

THE SUCCESS OF CHAPTER 11: A CHALLENGE TO THE CRITICS

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Although Chapter 11 has served as a model for bankruptcy reform around the world, the conventional wisdom has been that it is characterized by a relatively low success rate and endless delay. The data from large samples of Chapter 11 cases filed in 1994 and 2002 demonstrate that this characterization is wrong. Nearly all troubled companies choose Chapter 11 over Chapter 7 liquidation, which means that the system serves a critical screening function to eliminate hopeless cases relatively quickly. Almost half the unsuccessful cases were jettisoned within six months and almost eighty percent were gone within a year. The cases that survive the early screening result in confirmed plans of reorganization around seventy percent of the time. The mistaken conventional view has not only skewed the academic debate, but also prompted changes to the statute in 2005 regarding small business reorganizations, changes that may have produced little benefit in reducing delay at the price of blocking many small business reorganizations of a sort that were succeeding prior to the amendments.

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INTRODUCTION

American law claims many innovations, from the Bill of Rights to the Superfund. In the pantheon of extraordinary laws that have shaped the American economy and society and then echoed throughout the world, Chapter 11 of the U.S. Bankruptcy Code deserves a prominent place. Based on the idea that a failing business can be reshaped into a successful operation, Chapter 11 was perhaps a predictable creation from a people whose majority religion embraces the idea of life from death and whose central myth is the pioneer making a fresh start on the boundless prairie. So powerful is the idea of reorganization that Chapter 11 has heavily influenced commercial law reform throughout the world.¹

Yet even as the world has turned to Chapter 11 as a model to create value for a business's creditors, workers, investors, and communities, American-style reorganization has been widely disparaged. For many years, attacks on Chapter 11 have echoed through the academic community both in the United States and abroad. The critics often insist that economic efficiency requires the near abandonment of Chapter 11,² and some have lately

1. Michael E. Burke et al., *International Legal Developments in Review: 2006 Regional & Comparative Law: China*, 41 INT'L LAW. 777, 784–87 (2007) (commenting on China's Enterprise Bankruptcy Law, effective as of June 1, 2007, and its incorporation of the idea of reorganization); Jay Lawrence Westbrook, *A Global Solution to Multinational Default*, 98 MICH. L. REV. 2276, 2278–79 nn.2–15 (2000) (describing bankruptcy reform efforts throughout the world).

2. See, e.g., Barry E. Adler, *Bankruptcy and Risk Allocation*, 77 CORNELL L. REV. 439, 463–64 (1992) (criticizing risk-sharing theorists' assertion that the bankruptcy reallocation provisions reflect efficiency by claiming that bankruptcy reallocation benefits cannot outweigh its costs).

declared its imminent demise.³ These critics concede that reorganization is a worthy goal, but they claim that the current Chapter 11 system suffers from high failure rates and endless delays that prevent the system from yielding much value.⁴

This constant derision has had a potent impact. Congress recently amended Chapter 11, promoting its changes as fixes to a defective system riddled with delays.⁵ Other countries that had been attracted by the promise of Chapter 11 significantly modified their new systems by inserting features to correct for the high failure rates and delays claimed to exist in the U.S. system.⁶ For its part, the academic community has invested countless hours (and pages) arguing for corrections or replacements to deal with what it sees as a broken system of business reorganization.⁷

The claim of failure has been easy to make. A few cogent anecdotes coupled with an old government report have been sufficient to shift discussion immediately to proposals for change.

But before we bury—or perform further surgery on—Chapter 11, we suggest a more systematic factual inquiry. Before another country revamps its conception of reorganization to deal with the twin flaws of high failure rates and long delays, we recommend documenting both the rate of failure and the length of delay in the U.S. system as it existed before the 2005 Amendments. Here we offer data gathered from two large studies of business bankruptcies first filed in 1994 and 2002. These data show that much of the conventional wisdom about key elements of Chapter 11 is simply wrong. Contrary to so many assertions, Chapter 11 has been far more successful than supposed.⁸

3. Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 752 (2002) (“For the vast majority of firms in financial trouble, the traditional corporate reorganization has become increasingly irrelevant.”).

4. See Susan Jensen-Conklin, *Do Confirmed Chapter 11 Plans Consummate? The Results of a Study and Analysis of the Law*, 97 COM. L.J. 297, 325 (1992) (finding that only 6.5% of debtors confirmed and completed a reorganization plan, seemingly making saving a business under Chapter 11 very unlikely); Stephen J. Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509, 509 (2000) (“It has become a canonical tenet of academic discussions of corporate reorganization that Chapter 11—while not as costly as originally suspected—is substantially more expensive than other market driven methods of resolving a firm’s financial distress.” (footnote omitted)). See generally Conrad B. Duberstein, *Out-of-Court Workouts*, 1 AM. BANKR. INST. L. REV. 347, 351 (1993); Edith H. Jones, *Chapter 11: A Death Penalty for Debtor and Creditor Interests*, 77 CORNELL L. REV. 1088, 1089 (1992); James J. White, *Harvey’s Silence*, 69 AM. BANKR. L.J. 467, 473–74 (1995) (“[T]he largest and most palpable costs of Chapter 11 arise from delay.”).

5. H.R. Rep. No. 109-031, pt. 1, at 5 (2005).

6. See *infra* notes 76–78 and accompanying text.

7. See, e.g., ELIZABETH WARREN & JAY LAWRENCE WESTBROOK, *THE LAW OF DEBTORS AND CREDITORS* 877–89 (5th ed. 2006) [hereinafter WARREN & WESTBROOK, *DEBTORS AND CREDITORS*] (describing literature). See generally Philippe Aghion et al., *The Economics of Bankruptcy Reform*, 8 J.L. ECON. & ORG. 523 (1992); Philippe Aghion et al., *Improving Bankruptcy Procedure*, 72 WASH U. L.Q. 849 (1994); Elizabeth Warren & Jay Lawrence Westbrook, *Searching for Reorganization Realities*, 72 WASH. U. L.Q. 1257 (1994).

8. Professor Morrison has arrived at the same conclusion as to delays in resolution based on his study of a portion of the Northern District of Illinois. Edward R. Morrison, *Bankruptcy*

Because the Chapter 11 hospital is explicitly designed to deal with both ailing patients and corpses, the business failure rate can be understood better if the two kinds of cases are separated. Isolating those cases with a reasonable chance of success, as measured by the debtor's ability to advance a plan—any plan—of reorganization, we discovered that the success rate soars to more than seventy percent. We also found that the courts processed the losers relatively quickly: more than half of the losers were booted out in less than six months. After the first cull, the remaining cases had a decent chance of having a plan of reorganization confirmed. If, for example, a case could survive for six months, the odds of eventual success exceeded fifty-fifty.

The 2005 Amendments to the Bankruptcy Code, which imposed stricter time limits on both large and small cases, illustrate the high cost imposed by the Chapter 11 failure myth.⁹ Under the amendments, small companies have only six months to confirm a plan unless they can make a rigorous showing of likely success. But the data we analyzed for this Article show that eighty-two percent of the *successful* small business cases took longer than six months to confirm their plans.¹⁰ On that basis, most of these otherwise-successful businesses might have faced a serious risk of failing under the new provisions. Thus the cost of the six-month statutory time limit is potentially quite high, while our data show that the benefit of reducing supposed delays is much smaller because the failures were already being processed promptly.

No single study will quell concerns about Chapter 11, nor should it. As our economy changes, as lending practices evolve, and as financial markets innovate, newly configured businesses will rise and fall. Chapter 11 will be called on to adapt and to solve new problems. As it does so, new weaknesses and new strengths will be uncovered. We do not hope to stop debate, but urge that debate go forward informed by data from many sources.

I. THE DATA

A. *The Business Bankruptcy Project*

We have been working for a number of years on the Business Bankruptcy Project (“BBP”). The project now consists of two very large empirical studies of the businesses that file for bankruptcy.¹¹ With this

Decisionmaking: An Empirical Study of Continuing Bias in Small Business Bankruptcies 4, 7, 12 (Columbia Law Sch. Ctr. for Law and Econ. Studies, Working Paper No. 239, 2006). Professor Lubben has argued that the costs of Chapter 11 have been exaggerated. Lubben, *supra* note 4, at 511.

9. See *infra* note 119 and accompanying text.

10. See *infra* Section IV.B.

11. We offered an overview of the first project in *Financial Characteristics of Businesses in Bankruptcy*. Elizabeth Warren & Jay Lawrence Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L.J. 499 (1999) [hereinafter Warren & Westbrook, *Financial Characteristics*]. Data from both the first and second projects form the basis for our second report,

Article, we offer the first comprehensive look exclusively at Chapter 11, using numbers from both rounds of data collection.¹²

Unlike most recent empirical articles, this one examines a cross-section of all Chapter 11 business bankruptcies. The typical article about corporate reorganization is like a study of the sociology and economics of Park Avenue: the fabulous digs of the \$100 million reorganization cases and the big firms that handle them.¹³ By contrast, the total assets in our cases vary from a very modest \$13 to more than \$16 billion. Our set of cases thus more accurately reflects the Chapter 11 system as it operated throughout the U.S. economy. Park Avenue is here, but represented in context. We report data covering the full sweep of business reorganization in this large and richly varied country of ours, from Seattle to Orlando.

The first wave of data comes from an extensive longitudinal study of business bankruptcies originally filed in 1994. To develop detailed information about the progress of the cases, we went back to the courthouses and conducted telephone surveys with the debtors several times over a period of almost six years. The advantage of such a study is that it can report much more useful information about the progress of business cases. The disadvantage is that some of the study's findings might be considered out of date by the time they are finally compiled. In 2003, we returned to the courthouses to execute a study of business bankruptcy cases filed in 2002 to update our central findings. Because we focused on fewer data points in fewer districts

Contracting Out of Bankruptcy: An Empirical Intervention. Elizabeth Warren & Jay Lawrence Westbrook, *Contracting Out of Bankruptcy: An Empirical Intervention*, 118 HARV. L. REV. 1197 (2005) [hereinafter Warren & Westbrook, *Contracting Out*].

12. A colleague and former students have also analyzed parts of the data. See, e.g., Jennifer Connors Frasier, *Caught in a Cycle of Neglect: The Accuracy of Bankruptcy Statistics*, 101 COM. L.J. 307, 324–25 (1996); Stacy Kleiner Humphries & Robert L.R. Munden, *Painting a Self-Portrait: A Look at the Composition and Style of the Bankruptcy Bench*, 14 BANKR. DEV. J. 73, 79–80 (1997); Lubben, *supra* note 4, at 522–25; Stephen J. Lubben, *Real Options and the Other Liquidation Decision* 17–18 (Seton Hall Pub. Law Research, Paper No. 31, 2005) [hereinafter Lubben, *Real Options*], available at <http://ssrn.com/abstract=683621>.

13. See, e.g., Lubben, *supra* note 4, at 511 (noting that his empirical study was based on the costs associated with twenty-two large corporate bankruptcies filed in 1994). The most important source of data about these large companies is Professor LoPucki's storehouse of data concerning bankrupt companies with assets over \$100 million. Theodore Eisenberg & Lynn M. LoPucki, *Shopping for Judges: An Empirical Analysis of Venue Choice in Large Chapter 11 Reorganizations*, 84 CORNELL L. REV. 967, 973–74 (1999) (describing the methodology of the study that restricted cases to those filed by publicly held companies worth at least \$100 million in assets in 1980 dollars). See also Lynn M. LoPucki & Joseph W. Doherty, *Why are Delaware and New York Bankruptcy Reorganizations Failing?*, 55 VAND. L. REV. 1933, 1937–38 (2002) (indicating that the study used Professor LoPucki's Bankruptcy Reorganization Database); 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, 237 n.20 (2001) (describing the companies studied as large, public companies and acknowledging the use of Professor LoPucki's bankruptcy research database); Neill D. Fuquay, Note, *Be Careful What You Wish For, You Just Might Get It: The Effect on Chapter 11 Case Length of the New Cap on a Debtor's Exclusive Period to File a Plan*, 85 TEX. L. REV. 431, 431 n.1 (2006) (thanking Professor LoPucki for providing access to his bankruptcy research database).

in the second study, we were able to complete the data gathering much more quickly.¹⁴

The 1994 study collected nearly 200 data points from more than 3,000 business bankruptcy cases, spread across twenty-three districts across the United States.¹⁵ The cases were selected systematically from those filed in each district in each quarter of the year 1994. They included business cases filed by both natural persons and legal entities under Chapters 7, 11, and 13. The methodology is detailed in our first article reporting on that sample.¹⁶ For the current paper, we include the 985 Chapter 11 business cases from the 1994 study.¹⁷

The 2002 study was undertaken with more limited resources. We could no longer maintain representation of all eleven circuits as we had in 1994, but geographic and legal diversity remained important, so we selected cases from districts in nine different circuits.¹⁸ Again we took systematic samples of cases from each district, but in the second data collection we examined only business cases filed in Chapter 7 or Chapter 11.¹⁹ For the current paper, we focus on the 437 Chapter 11 business cases from the 2002 study. With one exception, we do not compare the 1994 and 2002 samples statistically or try to assess trends in this paper.²⁰

The combined 1994 and 2002 data gave us 1,422 Chapter 11 business cases to work with. In order to track outcomes over time, we followed the

14. Our return to the courthouses was mostly virtual because the 2002 study was the first time we had the chance to use Public Access to Court Electronic Records (“PACER”) in our work. *See generally*, Jay Lawrence Westbrook, *Empirical Research in Consumer Bankruptcy*, 80 TEX. L. REV. 2123, 2148 (2002). That access helped enormously in reducing both the time and the cost of our survey. We are grateful to the bankruptcy judges who permitted access to the PACER system.

