

# SEARCHING FOR REORGANIZATION REALITIES

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## I. INTRODUCTION

One measure of the success of a symposium is the sheer number of ideas that get tossed around during the course of the proceedings. We find ourselves speculating how different this toss-fest (the Washington University Interdisciplinary Conference on Bankruptcy and Insolvency Theory) might have been if all the participants had access to more information about the business bankruptcy system. Would some ideas have evaporated—shown to be silly excursions of limited interest? Would others have been expanded and enriched with insights prompted by curious and unanticipated twists in the actual functioning of the bankruptcy system? Would issues have been framed differently, and would proposed solutions find new forms? Or would the debates have continued as before, with unexpected factual insights admitted only through the trade entrance and kept below stairs?

We do not know the answer to these questions, but we speculate that whenever information about the operation of a system is introduced into debates about that system, something will change—even if it is only that the debaters will have to ignore the data more aggressively than they did when the data were not available. The nature of the change depends, at

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The work of the Project rests largely on the shoulders of its staff, led by Charles Trenckmann and Maria Vinall and ably assisted by Patti Giuffre. For this article, we are especially grateful to Charles Trenckmann and Jennifer Frasier for their research assistance, and to Kyle Fox for additional research help.

least in part, on the nature of the information that is introduced.

We are developing a study that will introduce more data into the policy debates about the business bankruptcy system. At the inception of this study, we must decide what data to develop. In effect, we must decide on a view of reality that we want to describe. The study, which is described in more detail below, is a projected five-year longitudinal analysis of business bankruptcy cases filed in twenty-three federal districts during calendar year 1994. Because the information presently available from systematic empirical studies on business bankruptcy is so limited,<sup>1</sup> our study necessarily must be devoted in large part to establishing baseline data about this sort of legal proceeding. But we have room within this framework to explore other visions of what data are important.

This paper provides an opportunity to do two things simultaneously. It continues a discussion we joined a decade ago about the role of empirical work in policy debates.<sup>2</sup> It also permits us to discuss specific issues that we confront in designing our new study, and to explore how various sorts of law-related realities might be defined and why one definition might be preferred over another. As to the first point, we argue that a debate without data is a useless excursion, a trip from nowhere to nowhere. As to the second, more specific endeavor, we are conscious that empiricists risk becoming captured by a view of reality that they can measure (looking for the nickel under the lamppost), and thereby lose track of alternative

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1. The leading contemporary study is the description of public companies in bankruptcy done by LoPucki and Whitford. Lynn M. LoPucki & William C. Whitford, *Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125 (1990) [hereinafter LoPucki & Whitford, *Bargaining*]; Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669, 722 n.184 (1993) [hereinafter LoPucki & Whitford, *Governance*]; Lynn M. LoPucki & William C. Whitford, *Patterns in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 78 CORNELL L. REV. 597 (1993); Lynn M. LoPucki & William C. Whitford, *Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 1991 WIS. L. REV. 11 (1991). The only other comprehensive study was done thirty years ago by the Brookings Institute. DAVID T. STANLEY & MARJORIE GIRTH, *BANKRUPTCY: PROBLEM, PROCESS, REFORM* (1971). There have been several smaller studies done in recent years, some of which are very helpful. See, e.g., Michael J. Herbert & Domenic E. Pacitti, *Down and Out in Richmond, Virginia: The Distribution of Assets in Chapter 7 Bankruptcy Proceedings Closed During 1984-1987*, 22 U. RICH. L. REV. 303 (1988); Richard F. Fullenbaum & Marianna A. McNeil, *The Function of Failure* (March 1994) (unpublished study, on file with the Small Business Administration, contract # SBA-664-0A-91); Lisa Hill Fenning & Brian Tucker, *Profile of Single Asset Real Estate Cases*, L.A. COUNTY BAR ASS'N, COM. L. & BANKR. SEC. NEWSL., Summer, 1994, at 4.

2. Teresa A. Sullivan, Elizabeth Warren, and Jay L. Westbrook, *The Use of Empirical Research in Formulating Bankruptcy Policy*, LAW & CONTEMP. PROBS., Spring 1987, at 195 [hereinafter *Use*].

views that might also describe reality. With the presentation of this paper, we seek ideas from colleagues in our field to help us focus our empirical efforts in the most interesting and useful way. At the same time, we invite those colleagues who do not labor in the field of fact to examine their thinking and to consider how their thoughts might be different if they were framed with more reference to hard data.

We begin by briefly surveying current academic and policy discussions as to form and approach, offering a summary empiricist critique. We then outline the study that we have undertaken with our co-principal investigator, Dr. Teresa Sullivan, giving a brief description of the central, comprehensive sample that this study will yield.<sup>3</sup> We follow that section with an acknowledgment of the limitations of the comprehensive sample and initiate an exploration of the additional realities we might try to study, soliciting the insights of our colleagues at this Symposium and elsewhere.

## II. ACADEMIC SPECULATION

Financial speculation and bankruptcy have long gone together, at least sequentially. Recently, the bankruptcy field has been deluged with speculation of the academic sort. The latest round began with Lucian Bebchuk's 1988 article in the *Harvard Law Review* which proposed changing the Chapter 11 system by incorporating a semi-automatic mechanism for dealing with financially distressed companies.<sup>4</sup> Among the article's most notable features was a lack of reference to any constraints imposed by reality. It had few citations to published cases. It had neither data nor anecdotal references relating to the financial and legal realities of business bankruptcy or of the capital markets for financially distressed firms. This absence of factual basis made the piece somewhat difficult to evaluate as a serious recommendation for statutory change. As pure theory, the article was also problematic because it was premised on numerous unarticulated assumptions about the world for which it suggested reform.<sup>5</sup>

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3. A more complete and technically detailed discussion is found in Teresa A. Sullivan, *Methodological Realities: Social Science Methods and Business Reorganizations*, 72 WASH. U. L.Q. 1291 (1994) [hereinafter *Methodological Realities*].

4. Lucian A. Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775 (1988). For a succinct and excellent critique of the Bebchuk approach, see Lynn M. LoPucki, *Comment: Stakeholder Interests and Bankruptcy*, 43 U. TORONTO L.J. 711, 712-13 (1993) [hereinafter *Stakeholder*].

5. For example, the author apparently assumed that all creditors would have equal access to important information about the debtor company or that any differences in the availability of information among creditors were not important as a matter of efficiency or fairness.

Because those assumptions were neither acknowledged nor systematized, it was impossible to determine whether the starting points for the logical leaps made sense.

So far as we know, the semi-automatic market solution has had no presence or even close analogy in the financial world. Yet the article has been a terrific success in the academic world. The piece has spawned a generation of speculative articles proposing various formulaic solutions to the bankruptcy problems of unspecified worlds.<sup>6</sup> And its form of speculation without reference to reality—which had many precedents—has since been widely imitated.<sup>7</sup>

Lest we seem unduly harsh in our critique, we should note that Professor Bebchuk is a very smart law professor who has taught corporate law, corporate finance, and law and economics for nearly a decade. Yet, he has never practiced or taught in the bankruptcy field, and this article was his first foray into the subject. The point for emphasis here is that a commentator with little experience in the field wrote one of the most imitated articles about business bankruptcies in recent years.

In the debates that followed Bebchuk's article, there was no absence of those who strongly disagreed with Bebchuk's approach—often on terms as abstract as those employed by Bebchuk himself. One of the difficulties with articles of this genre, however, is that their lack of grounding in empirical reality makes evaluation of any of the arguments nearly impossible. For example, is an author proposing a solution for all companies, or only for large companies, or for public companies, or for

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6. See, e.g., Michael Bradley & Michael Rosenzweig, *The Untenable Case for Chapter 11*, 101 YALE L.J. 1043, 1045 (1992) (claiming to begin with Bebchuk's analysis and to take it to its logical conclusion).

7. See, e.g., Barry E. Adler, *Financial and Political Theories of American Corporate Bankruptcy*, 45 STAN. L. REV. 311, 323-33 (1993) (proposing "chameleon equity" to solve bankruptcy problems through market sale of differently structured rights); Philippe Aghion et al., *The Economics of Bankruptcy Reform*, 8 J.L. ECON. & ORGANIZATION 523 (1992) (auctioning bankrupt company will perfectly yield value of company without transaction costs) [hereinafter Aghion et al., *Economics*]; Robert Gertner & David Scharfstein, *A Theory of Workouts and the Effects of Reorganization Law*, 46 J. FIN. 1189, 1192-99 (1991) (suggesting a "simple model of workouts and investment" laden with huge assumptions, including that "bank negotiation is assumed to be costless"); Michael C. Jensen, *Corporate Control and the Politics of Finance*, J. APPLIED CORP. FIN., Summer 1991, at 13, 31 (arguing that bankruptcy courts should auction off the business by selling "riskless securities"); Robert K. Rasmussen, *Debtor's Choice: A Menu Approach to Bankruptcy*, 71 TEX. L. REV. 51 (1992) (proposing that companies and their voluntary creditors be given a menu of debtor-creditor laws from which to choose); Lawrence A. Weiss, *Bankruptcy Resolution: Direct Costs and Violation of Priority of Claims*, 27 J. FIN. ECON. 285, 300 (1990) (delivering the company into the hands of its creditors as a means to avoid collection costs).

some other subgroup? Or is the author simply indifferent to relevant distinctions that might exist among companies?<sup>8</sup> If so, can the proposed solution be seriously considered as part of a policy debate, as opposed to an academic one?

