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Rediscovering Corporate Governance in Bankruptcy

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I am grateful to Jonathan Lipson, Bill Whitford, and the Temple Law Review editors for helpful comments.

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Abstract

In this Essay on Lynn LoPucki and Bill Whitford's corporate reorganization project, written for a symposium honoring Bill Whitford, I begin by very briefly describing its historical antecedents. The project draws on the insights and perspectives of two closely intertwined traditions: the legal realism of 1930s, whose exemplars included William Douglas and other participants in the SEC study; and the law in action movement at the University of Wisconsin. In Section II, I briefly survey the key contributions of the corporate governance project, which punctured the then-conventional wisdom about the treatment of shareholders in bankruptcy, managers' principal allegiance, and many other issues. In Section III, I consider two major shifts that have taken place in Chapter 11 practice in the twenty-five years since the study: the rise of creditor influence in Chapter 11, and shifts in the principal participants in (and scope of) large corporate reorganization cases. In Part IV, I explore one of LoPucki and Whitford's key proposals — compensation for unsecured creditors when they are made to bear business risk in bankruptcy — and consider its potential relevance for the hotly debated, current question of the scope of a secured creditor's lien in bankruptcy.

Keywords: Bankruptcy, corporate reorganizations, corporate governance, corporations, corporate finance, financial distress, insolvency shareholders, Chapter 11, compensation for unsecured creditors, Bill Whitford, Lynn LoPucki

JEL Classifications: G33, G34, K22

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REDISCOVERING CORPORATE GOVERNANCE IN BANKRUPTCY

David A. Skeel, Jr.[*]

INTRODUCTION

My first exposure to Bill Whitford's work was an anxious one. During my first year as a law professor many years ago,[1] I thought I had stumbled on a novel insight that might help launch my career as a scholar. Although most commentators treated them as entirely distinct fields, and very few law teachers worked in both areas at the time, corporate law and corporate bankruptcy were in fact closely connected. You could not fully understand one without studying the other. The same logic that explains corporate law voting rules, for instance, can also be used to assess voting and other features of the Chapter 11 reorganization process.

After spending several months researching these ideas, I discovered that Whitford and Lynn LoPucki had gotten there first. Not only did they recognize the interconnections between corporate law and bankruptcy, they had embarked on a massive study of corporate governance in the largest Chapter 11 cases. The first of their series of pathbreaking articles, "Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Corporations," had recently appeared in print,[2] and its successor would focus directly on corporate governance.[3] Before they finished, the project would include six articles,[4] and would dramatically alter much of the conventional wisdom about the role of managers, the treatment of shareholders, and other issues in the biggest reorganization cases.

Although my first thought when I heard about the LoPucki and Whitford study was "preemption," even then the LoPucki and Whitford studies were a gift.[5] For anyone who

* S. Samuel Arsht Professor of Corporate Law, University of Pennsylvania. I am grateful to Jonathan Lipson, Bill Whitford, and the *Temple Law Review* editors for helpful comments.

1. Twenty-five, to be exact.

2. 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*].

3. Lynn M. LoPucki & William C. Whitford, *Corporate Governance in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 141 U. PA. L. REV. 669 (1993) [hereinafter LoPucki & Whitford, *Corporate Governance*].

4. The other articles were Lynn M. LoPucki & William C. Whitford, *Compensating Unsecured Creditors for Extraordinary Bankruptcy Reorganization Risks*, 72 WASH. U.L. REV. 1133 (1994) [hereinafter LoPucki & Whitford, *Compensating Unsecured Creditors*]; 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, *Preemptive Cram Down*, 65 AM. BANKR. L.J. 625 (1991); Lynn M. LoPucki & William C. Whitford, *Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 1991 WIS. L. REV. 11 [hereinafter LoPucki & Whitford, *Venue Choice*].

5. Happily for me, LoPucki and Whitford's corporate governance article, the article most similar to mine, was not yet in print, and my effort was sufficiently different that there was room in the law review universe for

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has studied corporate reorganization in the past generation, these studies are the touchstone, the foundation for what we knew about Chapter 11 in the full first decade of the Bankruptcy Code era. Like others, I have marveled at many of Bill's classic commercial law and consumer bankruptcy articles, but the large-scale corporate reorganization studies are the ones I encountered first and have wrestled with, embraced, and learned from most.

The project was based on LoPucki and Whitford's empirical study of the forty-three largest publicly held companies to file for bankruptcy and complete a reorganization plan between 1979 and 1988.[6] In addition to examining the pleadings and reported decisions in the cases, as well as newspaper accounts, LoPucki and Whitford interviewed more than 120 of the bankruptcy professionals involved in the case. In its scope and ambition, the project recalls the voluminous Securities Exchange Commission (SEC) study overseen by William Douglas in the 1930s,[7] a study LoPucki and Whitford frequently refer to as they examine their own findings.