15. The districts were Massachusetts, Southern District of New York, New Jersey, Maryland, Northern District of Texas, Eastern District of Michigan, Northern District of Illinois, Minnesota, Central District of California, Colorado, Middle District of Florida, New Hampshire, Connecticut, Delaware, Eastern District of North Carolina, Eastern District of Louisiana, Western District of Tennessee, Eastern District of Wisconsin, Nebraska, Western District of Oklahoma, Hawaii, Western District of Washington, and Middle District of Georgia.

16. Warren & Westbrook, *Financial Characteristics*, *supra* note 11, at 503–17. Robert M. Lawless and Elizabeth Warren assemble substantial evidence to show that the introduction of computer-generated bankruptcy petitions has had the unintended result of undercounting the number of small business bankruptcies in Chapter 7. Robert M. Lawless & Elizabeth Warren, *The Myth of the Disappearing Business Bankruptcy*, 93 CAL. L. REV. 743, 768 (2005). That undercount has a powerful effect on the Administrative Office of the U.S. Courts’ (“AO”) statistics, but there is no reason to believe that it persists in Chapter 11, which is the focus of this inquiry.

17. We had a total of 1,017 cases in 1994, but missing data reduced the useful sample to 985.

18. The nine districts in both samples were Central District of California, Colorado, Delaware, Northern District of Illinois, Massachusetts, Nebraska, Southern District of New York, Northern District of Texas, and Western District of Washington.

19. We took Chapter 7 cases from only four of the districts. Warren & Westbrook, *Contracting Out*, *supra* note 11, at 1209. However, that fact is not relevant to this paper, which discusses only cases filed initially in Chapter 11.

20. We made this judgment for several reasons, but the most important is that the two samples vary by the districts included and the size of the cases, variations that have a substantial impact on results for some of the data discussed in this paper. We are currently working to develop a paper that will make some of these complex comparisons.

first sample for more than five years, and, thus far, we have followed the second for four years.

The largest case in our 2002 sample, *Global Crossing*, involved \$16 billion in assets.²¹ In our smallest case by assets in 2002, *Meyercon, Inc.*, the company declared that it arrived at the bankruptcy courthouse with only \$13 in its corporate coffers.²² In the 2002 sample, 15% are tiny cases, with less than \$100,000 in assets, while at the other end of the spectrum 6% involve over \$100 million in assets. Equally important, 19% are in the middle, between \$5 million and \$100 million. Although most of the cases in this sample would have less impact on capital markets or employment than *Global Crossing*, in the aggregate they represent the heart of the American economy. If the most important thing about the bankruptcy system is its ex ante effects on the granting of credit,²³ then we suspect these cases may collectively dwarf in importance most of those that appear in the pages of the *Wall Street Journal*.

The study was aimed at business cases. The question of which debtors make a case a business bankruptcy case and which make a case a nonbusiness case is somewhat more complex than might be assumed at first glance. Through the years, the AO has employed differing schemes for classifying cases as business and nonbusiness. At one time the local clerks decided which cases were classified as business or nonbusiness, using whatever criteria they thought were important. Over time, that system evolved into the current practice, which relies on a checkbox on the face sheet of the bankruptcy petition.²⁴ To find Chapter 11 business cases for this study, we included any cases in our sample districts that were in business form (e.g., corporations, partnerships, limited liability companies), that had a business name in the title (e.g., Jane Smith d/b/a Smith Ironworks), or for which the debtor had checked the “business” designation on the face sheet of the bankruptcy petition or indicated that the debtor was not a person.²⁵ Because we looked at the name of the debtor, which the AO evidently does not, it is possible that we picked up some cases where the “business” designation had not been checked and therefore would not have been included in the AO statistics.²⁶

21. Voluntary Petition (Chapter 11), *In re Global Crossing*, No. 02-40188 (S.D.N.Y. Jan. 28, 2002). A brief summary of key financial data for our 2002 sample is found in the Appendix. All monetary numbers in this paper are reported in constant 2002 dollars.

22. Voluntary Petition (Chapter 11), *In re Meyercon, Inc.*, No. 02-11228 (C.D. Cal. Feb. 19, 2002) (on file with authors).

23. See, e.g., Alan Schwartz, *Bankruptcy Contracting Reviewed*, 109 *YALE L.J.* 343, 344–48 (1999).

24. The classification systems are described in greater detail in Lawless & Warren, *supra* note 16, at 757–64.

25. We also collected data on nonbusiness Chapter 11s, but those data are not included in this analysis. Instead, in this paper we work only with cases identified as business proceedings under the protocol described in the text.

26. The great difficulties with the business classifications that appear in Chapter 7 and Chapter 13 when sole proprietors are classified as consumers are discussed in greater detail in Lawless &

Our approach, like the AO method, yields some sole proprietorships and other noncorporate business entities that file for Chapter 11. An important change from 1994 to 2002 lies in the much smaller proportion of natural persons in Chapter 11 in 2002. The percentage of natural persons dropped from about twenty-five percent in 1994 to about eleven percent in 2002. It is likely that the change reflects in part the increase in the debt limits on Chapter 13 effective in late 1994, which made it possible for many more entrepreneurs to seek relief there rather than in Chapter 11.²⁷ Even with this difference, however, there are few variations in the data between natural-person Chapter 11 cases and corporate cases, so the overall results are not much affected.

We recognize that some other researchers exclude noncorporate debtors from their studies of business bankruptcies, instead drawing an all-corporate sample.²⁸ By doing so, they risk biasing the data sample so that it no longer represents an accurate picture of the Chapter 11 system.²⁹ While it is true that omitting these debtors does not affect the specific data points we consider here, we could not know that fact if we had not collected the data about these debtors.

B. *One Measure of Success: A Confirmed Plan of Reorganization*

A discussion of plan-confirmation rates must begin with some careful distinctions. The idea of success in an ongoing, viable business can be elusive. On the one hand, a confirmed plan does not guarantee a successful future for the business. The evidence that a number of companies return to Chapter 11 after confirming a reorganization plan suggests that not all businesses will enjoy smooth sailing post-bankruptcy.³⁰ Even if a company does not soon return to the bankruptcy court, the definition of “success” in this context is subject to considerable debate. How long does a company have to exist post-reorganization before it is deemed a “success”? Must it be alive for ten years? Five years? Two years? What if it shrinks in size? Must it be profitable all or part of that time to be a success? What if it is purchased in

Warren, *supra* note 16, at 772–81. They speculate that the difficulties they identified are likely to be the result of the increasing use of pre-scripted Chapter 7 forms and computerized software that automatically designates all individuals as consumers, not businesses. *Id.* at 780. Those difficulties are unlikely to be present in Chapter 11 cases where such software is less likely to be used and, when used, would be far less likely to presume that the debtor was a consumer.

27. Ed Flynn, *Bankruptcy by the Numbers: Who Is Filing Chapter 11?*, 18-1 AM. BANKR. INST. J. 30, 30 (1999); Warren & Westbrook, *Financial Characteristics*, *supra* note 11, at 534.

28. See, e.g., Arturo Bris et al., *Who Should Pay for Bankruptcy Costs?*, 34 J. LEGAL STUD. 295, 308 (2005) (describing the model used to determine the efficient cost allocation in bankruptcy as including a firm that requires equity financing); Stephen J. Lubben, *Business Liquidation*, 81 AM. BANKR. L.J. 65, 70 (2007); Morrison, *supra* note 8, at 4, 20–22.

29. See Warren & Westbrook, *Financial Characteristics*, *supra* note 11, at 546 (demonstrating that an accurate picture of the Chapter 11 system should include sole proprietorships which are concentrated near the smaller end of the spectrum of Chapter 11 filings).

30. See LoPucki & Kalin, *supra* note 13, at 235 (finding that ten of thirty one companies followed in the study eventually refiled for bankruptcy). This phenomenon is often called “Chapter 22.”

year three? These and many similar questions make it difficult to pinpoint what constitutes success following confirmation.

An even more complex question is the meaning of the “success” represented by a liquidating plan. Because the bankruptcy code explicitly authorizes liquidating plans,³¹ confirmation of such a plan successfully resolves a case in Chapter 11, but it does not necessarily represent a salvaged business or the realization of going-concern value. In many cases a liquidating plan will mean that equity will lose its stake, but the business (and its employees) may continue under new ownership following a going-concern sale. On the other hand, a liquidating plan may contemplate piecemeal liquidation not much different from a typical Chapter 7 proceeding. We note that less than twenty-one percent of the confirmed plans in our samples were liquidating plans.³² We do not provide a more detailed analysis here.

While it is true that not every confirmed plan would meet a refined definition of success, the reverse is equally true: not every company whose Chapter 11 case is dismissed represents a complete failure.³³ Anecdotal evidence from experienced bankruptcy lawyers and judges suggests that a fair number of cases are dismissed because debtors and creditors have worked out a settlement that they were not able to achieve prior to the Chapter 11 filing.³⁴ For example, the debtor may have reached an arrangement with its principal lender, but have trouble with other creditors who refuse to return phone calls or to engage in serious negotiations. A filing may bring everyone to the table and permit a negotiated resolution, followed by swift dismissal.³⁵ Our data do not address these variations on success. With the data we have collected, we cannot measure post-bankruptcy outcomes to sort the happy workouts from the miserable failures.

Having said all of that, plan confirmation is surely the central measure of success in Chapter 11. A system that does not lead to confirmed plans cannot achieve its objectives. For example, filing for reorganization is unlikely to produce settlement and a friendly dismissal unless the debtor has a reasonable probability of confirming a plan if it remains in Chapter 11—and the

31. 11 U.S.C. § 1123(b)(4) (2006).

32. Sorting out the various forms of liquidating plans is not an exact science, but it appears that about 11.5% of the 1994 confirmed cases would fairly be described as liquidating plans in one form or another. By 2002 that proportion had risen to 16.6%, with another 4.2% of cases in which it was not possible to determine whether the plan reorganized a business that was in place or liquidated it. While this rise in liquidating plans gives some support for the repeated claim that Chapter 11 liquidations have been rising, it is important to look at these numbers in context. In their report of companies filing between 1976 and 1989, the AO indicated that “about 25%” of confirmed plans called for the liquidation of the business. Without more data, it would be hard to declare a trend. ED FLYNN, ADMINISTRATIVE OFFICE OF THE U.S. COURTS, STATISTICAL ANALYSIS OF CHAPTER 11, at 13 (1989).

33. See Gordon Bermant & Ed Flynn, *Bankruptcy by the Numbers, Outcomes of Chapter 11 Cases: U.S. Trustee Database Sheds New Light on Old Questions*, AM. BANKR. INST. J., Feb. 1998, at 8.

34. See Samuel L. Bufford, *What Is Right About Bankruptcy Law and Wrong About Its Critics*, 72 WASH. U. L.Q. 829, 833 (1994).

35. See *id.*

creditors recognize that likelihood. By the same token, many businesses would not have an opportunity to emerge from reorganization with a chance to succeed in the future were it not for a plan that discharged their old debts and gave them a plausible financial prospect. Further, confirmation generally requires the debtor to accomplish a number of tasks suggestive of future success, including garnering the support of a supermajority of creditors and persuading a court of a plan's feasibility.³⁶ Liquidation plans can also be categorized as successes. Although we are quick to recognize all the exceptions and caveats, we stand by the proposition that confirmation results constitute the most important single criterion for judging the benefits of the Chapter 11 system. Best of all from the point of view of two empiricists, we can measure confirmation rates.