Two of the latest examples of the abstract approach—and some of the bizarre implications that would necessarily accompany any serious attempt at actual implementation—have been presented in this Symposium. Professor Adler argued again for “chameleon equity” based on the Bebchuk model<sup>9</sup> and Professor Rasmussen argued again for his “menu-based” approach to bankruptcy-alternatives-by-contract.<sup>10</sup> The symposium format, however, revealed previously unknown aspects of these policy recommendations. When confronted with questions about the distributive impact of their proposals, for example, both authors conceded that a necessary first step to the adoption of their proposals was a major reform of tort law, of the law governing obligations owed to government entities, and of laws governing other obligations to involuntary creditors.<sup>11</sup> Under these

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8. For example, Bebchuk asserted the superiority of his proposal over all others, because it did not require a market in the debtor company's securities to insure fairness, and therefore, it would apply to all kinds of companies. See Bebchuk, *supra* note 4, at 790. But he was only referring to the fact that the holders of various positions in the debtor company would have a choice as to buying or selling, so that each of them would “have no basis for complaining.” *Id.* In other words, the holder who could not refer to a market for prices and might lack crucial information about the company had no basis for complaint simply because the holder could “choose” to invest blindly or not. Professor Bebchuk either was unaware of likely differences in information and information costs among holders, or he did not consider them relevant to fairness. He also did not discuss or acknowledge any relevant differences between the very small companies that populate the bankruptcy courts and the large, publicly traded companies that populate the front page of the *Wall Street Journal*.

9. Barry E. Adler, *A World Without Debt*, 72 WASH. U. L.Q. 811 (1994); see also Adler, *supra* note 7. Adler's theory is that each level of claimant, starting at the bottom with equity, is forced to choose between buying out those above the claimant in priority or forfeiting any claim in the troubled company.

10. Robert K. Rasmussen, *The Ex Ante Effects of Bankruptcy Reform on Investment Incentives*, 72 WASH. U. L.Q. 1159 (1994). Professor Rasmussen proposes that companies and their voluntary creditors be able to choose from a menu of debtor-creditor laws, including some that would waive bankruptcy protection for the company.

11. The discussion began with questions about what would happen to tort creditors under the Adler and Rasmussen proposals. Both systems permit debtors to favor contract-based creditors, leaving nothing for tort claimants or giving them the illusory option of assembling enough capital among themselves to buy out the contract creditors. Professors Adler and Rasmussen insisted they never intended such results and seemed to propose radical changes to tort law and the law of secured credit that would give tort claimants priority under nonbankruptcy as well as bankruptcy law. The vast extent of the needed reform was made clearer when the discussion moved to other claimants without contract-based rights, such as government claims for environmental cleanup or injured competitors' claims under the antitrust laws.

schemes, nonbankruptcy law would need to be adjusted to provide priority for involuntary creditors—or at least parity with contract-based creditors, including Article 9 secured parties. Both authors evidently dismissed such details as the trivial minutiae of implementation and regarded them as insufficiently important to require even a passing mention in their articles proposing reform. But for those seriously interested in legal reform, evaluation of the chameleon-equity or menu-based approaches to bankruptcy law might be very different if it were clear that such proposals were based on a significantly modified nonbankruptcy system, especially one that might sharply reduce the reliability of contract-based priorities.

Other proposals require leaps of intuition about the behavior of the parties involved in a failing company and the events with which they must cope. Professor Hart proposes a world in which bankruptcy could function much more efficiently using his market-based substitution for valuation efforts,<sup>12</sup> evidently assuming that valuation is the principal difficulty causing delays and expense in current bankruptcies. In discussion, however, he concedes that he does not know whether valuation is the principal difficulty in most business bankruptcies or whether other practical problems, such as distributional uncertainties or thin markets for failing companies, may confound his substitute valuation approach. The empirical evidence from Professors LoPucki and Whitford indicates that Professor Hart's empirical premise may be wrong. Their data suggests that market valuation may already be in use where it is useful to employ it and that significant savings are accomplished by not forcing it on parties where markets are inadequate to produce full value bids.<sup>13</sup>

It is unrealistic to demand that the proponent of every new idea become an empiricist. At a minimum, however, it does not seem too onerous to expect that authors who are not themselves empiricists should at least take account of the empirical work that has been done. We might also reasonably ask that they propose empirical research to test the robustness of their theories, even if they have no intention of looking for the underlying facts themselves.<sup>14</sup>

We will readily concede that our own commitment to empirical research is more than simply a matter of principle. We enjoy thinking about reality.

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12. Philippe Aghion et al., *Improving Bankruptcy Procedure*, 72 WASH. U. L.Q. 849 (1994); see also Aghion et al., *Economics*, *supra* note 7.

13. William C. Whitford, *What's Right About Chapter 11*, 72 WASH. U. L.Q. 1379, 1392-93 (1994).

14. See *Use*, *supra* note 2, at 226-31.

We find great satisfaction in struggling to impose some coherence upon its unruly facts. We relish being utterly surprised, even flummoxed for a while, by some unexpected fact.<sup>15</sup> We find it exhilarating to bring fact and theory together to speculate about the power of law to affect the world we observe. By contrast, we find reading purely theoretical articles rather like playing anagrams. They are fun, but not filling.

This enthusiasm for analyzing collected data does not extend to the actual gathering of data. We prefer air conditioning as much as our more speculative colleagues do, and document collection often involves hot, musty archives. We also dislike sitting in airports at 2 a.m., laden with portable copiers and boxes of papers while we await a delayed plane home from a distant courthouse. We feel sick over data dumps and frustrated by the technical details of gathering forms from places where they are supposed to be, but are not. We long for the day that the government will gather the necessary data routinely and we can call them up by modem.<sup>16</sup> Until that noble time, however, we must gather our own fragments of reality if we want to partake of the pleasure of assembling them.<sup>17</sup>

### III. POLICY SPECULATION

The dominance of speculation over systematic empirical inquiry has not been limited to academe. Congress, too, has embraced theories unburdened by fact. Proposed congressional legislation seems to rest in too many respects on anecdote and speculation. A good example of the legislative result of speculation is the proposed Chapter 10.<sup>18</sup> A new "small business chapter" may be a good idea, but it hangs in the air with no empirical foundation. To support the new chapter, proponents most often cite the

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15. In the consumer study, for example, when we found out that most of the Chapter 7 debtors were homeowners, we were incredulous, then puzzled, and then fascinated. TERESA A. SULLIVAN, ELIZABETH WARREN & JAY L. WESTBROOK, *AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA* 129 (1989) [hereinafter *AS WE FORGIVE*].

16. *See Use, supra* note 2, at 226-31.

17. Of course, data gathering has its finer moments. Sometimes, a seemingly routine interview with a judge or the casual comment of a trustee will suggest the importance of a variable that no one had given any thought. Those moments help keep us going.

18. SENATE COMMITTEE ON THE JUDICIARY, *OMNIBUS BANKRUPTCY REFORM LEGISLATION*, S. REP. NO. 168, 103d Cong., 1st Sess. 4. Since the Conference, Congress has passed legislation amending the Code without the proposed Chapter 10, which was deleted on the Senate floor by the bill's principal sponsor, Senator Heflin. 140 CONG. REC. S4539-01, S4541 (daily ed. Apr. 20, 1994). The new legislation creates a Commission to propose more extensive reforms, and it seems certain the proposed Chapter 10 will be one of the ideas it will be asked to consider. Bankruptcy Reform Act of 1994, Pub. L. No. 103-394, 108 Stat. 4106, § 601 (1994).

“fast track” procedure employed by the Honorable A. Thomas Small in the Eastern District of North Carolina.<sup>19</sup> The implication that the new Chapter 10 has somehow been tested is illusory. Judge Small’s procedure is a streamlined Chapter 11 approach. The proposed Chapter 10, by contrast, would be a “Super” Chapter 13, a very different proposition both in concept and practice. Few commentators seem to notice this difference either in supporting or attacking the proposal.