In this Essay on the corporate reorganization project, I begin by very briefly describing its historical antecedents. The project draws on the insights and perspectives of two closely intertwined traditions: the legal realism of 1930s, whose exemplars included Douglas and other participants in the SEC study; and the law in action movement at the University of Wisconsin. In Section II, I briefly survey the key contributions of the corporate governance project, which punctured the then-conventional wisdom about the treatment of shareholders in bankruptcy, managers' principal allegiance, and many other issues. In Section III, I consider two major shifts that have taken place in Chapter 11 practice in the twenty-five years since the study: the rise of creditor influence in Chapter 11, and shifts in the principal participants in (and scope of) large corporate reorganization cases. In Part IV, I explore one of LoPucki and Whitford's key proposals—compensation for unsecured creditors when they are made to bear business risk in bankruptcy—and consider its potential relevance for the hotly debated, current question of the scope of a secured creditor's lien in bankruptcy.

I. THE HISTORICAL CONTEXT OF THE CORPORATE REORGANIZATION PROJECT

Starting in the 1960s, Marc Galanter, David Trubek, Stewart Macauley, and other scholars at the University of Wisconsin pioneered a new mode of legal scholarship known as law in action.[8] Law in action was in turn a direct outgrowth of the legal realism movement of the 1920s and 1930s.[9] The corporate reorganization project drew inspiration from both movements and was their most important late twentieth-century flowering. As is well known, the legal realists sought to overthrow the reigning,

my article as well. *See* David Arthur Skeel, Jr., *The Nature and Effect of Corporate Voting in Chapter 11 Reorganization Cases*, 78 VA. L. REV. 461 (1992).

6. *See, e.g.*, LoPucki & Whitford, *Corporate Governance*, *supra* note 3, at 675–76 (describing the study).

7. See *infra* notes 17–19 and accompanying text.

8. Classic contributions include Marc Galanter, *Why the "Haves" Come Out Ahead: Speculations on the Limits of Legal Change*, 9 L. & SOC'Y REV. 95 (1974); Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963).

9. *See, e.g.*, Paul D. Carrington & Erika King, *Law and the Wisconsin Idea*, 47 J. LEGAL EDUC. 297 (1997).

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Langdellian conception of law, and to replace it with a more highly contextual, experimental, 'functional' approach.[10] In the words of a leading historian of legal realism, "[f]unctionalism . . . reflected an attempt to understand law in terms of its factual context and economic and social consequences."[11] As hard as this is to imagine now (although not quite so great an imaginative stretch as before the Great Recession), most of legal realism's early luminaries were business and commercial law scholars.[12] The leading corporate and corporate reorganization scholar—and by some accounts, the most prominent law professor in the country—was William Douglas.[13]

In the late 1920s and early 1930s, as part of a "business failures" project, Douglas conducted a remarkable study of bankruptcy cases—most of which involved consumers and small businesses—filed in New Jersey from 1929 to 1930 and in Boston from 1930 to 1931.[14] Douglas and his team conducted extensive interviews with hundreds of debtors and assembled case files on 1,500 bankruptcies. During this same period, he conducted a small study of equity receiverships—the principal device for reorganizing larger corporations—in Connecticut.[15] In 1934, he turned to large-scale corporate reorganization, writing an important article arguing for a balance between governmental oversight and private negotiation in railroad reorganization.[16]

As a result of this body of work, Douglas was tapped to oversee the massive SEC study of corporate reorganization.[17] As part of the Securities Exchange Act of 1934, Congress had created the SEC, and explicitly instructed it to conduct a study of corporate reorganization cases and to report back on its findings.[18] Given that Douglas had already been investigating equity receivership practice, he was the natural choice to lead the study.

Over the next six years, Douglas and his lieutenants at the SEC—including Abe Fortas, who, like Douglas, would later become a Supreme Court justice—interviewed several hundred lawyers, receivers, and other participants in large-scale corporate

10. I have borrowed this sentence and the next from David A. Skeel, Jr., *Vern Countryman and the Path of Progressive (and Populist) Bankruptcy Scholarship*, 113 HARV. L. REV. 1075, 1079 (2000).

11. LAURA KALMAN, LEGAL REALISM AT YALE: 1927–1960, at 3 (1986).

12. Underhill Moore, Wesley Sturges, and Karl Llewlellyn all specialized in commercial law, and much of Jerome Frank's early work centered on corporate law and corporate reorganization. Skeel, *supra* note 10, at 1079 n.18.