II. SUCCESS RATES

The conventional wisdom that the great majority of Chapter 11 cases fail has been accepted with a remarkable lack of skepticism. With some limited exceptions, it was unrefuted and largely uninvestigated prior to the study we describe here. Yet, depending on acceptance of our proposed metrics, it is either wrong or very wrong.

A. Conventional Wisdom: Most Cases Fail

In the world of failing businesses, any device that promises to enhance value draws rapt attention. Chapter 11 reorganization is held up as the alternative to liquidation, a solution that can put more dollars in the pockets of the creditors, save more jobs, and preserve local tax bases. At least as to the first objective, Professors Bris, Welch, and Zho say the data back up the claim. In their study of confirmed plans, they conclude that "the average Chapter 11 case retains value seventy-eight percent better than the average Chapter 7 case."³⁷

That is good news about the Chapter 11 system, but it does not quiet the critics. The primary complaint about Chapter 11 has not been that successful reorganizations did not produce value but rather that too few cases ever manage to confirm a plan of reorganization so that they can preserve that value.³⁸ The conventional wisdom for plan-confirmation rates was

36. See 11 U.S.C. §§ 1126, 1129(a).

37. Arturo Bris et al., *The Costs of Bankruptcy: Chapter 7 Liquidation versus Chapter 11 Reorganization*, 61 J. FIN. 1253, 1269 (2006) (presenting a study of 225 Chapter 11 corporate cases and 61 Chapter 7 corporate cases from Arizona and New York filed from 1995 to 2001). In a review of what they describe as a "similar" dataset, Professors Baird, Bris, and Zhu add the caveat that cases involving assets under \$200,000 pay little to the general unsecured creditors and that payments tend to come only from companies with larger assets. That analysis is based on a study of 17 small cases from a sample of 139 cases filed in Arizona and New York. Douglas Baird et al., *The Dynamics of Large and Small Chapter 11 Cases: An Empirical Study* (Yale Univ. Int'l Ctr. for Fin., Working Paper No. 05-29, 2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=866865.

38. Cf. 1 NAT'L BANKR. REVIEW COMM'N, BANKRUPTCY: THE NEXT TWENTY YEARS 610-12 (1997), available at <http://govinfo.library.unt.edu/nbrcreportcont.html> (defining Chapter 11 success

established in the 1980s by a report issued by the AO, estimating a seventeen percent confirmation rate for all Chapter 11 filings.³⁹ This meant, of course, that more than eight out of every ten Chapter 11 cases hit the skids before a plan of reorganization could be put in place. This is a huge failure rate in a commercial law world measured by rising profits and unflagging growth.

The AO report of high failures was a particularly grim blow to the reputation of Chapter 11 because of its timing. In the 1960s, the Brookings Institute had estimated that the Bankruptcy Act of 1898 had produced successful reorganizations in about thirty-three percent of business cases.⁴⁰ A one-third success rate was perceived as dismal, and a significant part of the impetus behind the revision of Chapter 11 in the Bankruptcy Reform Act of 1978 was to create a modernized Chapter 11 that would be more successful. Instead, in the first report on the new law, the AO reported that success rates had fallen by nearly half to one in six.⁴¹ This finding was a body blow that greatly strengthened the view that the post-1978 Bankruptcy Code's Chapter 11 process was beset by problems.⁴² As a consequence, people adopted the conventional wisdom that plan-confirmation rates under the modern regime have been very low.

A scholarly article published soon after the AO report reinforced the vision of Chapter 11 as a high-failure system. In a study of Chapter 11 cases filed over a ten year period in Poughkeepsie, Susan Jensen-Conklin reported that only 17.3% confirmed a plan of reorganization.⁴³ Ms. Jensen-Conklin went on to work as the General Counsel of the National Bankruptcy Review

as the confirmation and carrying out of a reorganization plan, citing Jensen-Conklin, *supra* note 4, at 325 nn.1551–55, and reporting that her study found that only 6.5% of debtors confirmed and completed a reorganization plan).

39. FLYNN, *supra* note 32, at 10–11 (estimating a seventeen percent confirmation rate for all Chapter 11 filings). The AO analysis was based on data collected by Ernst & Young, drawn from 2,395 cases filed between 1979 and 1986 in 15 districts.

40. DAVID T. STANLEY & MARJORIE GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* 115 (1971). The Brookings Study did not focus on the proportion of cases that confirmed a plan. Instead, it found that two years after their Chapter 11 proceedings were closed, approximately one third of the debtors were still operating their own businesses. *Id.* But they had eliminated the cases that closed before confirmation, so that their finding is not directly comparable to the current inquiry. *Id.*

41. FLYNN, *supra* note 32, at 10–11.

42. An earlier report by Professor Lynn M. LoPucki reported a somewhat higher confirmation rate (twenty-seven percent), but the data were all collected from one district in Missouri and only fifty-seven cases were studied. Lynn M. LoPucki, *The Debtor in Full Control—Systems Failure Under Chapter 11 of the Bankruptcy Code? (First Installment)*, 57 AM. BANKR. L.J. 99 (1983). As a result, the much larger, much better-funded GAO study continued to dominate the conventional wisdom. *See, e.g.*, Jensen-Conklin, *supra* note 4, at 303 n.30. Moreover, the other criticisms launched in the article hardly served as an advertisement for success in Chapter 11. *See* LoPucki, *supra*.

43. Jensen-Conklin, *supra* note 4, at 318. Any doubt about the AO claims would have been set aside by Jensen-Conklin's even more distressing report that only 6.5% of debtors confirmed and completed a reorganization plan. *Id.* at 325.

Commission, and the subsequent Commission Report cited both the AO report and Jensen-Conklin's numbers in its discussion of Chapter 11.⁴⁴

The seventeen percent figure stuck so firmly in the collective consciousness of those interested in bankruptcy that little attention was paid to a few later studies that bore far less grim tidings. In 1998, a little-discussed paper based on data from the Executive Office for United States Trustees reported confirmation rates in business Chapter 11 cases of approximately twenty-six percent.⁴⁵ The power of the study may have been undercut by the authors' description of the data as "preliminary" and a "first look."⁴⁶ Worse yet, the paper provided no explanation of methodology, missing data, and other important details that make the data useful in the academic community. Despite the implied promise of a coming "second look," no further analyses of the data have been published.

Recently, Professors Bris, Welch, and Zhu studied costs of Chapter 11 cases, but their sample deletes "[a]bout half of all bankruptcy cases" because they are "dismissed or transferred to other courts shortly after filing" and deletes all "bankruptcies designated as 'pre-packs.'"⁴⁷ The implications are tantalizing, but without clearer reports of the data, it is impossible to use that research to determine overall confirmation rates for Chapter 11 filings.

A promising study from Professor Morrison reports data generally consistent with ours as to the efficiency of the Chapter 11 process. But the data are drawn from a single year in a single district, with fewer than 100 total cases.⁴⁸ More importantly for this discussion, as of 2008, the data are circulating in a working paper, but they have not yet been published.

Even with these additional reports, there has been no serious challenge to the claim of high failure rates in Chapter 11. The scant contrary data has left the conventional wisdom—with an eighty-three percent failure rate—largely unchallenged.

B. Better Data: Measuring Success Rates

This Section develops two main points. First, this study provides the first fully reported, multidistrict data on the percentage of Chapter 11 cases that result in confirmed plans. The data show that the success rate is at least twice what conventional wisdom holds, approaching a third of the cases filed, even if a simple, naïve metric is employed. Second, by separating cases that were likely dead-on-arrival ("DOAs"), it is possible to develop more realistic confirmation rates. By segregating cases that do propose a plan of reorganization from those that do not and isolating cases that avoid

44. NAT'L BANKR. REVIEW COMM'N, REPORT OF THE NATIONAL BANKRUPTCY REVIEW COMMISSION, ch. 2, nn. 781–82 (Oct. 20, 1997), available at <http://govinfo.library.unt.edu/nbrcreport/09amass.html>.

45. Bermant & Flynn, *supra* note 33.

46. *Id.* at 8.

47. Bris et al., *supra* note 37, at 1256–57.

48. See Morrison, *supra* note 8, at 5–6, 9.

quick dismissals or conversions, it is possible to isolate DOAs from those companies that had a reasonable prospect of success. Using these metrics, we report plan success rates far higher than those estimated by the conventional wisdom.

1. *The Naïve Metric*

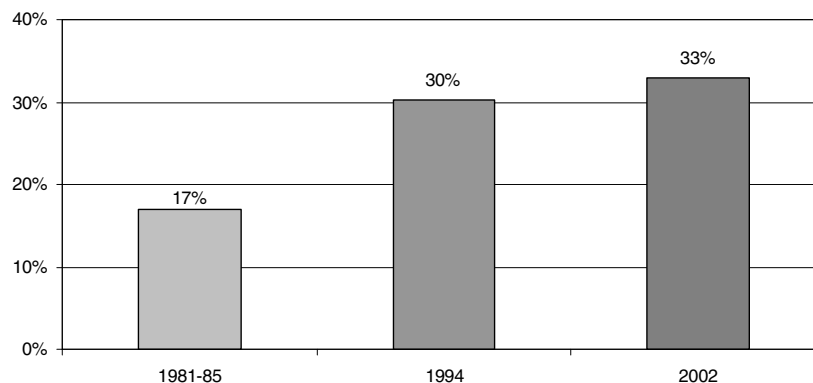
When we take a first look at the Chapter 11 cases from 1994 and 2002, the most striking point is that overall confirmation rates are considerably higher than the 17% confirmation rate initially reported by the AO. In 1994, 30.3% of the cases resulted in confirmed plans. In our 2002 sample, the results are even better, with confirmation rates at 33.4%.⁴⁹ In Figure 1, we compare reported confirmation rates, using this naïve metric.

Our data reveal confirmation rates that are almost double the rate reported by the AO. Instead of a success rate of one in six, these samples suggest that confirmation rates are closer to one in three.⁵⁰ Even by the simplest possible metric, confirmation rates are considerably higher than the conventional wisdom holds.

49. Nine cases (2.1% of the 2002 sample) remain open. We eliminate those cases from this analysis, unsure whether they will confirm or dismiss at rates higher or lower than the other ninety-eight percent of the cases. Given that a case has more opportunity to confirm over time, the pending cases could be predicted to produce a confirmation rate higher still. *See infra* Section III.B.3. In either case, the number of outstanding cases would not change the report substantially.

50. These results are generally consistent with the “first-look” paper issued by the Executive Office for the U.S. Trustees in 1998. *See* Bermant & Flynn, *supra* note 33 (finding that the average annual confirmation rate for the period observed was approximately twenty-six percent).

FIGURE 1
CHAPTER 11 CONFIRMATION RATES:
THE NAÏVE METRIC, ALL CASES⁵¹



N for 1994 = 951; N for 2002 = 422
Sources: Administrative Office of U.S. Courts, 1981-85; Business Bankruptcy Project, 1994 & 2002

We label these figures on confirmation rates “naïve” because they imply one of two propositions, both of which are false: (1) all Chapter 11 cases are plausible candidates for reorganization, or (2) the courts are unable to identify the implausible cases. In effect, this approach is like measuring the success of an emergency room by counting the number of people who die. If it attracts a large number of DOAs, even the best-run emergency room will generate bad reports because the metric is wrong. Like an emergency room, Chapter 11 should be recognized first for its capacity to triage the cases—sorting out the sure losers from those with a chance of survival. Only among the possible survivors should the success rate be measured.

The existence of these two classes of cases is a direct result of the underlying philosophy of Chapter 11. The U.S. bankruptcy system, unlike other systems around the world, places the bankruptcy decision in the hands of the parties, who have superior information about the finances and the likely future of the business and who will not often expend resources to dispute the appropriateness of the filing.⁵² There are many reasons troubled companies do not file for bankruptcy: managers will lose control of the business and

51. Percentages rounded to the nearest unit in all figures. Figure 1 presents the following data:

| 1981-85 | 1994 | 2002 |
|---------|-------|-------|
| 17.0% | 30.3% | 33.4% |

52. For a more detailed discussion of this normative principle as it plays out in Chapter 11, see Elizabeth Warren, *Bankruptcy Policymaking in an Imperfect World*, 92 MICH. L. REV. 336 (1993), reprinted in CHARLES J. TABB, *BANKRUPTCY ANTHOLOGY* 678 (2002). See also WARREN & WESTBROOK, *DEBTORS AND CREDITORS*, *supra* note 7, at 374-76.

risk losing their jobs;⁵³ bankruptcy filings are costly, both in legal fees and lost business;⁵⁴ the optimism that fuels management risk taking also causes management to believe that success is just around the corner.⁵⁵ For these and many other reasons, decision makers may delay seeking bankruptcy help until long after the company can no longer be saved.⁵⁶

There is some evidence that Chapter 11 is used as both emergency room and morgue. Among larger companies, Chapter 11 is the nearly uniform choice of those filing for bankruptcy.⁵⁷ It is highly unlikely that every one of these companies is a realistic candidate for reorganization, but they all take advantage of their right to try. Thus the challenge for a reorganization system is to identify those that do have a realistic chance to succeed. In effect, the large front door for Chapter 11, which admits both companies that can be saved and DOAs, is likely to yield relatively lower total confirmation rates, even if the system is wildly successful in dealing with businesses that have any hope of reorganization.