The resulting debate is made even more amazing by the potential availability of data that might give important insights about a Super Chapter 13. In some parts of the country a “business Chapter 13” (Business 13) is a fairly common occurrence, although it remains virtually unknown in other places. According to data from the Administrative Office of the Courts, nearly thirty-nine percent of the nonliquidation business bankruptcies in the United States in 1993 were these Business 13s.<sup>20</sup> These cases presumably exemplify what we should expect in the proposed Chapter 10, but this empirical connection seems to be a secret. Business 13s are virtually unmentioned in the bankruptcy literature<sup>21</sup>—at least at the law review level—and they have not been a significant part of the limited congressional debate that has occurred thus far.<sup>22</sup> Are these Business 13 cases successful by some criteria of success? Is Chapter 13 fair in practice to business creditors who do not get to vote? Is the Chapter 13 trustee sufficiently equipped and properly compensated to supervise more business cases? What does disposable income mean in the context of a small, solely owned business? We have come close to enacting a near variation of Business 13s without having a clue about how the current Business 13s operate.

When it was first suggested that we propose a large empirical study of business bankruptcy, everyone assumed that we would look at a lot of Chapter 11 cases. Indeed, in its early phases, the study was simply referred to as the “Chapter 11 Study.” Once we started thinking about the problem and, more importantly, started looking at the data available, we observed that Business 13s, at least by number, seemed to be a substantial part of the

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19. For a description of this procedure, see Hon. A. Thomas Small, *Small Business Bankruptcy Cases*, 1 AM. BANKR. INST. L. REV. 305 (1993).

20. THE BANKRUPTCY YEARBOOK AND ALMANAC 8 (Christopher M. McHugh ed., 4th ed. 1994) [hereinafter YEARBOOK].

21. *But see* AS WE FORGIVE, *supra* note 15, at 120-21, 123 n.7, 258 tbl. 13.6 (discussing the effect of self-employment on chapter choice).

22. *See The Bankruptcy Amendments Act of 1993: Hearings on S. 540 Before the Subcomm. on Courts and Administrative Practice of the Senate Comm. on the Judiciary*, 103d Cong., 1st Sess. (1993).

business bankruptcy story. We decided to devote significant resources to learning something about those cases as well. That decision was reinforced by pending proposals for Chapter 10. We also came to realize that we would have to study Chapter 7 business cases, because liquidation establishes the bankruptcy baseline, both in theory and in practice, and no one had taken much of a look at business liquidation since the Brookings Study in the 1960s<sup>23</sup> and a small, but excellent study by Herbert and Pacitti in 1987.<sup>24</sup> Thus, our sample is now divided into thirds, business filings in Chapter 7, in Chapter 13, and in Chapter 11. We have defined the reality of business bankruptcy informed by some available data, some theoretical insights, and some intuitions about what constitutes the business system.

To a large extent, speculative academic articles assume, usually implicitly, that there is only one type of business bankruptcy case: the large, usually public company. Pending legislation, on the other hand, assumes that there are serious problems in a very different sort of case—the small business proceeding. Even taken together, the debates seem to posit that all business Chapter 11 cases are exemplified either by Eastern Air Lines or Joe's Welding. This stereotyping has occurred even though the few data we have suggest a continuum of proceedings, including many cases lying between Joe's and Eastern.

This paper is about our search for the reality of business bankruptcy—from the perspective of people lucky enough to have been given substantial resources for empirical research. Even generous resources are spartan compared with the range of all possible research, however, so we must make the very best decisions we can about what to study and how to study it. We have made some decisions, but we still have some important decisions to make. We wrote this paper to stimulate discussion about how one makes those decisions and to explore how empirical research fits into the academic and policy debates in our field.

#### IV. THE STUDY: A CROSS-SECTION OF REALITY AS A WHOLE

We have the good fortune, and the daunting responsibility, of being the recipients of a substantial grant from the Educational Endowment of the National Conference of Bankruptcy Judges to conduct an empirical study

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23. STANLEY & GIRTH, *supra* note 1, at 107-46.

24. Herbert & Pacitti, *supra* note 1.

of business bankruptcy.<sup>25</sup> The general goals of the study include the following:

- 1) To identify the characteristics of the businesses and individuals that use bankruptcy, including a financial profile of the business, the business' operating status at the time of filing, the sizes and types of businesses, the events businesses report as triggering their bankruptcy filings, and the businesses' description of what they hope to accomplish in the bankruptcy proceeding. Because the study will include data from business debtors filing in Chapter 11, Chapter 7, and Chapter 13, we hope to create a spectrum that accurately describes the range of debtors in the bankruptcy system.
- 2) To explore the disposition of business cases with a particular focus on Chapter 11 cases, including the proportion of dismissals, conversions, and confirmations, the time involved in dispositions, the fees awarded during the bankruptcy process, the amount and kind of debt repaid or promised to be repaid, the number of employees retained while the business remains operational, and the court management procedures employed in the cases.
- 3) To examine associations among the factors identified: for example, whether certain fast-track or other case management procedures identify unsuccessful cases and eliminate them from the system earlier; whether size or type of business, or status as owner-managed, correlates with confirmation rates or other indicia of success; whether the existence and extent of security correlates with confirmation or other indicia of success; whether cases that are dismissed usually result in termination of operations or liquidation of the business within a short time; whether creditors are paid or promised more in cases that are converted, dismissed, or confirmed; and whether fees awarded bear any relationship to outcomes.
- 4) To gather data on Chapter 7 business bankruptcies in order to establish a baseline of debtor characteristics and typical results in such cases, with an emphasis on amounts distributed for administration costs and to creditors of various classes, and with some attempt to identify sales of businesses as going concerns.

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25. We have also received supplementary grants from the Arthur Moller Chair in Bankruptcy Law and Practice at the University of Texas at Austin and from the National Bankruptcy Conference. In addition, we continue to apply for other research funds to complete other parts of the data gathering.

- 5) To explore Chapter 11 as a liquidation mechanism, identifying the cases in which Chapter 11 is being used, explicitly or implicitly, as a method of liquidation rather than as a reorganization effort; to attempt to identify criteria that are characteristic of such cases; and to compare results in Chapter 11 liquidation cases to those in Chapter 7 cases.
- 6) To examine the use of Chapter 13 for the resolution of problems for small businesses by gathering data on plans, payouts, and outcomes in those cases and comparing those data with the data gathered about small businesses in Chapter 11 and Chapter 7.

The origin of the goals of this study is something of an odyssey in itself. In part, the goals simply derive from our own experiences through years of studying (and, for one of us, practicing in) the bankruptcy system. We produced questions in two categories. The first category was information that is fundamental to all questions about business bankruptcy. We tried to determine what kind of information would be relevant to almost any conceivable question about the bankruptcy system or to any hypothesis about how it operates. The central example is the financial information filed with the petition. It is hard to think of any sensible question or theory about bankruptcy that would not be informed by knowing something about the financial circumstances of business debtors at the time of filing. The same is true about the ownership and management structure of the business and other similar data.

The second sort of question we asked of ourselves arose from our own questions about the system. Is it possible that companies from certain industries are consistently more successful at reorganizing in Chapter 11, whereas companies from other industries use Chapter 11 only as a delaying tactic on the way to liquidation? Are single asset real estate cases a substantial fraction of Chapter 11 cases or just a prominent one? How much do unsecured creditors receive on average in confirmed Chapter 11 cases? The list of potential inquiries goes on and on.

Our questions blended imperceptibly into the third category—questions that have arisen in the great policy debates about business bankruptcy over the last decade. Over and over, the disputants have asserted this and that about the system, with no idea whether the assertions were true, but with much riding on their truth or falsity. Is there really great delay and cost in Chapter 11 cases? Of course, that question is meaningless in the usual form in which it is asked, because it is not compared with some standard (for example, delay and cost in civil litigation generally, or delay and cost

in initial public offerings<sup>26</sup>). Notwithstanding that problem, however, we speculate that the policy debates would acquire some substance if we knew how long Chapter 11 cases take (that is, the ones that get to confirmation) and how much they cost. It would be better still if we knew cost-and-delay information for various sizes and types of Chapter 11 cases.

These questions and others from the public debates have furnished us with questions and goals for the study. Note that many of our questions share with the public-debate questions the characteristic that they are oriented to law reform and to improving the system. That similarity is worth noting because it is generally unfashionable for law professors to worry too much about real reform, perhaps because such an approach is frequently antithetical to the more sweeping questions thought to be appropriate to the academy.