13. University of Chicago President Robert Hutchins is said to have praised Douglas in this fashion. WILLIAM O. DOUGLAS, GO EAST, YOUNG MAN: THE EARLY YEARS 163–64 (1974).

14. *See, e.g.*, William Clark, William O. Douglas & Dorothy S. Thomas, *The Business Failures Project—A Problem in Methodology*, 39 YALE L.J. 1013 (1930); William O. Douglas & J. Howard Marshall, *A Factual Study of Bankruptcy Administration and Some Suggestions*, 32 COLUM. L. REV. 25 (1932).

15. William O. Douglas & John H. Weir, *Equity Receiverships in the United States District Court for Connecticut: 1920-1929*, 4 CONN. B.J. 1 (1930).

16. William O. Douglas, *Protective Committees in Railroad Reorganizations*, 47 HARV. L. REV. 565 (1934).

17. SEC. AND EXCH. COMM'N, REPORT ON THE STUDY AND INVESTIGATION OF THE WORK, ACTIVITIES, PERSONNEL AND FUNCTIONS OF PROTECTIVE AND REORGANIZATION COMMITTEES (1937).

18. Securities Exchange Act of 1934, Pub. L. No. 73-291, § 211, 48 Stat. 881, 909 (codified at 15 U.S.C. §§ 78a–78pp (2012)).

reorganization cases.[19] In contrast to Douglas's earlier work, which sought to provide an objective, "scientific" analysis of receivership practice, the SEC report was framed with reform in mind. The SEC reformers used their analysis to make a case for rooting out the influence of Wall Street banks and lawyers over reorganization practice. The banks and lawyers were protecting their own interests, Douglas and the reformers believed, rather than the interests of the ordinary investors they ostensibly represented. As part of the Chandler Act of 1938, the reformers created an entirely new chapter for the reorganization of large-scale corporations. Chapter X, as the provisions were quite appropriately known, kicked out the managers of a corporation that filed for bankruptcy, and prohibited a bank or law firm that had represented the firm before bankruptcy from continuing in that capacity after the filing. Since the reorganizations of the time were orchestrated by the firm's lawyers and banks, working with its managers, Chapter X effectively ended traditional reorganization practice.[20]

One of the unexpected consequences of the Chandler Act reforms was to help create the very split between corporate and securities law, on the one hand, and bankruptcy, on the other, that the LoPucki and Whitford studies would provide such surprising insight into.[21] Prior to 1938, securities law and bankruptcy were tightly connected, since the same investment banks that underwrote a company's stock and bonds would negotiate on the securities holders' behalf in the event the firm later fell into financial distress. Once the Chandler Act took hold, securities and bankruptcy practices diverged. This divergence was later echoed in the scholarly world as well. Whereas scholars like Douglas and Adolf Berle wrote about both corporate and securities law and bankruptcy, their successors tended to do one or other.[22]

The Wisconsin law in action tradition is often associated with Stewart Macauley's classic 1963 study of the contracting patterns of auto manufacturers.[23] By interviewing the contracting parties, Macauley discovered that their behavior and expectations deviated widely from the literal terms of their formal contracts. In practice, their interactions were considerably more relational. There was a marked difference between the law in action and the law on the books.

The distinctive features of both traditions can be seen in LoPucki and Whitford's corporate reorganization project. The project has a resolutely quantitative dimension that is quite similar to legal realism as practiced by William Douglas. Like Douglas, LoPucki and Whitford examined every relevant case—all forty-three of the largest corporate reorganizations of the 1980s.[24] Based on their interviews and research, LoPucki and Whitford created simple categories such as "tainted" versus "untainted" chief executives,

19. The developments described in this paragraph are described in much more detail in DAVID A. SKEEL, JR., DEBT'S DOMINION: A HISTORY OF BANKRUPTCY LAW IN AMERICA 109–13 (2001).

20. *Id.* at 113–24.

21. *See, e.g.*, David A. Skeel, Jr., *Welcome Back, SEC?*, 18 AM. BANKR. INST. L. REV. 573 (2010).

22. Leading corporate scholars of the 1970s, such as Mel Eisenberg and later Frank Easterbrook and Daniel Fischel, overlapped only slightly with the leading bankruptcy scholars, such as Vern Countryman and Frank Kennedy.