The measurement trick, of course, is how to sort cases that might plausibly be reorganized from their DOA look-alikes at the moment of filing. Whether a case is implausible or not may be in the eyes of the beholder—or perhaps the owners and managers. Obviously, it would be tautological to say the cases that confirmed a plan could be reorganized and those that did not do so could not be. We look instead for an independent metric. We found two: whether the debtor ever proposed any kind of plan of reorganization and the length of time that a case remained in Chapter 11.

2. Realistic Confirmation Rates I: Companies with a Plan

Any Chapter 11 case that was derailed before a plan could be filed was likely in so much trouble that reorganization was very unlikely.⁵⁸ If the business could not get itself organized enough to put forth some blueprint for getting out of its financial jungle, then it was likely that this business was already doomed before the bankruptcy filing occurred. Once these

53. Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 YALE L.J. 437, 450 (1992) (collecting studies showing high turnover rates among Chapter 11 managers); see also Henry T.C. Hu & Jay Lawrence Westbrook, *Abolition of the Corporate Duty To Creditors*, 107 COLUM. L. REV. 1321, 1377 (2007) (discussing incentives to resolve financial difficulties outside of bankruptcy).

54. Warren, *supra* note 53, at 476 (collecting studies illustrating the costs of Chapter 11).

55. WARREN & WESTBROOK, DEBTORS AND CREDITORS, *supra* note 7, at 406.

56. Indeed, many more companies fold each year than file for Chapter 11. Edward R. Morrison, *Bargaining Around Bankruptcy: Small Business Workouts and State Law 2* (Columbia Univ. Sch. of Law, Ctr. for Law and Econ. Studies, Working Paper No. 320, 2008) (“About 540,000 small businesses closed their doors during 2003, but only 34,000 (six percent) filed [for bankruptcy].”).

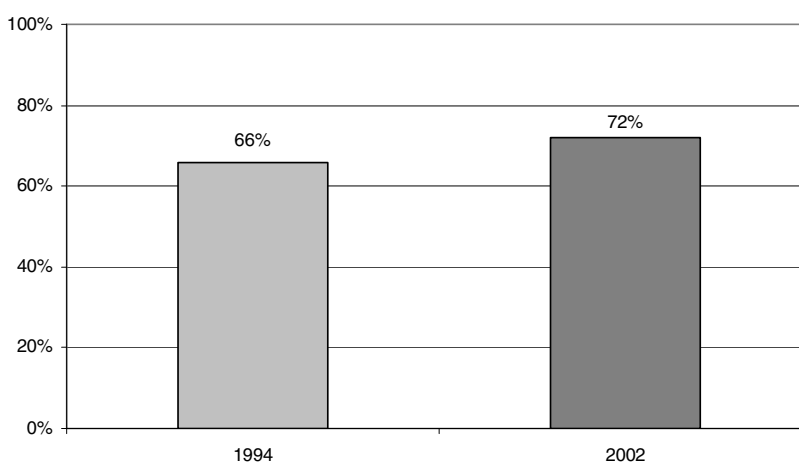
57. Warren & Westbrook, *Financial Characteristics*, *supra* note 11, at 523. Bris, Welch, and Zhu draw a similar conclusion: “Firms are more likely to file for Chapter 11 when they are not tiny.” Bris et al., *supra* note 37, at 1261. They also note that firms are more likely to file for Chapter 11 when they have several secured creditors. *Id.*

58. It could also be a fast-settlement case, as mentioned earlier, so a filing was necessary but not a plan of reorganization. See *supra* text accompanying notes 33–35.

no-plan-ever businesses are sorted out of the Chapter 11 sample, the confirmation rates move sharply upwards.

More than half of the cases in our samples were implausible candidates for reorganization because the debtors never even proposed a plan of reorganization.⁵⁹ As the data in Figure 2 illustrate, among the 1994 filings, 65.5% of cases in which the debtor proposed at least one plan of reorganization eventually confirmed a plan, and in 2002 filings the number was 71.6%.

FIGURE 2
CHAPTER 11 CONFIRMATION RATES,
CASES WITH PLAN PROPOSED⁶⁰



N for 1994 = 437; N for 2002 = 197
Source: Business Bankruptcy Project, 1994 & 2002

It is worth pausing to speculate on which cases never proposed a plan of reorganization. After all, the legal requirements for proposing a plan are minimal at best. Formally, a debtor needs little more than an explanation of how the business will deal with its creditors and the prospects for continuing the business. A thin plan may not win creditors over, but it signals the debtor's basic idea and can be a basis for initiating negotiations with creditors. Why then, did so many Chapter 11 debtors never manage to explain even the barest outline of how they propose to reorganize?

59. Among the sample cases in 1994, 53.7% never filed a plan. Among the sample cases in 2002, 51.7% never filed a plan.

60. Figure 2 presents the following data:

| 1994 | 2002 |
|-------|-------|
| 65.5% | 71.6% |

For some, the problem may have been money. It took only a modest amount to file the documents needed to initiate a Chapter 11 proceeding. The legal requirements for a plan may have been modest, but the business requirements were substantial. To develop a strategy for how the business would survive requires delving into the financial operations of the business, to diagnose its problems and to work out a strategy to solve its problems, which would take substantially more resources. The debtor, the debtor's counsel, or the debtor's business consultants would have to have devoted substantial time—and in the business world, time is money. There might have been a perfect solution lurking out there for the business, but finding that solution could cost more than the business could afford.

The problem may also have been the closely related question of organization. A business that was in chaos, perhaps following the death of a key person or the discovery that funds have been embezzled, may not have been able to gather sufficient information about its own operations to figure out what was wrong and to propose a credible solution. Some experts estimate that many small businesses failed because their poor record keeping and faulty accounting made it impossible for them to tell which business activities were profitable and which were not.⁶¹ Those same difficulties would likely have precluded filing a plan of reorganization.

The most frequent reason that some Chapter 11 debtors did not propose plans may be the most prosaic: once their bankruptcy lawyer or someone else helped them understand just how much trouble the business was in, those in control of the business realized there was no hope. No plan of reorganization can save a business that has lost its customers or that faces costs that exceed what the business can charge for its services. A Chapter 11 filing brought the no-longer-avoidable moment of truth. For the managers of these businesses, it was time to abandon this ship and to begin worrying about personal liability—and for many entrepreneurs, time to move on to the next business undertaking.

If we take the failure to file a plan as a strong indicator that a case was doomed from the start, Chapter 11 could be seen as serving a dual function. It gave the hopeless cases a bit of time to figure out that they were hopeless—an interim step in getting past denial—while offering the protection of the automatic stay for those businesses for which there was some hope. Because the Chapter 11 filing kept hope alive for a while longer, debtors were willing to come into the system. Only after the federal bankruptcy net had been thrown over all the debtor's remaining assets was the debtor forced to face the reality that the business cannot succeed. In those cases, Chapter 11 would not result in a confirmed plan, but it would have served an important function nonetheless.

61. Jim Everett & John Watson, *Small Business Failure and External Risk Factors*, 11 *SMALL BUS. ECON.* 371, 372 (1998) (“The two primary causes of small business failure appear to be a lack of appropriate management skills and inadequate capital . . .”); Stephen Haswell & Scott Holmes, *Estimating the Small Business Failure Rate: A Reappraisal*, *J. SMALL BUS. MGMT.*, July 1989, at 68, 72–73 (suggesting that poor managerial skill, incompetence, inefficiency, and inexperience are common factors in small business failures).

If the initial filings contained both kinds of cases—the impossible and the possible—then any fair evaluation of the data suggests far more success than the naïve rate implies. If serious reorganization candidates were those in which the debtor proposes a plan of reorganization, then the confirmation rates blossom to more than seventy percent for such serious candidates. These rates are more than double the naïve confirmation rate we calculate, and nearly four times the rate cited by the government in the AO report that has served as the core of the conventional wisdom about the success of Chapter 11 for nearly two decades. These data show that for the truly hopeless, life remained hopeless in Chapter 11. But for debtors that can propose a plan of reorganization, the prospects of plan confirmation are quite favorable.

3. *Realistic Confirmation Rates II: Companies that Survive the Cull*

Another independent metric for sorting the cases where debtors could be reorganized from their DOA companions is to examine confirmation rates against the background of the Chapter 11 sorting process. Instead of focusing on the action of the debtor—proposing a plan of reorganization—it is possible to focus on actions largely driven by the creditors and the courts—dismissals and conversions. In other words, if the creditors and courts got rid of the worst cases fast, then survival time in Chapter 11 might be a signal that someone other than the debtor believes that a case has some plausible chance for reorganization. Just as important, quicker action on cases that would fail means that fewer resources were likely expended on those cases and that creditors were held back from enforcing their contract rights for a shorter time. For this analysis, we again look at confirmation rates, this time by exploring what happens to the cases that survive early screening. We discuss the overall culling process in more detail below.

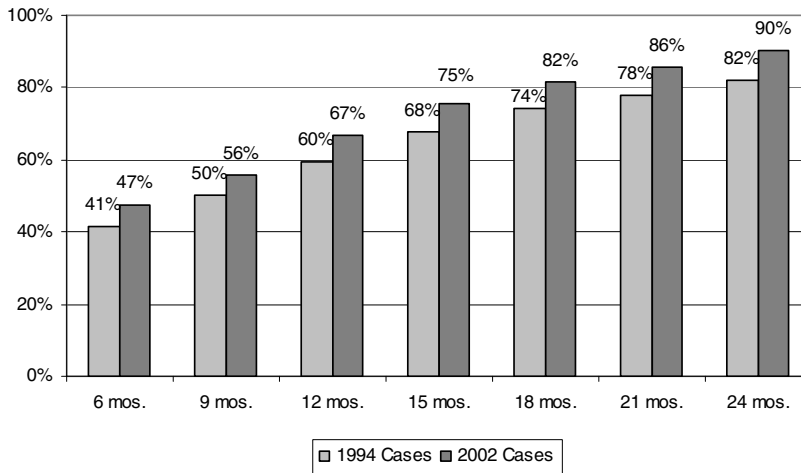
The data reported in Figure 3 show that substantial screening occurred early in a case. In both 1994 and 2002, if a Chapter 11 case was not dismissed or converted within the six months after filing, it stood a good chance of confirming a plan. For 1994, the confirmation rate for cases that survived six months was 41%, and by 2002, the confirmation rate for cases surviving six months was 47%.⁶² Thus, once the courts culled the weak cases in the first few months, the Chapter 11 confirmation rate was more than twice as high as the 17% rate laid down by the AO report. This one screen also produced confirmation rates that are almost 50% higher than the naïve rate that we had found for the whole sample.

At the nine-month mark, the confirmation rates rise even higher. Any case that survived nine months had a 50.4% chance of surviving to plan con-

62. The two samples differ substantially as to district and size of cases. As noted above, we have only nine districts in 2002, compared with twenty-three districts in 1994. *See supra* notes 15, 18, 20 and accompanying text. Moreover, the cases in the 2002 sample are larger on average than their counterparts in the 1994 sample. Given district level variation and differences we report in this paper as to size of cases, it is impossible to be certain about the substantive significance of comparisons between the two samples.

firmation in 1994 and a 55.7% chance in 2002. Even after the first months in Chapter 11, the courts continued to squeeze out the weak cases. After fifteen months, the confirmation rate was two-thirds in 1994 and 75% in 2002. When we look as far out as two years after a case was filed, the data for the surviving cases shows that 82% and 90% of all cases in 1994 and 2002 respectively resulted in confirmed plans.⁶³

FIGURE 3
CUMULATIVE CONFIRMATION RATES,
BY LENGTH OF SURVIVAL IN CHAPTER 11⁶⁴



N for 1994 = 697; N for 2002 = 298
Source: Business Bankruptcy Project, 1994 & 2002

These data suggest that the courts pushed the losers out early. In those cases in which debtors and creditors had to be more patient, the result was frequently worth the wait, at least to the extent that the company left Chapter 11 with a confirmed plan in place. Once the courts had done some early culling of the DOA cases, confirmation rates rose sharply. Cases that

63. Of course, that means that about one in ten of the cases that hung around the courthouse for two years or more in 2002 did not get confirmed, which suggests an area of further research and possible reform.