The third source of questions has been judges, lawyers, trustees, and others active within the system. The judges have been a particularly valuable resource, although we want to emphasize that no judge has ever sought, expressly or impliedly, to determine or limit what we ask in this study or to require the inclusion of any question or research goal. We have asked judges about their views of the system because we believe their perspective gives them unique insights about the system. They have supplied us with long lists of questions about how bankruptcy operates. Not surprisingly, this source too has a law-reform orientation. Overall, our questions and goals are a curious blend of a childish eagerness to learn for the sake of learning—to “know how it works”—combined with an old-fashioned determination to gain the knowledge required to improve the bankruptcy system.

In an academic setting such as this Conference, the obvious question is: Why have we not stated a series of hypotheses based on some theory which we will test empirically? The question quickly leads to issues far beyond the scope of this paper, but it is appropriate that we should address it briefly, saving a full analysis for another occasion.

The first response must be to note that all of our “goals” and questions can be restated as formal hypotheses. For example:

- There is a positive relationship between financial condition (balance sheet, cash flow, and so on) and success in confirming a Chapter 11 plan. A similar relationship exists between financial condition and the total amount paid to unsecured creditors under such plans.

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26. There could also be a comparison with nonbankruptcy workouts, but that raises its own problems. See *infra* note 61.

- Administrative costs bear a positive relationship to time spent in bankruptcy.
- Creditors' committee activity is positively correlated with overall costs, but not with improved creditor payout.
- Active managerial judging will have a positive effect on the cost and the success of reorganization cases.

The study does not lack for hypotheses. As this list suggests, we could articulate dozens of hypotheses that we will test in the course of our data analyses. What the study does lack, however, is a *single* overarching theory or a single hypotheses to be tested. Each hypothesis we review represents a theory about the world, but no one theory generates all of the hypotheses. We understand much of the critique of our approach at the Conference to be reducible to a complaint that we go forth to find facts without some large theory that generates all the hypotheses we will test. For that reason, it is important to acknowledge clearly that we are doing just that and that we make no apologies.

We stick to our refusal to embrace an overarching theory for two reasons. The first is that the study of law as a social phenomenon, and as a functioning set of institutions in a complex society, is in its infancy. Law as a set of doctrines or as moral and political philosophy has long been the subject of great minds, but law as a functioning social artifact is a much newer subject of study. To the extent that science is our guide, the proper model is physics in the seventeenth century, not the twentieth. Today's legal empiricists are closer to Galileo than to Fermi. Our science is at the early stage of observation, description, and classification—not at the later stage of refined experiments testing ever narrower hypotheses that bring reality into tighter focus. Perhaps our work is closer to the kind that Clifford Geertz calls "thick description."<sup>27</sup> By any measure, however, we are not on the verge of a unified field theory.

Thus, it is entirely appropriate that we approach our modest undertaking in the spirit of Lewis and Clark setting out into the wilderness. Like Lewis and Clark, we set out knowing the Pacific is over in that direction. But it would be folly to pretend we have some grand theory that covers the entire spectrum.

We believe that to indulge in the hubris of a grand theory would actually prejudice our efforts. We do not wish to be prisoners of our articulated

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27. See generally CLIFFORD GEERTZ, *THE INTERPRETATION OF CULTURES* (1973); CLIFFORD GEERTZ, *LOCAL KNOWLEDGE: FURTHER ESSAYS IN INTERPRETIVE ANTHROPOLOGY* (1983).

hypotheses. We deliberately overcollect data, unsure at this stage when we might record data that fit no established hypotheses but that, in the serendipity of exploration, might give us some critical insights into the bankruptcy system.<sup>28</sup> The process is expensive and consumes more time and energy than would a more highly focused rifle-shot study that explores a handful of discrete operational hypotheses. At some point, those rifle-shots will be the appropriate vehicles to move along policy debates about the bankruptcy system. But because so little has been systematically recorded about the operation of the system, we feel bound to do a more open-ended, dense collection of data. Thus, we can open our data to use by other scholars and provide, we hope, a background against which other studies might later unfold.

The second reason we have not designed the study around formal hypotheses linked to a single theory is that those who aspire to be theorists in our field do not generate testable hypotheses. This point is developed below.<sup>29</sup>

These goals we have mapped out are as ambitious as they are general. We have already constructed the central, comprehensive sample that will be the centerpiece of our study, which we expose in summary form below for critique and comments and which is developed in finer detail by our co-investigator, Dr. Teresa Sullivan, in the following paper, *Methodological Realities: Social Science Methods and Business Reorganizations*. In our paper, we put forward a request for help in defining additional realities beyond this comprehensive sample. In the section following the discussion of the comprehensive sample, we offer some ideas about alternative samples we might explore, which we hope will stimulate a discussion of the most important realities of the bankruptcy system.

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28. Our consumer study provides many examples. We recorded information about lawsuits mainly because it was there, but it turned out, to our surprise, that there were very few lawsuits given the fact that these debtors were in default on most, if not all, of their obligations. See AS WE FORGIVE, *supra* note 15, at 305; Teresa A. Sullivan, Elizabeth Warren & Jay L. Westbrook, *The Persistence of Local Legal Culture: Twenty Years of Evidence from the Federal Bankruptcy Courts*, 17 HARV. J.L. & PUB. POL. 801, 851 n.144 (1994) [hereinafter *Local Legal Culture*]. Then again, we had no particular hypothesis about the role of homeownership in consumer bankruptcy, and the literature revealed very little, but we recorded it and it turned out to be important in a host of different ways. See AS WE FORGIVE, *supra* note 15, at 128-46. For the most part, the few ideas the literature had proposed about the relationship of homeownership to bankruptcy turned out to be wrong. These data revealed important social functions of consumer bankruptcy which a hypothesis-constrained study would have been very unlikely to reveal. *Id.* at 84-85, 104 n.3.

29. See discussion *infra* Part VII.

## V. THE COMPREHENSIVE SAMPLE<sup>30</sup>

Our principal data collection efforts will be directed toward gathering a comprehensive sample of bankruptcy cases. For this sample, we are looking both for typical bankruptcy cases and for the range of variation that occurs within the system.

For the comprehensive sample, we have tried to retain the advantages of sampling, while limiting the locations at which we will collect data to a manageable number of sites. Our sample is taken from twenty-three districts that will be the sites for our study; in each site we will sample cases wherever they are kept.<sup>31</sup> We sample all the sites within a district in order to capture the full range of variation in cases within the district.<sup>32</sup> The two most important methodological decisions we have had to make are: (1) how to select the districts, and (2) how to select the cases within each district.

### A. Selection of Districts

The districts we sample take account of some of the major sources of heterogeneity that can be foreseen at the beginning of the study. Our strata include the following: judicial circuit; the relative number of filings within the district (high-filing versus low-filing); the distribution of filings among the different kinds of business bankruptcies (Chapter 7, Chapter 11, Chapter 13), and case management practices. Within each judicial circuit, we have established as our initial criterion the selection of two districts: the district with the highest number of business filings, and the district with the lowest number of business filings. Circuit-level rulings are a conceivable influence on the operation of the courts. Moreover, this criterion gives us a suitable geographic distribution of districts and also tends to represent equally the parts of the country that are experiencing good economic times and those that are in regional recessions.

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30. For a more detailed discussion of the sample, see *Methodological Realities*, *supra* note 3, at 1297-1302.

31. In some districts, cases are filed and stored in only one city, while in others, they are filed and stored in several cities. In New Jersey, for example, cases are filed and kept in Camden, Trenton, and Newark, while in Delaware, cases are filed and stored only in Wilmington. Because some districts use multiple-city filing, the number of cities from which we must collect data for the twenty-three districts is forty-three.

32. In some districts, we may need to make special arrangements to draw cases from divisions in proportion to the total number of cases filed in the division during the preceding year, lest we underrepresent cases from some divisions.

It was also necessary, however, that we have sufficient cases to conduct our analysis, so we set ancillary criteria: at least fifty Chapter 11 cases had to have been filed during the twelve months ending in June 1993 (the most recent time period for which we had data). In order to select a district with a fast-track case management system, we selected the Eastern District of North Carolina for our study, even though it would have ranked only third within the Fourth Circuit as the low-filing district best fitting all of our criteria.<sup>33</sup> Because we emphasized Chapter 11 in our selection criteria, we ended up with some districts that may yield fewer than fifty business Chapter 13 cases. All the districts chosen should have more than fifty business Chapter 7 filings.

The districts chosen because they had the highest number of business filings in their circuit were: District of Massachusetts, Southern District of New York, District of New Jersey, District of Maryland, Northern District of Texas, Eastern District of Michigan, Northern District of Illinois, District of Minnesota, Central District of California, District of Colorado, and Middle District of Florida. In this group, the Southern District of New York recorded only six Business 13s, which means that its case base for that chapter is likely to be deficient.