23. Macaulay, *supra* note 8.

24. LoPucki & Whitford, *Corporate Governance*, *supra* note 3, at 675.

and managers who are oriented toward creditors, shareholders, maximizing the estate, or preserving value; and they reported the numbers of cases that fell into each category.[25]

But the study also has the more qualitative markers of a Wisconsin law in action project, as reflected in LoPucki and Whitford's description of their methodology as "somewhat akin to an anthropological study, in which an observer attempts a holistic explanation of a culture after immersion in it for an extended period of time."[26] The qualitative dimension of the project comes to the fore as LoPucki and Whitford ask why shareholders so often received at least a small stake in the reorganized company, even if the company was insolvent.[27] Although participants in the cases offered a variety of explanations for the reluctance to cut shareholders off, LoPucki and Whitford suspected the explanations were incomplete. "Even when considered together," they wrote, "we do not think that the factors of litigation expense, timing, managerial preferences, loss spreading, public relations concerns, and the making of markets for the company's securities adequately explain the size of the payments made to shareholders."[28] The interviews suggested a more subtle, surprising explanation:

> [T]he outcomes of these negotiations are significantly determined by the social norms of the legal culture which has grown up around these kinds of cases. The highly intermediated nature of the chapter 11 process provides bankruptcy lawyers, bankruptcy judges, turnaround managers, and creditor representatives with a considerable degree of independence from their constituencies.[29]

This qualitative, law in action perspective is a hallmark of Whitford's work.[30] At their best—and in Whitford's work, they are—qualitative approaches can be an extraordinarily powerful mechanism for discovering truth, especially if the researcher curbs the temptation to filter the findings through the lens of her preexisting biases. Whitford's research is remarkable in this regard. By American standards, Whitford's own politics are radical, tending toward democratic socialism.[31] But his and LoPucki's findings in the corporate reorganization project are not radical at all. In their study of venue shopping, for instance, which revealed that the largest corporate debtors shop for a desirable filing location, LoPucki and Whitford provided a remarkably evenhanded assessment.[32] No doubt Whitford's own perspective shaped what he looked for and how he presented what he found. But his objective in this study, as in his other work, was to pursue the truth of the matter, wherever that might lead. His work in general, and the

25. *See, e.g.*, *id.* at 745 tbl.VII (charting "[m]anagement [o]rientations").

26. *Id.* at 750.

27. LoPucki & Whitford, *Bargaining*, *supra* note 2, at 146–54.

28. *Id.* at 154.

29. *Id.*

30. It is interesting to note, in this regard, that Whitford's work has continued in this vein since the corporate reorganization project, whereas LoPucki's scholarship has generally tended in a more quantitative direction. The statistical analysis in LoPucki's recent work is more sophisticated than in the earlier corporate reorganization project, and the statistical analysis is more often central.

31. When I made this comment at the conference that gave rise to this Symposium, several members of Bill Whitford's family laughed. They weren't questioning my characterization, but chortling at the fact that by the standards of his family Whitford's politics are quite moderate.

32. LoPucki & Whitford, *Venue Choice*, *supra* note 4.

corporate reorganization project in particular, is a model of truth-seeking, Wisconsin-style scholarship.

II. SOME LESSONS AND UNEXPECTED DISCOVERIES

LoPucki and Whitford's corporate reorganization project came after bankruptcy scholarship had begun to take off following decades of quiescence. The immediate spur was the advent of the 1978 Bankruptcy Code, which removed many of the strictures that had discouraged large businesses from filing for bankruptcy since the enactment of the Chandler Act in 1938.[33] Shortly after the Code was enacted, Thomas Jackson began writing the series of articles that culminated with his book *The Logic and Limits of Bankruptcy Law*.[34] (During this same period, Elizabeth Warren, Teresa Sullivan, and Jay Westbrook conducted the consumer bankruptcy studies they would analyze in *As We Forgive Our Debtors*.[35])

Those of us who were just starting out as bankruptcy scholars in the early 1990s—we were legion, by comparison to the prior generation[36]—knew that bankruptcy was an unexpectedly promising field. But most of us had only a general sense of the tendencies of large-scale reorganization cases. We tended to make the same assumptions about corporate governance in big cases that LoPucki and Whitford refer to and correct in their articles.

The LoPucki and Whitford findings were startling. They portrayed a world that was more nuanced, and in some cases simply different, than the conventional wisdom suggested. For most of us, nearly everything we knew about large-scale reorganization in the 1980s came directly from these studies. In this Section, I briefly chronicle a few of the major surprises.