64. Figure 3 presents the following data:

| | 6 Months | 9 Months | 12 Months | 15 Months | 18 Months | 21 Months | 24 Months |
|------------|----------|----------|-----------|-----------|-----------|-----------|-----------|
| 1994 Cases | 41.3% | 50.4% | 59.5% | 67.8% | 74.0% | 78.1% | 81.8% |
| 2002 Cases | 47.3% | 55.7% | 66.8% | 75.4% | 81.5% | 85.5% | 90.4% |

survived the initial screening were far more likely to confirm a plan of reorganization.

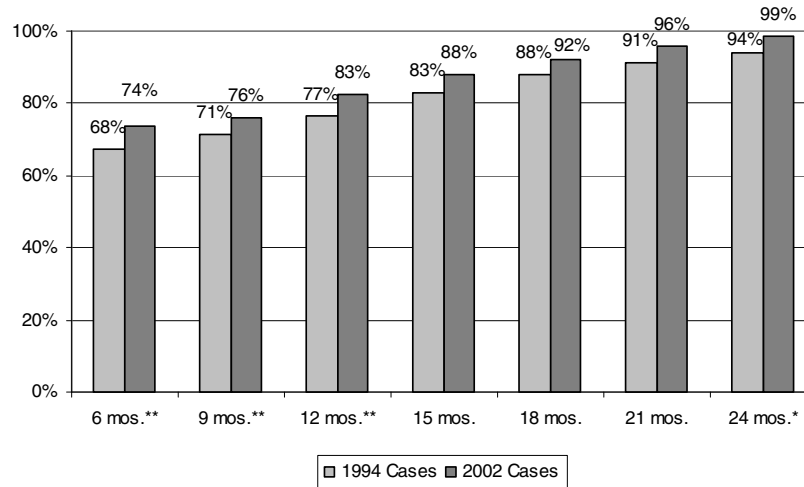
4. *Realistic Confirmation Rates III:
Companies that Survive a Double Screening*

Following the lead of doctors who look at multiple symptoms to diagnose patients, it is possible to combine factors to sort out the cases that might be reorganized from those that have no hope. The DOAs might be grouped as those cases that either could not propose a plan or could not survive six months, or both. The remaining cases were serious candidates for reorganization. In 1994, sixty-eight percent of the businesses confirmed a plan if they lasted as long as six months in Chapter 11 *and* filed a plan. By 2002, the equivalent rate was seventy-four percent.⁶⁵

The cumulative confirmation rates continued to rise with survival time in Chapter 11. As Figure 4 illustrates, cases that survived a year and proposed a plan of reorganization managed to confirm a plan 76.5% of the time in 1994 and 82.5% of the time in 2002. After two years, the numbers were even more positive. Fully 94.1% of the 1994 cases that proposed a plan and survived for two years managed to confirm a plan; by 2002, the number was 98.6%.

65. See *supra* note 62.

FIGURE 4
CUMULATIVE CONFIRMATION RATES FOR CASES THAT
PROPOSED A PLAN BY TIME OF SURVIVAL⁶⁶



N for 1994 = 697; N for 2002 = 298
Source: Business Bankruptcy Project, 1994 & 2002
*Significant at $p \leq 0.05$; **Significant at $p \leq 0.01$

Success is an elusive concept, but these data show that when Chapter 11 performed its sorting function, plan-confirmation rates were quite high.

III. TIME TO CONFIRMATION

In Part II, we discussed success rates, with only a nod to the time required for success. Here in Part III, we emphasize the time it took successful cases to confirm a plan. Higher-than-expected confirmation rates will change the vision of the pre-2005 Amendment version of Chapter 11, but they will not win over all the skeptics. Some will ask, quite reasonably, what was the cost of reaching plan confirmation? How long will the automatic stay hold creditors at bay, while they are unable to collect on their debts or seize collateral, in order to give the debtor time to reorganize the business? Scheming debtors and their dilatory counsel sapped all the value out of a

66. Figure 4 presents the following data:

| | 6 Months** | 9 Months** | 12 Months** | 15 Months | 18 Months | 21 Months | 24 Months* |
|------------|------------|------------|-------------|-----------|-----------|-----------|------------|
| 1994 Cases | 67.5% | 71.3% | 76.5% | 82.9% | 88.0% | 91.1% | 94.1% |
| 2002 Cases | 73.8% | 76.2% | 82.5% | 88.1% | 92.2% | 95.9% | 98.6% |

*Significant at $p \leq 0.05$

**Significant at $p \leq 0.01$

business and left it a hollow shell—or so goes the conventional wisdom. The data we report here, however, suggest that the conventional wisdom is wrong.

A. Conventional Wisdom: Endless Delay

*In re Humble Place Joint Venture*⁶⁷ was a Fifth Circuit opinion that crystallized much of the perception of Chapter 11 cases in the 1980s and 1990s. Judge Jones excoriated a real estate development company that had filed Chapter 11 to stave off foreclosure of a real estate development. The developer had testified that, while the Chapter 11 case was pending, the owner's business plan consisted of "mowing the grass and waiting for market conditions to turn,"⁶⁸ causing Judge Jones to confirm dismissal of the developer's case as a bad-faith filing.⁶⁹ Despite the dismissal, the case only intensified the view that bankruptcy had become a haven for businesses that wanted to hide out from their creditors. Chapter 11, so went the story, was a safe zone that scoundrels used to evade their responsibilities—except perhaps in the rare cases in which a valiant judge would force them out.

Both practitioners⁷⁰ and academics⁷¹ seized on the theme. They argued that debtors like the one in *Humble Place* were typical of Chapter 11. These businesses sought only delay and strategic advantage, not true reorganization, and their creditors bore the costs. Indeed, an academic cottage industry sprang up advancing proposals to cope with this abuse. Various forms of auctions or other automated bankruptcy devices were proposed in order to move debtors in and out of bankruptcy in a matter of days so that the costs and leverage associated with delay would be eliminated.⁷² The problem of abuse-by-delay was so well recognized that it evidently required no proof of its existence, permitting most papers to begin with the well-accepted assertion of the problem and segueing quickly into the author's specific fixes.⁷³

67. 936 F.2d 814 (5th Cir. 1991).

68. *In re Humble Place*, 936 F.2d at 817.

69. *Id.* at 818–19.

70. See, e.g., Martin J. Whitman et al., *A Rejoinder to "The Untenable Case for Chapter 11"*, 2 J. BANKR. L. & PRAC. 839 (1993).

71. See, e.g., Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043 (1992).

72. See, e.g., Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 323–33 (1993) (positing a system of tiered-debt priority governed by contract as a substitute for the current organization process); Aghion et al., *Improving Bankruptcy Procedure*, *supra* note 7, at 861–66 (attempting to eliminate delay in resolving bankruptcy by replacing the bargaining that occurs in the current reorganization system with a process that is consistent with absolute priority); Lucian A. Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775, 782–88 (1988) (suggesting that the current reorganization process be replaced with a system that categorizes different stakeholders and gives each class separate rights based on a "reorganization value" that will operate automatically and quickly); Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Corporate Bankruptcy*, 71 TEX. L. REV. 51, 100–07, 116 (1992) (calling for a reorganization system that creates bankruptcy by contract where the debtor chooses from a menu of different options at its inception).

73. See generally Warren & Westbrook, *Contracting Out*, *supra* note 11.

Any thoughtful evaluation of Chapter 11 eventually boils down to weighing costs and benefits. It is clear that any legal system that allows for reorganization will incur costs from delayed liquidation that must be balanced against the benefits of reorganization. The problem of costs is often overstated,⁷⁴ but costs remain substantial nonetheless. The professional fees and other expenses associated with a Chapter 11 case diminish the value available to creditors, a consequence that is felt most sharply if the reorganization fails and liquidation follows. In addition, the time spent in bankruptcy itself leads to the loss of value, comprising an indirect cost. On the other side of the ledger, it is generally thought that successful reorganization preserves value, especially going-concern value, compared with a liquidation option. A reorganization is also thought to produce substantial positive externalities, such as maintaining employment, preserving the local tax base, and advancing community stability.⁷⁵ To ensure that these benefits exceed the costs of delay and the administrative expense of reorganization, a reorganization system should move cases through the system quickly, giving an opportunity to those with a real chance of success and disposing of those that were destined for liquidation.

This quick-resolution effect has been a paramount concern in bankruptcy reform efforts in countries around the world. Chapter 11 has proven to be a very attractive model for these countries, with certain caveats.⁷⁶ A principal reservation has arisen from articles, mostly by Americans, claiming that Chapter 11 has led to substantial delays.⁷⁷ The combined attraction and concern resulted in the enormously influential German reform adopted in 1994. The new German approach was a reorganization procedure closely following the Chapter 11 model, but with a single entry point for liquidation and reorganization cases.⁷⁸ As one of the principal architects of the German law has said:

The new [German] law introduced a unitary insolvency proceeding. This proceeding differs from existing bankruptcy and composition proceedings (i.e., Chapters 7 and 11 of the U.S. Bankruptcy Code) in that it does not distinguish either the procedural rules or the influence and exit rights of claimants according to who files (i.e., the debtor or the creditor), or

74. See Lubben, *supra* note 4, at 509–10 (observing that the marginal costs of Chapter 11 are nominal).

75. See, e.g., Warren, *supra* note 52, at 345.

76. One, of course, is the debtor-in-possession, which is very difficult for our foreign friends to accept—fox in charge of the hen house and all that.

77. For example, J.J. White believes “that the largest and most palpable costs of Chapter 11 arise from delay,” and that, indeed, “Chapter 11—at least as practiced in large cases—appears to condone and even exaggerate delay and the attendant costs.” White, *supra* note 4, at 473–74. See also Thomas H. Jackson, *Of Liquidation, Continuation, and Delay: An Analysis of Bankruptcy Policy and Nonbankruptcy Rules*, 60 AM. BANKR. L.J. 399, 402 (1986); sources cited *supra* note 4.

78. Manfred Balz, *Market Conformity of Insolvency Proceedings: Policy Issues of the German Insolvency Law*, 23 BROOK. J. INT’L L. 167, 170, 172 (1997); Klaus Kamlah, *The New German Insolvency Act: Insolvenzordnung*, 70 AM. BANKR. L.J. 417, 421, 424 (1996).

according to which outcome of the proceedings is expected or preferred by the petitioner (i.e., liquidation or reorganization).⁷⁹

That is, in Germany a company merely files for “bankruptcy.” An insolvency administrator is then appointed and given a period to investigate and then recommend whether liquidation or reorganization is the appropriate goal for that company, evidently avoiding the Chapter 11 invitation for debtor delay.⁸⁰ Other countries have followed that model as well, notably our neighbor Mexico.⁸¹

The new German structure was explicitly based on Chapter 11, but with important differences.⁸² Dr. Balz’s explanation of the deviations from the United States’ Chapter 11 model makes it clear that the delay decried by American academics was a central reason for those modifications.⁸³ Thus a major bankruptcy reform rested in significant part on the conventional wisdom that Chapter 11 was slow and inefficient.

The impact of conventional wisdom is palpable. Within the United States, some of the most prominent authorities of a generation have focused their considerable talents on constructing and advocating the complete redesign of Chapter 11 in part to avoid the kind of “just mowing and waiting” problems denounced by Judge Jones.⁸⁴ Around the world, the effects are even more concrete. Legal structures to reorganize failing businesses have been tailored, at least in part, to push cases along in order to avoid the perceived pitfalls of America’s Chapter 11 system.

B. Better Data: More Speed

The median time spent in Chapter 11 is about eleven months, but once again a too-simple metric obscures a clearer understanding of how the system operates. The data show that a substantial number of cases are moved out far more quickly. A third of all cases were ejected within six months and about half were gone by the nine-month mark. Among the DOA cases (identified this way because no plan was ever filed), fully seventy percent of the losers were gone within nine months. In various combinations, the data all point toward the conclusion that the sorting out happens quite promptly.

79. Balz, *supra* note 78, at 172 (footnotes omitted).

80. *See id.* at 172–79.