The districts chosen because they had the lowest number of business filings in 1992 in their circuit, but had at least fifty Chapter 11s, were: District of New Hampshire (one Business 13), District of Connecticut, District of Delaware (seventeen Business 13s), Eastern District of North Carolina, Eastern District of Louisiana (no Business 13s), Western District of Tennessee, Eastern District of Wisconsin (forty-one Business 13s), District of Nebraska (forty-one Business 13s), Western District of Oklahoma (thirty-eight Business 13s), District of Hawaii (six Business 13s), and Middle District of Georgia (fourteen Business 13s). As the parenthetical numbers indicate, only three of these districts (Connecticut, Eastern North Carolina, and Western Tennessee) had as many as fifty Business 13s. Connecticut was the second best choice in the Second Circuit, but it was chosen because it had at least fifty Chapter 11s. The difficulty that should become apparent is that low-volume Chapter 11 districts often tend to be even lower-volume Business 13 districts. Insisting on a sufficient number of Chapter 13 business filings as well would have eliminated many low-volume districts entirely and generally skewed the sample toward high-

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33. It would actually have been only fifth-best as a low-filing district, but two other low-filing jurisdictions were independently disqualified because they did not have enough Chapter 11 cases.

volume districts.

At the suggestion of several of the bankruptcy judges with whom we consulted, we added an additional district within the Ninth Circuit, the Western District of Washington. The Ninth Circuit currently accounts for about one-third of the bankruptcies in the country, which argues for its greater inclusion in the district samples to better reflect the national filing data. In addition, because a proposal to create a new Twelfth Circuit is pending, we wanted to include at least one district that would become part of this new circuit. Of the potential Twelfth Circuit districts, Western Washington would be the "high-filing" district.

All together, our twenty-three districts represented about forty-two percent of the business cases filed in the United States in 1993, according to the data provided by the Administrative Office of the U.S. Courts.<sup>34</sup>

Professor LoPucki has challenged us by saying that we should have focused on the districts with the most cases, so that our sample would reflect the largest portion of U.S. bankruptcy filings. He argues that because we cannot achieve a completely representative sample short of sampling all districts, we would do better to draw a sample from the districts with the maximum number of cases. The point is well worth considering, but after consideration we disagree.

Such a sampling technique would not permit us to determine whether business bankruptcies served a different function in low-filing districts than in high-filing districts. It is possible, for example, that workouts occur outside the formal system altogether in low-filing districts and that the business bankruptcy system is used principally to say a blessing over imminent liquidations. In high-filing districts, debtors might file bankruptcy earlier in their times of trouble and make a more aggressive effort to reorganize their businesses through the bankruptcy courts. We sacrifice some improvement in the size of the sample from which we draw our cases in order to pick up lower-volume districts that might represent important variations. In balancing the competing considerations, we believe our sample is of sufficient size to retain the advantages associated with drawing cases from a large sample.

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34. In 1993, there were 25,872 business cases filed in our twenty-three districts and 62,304 business cases filed nationwide. See YEARBOOK, *supra* note 20, at 17-20.

### *B. Selection of Cases*

In considering the selection of a representative sample of cases, we face the unexpectedly thorny problem of defining a “business” bankruptcy for the purposes of determining eligibility for our study. The Administrative Office of the Courts defines business cases as those for which someone (presumably, but not necessarily, the debtor’s attorney) has checked the “business” designation on the front sheet of the filing. We decided this definition might be both overinclusive and underinclusive. We define a case as a “business” bankruptcy if any of the following indicia are present: 1) the lawyer has checked “business” in the business-nonbusiness box on the face sheet of the petition; 2) the petitioner has a business style (e.g., “Corp.,” “Inc.,” “Co.”); 3) the petitioner has a designation of “doing business as,” of “formerly doing business as,” or of “also known as” if the second designation is a business. Our pretests indicate that the overlap among these indicia varies substantially by district. In order to be as inclusive as possible, we accept cases that meet any of the three criteria. If, however, when we interview the debtor, the debtor denies that there is a business bankruptcy, we administer an additional set of questions designed to probe whether a failure of the debtor’s business is involved in the bankruptcy filing. This permits us to eliminate from our sample obvious mistakes, such as the bankruptcy of a wage earner whose attorney simply checked the wrong box.

Within each district, every business bankruptcy case should have an equal chance of being selected in order to minimize the risk that the sample would be unrepresentative. For the most part, we achieve that result by drawing cases in the order in which they are filed, with random selection for ties.<sup>35</sup> The objective of these procedures is to minimize human judgment that might introduce bias into the sample. By setting up these procedures a priori, we increase the likelihood that the sample will be representative. On the other hand, the odds are against any particular case, even a case of stunning magnitude, falling into the sample.<sup>36</sup>

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35. In some high-volume districts, for example, a single day’s filings may exceed the number of cases needed for the sample for the quarter. In order to minimize any bias in the selection of such cases, we select the sample randomly from that day’s filings.

36. Thus, we can already tell that we missed the Zsa Zsa Gabor and Lynn Redgrave filings, even though we confess that we looked to see if they popped up in the sample.

### *C. Expected Results*

The following are some of the many categories of data that we expect to obtain from the comprehensive sample:

From the files:

- Complete financial data
- Type and timing of events during bankruptcy (for example, lift stay motions, cash collateral orders, and so forth)
- Distributions to creditors
- Professional fees
- Distribution and time of outcomes (for example, confirmation, dismissal, or conversion)

From the debtors:

- Structure of debtor ownership (family, closely held, dispersed nonpublic, public, etc.)
- Perceived causes of the business' difficulties
- Debtors' goals in filing
- Basis for choice of a bankruptcy remedy
- Number and type of employees affected
- Debtors' perceptions of the system

From other sources (as available):

- Classification of judge's managerial styles
- Brief history of each business

We hope to be able to use these data to develop a fairly comprehensive baseline picture of business bankruptcy filings, including theorized relationships. For example, we may be able to determine if success of a case is significantly related to the size of the business, the structure of the business, the case management techniques employed by various judges, the attorney fee arrangements or size of fees, and so on. We may be able to establish in liquidation cases, for example, whether tax debts seem to weigh heavily toward the liquidation alternative, and whether ownership and management structures seem to contribute to the likelihood of liquidation rather than reorganization. We will be able to determine the amounts distributed to creditors in various kinds of cases and to compare payouts among Chapters 7, 11, and 13. We are continually amazed that we lack information so basic about this system. The fact that we do underscores the point that this type of study is still in its infancy and that baseline data are the most indispensable product of a large, comprehensive study.

## VI. BUT IS IT REALITY?

The comprehensive sample will give us a good idea of the typical businesses that use bankruptcy. It will provide a great deal of basic information about how the system operates and the identity of the debtors and creditors tangled within it. But is it reality?

In one sense, of course it is. It is the fundamental reality. The comprehensive sample is a large, statistical cross-section of the businesses that file for bankruptcy. It is not merely representative; it also provides the essential baseline of business failures and the legal system's response to those failures. Among other things, it is not possible to understand fully how the system deals with one type of case without comparing and contrasting the system's treatment of other types of cases. Given our current ignorance, a large empirical project must start with such a comparison.

But the comprehensive sample, by using each business that files as an equally important unit of analysis, obscures other realities. We could predict to have as few as four public company cases in our sample.<sup>37</sup> The odds against finding enough publicly traded cases to analyze statistically within a sample are astronomical. But Macy's bankruptcy filing involves more debt, more jobs, more real estate, more lawyers, more newspaper ink, and more paper than the bankruptcy of Harrelson's Fixup of Bethany, Oklahoma.<sup>38</sup> Harrelson's has already made it into the comprehensive sample; the 1994 equivalent of Macy's may not. Although all of the cases like Harrelson's Fixup together may be more important than Macy's, a discussion of the business bankruptcy system without companies like Macy's has a hole in it.

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37. In 1993, only 86 public companies filed for bankruptcy out of 50,721 Chapter 7 and 11 business filings. The percentage of public company filings was 0.16955%, or about 1.7 out of every thousand cases. See YEARBOOK, *supra* note 20, at 37, 60. Our sample will consist of approximately 2,208 business cases in Chapters 7 and 11. Assuming a random distribution of cases, multiplying 0.0016955 by 2,208 produces an approximate value of 3.7. Of course, there are other variables, including the possibility that we will get more public cases because our districts include Delaware and Southern New York.

