Type of Settlement: Out of Court ____; Cramdown ____; Consensual Plan _____

4. Were maintenance and taxes current pre-workout or prepetition? (Y/N) _____

5. Terms of Debt/Settlement:

A. Senior Secured Creditor with Mortgage or Deed of Trust on Real Estate

Priority of Lien: (Should be First; Indicate if any subordination) _____

Amount of debt? (Pre and Post Workout or Plan) _____

Interest Rate? (Pre and Post Workout or Plan) _____

Term? (Pre and Post Workout or Plan) _____

Other Relevant Information _____

B. Junior Secured Creditor with Mortgage or Deed of Trust on Real Estate

Priority _____

Amount of debt? (Pre and Post Workout or Plan) _____

Interest Rate? (Pre and Post Workout or Plan) _____

Term? (Pre and Post Workout or Plan) _____

Other Relevant Information _____

C. Other Secured Creditor

Priority _____

Amount of debt? (Pre and Post Workout or Plan) _____

Interest Rate? (Pre and Post Workout or Plan) _____

Term? (Pre and Post Workout or Plan) _____

Other Relevant Information _____

Debtor (Identify the Debtor if the information is Not Confidential):

New or Retained Equity _____

New Capital Infused _____

Management Contracts, Salaries, or Other Private Benefits _____

Debt Forgiven _____

Relevant Information _____