81. *See* AM. LAW INST., TRANSNATIONAL INSOLVENCY: COOPERATION AMONG THE NAFTA COUNTRIES, INTERNATIONAL STATEMENT OF MEXICAN BANKRUPTCY LAW 26–27 (2003). Mexico’s example is telling, because of its emphasis on reorganization, rather than liquidation. *Id.* at 81. In this system, no reorganization can be undertaken until the conciliator has recommended that course of action to the court. *See id.* at 27.

82. *See* Balz, *supra* note 78, at 170.

83. *Id.* at 170–71, 174–75.

84. *See, e.g.*, Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311 (1993); Edith H. Jones, *Chapter 11: A Death Penalty for Debtor and Creditor Interests*, 77 CORNELL L. REV. 1088 (1992).

1. How Long in Chapter 11?

There were four possible outcomes in most Chapter 11 cases: dismissal, conversion to Chapter 7, liquidation by sale in Chapter 11, and confirmation of a plan of reorganization.⁸⁵ Any of these outcomes resolved the case in the sense that the system had completed its job. Admittedly, the categories are not perfect predictors of eventual disposition; even a confirmed plan does not guarantee continuation of the business, while a dismissal may be the prelude to a sale or private refinancing. But either plan confirmation or case dismissal ends the reorganization system's involvement in reshaping the business.⁸⁶ Similarly, conversion to a Chapter 7 liquidation meant that the bankruptcy system as a whole still had work to do, but the Chapter 11 system had reached resolution. Upon the achievement of any of the four listed outcomes, Chapter 11 was successful in finding a resolution of the two questions presented to it. First, could this company be reorganized to the point of a confirmed plan and sent back into the marketplace for another go? Second, if not, what was the proper disposition of the case: dismissal, conversion, or Chapter 11 liquidation? While the resolution achieved may or may not have been the best available,⁸⁷ the question we address here is whether it was achieved promptly or whether, as so many have charged, the case languished in the protective bosom of the bankruptcy court.

Of course, what timing is "prompt" lies to some extent in the eyes of the beholder. To a secured party anxious to foreclose in a declining market, six months in Chapter 11 may have seemed like an eternity, while to the management of a major airline trying to rework a business plan around labor contracts, pension obligations, rising fuel prices, increased security regulations, the need to replace aging equipment, and a fickle flying public, two years may have passed all too quickly.⁸⁸ In the context of a major decision

85. We did not gather data about § 363 sales in the 1994 database, but we did identify cases in which there was a "substantial sale" in our 2002 database. Thus for our original 1994 database, there are only three categories of case resolution: dismissed, converted, or confirmed. We included confirmations of both reorganization and liquidation plans, given that either type resolves the Chapter 11 case.

86. The technical finish of any bankruptcy case comes when the case is "closed," but that is a purely administrative procedure involving pulling the files together and sending them off to be archived, after all the substantive work has been done. When a case is closed may often depend more on the schedule and resources of a clerk's office than upon anything about the substantive resolution of the case. FED. R. BANKR. 3022 advisory committee's n.; *see also In re Kleigl Bros. Universal Elec. Stage Lighting Co.* 238 B.R. 531, 541 (Bankr. E.D.N.Y. 1999).

87. For example, the imperfections of a reorganization system might cause the dismissal or conversion of a company that could have been saved or might cause the confirmation of a plan bound to fail quickly after the company's reemergence. The facts about these sorts of questions range from hard-to-measure to immeasurable. *But see* LoPucki & Kalin, *supra* note 13.

88. The outside period during which management has the exclusive right to propose a plan of reorganization in Chapter 11 is now eighteen months; after that, any interested party may propose a plan. 11 U.S.C. § 1121(d)(2) (2006). Absent a showing of likely success, which is difficult to make, a "small business" has only six months. 11 U.S.C. § 1121(e). These provisions were both added as part of the 2005 Amendments to the Bankruptcy Code. At the time these data were collected, courts could extend the period of exclusivity indefinitely for large or small cases. 11 U.S.C. § 1121 (2000) (current version at 11 U.S.C. § 1121 (2006)).

about the life or death of a business, including attempts to negotiate a plan of reorganization with creditors while repositioning the business in the marketplace, the data suggest to us that the courts are sorting the sheep from the goats quite promptly.

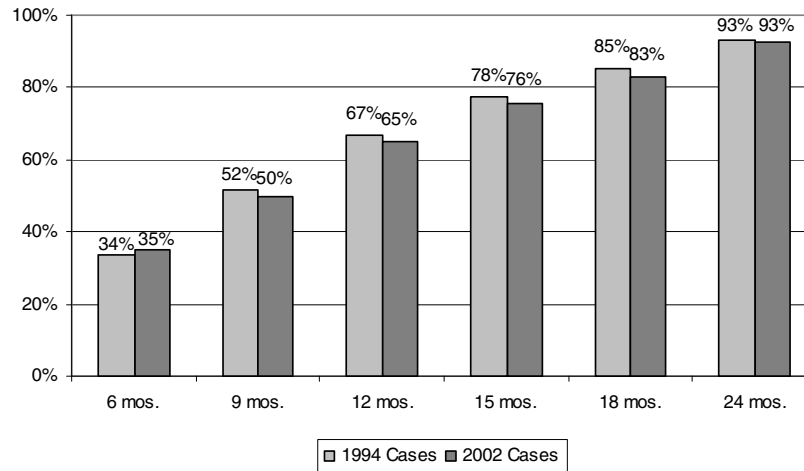
In both samples, the 1994 cases and the 2002 cases, more than a third of the cases had reached final resolution within just six months of filing—with dismissal of the case, conversion to another chapter, or confirmation of the plan.⁸⁹ Some combination of judicial management, creditor pressure, incentives, and disincentives pushed a third of the cases out of court very quickly.

As Figure 5 illustrates, if the time is lengthened just a bit, the resolution rate increases. Within nine months, half the cases were resolved. By one year, two-thirds of the cases were completed. In a system that was willing to pay some price to see to it that businesses have a meaningful opportunity to survive, moving one-third of the cases through the system in less than six months and two-thirds in less than a year seems quite efficient.⁹⁰

89. Among the cases filed in 1994, 33.5% were resolved within six months, 51.5% were resolved within nine months, 66.7% were resolved within a year, and 92.9% were resolved within two years. Among the cases filed in 2002, 35.1% were resolved within six months, 49.6% were resolved within nine months, 65.2% were resolved within a year, and 92.6% were resolved within two years. See *supra* note 62 for information about comparing these two years.

90. The timing reported here appears to compare quite favorably with the length in Chapter 11 reported by Bris, Welch, and Zhu. They claim that “the average Chapter 7 and Chapter 11 bankruptcies take about 2 years to resolve.” Bris et al., *supra* note 37, at 1270. But once again, it is critical to note the differences in the cases studied. Because the authors eliminated all cases that were dismissed early in the process, they produce a profound right-bias to the timing question. *Id.* at 1256–57. In effect, their data stand for the proposition that once the cases that are taken care of quickly are eliminated, the cases that take a longer time take two years on average. Similarly, Franks and Touros report that Chapter 11 cases from the 1980s took an average of 3.7 years to resolve, but their sample has eliminated the cases that are dispensed with early in the process. Julian R. Franks & Walter N. Torous, *An Empirical Investigation of U.S. Firms in Reorganization*, 44 J. FIN. 747, 753 (1989).

FIGURE 5
CUMULATIVE DISPOSITION OVER TIME, ALL CASES⁹¹



N for 1994 = 925; N for 2002 = 419
Source: Business Bankruptcy Project, 1994 & 2002

The typical Chapter 11 case was resolved in about nine months.⁹² The mean time, pulled up by a handful of cases that took much longer, was still less than a year, running about eleven months, on average.⁹³ By two years, nearly all cases were resolved.⁹⁴

Some of those dispositions no doubt arose from lifting the stay to permit secured creditors to repossess or foreclose, with dismissal following quickly. Others may have represented settlements achieved with creditors on the courthouse steps, so that dismissal was a handshake among the key parties as they settled on a survival plan for the business. Others may have resulted from the work of judges who actively and vigorously managed their

91. Figure 5 presents the following data:

| | 6 Months | 9 Months | 12 Months | 15 Months | 18 Months | 24 Months |
|------------|----------|----------|-----------|-----------|-----------|-----------|
| 1994 Cases | 33.5% | 51.5% | 66.7% | 77.5% | 85.2% | 92.9% |
| 2002 Cases | 35.1% | 49.6% | 65.2% | 75.7% | 82.8% | 92.6% |

92. The median time-to-resolution for a Chapter 11 case filed in 1994 was 264 days, while the median time-to-resolution for a Chapter 11 case filed in 2002 was 274 days.

93. The time-to-resolution for cases in the 1994 and 2002 studies was 329 and 327 days, respectively.

94. After two years 92.9% of cases from the 1994 study were resolved and 92.6% of cases from the 2002 study were resolved.

dockets.⁹⁵ Still others may reflect the decision of judges to eschew active case management, but to clarify legal standards and to make prompt decisions when disputes arose. The reasons may be myriad, but the speed of the results is nonetheless clear.

2. *Pushing out the Losers*

Like the naïve metric for confirmation rates, a single analysis of the time consumed by all Chapter 11 cases in our data set mixes up two kinds of cases, thereby yielding less useful information. To measure whether the Chapter 11 system quickly sorted DOAs from businesses showing signs of life, it is necessary to look more closely at the cases that were booted out of the system. An efficient reorganization system should aim to dispose of the losers as soon as possible, avoiding both further delay and professional costs.⁹⁶ Time and fees that may be justified to secure a reasonable chance of reorganization may not be justified for the lesser task of sweeping the losers out the door.

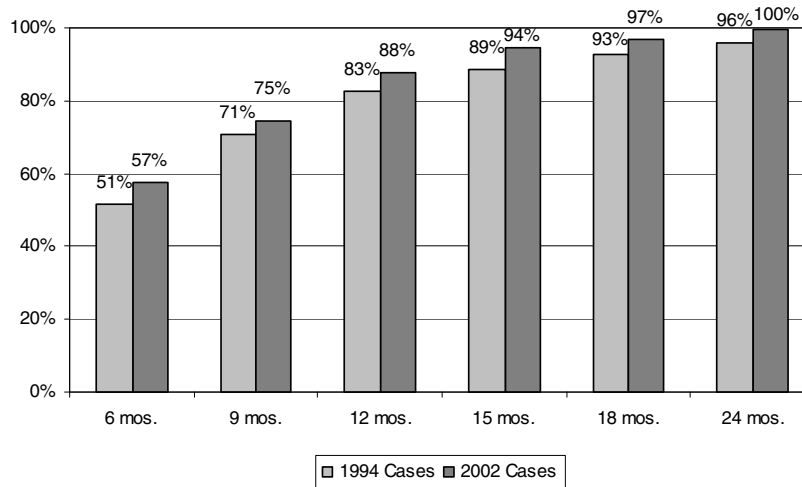
There is a high potential for circular reasoning in describing what happened when cases were forced out of the system quickly: once a case was forced out, it became, by definition, a failure. A bankruptcy judge could have a very speedy track record by pushing all cases out in a matter of days, but then the benefits of Chapter 11 reorganization would be lost.

Once again, it is useful to look at an independent metric to sort winners from losers. Figure 6 shows that, of all the cases that were eventually pushed out of Chapter 11 without a plan having been filed, more than half were gone in less than six months, 70% were gone by nine months, and more than 80% were gone within a year. By eighteen months, more than 90% of all the cases that will exit Chapter 11 without a plan on file had already been pushed out of the system.

95. See, e.g., Humphries and Munden, *supra* note 12, at 74–75.

96. As noted earlier, we recognize that some dismissed cases may represent a use of Chapter 11 to permit negotiations that lead to satisfactory solutions outside a plan, but we have no data on that point. See *supra* note 34 and accompanying text.

FIGURE 6
DISMISSAL/CONVERSION OVER TIME,
CASES WITH NO PLAN PROPOSED⁹⁷



N for 1994 = 925; N for 2002 = 419
Source: Business Bankruptcy Project, 1994 & 2002

In those cases where no plan was confirmed, whether or not one was ever proposed, the system's sorting performance was almost as good. Naturally, inclusion of unsuccessful cases where a plan was proposed would increase the overall disposition time because those cases might last a bit longer than failed cases where no plan was even on the table. Still, of all the cases that were eventually pushed out of Chapter 11 in 1994 without confirming a plan, 40% were gone in less than six months, 60% were gone by nine months, and about three-quarters were gone within a year. By 18 months, almost 90% of all the cases that will exit Chapter 11 without a confirmed plan have already been pushed out of the system. The figures in our 2002 sample were even better: 48%, 63%, 79%, and 93% for six, nine, twelve, and eighteen months respectively.