The first big revelation was LoPucki and Whitford's findings about the treatment of shareholders. According to the conventional wisdom, shareholders used their holdup power to extract major payoffs, even if the company was deeply insolvent.[37] Not only were managers and directors generally favorable to shareholders, the reasoning went, but the debtor could not confirm a reorganization plan consensually without a favorable vote from shareholders, so companies were forced to buy peace from shareholders.[38] LoPucki and Whitford found that the conventional wisdom was correct in one respect: shareholders did receive payouts in many of the big cases. Twenty-one of the thirty largest cases included a distribution for shareholders. But the distributions were quite small. "Expressed as a percentage of the entire distribution in these cases," LoPucki and Whitford concluded, "the deviations from the absolute priority rule are small and rarely exceed 10%."[39] These findings made clear that the widespread lament that distributions

33. Many seasoned bankruptcy lawyers believe that the 1978 Code furthered a trend that was already underway. Some point to the Penn Central bankruptcy of the early 1970s as the dawn of the new era.

34. THOMAS JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW (1986).

35. TERESA SULLIVAN, ELIZABETH WARREN & JAY WESTBROOK, AS WE FORGIVE OUR DEBTORS: BANKRUPTCY AND CONSUMER CREDIT IN AMERICA (1984).

36. "Legion," in this context, means more than two or three.

37. *See, e.g.*, LoPucki & Whitford, *Bargaining*, *supra* note 2, at 134.

38. *See* 11 U.S.C. § 1129(a)(8) (2012) (requiring affirmative vote of each class of claims or interests).

39. LoPucki & Whitford, *Bargaining*, *supra* note 2, at 178.

to shareholders were seriously undermining ordinary priority rules was, as LoPucki and Whitford put it, "a tempest in a teapot."[40] LoPucki and Whitford also speculated that it was "possible that in the future the deviations from the absolute priority rule will become less frequent in large cases, as creditor groups realize the feasibility of cram down"[41]—a prediction that proved prescient in the decade that followed.

At least as surprising—and embarrassing to scholars who had confidently imported corporate law assumptions into the bankruptcy context—were LoPucki and Whitford's findings about managers' loyalties in a large Chapter 11 case. Outside of bankruptcy, managers and directors owe their principal obligations to common stockholders.[42] Many commentators simply assumed that managers' loyalties remained intact after a company fell into financial distress, and that the managers continued to treat shareholders as their primary constituency.[43] Here, too, LoPucki and Whitford discovered that actual practice looked very little like the conventional wisdom. Rather than routinely serving as shareholders' champions, as many expected, managers aligned with shareholders in only five of the forty-three cases.[44] Nearly twice as often (nine cases), managers promoted creditors' interests, and they more frequently sought simply to preserve the estate (seven cases) than to advance the interests of shareholders.[45] LoPucki and Whitford speculated that managers tended to be more sympathetic to shareholders if there was a major shareholder, but they found that the managers rarely aligned with shareholders if the corporation was insolvent.

Two other related findings were not quite as novel but were also quite important: although the managers and shareholders were thought to dominate the Chapter 11 process during the 1980s, their status actually was quite fragile. Confirming earlier work by Harvard Business School professor Stuart Gilson,[46] the corporate governance project found that filing for bankruptcy is generally not a great career move for corporate managers. Most were displaced at some point in the bankruptcy process, with only twenty-nine percent remaining in place for a four-year period starting shortly before the Chapter 11 filing.[47] Shareholders fared even worse. Not only did managers cease focusing primarily on shareholders' interests in most cases, but shareholders' efforts to invoke an important state corporate law corrective—the right to call a shareholders' meeting to elect new directors—often proved futile. Although bankruptcy judges allowed shareholders' meetings in several cases, they denied the requests in others—including the very high profile Johns Manville case.[48]

Another key finding was, as noted earlier, a classic illustration of the insights of the Wisconsin law in action tradition. As they tried to understand why shareholders often

40. *Id.* at 126.

41. *Id.* at 186.

42. Dodge v. Ford Motor Co., 170 N.W. 668 (Mich. 1919).

43. *See, e.g.*, LoPucki & Whitford, *Corporate Governance*, *supra* note 3, at 673 n.8 (citing Lucian Bebchuk and several other scholars).

44. *Id.* at 745.