38. The name has been changed to protect the insolvent. Although the bankruptcy files are public records, we are committed to keeping confidential the names of the small companies and individuals we sample. See AMERICAN SOCIOLOGICAL ASS'N, CODE OF ETHICS IB(2), (10) (1989) (stating that human subject anonymity should be protected regardless of funding source); Daniel B. Cornfield & Teresa A. Sullivan, *Fieldwork in the Oligopoly: Protecting the Corporate Subject*, 42 HUM. ORGANIZATION 258 (1983) (discussing the need to conceal the identity of large, complex, profit-making organizations in case studies to promote access to large corporations and to ease tension between researchers and corporate managers).

We recognize the intuition that somehow we need to know about the 1994 equivalent of Macy's as well as about Harrelson's in order to describe the business bankruptcy system. But to assert that bankruptcies of large companies are much more important than their proportion of the total number of filings is to put forth another unspoken assertion: criteria other than numerosity define "important" and thus construct another bankruptcy reality. We wanted to explore those other realities in this Conference.

We describe below five competing slices of reality that we might try to observe in an empirical study of business bankruptcy. We discuss the pros and cons of each in the context of the policy debates and the existing academic dialogue.

#### *A. Economic Impact—Sample Dollars Instead of Cases*

Policymakers are probably most interested in the businesses that have the greatest economic impact. That part is easy. How to measure economic impact is a little more treacherous.

Is the sorting device for economic importance the amount of debt listed by the failing company? This criterion makes some sense. After all, bankruptcy is about debtors and creditors, and debt is what brings them together. So perhaps big debt is the appropriate measure of importance. But what should the debt criterion encompass? Should we include all debt, even if it is fully or mostly secured and therefore likely to be repaid in full, in or out of bankruptcy? Such a test would eliminate cases with lower debt, but this result may not be beneficial. The lower-debt cases may include nearly all unsecured debt that is subject to discharge in a Chapter 11 reorganization and that may be held by the unsecured creditors who are traditionally the targeted beneficiaries of the bankruptcy system. If sheer size of debt were the sorting device, would we thereby disproportionately include companies that borrowed to invest in other ventures, and have few employees and no product or service of their own? If we ratchet up the debt levels sufficiently, we might limit our sample to the carcasses left from leveraged buyouts. These debt-laden companies surely have a story to tell, but if the criterion is "economic importance," is this the most important story about what is happening to faltering American companies? If secured debt counts, would companies seeking to reorganize the debt that permitted them to purchase real estate—hotels, office buildings, and apartment complexes—dominate the sample, perhaps skewing it toward limited partnerships organized in part to shelter income from taxes and in part to pick up the spare cash of risk-loving dentists?

Perhaps in a search for economic importance we might shift to an exploration of the effect of bankruptcy on jobs. Since presidential politics

seem to turn on how many jobs one party or another can claim to have created, perhaps bankruptcy's importance should be measured by the number of jobs it purports to save. We could start by determining the number of workers employed by each debtor. That would tell us how many jobs are contingent on the success of this reorganization effort.

Of course, if jobs are the critical measure, then we should also consider the multiplier effect—all of the people whose jobs depend indirectly on the troubled business. Those of us old enough to remember when Chrysler was in trouble in the late 1970s recall the news stories about the potential impact of a shutdown on suppliers and small businesses throughout the Midwest.<sup>39</sup> Because each dependent business is small, they—and their employees—would be hard to find in a sample drawn to screen for high-employment businesses. A debtor's demise may affect thousands of other jobs, and yet its own displaced employees might number only in the handfuls.

It also is possible that a liquidation would not put anyone out of work. Those who believe in perfect markets would simply hypothesize good jobs for all those displaced, and in some cases they would be right. Perhaps the business could be sold intact. Perhaps the employees have skills that are valued elsewhere and they could make a smooth transition to other jobs. Perhaps workers are largely fungible, and can be inserted anywhere in the economy as needed—former parts welders from Ypsilanti can fill the demand for waiters in Mexican restaurants in Santa Fe. Perhaps.

We could measure economic importance yet another way. We could create a sample of publicly traded companies. These companies have already proven their importance to the American economy in a significant way: they made it through an initial public offering of their stock. Of course, this sample would omit some very big companies that have been taken private.<sup>40</sup> Beyond the leveraged buyouts, such a move would exclude a large number of multi-million dollar companies that employ tens of thousands and borrow billions, but are held by families, trusts, investment consortia, and other nonpublic holders.

More critically, the public-company criteria might prove too narrow in another way. The public companies may be big and important, but they are

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39. See generally MICHAEL MORITZ & BARRETT SEAMAN, *GOING FOR BROKE: THE CHRYSLER STORY* (1981).

40. For example, TLC Beatrice is a huge conglomerate that would not qualify for a public-company sample if it became financially troubled because it was taken private in 1986 and is no longer publicly traded. See Bloomberg Business News, *46 Beatrice Holders Plan Sales of Shares*, N.Y. TIMES, Dec. 28, 1993, at C2, D2.

only a tiny fraction of the debtor pool. Consequently, a tight focus on them might tell a story that is not about the either the economic system or the bankruptcy system so much as it is about aberrations such as takeovers and debt leveraging that affect only a very specialized subset of American industry. In the early 1990s, bankruptcy filings of publicly traded companies shot up—far out of proportion to the rise in the same years in all business filings.<sup>41</sup> Some experts speculate that the sharp rise had to do with the junk bond trend of the 1980s more than anything about the overall economy or the bankruptcy system itself.<sup>42</sup> This speculation may or may not be true, but with a tiny case base, the possibility for wild distortions in the reported data are exceedingly high. Five more cases filed in 1993, for example, would have meant a six percent increase in total public-company filings—and a proportionate shift in whatever data were collected from these companies.

Perhaps the most compelling reason not to create a public-company sample is a pragmatic one. LoPucki and Whitford have published an excellent study.<sup>43</sup> In a world of infinite resources, we would like to revisit this sample, perhaps asking different questions this time about the progress of the bankruptcy cases and looking for changes over time between the companies filing in the early 1980s and those in the early 1990s. But neither resources nor time are infinite. The LoPucki and Whitford study was very resource-intensive. The researchers took several years to study 43 companies.<sup>44</sup> They interviewed 125 attorneys, managers, and other people associated with the cases in their sample.<sup>45</sup> And when they were through, they lit a candle that shed some important light on the bankruptcies of publicly traded companies. Until there are more candles to go around, it seems a little wasteful to light another so nearby.

### B. Public Attention

Economics are important, but they do not play an overwhelmingly influential role in shaping policies and perceptions about the bankruptcy system. We could study those cases that have an important impact on the

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41. Alison Leigh Cowan, *The Bankruptcy Business Hits Hard Times*, N.Y. TIMES, Jan. 13, 1994, at A1 [hereinafter *Hard Times*].

42. *Id.*

43. See LoPucki & Whitford, *Bargaining*, *supra* note 1.

44. These were public companies with over \$100 million in assets that filed from 1979 to early 1988. See LoPucki & Whitford, *Bargaining*, *supra* note 1, at 134-35.

45. See LoPucki & Whitford, *Governance*, *supra* note 1, at 722 n.184.

bankruptcy debates for reasons that are only incidentally related to their economic importance.

We think of this sample as the bankruptcy equivalent of *Lifestyles of the Rich and Famous*. A number of factors enhance voyeuristic attraction. Business bankruptcy is frequently low on the salacious scale, but as a subculture we have our own “rich and famous” that provide the fodder for the cocktail party references necessary to show one’s status as a player. Moreover, we recognize that some cases generate lots of public interest—or at least the interest of reporters, who, in turn, try to stir some public interest. We could select a sample from these cases.

How would we pick a Public Impact sample? We could choose cases discussed in the *New York Times*, whose reporters seem to spend an extraordinary amount of time poring over lawyer time sheets and expense accounts in big bankruptcy cases, describing the professionals as “vultures” and the companies as “carrion.”<sup>46</sup> The unstated sorting device would be importance to mid-town law firms. Or we could pick cases mentioned in the *Wall Street Journal*. Either approach might give us a powerful East Coast bias, but that would cut down on travel costs. We might expand the sample to pick up bankruptcies mentioned in the key newspapers in a dozen American cities, which would give us Kim Basinger and the Baltimore Orioles, along with the bankruptcies of companies tied to local notables. Perhaps we could even include the rural papers. We would surely find out what inquiring minds want to know.

We make this suggestion only half tongue-in-cheek. We recognize the power of the press to shape the perceptions of how the bankruptcy system operates. And we are mindful that important legal policies may be shaped by such perceptions. Following the Eastern Airlines filing, Congress held quick public hearings to consider amending the laws regarding substantive consolidation in bankruptcies in the airline industry as a possible countermove to Frank Lorenzo’s unpopular public stunts. A single bad case—if retold often enough and vividly enough—has the power to change a legal system.