As Figure 6 illustrates, in both samples, in cases filed eight years apart, the reorganization system was sorting out the winners from the losers in reasonably short periods of time. Perhaps equally impressive, the median time for resolution of all cases that were dismissed or converted was about

97. Figure 6 presents the following data:

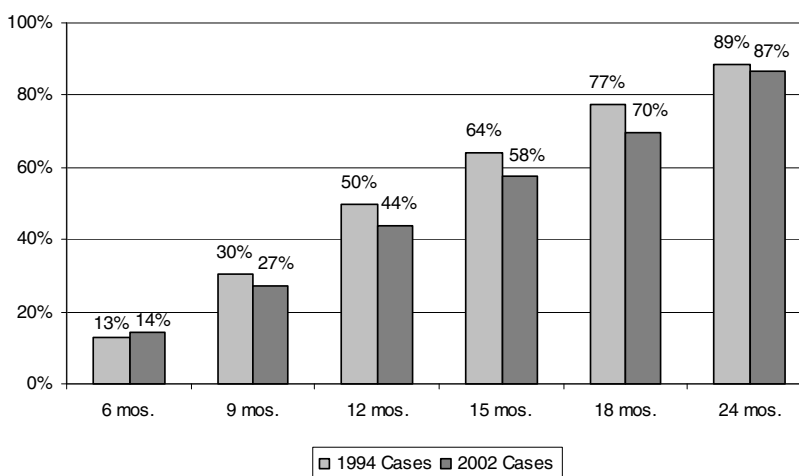
| | 6 Months | 9 Months | 12 Months | 15 Months | 18 Months | 24 Months |
|------------|----------|----------|-----------|-----------|-----------|-----------|
| 1994 Cases | 51.4% | 70.7% | 82.5% | 88.8% | 92.7% | 95.7% |
| 2002 Cases | 57.4% | 74.6% | 87.6% | 94.3% | 96.7% | 99.5% |

seven months in both samples. From the viewpoint of these exit cases, the system's performance was remarkably quick.

3. Giving Winners Time to Win

At the success end of the spectrum, the work was slower. As befits the portion of the system that requires negotiations, notice, voting, confirmation hearings, and the like, the time to confirmation was about a third longer than the time to dismissal. As Figure 7 illustrates, in both 1994 and 2002 the median time to confirmation was close to one year.⁹⁸ Even in confirmation, however, some cases moved quite quickly. More than a quarter of the confirming cases confirmed in the first nine months.

FIGURE 7
CUMULATIVE CONFIRMATION TIMES FOR CASES
WITH CONFIRMED PLANS⁹⁹



N for 1994 = 925; N for 2002 = 419
Source: Business Bankruptcy Project, 1994 & 2002

98. The mean time to confirmation in the 1994 sample was fourteen months, but was 15.4 months in 2002.

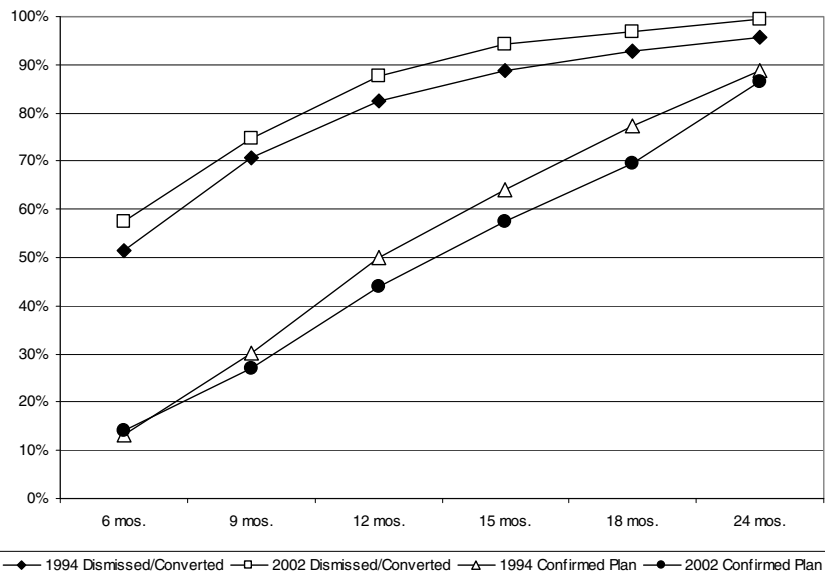
99. Figure 7 presents the following data:

| | 6 Months | 9 Months | 12 Months | 15 Months | 18 Months | 24 Months |
|------------|----------|----------|-----------|-----------|-----------|-----------|
| 1994 Cases | 13.1% | 30.3% | 50.0% | 64.2% | 77.4% | 88.7% |
| 2002 Cases | 14.2% | 27.0% | 44.0% | 57.5% | 69.5% | 86.5% |

Success carries its own costs, and taking the time to succeed is obviously one of those costs. Cases can fail quickly, but the data suggest that the negotiations, proposals, and strategies employed to resuscitate a failing business take time.

The time-to-resolution for success and failure in Chapter 11 are summarized in Figure 8 for the two sample years. In both years, the top two lines show that failures move out of the system quickly, while the bottom two lines represent the necessarily slower pace of successful business reorganizations.

FIGURE 8
CUMULATIVE DISPOSITIONS OVER TIME,
BY CONFIRM OR DISMISS/CONVERT¹⁰⁰



Source: Business Bankruptcy Project, 1994 & 2002

100. Figure 8 presents the following data:

| | Dismissed/Converted | | Confirmed Plan | |
|-----------|---------------------|--------|----------------|--------|
| | 1994 | 2002 | 1994 | 2002 |
| 6 months | 51.40% | 57.40% | 13.10% | 14.20% |
| 9 months | 70.70% | 74.60% | 30.30% | 27.00% |
| 12 months | 82.50% | 87.60% | 50.00% | 44.00% |
| 15 months | 88.80% | 94.30% | 64.20% | 57.50% |
| 18 months | 92.70% | 96.70% | 77.40% | 69.50% |
| 24 months | 95.70% | 99.50% | 88.70% | 86.50% |

The data show that cases move through the Chapter 11 system at a lively pace, both in the aggregate and in the subcategories of success and failure. Losers move faster than winners, suggesting that courts are actively engaging in culling cases that have little prospect of confirming a plan of reorganization. The similarity of the patterns in both 1994 and 2002 indicates systemic approaches that persist over time.

IV. WHO SUCCEEDS: SIZE, SPEED, AND SUCCESS

A. A Critical Combination

Throughout the analysis of these data we try to remain cognizant of the wide variety of the Chapter 11 cases in our data set. Not only were there cases in different states of distress, there were also big differences in size. The interactive effects of speed and success add another dimension to the understanding of Chapter 11. Our data confirm that success takes longer than failure, but they also show that large-company failures take longer than small ones.

To compare outcomes for companies in bankruptcy by size, we use the handy metric of total debt.¹⁰¹ It is not a perfect measure, particularly because small outfits can run up huge debts. But the debt load provides some sense of the magnitude of the business's borrowing before bankruptcy and of the kind of problem the debtor is dealing with in Chapter 11. Among the businesses in our Chapter 11 sample, in 1994, cases spread from a reported debt of \$398 to \$222 million, with a median total debt of about \$643,490 (in nominal dollars). By 2002, case size had expanded. The range in Chapter 11 grew even larger, from \$6,258 to just over \$6 billion. The median also moved up to \$1.8 million.

As we noted earlier, most companies of any size file for Chapter 11 even if they are ultimately destined for liquidation.¹⁰² In 2002, ninety-seven percent of our Chapter 7 business filings were for companies with less than \$500,000 of assets.¹⁰³ Larger companies do not file for Chapter 7, even when

101. Asset valuation, especially for companies in financial distress, is notoriously difficult and uncertain, in part because used assets may be difficult and expensive to market and the value of the asset may depend in critical part on the success of the business. Restaurant equipment that can remain in place in an operational restaurant, for example, may be far more valuable than restaurant equipment that will be sold when the business closes. It is not clear at the inception of a case what kind of valuation the debtor has employed. By contrast, debt is typically easy to calculate and debtors have every incentive to accurately list every creditor and the amount owed. For a more detailed discussion of the value of using debt rather than assets for size comparisons in bankruptcy, see Lubben, *supra* note 4. Lubben states: "An analysis that focuses solely on asset levels also distinctly neglects a large portion of the class of 'large' debtors: a company that owes hundreds of millions of dollars to investors clearly did not arrive at such a situation by being 'small,' regardless of currently existing asset levels." *Id.* at 521.

102. Among companies with \$1 million or more in debt, ninety-five percent begin their time in bankruptcy in Chapter 11. Warren & Westbrook, *Financial Characteristics*, *supra* note 11, at 523.

103. Two-thirds of those businesses had \$100,000 or less of assets. The comparable figure for 1994 was seventy-four percent. *Id.* at 524 tbl.2A.

liquidation is an almost-certain prospect.¹⁰⁴ Instead, they file for Chapter 11, using it either for a reorganization effort or as a vehicle for liquidation.

Smaller companies, by contrast, exhibited more diversity in filing choices. Management of small companies may have preferred Chapter 11, and many small businesses filed Chapter 11 cases.¹⁰⁵ Nonetheless, Chapter 11 was not the exclusive option for such companies, and many small businesses began and quickly ended their days in bankruptcy by liquidating in Chapter 7. The first level of sorting—sending the DOA cases somewhere else—had already occurred in a two-chapter system.

The effectiveness of the chapter choice as a device for sorting by size is echoed in part by the confirmation rates. Using the naïve metric, it is possible to measure confirmation rates for bigger and smaller cases. Among the businesses filing in Chapter 11 in 1994, those with debts below the median managed to confirm plans of reorganization at a rate of about 24.6%, while those above the median enjoyed a confirmation rate of 36.7%.¹⁰⁶ By 2002, that difference was even sharper. The confirmation rate for below-median cases was 21.3%, while the confirmation rate for above-median debtors was 48.5%.¹⁰⁷ By 2002, bigger cases enjoyed more than double the success rate of their smaller counterparts.

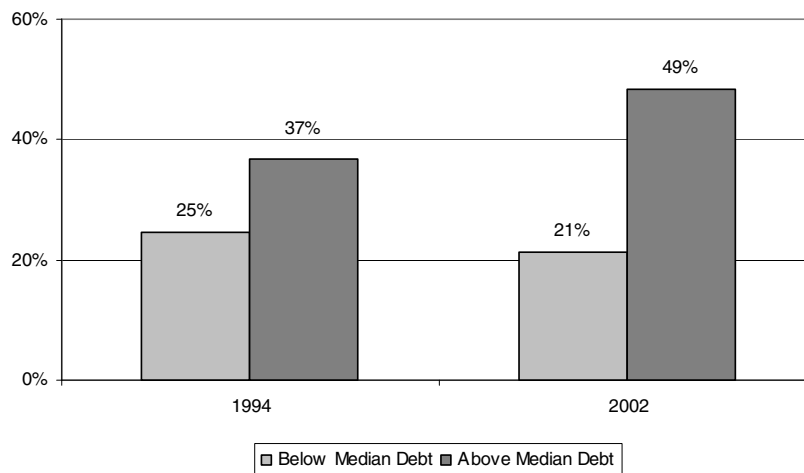
104. *Id.* at 523. Bris, Welch, and Zhu draw a similar conclusion: “[f]irms are more likely to file for Chapter 11 when they are not tiny.” Bris et al., *supra* note 37, at 1261. They also note that firms are more likely to file for Chapter 11 when they have several secured creditors. *Id.*

105. More than two-thirds of businesses filing under Chapter 11 had \$1 million or less in assets. Warren & Westbrook, *Financial Characteristics*, *supra* note 11, at 524 tbl.2A.

106. The difference is statistically significant at $p < 0.001$. A similar difference shows up when the breakpoint is mean. Confirmation rates for debtors with below-mean debts were 27.89%, compared with 43.62% for debtors with above-mean debts. The difference was significant at $p < 0.001$.

107. The difference is statistically significant at $p < 0.01$. A similar difference shows up when the breakpoint is mean. Confirmation rates for debtors with below-mean debts were 29.05%, compared with 94.05% confirmation rates for above-mean debtors. The difference was significant at $p < 0.001$. Because the mean is pushed up by a few very large cases, the above-mean cases are only 8.9% of the total sample.