45. *Id.*

46. Stuart C. Gilson, *Management Turnover and Financial Distress*, 25 J. FIN. ECON. 241 (1989).

47. LoPucki & Whitford, *Corporate Governance*, *supra* note 3, at 727.

48. *Id.* at 695–97.

received at least a small recovery, even in cases where they did not seem to be entitled to participate, LoPucki and Whitford were skeptical of the explanations offered by their interviewees. LoPucki and Whitford suspected that the real explanation for shareholders' recovery in so many cases was the intermediated nature of the legal culture. Mindful that their roles might be reversed in other cases, bankruptcy lawyers tended to seek a consensual resolution to the Chapter 11 case that provided something for everyone. "In this context," LoPucki and Whitford concluded,

> the impracticality of cram down can be both a useful myth and a self-fulfilling prophecy. To the extent that clients believe cram down to be impossible, they avoid or discharge lawyers who might attempt it, thereby enforcing the norm in favor of consensual plans and undermining lawyers who might be inclined to attempt a cram down.[49]

In retrospect, the discovery that the interests of bankruptcy lawyers might shape the structure of the Chapter 11 process seems obvious, and other scholars subsequently have identified other areas of bankruptcy where legal culture has played a central role.[50] At the time, it was revelatory. Even scholars who did not write from within the Wisconsin tradition began to consider ways in which bankruptcy professionals shaped the bankruptcy process.

The last finding I highlight here is LoPucki and Whitford's discovery of venue shopping in bankruptcy cases.[51] It was well-known that most of the largest Chapter 11 cases ended up in the Southern District of New York, and that the New York bankruptcy judges seemed to be willing to extend managers' exclusivity period indefinitely. What bankruptcy scholars had not stopped to consider was how the cases got to New York. LoPucki and Whitford found that distressed companies took advantage of the malleability of bankruptcy's venue statute to file their cases in New York even if they did not have any real presence in New York prior to the bankruptcy filing. At the time, scholars paid less attention to this discovery than to LoPucki and Whitford's findings about managers and shareholders in large Chapter 11 cases. The venue shopping issue would later become one of the most hotly contested issues in corporate bankruptcy law, after Delaware joined New York as a destination of choice for the largest cases.[52]

III. WHERE ARE WE NOW?

Looking back from our vantage point twenty-five years later, the world that the corporate governance project revealed is recognizable in some respects, long since superseded in others. In this Section, I briefly describe two of the most obvious transformations, the much-documented shift toward a more creditor and sales oriented

49. LoPucki & Whitford, *Bargaining*, *supra* note 2, at 154, 156–57.

50. *See, e.g.*, Jean Braucher, *Lawyers and Consumer Bankruptcy: One Code, Many Cultures*, 67 AM. BANKR. L.J. 501, 503–04 (1993).

51. LoPucki & Whitford, *Venue Choice*, *supra* note 4.

52. LoPucki became the principal critic of venue shopping, adopting a much more critical stance in his subsequent work. *See, e.g.*, LYNN M. LOPUCKI, COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS (2005). For a contrary view, see Kenneth Ayotte & David A. Skeel, Jr., *An Efficiency-Based Explanation for Current Corporate Reorganization Practice*, 73 U. CHI. L. REV. 425 (2006) (reviewing Lynn M. LOPUCKI, COURTING FAILURE (2005)).

Chapter 11 process, and the new face of bankruptcy intermediation. I relate each to the findings and proposals of the corporate governance project.

A. Creditor Governance and Bankruptcy Sales

The paradigmatic case of the late 1980s, the end of the period covered by the corporate reorganization project, was a company like Revco that filed for bankruptcy after a management buyout that didn't work out, a retailer like Macy's, or more notoriously, Eastern Airlines. These companies tended to have appreciable amounts of unencumbered assets when they filed for bankruptcy, and the debtor often took advantage of its exclusivity period to spend considerable time negotiating a reorganization plan. The duration and apparent costliness of many cases led to a perception that U.S. bankruptcy law was extremely debtor friendly, and to calls for Chapter 11 to be replaced by more market-oriented restructuring alternatives.

A decade later, Chapter 11 looked considerably different. Some of the companies that filed for bankruptcy came from similar industries—there were airlines like U.S. Air and retailers like Kmart—but their stay in Chapter 11 was likely to be much shorter and to have been negotiated in advance.[53] Many companies sidestepped the Chapter 11 framework by selling their assets at the outset of the case, or proposed prepackaged reorganization plans. The transformation was not spurred by any change in the statute; creditors adjusted their contracts to limit the flexibility that Chapter 11 gave to the debtor's managers. The debtor's lenders might insist that the debtor bring in a chief restructuring officer, and the strict covenants they included in the debtor-in-possession financing agreement forced the company to cut costs and hasten the case through Chapter 11. Some debtor-in-possession financing agreements gave debtors a set period of time to propose a reorganization plan; the managers agreed to permit a liquidation if the deadline was not met. Managers increasingly were given performance-based compensation contracts that rewarded them for a quick reorganization and punished them for delay.[54]