### C. Social Impact

Some business bankruptcies create a public impact disproportionate to their assets and liabilities because they profoundly affect other segments of

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46. See, e.g., *Hard Times*, *supra* note 41, at C2, C12.

American life.<sup>47</sup> An airline bankruptcy is a good example, with the infrastructure of the country's transportation system gravely threatened—or not. As with jobs, one can debate the existence or extent of the effects, but one cannot deny that some kinds of cases might plausibly have disproportionate effects on communities, or even the country as a whole. A similar situation may arise in other transportation bankruptcies, such as bus lines or trucking companies, or in the bankruptcies of other infrastructure businesses, such as power companies and hospitals.

Some commentators have gone so far as to propose that certain cases should receive separate statutory treatment. For example, some specialists have suggested that asbestos cases should be treated under a separate provision (a Chapter 14) added to the Bankruptcy Code.<sup>48</sup> Still others see a pressing need to rationalize the insolvency law of the insurance industry, perhaps putting it under a new section of the Bankruptcy Code.<sup>49</sup>

The key point here is the presence of a magnified public interest, beyond the immediate concerns of stockholders, creditors, and employees. It may be that for some industries specialized treatment is appropriate to reflect the unique interests of the community. A study might, for example, consider the effects on communities of transportation bankruptcies that leave those communities without adequate airline connections or truck deliveries. Among other things, one could consider whether changes in the bankruptcy laws would be an appropriate response or whether public subsidies are a more sensible way to deal with these special problems.

The difficulties of undertaking such a study, however, are sizeable. Without a detailed, comprehensive data base covering a number of industries, it is almost impossible to analyze the data. Are the data the product of differences in the industry, or are they widely replicated elsewhere? Without a good baseline, it is almost impossible to develop a meaningful study of a special subset. Moreover, the payoff from single-

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47. See, e.g., RICHARD B. SOBOL, *BENDING THE LAW: THE STORY OF THE DALKON SHIELD BANKRUPTCY* (1991) (discussing the A.H. Robins bankruptcy). See also KEVIN J. DELANEY, *STRATEGIC BANKRUPTCY: HOW CORPORATIONS USE CHAPTER 11 TO THEIR ADVANTAGE* (1992).

48. David Johnston, *Some Would Write Asbestos into Bankruptcy Law*, PHILA. INQUIRER, Aug. 6, 1993, at C1.

49. See, e.g., Stephen W. Schwab et al., *Onset of an Offset Revolution: The Application of Set-Offs in Insurance Insolvencies*, 95 DICK. L. REV. 449 (1991); ABA Business Law Section, Business Bankruptcy Committee, *Insurance Insolvency: A Proposed Federal Venue* (1991); *Close Watch on the Insurance Industry, Part II—Independent Regulatory Agency Proposed*, 21 BANKR. CT. DEC. 39-1 (Sept. 26, 1991).

sector studies are necessarily also limited. By definition, generalization is almost impossible, which makes it difficult to explain spending scarce resources for forays in this direction. On the other hand, some might argue that the presence of a great public interest in these sectors justifies such priority treatment.

#### *D. Hot Legal Disputes*

Bankruptcy is a legal system, and like all legal systems, at any given time there are a number of debates raging about various aspects of the system. Sometimes the debates are prompted by a novel application of the law, proposed by a creative debtor and adopted by a flexible court. Other times the debates are about the resolution of ambiguities in the Code or the extant case law, where courts starting from a single point have taken different paths that reshape the rights of debtors and creditors. And still other times an interest group persuades some portion of the relevant bankruptcy community that the laws as written and enforced impose an injustice on one or another party and should be changed. In all these cases, relevant empirical evidence would likely be useful to the debate. But to provide the needed relevant data requires yet another approach to defining and sampling reality.

To some extent, as discussed above, we have used policy debates as a source of questions and goals in specifying the data to be gathered from the comprehensive sample. The question here is the extent to which we use the debates to select another sample.

Single asset real estate cases provide an illustration. These cases have prompted an extraordinary number of published judicial opinions, law review articles, proposed statutory amendments, seminars, CLEs, and newspaper articles. (An interesting empirical study might begin by determining the ratio between published articles about single asset cases and the total number of single asset cases.) It would be possible to draw a sample of single asset cases and examine how they proceed through bankruptcy.<sup>50</sup> It might even be possible to compare them with nonfiling single asset companies that were also in trouble. Surely the information gained would add some much needed light to a very heated debate.

But would such a study describe enough reality to be worth the expense?

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50. A very interesting study of real estate cases has been published since the Conference. See Fenning & Tucker, *supra* note 1.

This raises a much more difficult question about empirical data, a question we empirical researchers like to skirt as much as possible: How much data do we need to make informed policy decisions? Must there be a separate study to inform the disparate policy debates? And will one study be enough, or will the data be sufficiently ambiguous that they will tell us only tantalizing fragments about each issue, prompting us to return to the field for a more definitive answer? What kind of resources should be devoted to shifting policy decisions from the anecdotal-and-political to the partially-informed-and-political? We like to avoid these questions because we recognize that they push us closer to the futility argument: we cannot know everything, so we need not spend the resources—or slow down the debates—to get some hard information about reality. We have a short response to this argument: “Nonsense.”

That we cannot know everything does not mean we cannot know some very useful things. And some of those things can powerfully change debates. Years ago, we undertook a study of consumer bankruptcy in an environment where the assertion was seriously put forth that large numbers of debtors were discharging debts they could easily repay and that the system was a “source of enrichment” that debtors would use as often as the law would allow.<sup>51</sup> We analyzed 1557 consumer bankruptcy cases in great detail, concluding that some fraction of the debtors undoubtedly could have repaid their debts. We could not tell the number for sure—maybe one percent, maybe two, maybe even five. But the data clearly demonstrated that it was not 80% who could repay. Nor was it 50%, nor 20%.<sup>52</sup> And very few debtors filed more than once.<sup>53</sup> As measured by the neediness of the debtors who used it, the bankruptcy system was working remarkably well. In our view, this is one of the most effective uses of data in the policy debates: we could not know everything, but we could at least eliminate some terribly wrong answers that might otherwise distort public policy decisions.

So we might pick a policy debate and develop a precisely focused study to shed some light on it. The sample would likely depend on what we were planning to study, as in the single asset cases we described above.

This can be a very valuable approach. For example, Professor Ray

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51. CREDIT RESEARCH CENTER, PURDUE UNIVERSITY, 2 CONSUMER BANKRUPTCY STUDY 131-33, 139 (1982).

52. See AS WE FORGIVE, *supra* note 15, at 220.

53. *Id.* at 192.

Warner focused on the hotly disputed issue of routine fee holdbacks.<sup>54</sup> Judges utilize routine holdbacks to create an incentive device to encourage attorneys to move cases to conclusion faster. This approach is supported by the law-and-economics aficionados who embrace such incentive manipulation. Warner tested the empirical premise by asking whether such holdbacks had any measurable effect on the time it takes to conclude cases. He developed data that permitted him to compare case progress in jurisdictions that routinely employed holdbacks with progress in jurisdictions that did not. He found that cases moved as quickly—or as slowly—in both kinds of jurisdictions and that holdbacks had no discernible effect on how long cases remained open.<sup>55</sup> At a minimum, these data ought to change the outlines of a longstanding debate.

#### *E. Actors Who Can Affect the System*

There is yet another reason certain cases may be deemed “important” in the bankruptcy system. Cases may be important if certain actors, principally judges and attorneys, can make an important difference in what happens during a case by changing the procedures they follow. Such cases become important to those actors because they occupy most of their time and attention.

When we wrote about the consumer bankruptcy system, we noted that the overwhelming number of consumer lending decisions were actuarial, not individualized. Creditors adopted broad policies based on established criteria, and debtors either were eligible for credit or not. There was little about a debtor individually—her industrious nature, his family background—that affected the lending decision if it were not already encompassed in the routinized criteria. The same is true of meting out justice. A large number of cases are handled routinely in the bankruptcy system. Policies are adopted and parties must either conform or face preordained consequences. Cases are filed, reports are due, payments must be made, cases are dismissed, and so on, without much individual attention to most of the cases. Much of what we will learn about the comprehensive sample will assist in the policy decisions that establish these procedures and rules.

But there are a significant number of cases that receive far more

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54. G. Ray Warner, *Interim Compensation and the Routine Holdback: The Effect of the Jenkins Case*, 1 J. BANKR. L. & PRAC. 565 (1992).