FIGURE 9
PLAN-CONFIRMATION RATES BY SIZE, 1994, 2002¹⁰⁸



N for 1994 = 859; N for 2002 = 393
Source: Business Bankruptcy Project, 1994 & 2002

The observations that law is not free and that the cost of legal services may deter access to the courts have had a subtle but pervasive influence on the practice of law.¹⁰⁹ These observations have extended into the bankruptcy field, with evidence to suggest that more expensive and contentious adversarial actions have been disappearing in the realm of consumer cases, where resources are typically quite limited, and are reduced in number in typical business cases.¹¹⁰ The data presented here are consistent with the hypothesis that the costs of Chapter 11 are sufficiently high that many small companies were squeezed out of the system, forcing the managers to liquidate the business quickly in Chapter 7 or die quietly completely outside the bankruptcy system.

The differential impact of cost could arise from many sources. Chapter 11 may be sufficiently complex that only companies with substantial resources can hire the professional talent needed to negotiate a successful

108. Figure 9 presents the following data:

| | 1994 | 2002 |
|-------------------|-------|-------|
| Below Median Debt | 24.6% | 21.3% |
| Above Median Debt | 36.7% | 48.5% |

109. See, e.g., Marc Galanter, *The Vanishing Trial: An Examination of Trials and Related Matters in Federal and State Courts*, 1 J. EMPIRICAL LEGAL STUD. 459 (2004) (documenting the rise in the number of lawsuits filed coupled with the decline in the number of lawsuits tried in a court of law).

110. See Elizabeth Warren, *Vanishing Trials: The New Age of American Law*, 79 AM. BANKR. L.J. 915, 918–31, 934–42 (2005).

plan. Larger companies may also have had bigger war chests to withstand the disruptions in supplies and other economic bumps that accompany a bankruptcy filing. Big companies may be more sophisticated about considering a Chapter 11 alternative, and they may have headed to Chapter 11 earlier, before the business had completely collapsed. Workout professionals are more likely to help big businesses, and they may be especially willing to recommend bankruptcy. Whatever the reasons, it is clear that bigger companies file for Chapter 11 in higher numbers and, once they have arrived, they fare better within Chapter 11.

Size also affects speed.¹¹¹ Larger companies may have had to resolve difficulties imposed by more complex operations and have had more creditors to negotiate with. On the other hand, these larger companies may also enjoy the benefits of resources to hire expert lawyers, accountants, and other professionals. The time it takes to reorganize or liquidate a business might differ between big cases and small cases, although reasonable people might differ in their speculations about which would be longer and which would be shorter.

When we analyze the cases in our data set by size, we discover that bigger cases took longer to reach resolution—any resolution. In 1994, cases above the mean total debt took more than three months longer to resolve than cases with debt below the mean. In the 2002 sample, this difference was magnified, the bigger cases taking more than four months longer. In both 1994 and 2002, the differences between the big cases and the small cases were significant.¹¹²

But the differences in time-to-resolution are driven by the failures, not by the successes. Bigger cases took, on average, about the same length of time to confirm a plan of reorganization as did smaller cases.¹¹³ But bigger failures took much longer to be pushed out of the system than smaller cases. In 1994, losers with above-median debt took, on average, about forty-nine days longer to be dismissed or converted.¹¹⁴ In 2002, the difference intensified, with above-median failures taking 107 days longer to be dismissed or

111. As noted above, we are exploring a further paper that would address size issues in more detail. *See supra* note 20.

112. For the 1994 sample, $p < 0.001$; for the 2002 sample, $p < 0.01$. OLS regressions of time-to-resolution on above-mean debt indicated the difference was significant: for the 1994 sample, $p < 0.001$; for the 2002 sample, $p < 0.01$.

113. There is no significant difference between the length of time to confirm a plan of reorganization for debtors with above-median debt and the length of time to confirm a plan for their below-median counterparts. The same is true when the dividing line is mean debt rather than median debt. OLS regression indicates that there is no significant difference between the length of time to confirm a plan of reorganization for debtors with above-median debt than to confirm a plan for their below-median counterparts; $p = 0.487$ for 1994; $p = 0.067$ for 2000. The same is true when the dividing line is mean debt rather than median debt; $p = 0.114$ for 1994; $p = 0.995$ for 2000.

114. The difference is significant at 0.05. The difference for above/below mean debt in 1994 is eighty-six days, a difference that is also significant at the 0.05 level using OLS regression.

converted.¹¹⁵ Perhaps the resources a larger company can command ensure that it never goes quietly into liquidation.

For those designing—or redesigning—Chapter 11 systems, this insight is significant. Not only did it take time to reorganize businesses successfully, but that time was not shorter for small businesses than for their bigger counterparts. If there is a saving to be accomplished, it might be in the realm of pushing big Chapter 11 failures out of the system faster. More generally, the data support the claim that, prior to the 2005 Amendments, the bankruptcy courts were doing a very good job of resolving cases quickly. Furthermore, even as they moved cases along at a lively pace, the courts kept sorting the wheat from the chaff, pushing many of the failures out in a matter of weeks while giving plausible candidates more time to succeed.

B. *The Special Case of Congress and the Small Business*

The conviction that Chapter 11 cases were taking far too much time resulted in the change in the law in 2005. Judge Edith Jones, who wrote the opinion in the “just mowing and waiting” case,¹¹⁶ was a leading member of the National Bankruptcy Review Commission. She pressed the Commission to endorse recommendations for sharp deadlines and increased supervision for Chapter 11 cases. Lawyers and turn-around managers who handled big Chapter 11 cases insisted that such deadlines would result in higher failure rates in the cases they handled. There was, however, no similarly powerful constituency to resist changes applicable to the small cases. Unable to command a majority vote for a recommendation to apply to all Chapter 11 cases, Judge Jones settled for Commission recommendations designed to force small businesses out of Chapter 11 more quickly.¹¹⁷ Those recommendations were lifted almost wholesale into the omnibus package of amendments to the bankruptcy laws that Congress passed in 2005, along with some more modest changes for bigger Chapter 11 cases.¹¹⁸ The new small business provisions imposed inflexible deadlines and several other burdens on Chapter 11 businesses with less than \$2 million in debt.¹¹⁹ This change to the bankruptcy laws is a highly visible indicator of the power of the Chapter 11 myth.

Our data show that the Chapter 11 system moved at a reasonably swift pace overall, but the data can also be harnessed to test the delay claim in relation to the special case of small businesses. Our data were collected prior to the 2005 Amendments, so they do not reflect the exact definitions

115. The difference is significant at 0.001. Interestingly, the difference for above/below mean debt in 2002 is not significant ($p = 0.764$), but this may be a consequence of the high mean (pushed upward by a few mega-cases) and the resulting small *N*s in the above-mean group.

116. See *supra* notes 67–69 and accompanying text.

117. 1 NAT'L BANKR. REVIEW COMM'N, *supra* note 38, at 618–25.

118. See 11 U.S.C. §§ 1116, 1121(e)(2006).

119. *Id.* §§ 101(51D), 1121(e). For a discussion of the small business amendments, see, for example, WARREN & WESTBROOK, DEBTORS AND CREDITORS, *supra* note 7, at 678–85.

and exceptions in the statute, many of which were changed several times prior to final adoption. With some reasonably realistic assumptions, however, the data can be adapted to test the likely impact of the 2005 changes. If, as is widely assumed, the small cases in our sample had no active creditors committee and if they were not affiliates of corporate groups aggregating more than \$2 million in debt, then the cases in the sample with less than \$2 million (inflation adjusted) in assets would have fallen within the new restrictions imposed by the 2005 Amendments.

Fully eighty-two percent of the small business cases in our 2002 sample that confirmed a plan did so outside the time limits imposed by the new amendments. Under the amended law, every small business case faces a substantial risk of failure when it hits the 181st day after filing. The risk arises from the loss of the debtor's exclusive right to propose a plan.¹²⁰ If the amendments had been in place earlier, such laws might have eliminated eight out of every ten small business successes in the Chapter 11 system.

It is possible, of course, that some of these companies could have filed more quickly. It is also possible that the debtor might have persuaded the court to extend exclusivity beyond the 180-day deadline or that the debtor could have confirmed a plan even after losing control of the case. But by any measure, the 2005 Amendments would have made life much more difficult for eighty-two percent of the small businesses that ultimately managed to succeed in confirming a plan of reorganization. Those difficulties would likely have forced some, perhaps most, of these otherwise-successful companies into failure.

For small businesses, a few weeks can be crucial. If the 2005 Amendments, for example, had extended the period of exclusivity by just ninety days, the proportion of ultimately-confirmed cases that could have made it through the system with the same protection as before the amendments would have doubled from eighteen percent to thirty-five percent. Even so, some observers would regard a system that put two-thirds of the successful cases in jeopardy as very bad policy.

The other side of the coin is equally interesting. Even before the 2005 Amendments, which were allegedly developed to speed cases along, half of the no-plan failures were pushed out in less time than the 180 days the amendments provide. Seventy percent were ejected in just nine months.¹²¹ The delays that are said to have sickened the bankruptcy system are not obvious in these data. The result is yet another lesson in what can happen when a solution precedes a clear grasp of the problem.

120. See 11 U.S.C. § 1121(e)(1). It is generally recognized that the exclusivity right is a very important part of the Chapter 11 bargaining process, providing the debtor breathing room to negotiate and some incentive for creditors to come to the table. A second, more draconian provision, says that a small business debtor who has not filed a plan within 300 days is automatically expelled from bankruptcy. *Id.* § 1121(e)(2). In both cases, the result can be avoided only if the debtor can make a positive showing that confirmation of a plan is likely, which is a difficult burden to carry in the fluid and dynamic atmosphere of a Chapter 11 negotiation. *Id.* § 1121(e)(3).

121. See Figure 5, *supra*.

CONCLUSION

Critics have been quite confident in their condemnation of the U.S. Chapter 11 system. They have been so confident, in fact, that they have advanced significant legal changes to the system and have proposed even more sweeping revisions in order to counteract its purported inefficiencies. Foreign policy makers, lured by the promise of reducing losses imposed by failing businesses, have moved toward Chapter 11-style systems, but some, such as Germany and Mexico, made critical adjustments to their reorganization systems to avoid those same purported problems.

These data expose the heart of the efficiency question: is successful reorganization a rarity, available in a relatively small number of cases? Are the benefits of Chapter 11 achieved only at the expense of long delays? Our data offer a very different picture from the conventional wisdom. They show that confirmation rates before the 2005 Amendments were nearly double the commonly accepted number, even when measured by the most naïve metric. They also show that confirmation rates jumped to two-thirds or more among larger debtors, debtors that were able to survive the first nine months in bankruptcy, and debtors who at least proposed a plan to reorganize.

The data reveal that the cases—both those that exit the system and those that confirm plans of reorganization—moved at a lively pace. They also suggest that, at least between 1994 and 2002, the system showed signs of improvement. While the data cannot answer the normative question about whether the movement is as substantial as it should have been, they are adequate to dispel the notion that great numbers of debtors were hiding out in Chapter 11 for years, just mowing the lawn and waiting for the market to turn.

Emergency surgery is never pretty and often unsuccessful, but the data reveal that Chapter 11 offered a realistic hope for troubled businesses to turn around their operations and rebuild their financial structures. These data show that prospects are far better than much of the world has been led to believe.

APPENDIX

TABLE 1
RANGES OF ASSETS, CHAPTER 11 BUSINESS DEBTORS, 2002

| | ASSETS | | | | | Total |
|-------------|-----------------|-------------------|-------------|-----------|-------|--------|
| | Under \$100K | \$100K– \$500K | \$500K–\$1M | \$1M–\$5M | \$5M+ | |
| Frequency | 58 | 90 | 43 | 100 | 98 | 389 |
| Row Percent | 14.91 | 23.14 | 11.05 | 25.71 | 25.19 | 100.00 |

Missing = 48
Source: Business Bankruptcy Project

TABLE 2
RANGES OF TOTAL DEBT, CHAPTER 11 BUSINESS DEBTORS, 2002

| | DEBT | | | | | Total |
|-------------|-----------------|-------------------|-------------|-----------|-------|--------|
| | Under \$100K | \$100K– \$500K | \$500K–\$1M | \$1M–\$5M | \$5M+ | |
| Frequency | 18 | 79 | 57 | 111 | 131 | 396 |
| Row Percent | 4.55 | 19.95 | 14.39 | 28.03 | 33.08 | 100.00 |

Missing = 48
Source: Business Bankruptcy Project