Based on their corporate reorganization project, LoPucki and Whitford had proposed that courts be permitted to authorize a "preemptive cram down" if shareholders were clearly underwater.[55] The preemptive cram down would streamline the reorganization case by reducing the number of parties whose approval was necessary. The events of the 1990s overtook even this sensible proposal. Cram downs that cut off equity became more common, and in other cases the parties sidestepped cram down by giving shareholders warrants that would only be valuable if the company's fortunes improved significantly after bankruptcy.[56]

This dramatic shift in Chapter 11 practice—a shift in precisely the direction that the loudest Chapter 11 critics were advocating in the early 1990s, to an extent LoPucki, Whitford and others did not anticipate—is a vivid reminder that statutory change often

53. For discussions of the rise of creditor control in Chapter 11, see Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751 (2002); David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917 (2003).

54. These developments are discussed in detail in Skeel, *supra* note 53.

55. LoPucki & Whitford, *Bargaining*, *supra* note 2, at 186–88.

56. *See, e.g.*, Douglas G. Baird & Donald S. Bernstein, *Absolute Priority, Valuation Uncertainty, and the Reorganization Bargain*, 115 YALE L.J. 1930 (2006).

is not necessary to correct problems in the bankruptcy process. Indeed, given the frequent lag time between the emergence of a potential problem and lawmakers' response, statutory reform may prove to be counterproductive. This lesson too can be found in recent bankruptcy history. As part of their extensive amendments to the Bankruptcy Code in 2005, lawmakers sharply curtailed managers' exclusivity period in Chapter 11, imposing a strict eighteen-month limit.[57] In the 1980s, when many cases dragged on far too long, this might have appeared to be a promising reform. By the 2000s, by contrast, the pattern of excessively lengthy Chapter 11 cases had long since disappeared. The restriction on exclusivity solved a problem that no longer existed. In many cases the new provision will therefore not have any effect, and it may occasionally prevent abuses; but in other cases the artificial deadline has introduced unnecessary frictions.

B. The New Face of Bankruptcy: Women, Hedge Funds, and Foreign Shores

One of the great contributions of the corporate reorganization project, as we have seen, was LoPucki and Whitford's analysis of the culture of Chapter 11 practice. Based on their interviews with more than 120 of the nation's leading bankruptcy professionals, LoPucki and Whitford provided a picture of the law in action in the largest Chapter 11 cases, as reflected most vividly in their suspicion that "intermediation" was the principal explanation for shareholders' recoveries in many of the cases. Given the striking changes that have taken place in Chapter 11 practice in the past several decades, we might also expect to find significant cultural changes. Because no one has yet undertaken a new LoPucki and Whitford–style study, my evidence is necessarily impressionistic. But it seems to me that the demographics of Chapter 11 have indeed changed in at least three ways.

The first shift is a significant increase in the number of women involved in the major cases, although bankruptcy practice still is disproportionately male. To twenty-first century eyes, the most distinctive feature of the long list of names in the initial footnote of each of the corporate reorganization project articles is the dearth of women on the list. By my count, the list of interviewees included only three women—in percentage terms, less than .025% of the lawyers interviewed.[58] I am quite confident that this is a reflection of the bankruptcy bar in the early 1990s, not LoPucki and Whitford's selection methods. If one were to create a list of the top 120 bankruptcy lawyers today, the roster would include far more than three women. It would be interesting to consider whether and how this change in demographics has shaped bankruptcy practice. I suspect it stands somewhat in tension with the second marked change in bankruptcy practice.

The second shift is a marked increase in the importance of professionals other than bankruptcy lawyers in many of the big cases. Under the old model, bankruptcy lawyers were the focal point of the process—intermediating on behalf of their clients. Especially given the prevalence of sales in recent cases, investment bankers now figure much more prominently. As a result of claims trading and the distressed debt market, the nature of negotiations even in cases that look more like traditional Chapter 11 reorganizations is quite different than it was twenty-five years ago. If LoPucki and Whitford's successors

57. 11 U.S.C. § 1121(d) (2012).

58. *See, e.g.*, LoPucki & Whitford, *Corporate Governance*, *supra* note 3, at 669 fn.† (acknowledging Barbara Kaplan, Selinda Melnick, and Candace S. Schiffman).

assembled a list of the key professionals in current bankruptcy cases, they would need to include investment banks like Houlihan Lokey and Miller Buckfire, among many others.

Third, the last several decades have seen a partial internationalization of large-scale corporate reorganization practice. There is almost no evidence of an international dimension to U.S. bankruptcy practice in the corporate reorganization project. Twenty-five years later, the largest U.S. law firms have partners who are U.K. insolvency law experts, just as the largest U.K. firms have partners who specialize in U.S. bankruptcy law. The International Monetary Fund and United Nations each have major reform initiatives focusing on best practices for a bankruptcy or insolvency regime. American bankruptcy judges, lawyers, and professors hobnob with their international counterparts, and in some cases, export elements of Chapter 11 to other countries.