55. *Id.* at 578-81.

individualized care. These are cases in which more money is at stake, more activity is initiated by the creditors, more individually crafted solutions are offered by counsel, more oversight is initiated by the U.S. Trustee, and more court time and attention is allocated by the judge. These are the cases in which extensions of exclusivity, imposition of a new value exception to the absolute priority rule, early motions to terminate cases, and debt classification disputes may be ferociously argued and may powerfully affect the ultimate disposition of the case. These are also the cases in which different forms of judicial case management may significantly affect outcomes. These are the cases in which the crafts of lawyering and judging matter a great deal. These might be termed the "craftable" cases. It is also relevant that these cases are the most intellectually interesting to bench and bar.

Judges have a powerful role to play in any case, but realistically, the role they play in most cases is limited to a routine disposition of fairly standard issues. They may pick an occasional consumer or small business case as an occasion to clarify a particular point of wide applicability, as Judge Bufford did in announcing a rule for measuring attorney conflicts of interest in all small cases in *In re Lee*.<sup>56</sup> And very small cases can sometimes raise important issues of principle, even if they apply only infrequently.<sup>57</sup> But the more complex aspects of the Code, and consequently, the greater opportunities for the judge to manage a business case, occur when cases are larger. The same, of course, could be said for other players, including the U.S. Trustee, counsel who serve creditors' committees, debtors' counsel, and so on.

Judges, attorneys, trustees, and creditors can affect outcomes in these larger cases, and they spend a disproportionate amount of their time doing so. In order to inform their decisionmaking, however, they need something different from the comprehensive sample. They need to know about a range of issues that occur in many fewer cases, but in enough cases to warrant significant expenditure of their time. The decisions that come from these cases are widely applied in similar cases and significantly affect how parties negotiate out-of-court settlements. Without data about how these

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56. 94 B.R. 172, 176 (Bankr. C.D. Cal. 1989).

57. *Christians v. Crystal Evangelical Free Church (In re Young)*, 148 B.R. 886 (Bankr. D. Minn. 1992) (allowing recovery, as a fraudulent conveyance, of contributions to the debtor's church in the year before bankruptcy), *aff'd*, 152 B.R. 939 (D. Minn. 1993). See also Laurie Goodstein, *Religious Groups Fight U.S. in Bankruptcy Case*, WASH. POST, May 23, 1994, at A1.

cases generally operate, and some systematic view of the impact of different approaches, judges are left to make decisions without crucial factual context.

These cases—more common than the very rare publicly traded cases, but less common than the routine cases that fill the docket—are the significant source of many published judicial opinions. They are also the object of a variety of different case management approaches. Any judge or attorney generally knows which cases these are, but developing a protocol to determine which cases are in the universe and eligible for the sample is a bit tricky. In particular, it must be remembered that a sample criterion must generate enough cases to create statistical cells large enough for statistical analysis, but it cannot waste resources by causing collection of many irrelevant cases in each category.

We could use certain levels of debt and assets as proxies for these cases but there are no baseline data to help us determine in advance whether a particular level will generate a sufficient number of the cases we want. It is unclear, for example, whether exclusivity issues arise in 1% or 10% or 50% of the cases with assets and debts in the \$1-\$10 million range, but we need some idea of the incidence in order to draw a sample. To complicate the problem, it is not clear whether either the incidence or the disposition of cases may differ in the \$10-\$100 million range, making two or three or four different samples necessary to understand what is happening. The further complications of “local legal culture” may mean that the answers to these questions would vary from district to district.<sup>58</sup>

Notwithstanding these difficulties, one could argue that these cases are especially worth studying because the results will really matter. Congress may or may not pay attention to comprehensive data, and the explanatory power of such data is always limited by the very scope of its coverage—broad but thin. In the craftable cases, however, specific findings may well assist judges and lawyers to do a better job. If one is limited to drawing a single bucket of water, it may be better to pour it into the garden rather than the field.

## VII. ACADEMIC DEBATES

The obvious source for empirical questions and hypotheses is academia, including conferences such as this one. But that point brings us full circle

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58. See *Local Legal Culture*, *supra* note 28.

to the critique that began this paper. Most academic theorizing in our field at the present time does not generate testable hypotheses. The theories proposed are almost defiantly far removed from reality and therefore untestable by empirical research.

We were pressed by our colleagues at this Conference to formulate formal hypotheses for our study following one version of the classic scientific model. But that model supposes that theorists will propose testable hypotheses and empiricists will then go forth and test—the two groups working in tandem. It does not suppose that the empiricists have to propose as well as test. Stephen Weinberg proposes a theory that predicts the ‘Z’ particle and then Carlo Rubbia looks for it in nature.<sup>59</sup> When Rubbia finds it, they both get Nobel prizes. This sounds good to us, but where are the predictions to be tested? Despite the stern (but good-natured) challenge we issued in this paper, no one at the Conference proposed a single hypothesis to be tested. For the most part, the current academic debates are useless as a source of empirical questions.

Even more surprising to us was the absence of suggestions for a “second sample.” We expected our colleagues to have a thousand ideas for the most important subset of reality to study among the business cases—especially if they did not have to actually collect the data. Instead, there was an almost universal rejection of any sample other than a comprehensive one. On reflection, we realize that this view may actually be consistent with the implicit assumption in recent literature that there are no important distinctions among types or sizes of cases.<sup>60</sup>

The only proposal that attracted wide support at the Conference was that we survey nonbankrupt companies by way of comparison with the bankrupt sample. We intend to make comparisons between our sample and nonbankrupt companies generally, of course, drawing on various business data bases. The suggestion at the Conference, however, was to sample some subset of companies in financial trouble, but not in bankruptcy. Unfortunately, no one was able to articulate how such a sample would be defined, much less located. As with our bankruptcy sample, it was to be universal (that is, not limited by size, type of company, and so on), but no one had much more to say.

If the point is to sample nonbankrupt companies who are in financial

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59. ROBERT K. ADAIR, *THE GREAT DESIGN: PARTICLES, FIELDS, AND CREATION* 332-38 (1987); see also LEON LEDERMAN & DICK TERESI, *THE GOD PARTICLE* 330-33 (1993).

60. See *supra* note 8 and accompanying text.

trouble, how shall we define financial trouble? If we say every company that has missed a bank payment, we will be far too inclusive and the comparison will not differ much from a comparison of the bankruptcy sample with companies generally. We should not spend our resources replicating those data. To make a useful, new comparison, we must be looking for companies at the margins of bankruptcy. Yet to define that sample, we must complete our current bankruptcy study to learn something about the companies that are in bankruptcy. We cannot meaningfully discuss what it means to be at the margin if we do not know what it means to be over it. One interlocutor insisted that we should draw a sample "just like" the bankruptcy sample, only not in bankruptcy. We asked how that might be done if we did not know who was in bankruptcy.<sup>61</sup> We still do not have the answer.

#### VIII. CONCLUSION

Notwithstanding our sometimes cranky demeanor about the state of the bankruptcy policy debates, we have raised these issues to encourage other scholars, not to scare them off. We want other scholars, including those not of an empirical bent, to consider what is involved in designing one aspect of an empirical study. We hope to draw on the intelligence and insights of others to better shape our own work and to help us make decisions about how to pursue this research.

We invite everyone in the field, as we invited everyone at this Conference, to give us one question they would most like to ask of any of the realities described here. But the price of admission is that the inquirer must define how the question can be asked—that is, how the answer can be extracted and from which sample the answer should be collected. In developing a question, it will be useful for the inquirer to remember that empirical work functions best in revealing propositions to be false (or unlikely to be true) as opposed to demonstrating that propositions are true.

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61. If we succeed in doing what our fellow Conferees did not do—defining the proposed nonbankrupt sample—how could we find the companies? It was suggested that we "talk to banks." Can one really imagine getting a large number of banks to reveal the names of companies in default for certain periods or with debt-to-earnings or debt-to-equity ratios of a certain level? If not, do banks themselves have the sort of data about these companies that would be useful on an anonymous basis and would they (or could they) release those data? Furthermore, Professor Baird's paper cites data suggesting that many small businesses do not have bank debt at all. Douglas G. Baird, *The Reorganization of Closely Held Firms and the "Opt Out" Problem*, 72 WASH. U. L.Q. 913, 919 (1994).

We also confess to writing this paper with a missionary spirit. We hope that discussion of the thought process that forces the researcher to frame empirical questions would make more obvious the importance of empirical questions to both academic and policy debates. Even if we cannot entice everyone else to conduct the studies, we would be enormously pleased to see the dialogue modified to highlight underlying empirical assumptions and to make theoretical work a bit less than respectable if it lacks testable hypotheses. Even better would be a general agreement that sweeping new policy pronouncements are premature until something more is known about the underlying realities.