For U.S. bankruptcy professionals, the internationalization is still partial, even now. Many large-scale reorganization cases have little more than an incidental foreign dimension. But the Lehman Brothers bankruptcy may have marked a turning point. Much as the Penn Central bankruptcy in the early 1970s signaled the return of large-scale corporate reorganization practice in the United States shortly before the enactment of the Bankruptcy Code, we may one day look back at Lehman Brothers as the forerunner of bankruptcy's more international future. The Lehman case unfolded around the world, and required coordination with insolvency professionals in the United Kingdom, Japan, and elsewhere.

One can see hints of a Whitford-style, qualitative study of a few elements of current bankruptcy practice, particularly in its international dimensions. Several scholars recently published a study of the United Nations Commission on International Trade Law model law process,[59] and there has been other qualitatively oriented work on somewhat related issues.[60] We do not have a comparable recent study of the shifts in contemporary U.S. bankruptcy cases. The dearth of work on anything like the scale of LoPucki and Whitford's corporate governance project may be due in part to the increased complexity and fragmentation of bankruptcy practice; but it also is a reminder of just how remarkable and comprehensive the work of corporate governance project was.

IV. HAS THE TIME COME FOR RISK COMPENSATION PAYMENTS?

The corporate reorganization project is usually remembered for its empirical evidence of and qualitative insights into the large-scale corporate reorganization practice. But LoPucki and Whitford also provided a careful assessment of the heated debates over the efficacy of Chapter 11 and offered a handful of proposals for legal reform. I discussed one of their proposals in the last Section—their call for "preemptive cram down." In this Section, I explore the other major normative proposal that emerged from the corporate

59. TERENCE C. HALLIDAY & BRUCE G CARRUTHERS, BANKRUPT: GLOBAL LAWMAKING AND SYSTEMIC FINANCIAL CRISIS (2009); *see also* Jay Lawrence Westbrook, *Interpretation Internationale*, 87 TEMP. L. REV. 739 (2015) (comparing recent decisions under the Model Law on Cross-Border Insolvency in the United Kingdom, Canada, and the United States).

60. Most notably, Annelise Riles's study of the efforts of the International Swaps and Derivatives Association's campaign to secure legal protection for derivatives in Japan and elsewhere. ANNELISE RILES, COLLATERAL KNOWLEDGE: LEGAL REASONING IN THE GLOBAL FINANCIAL MARKETS (2011).

reorganization project—"risk compensation payments."[61] Although the proposal was framed with the concerns of the 1980s in mind, it was in some respects two decades ahead of its time.

The risk compensation proposal started with the observation that the shareholders and creditors of a Chapter 11 debtor have conflicting incentives. A venture that may increase the expected payout for shareholders, for instance, could reduce the value of creditors' claims if creditors will bear some of the downside risk. Because strategies that benefit shareholders may hurt junior creditors, or vice versa, each will jockey for influence with the firm's managers. LoPucki and Whitford's empirical research suggested that managers usually respond by adopting a "prudent investment strategy," which "emphasize[s] maintenance of the status quo, avoiding quick liquidation of assets but also avoiding investment in acquisitions or new business strategies."[62] While prudent investment was safe, it often did not seem to maximize the overall value of the company.

LoPucki and Whitford's risk compensation payments are a strategy for purchasing unsecured creditors' acquiescence to a wealth-maximizing strategy that might otherwise undermine their interests.[63] The currency for the payment would be stock or other securities in the reorganized debtor. If the debtor's managers wished to pursue a risky but promising strategy, the bankruptcy judge would determine the cost to creditors of the optimal investment strategy and compensate them accordingly. A "quick and dirty" determination would suffice,[64] and the judge could calibrate the compensation by adjusting the amount of stock creditors and shareholders would receive in the newly reorganized debtor.[65]

Looking back at the proposal two decades later, it initially seems far removed from the concerns of current corporate reorganization practice. It was crafted at a time when the average Chapter 11 case took more than two years and was designed to compensate creditors for the risk of new business initiatives undertaken during the Chapter 11 case. In today's cases, creditors have much of the leverage, and even large cases are quite quick.[66]

Despite these changes, the risk compensation proposal was prescient in two respects. The first was LoPucki and Whitford's recognition that if corporate decision makers pursue the interests of either shareholders or creditors, their decisions might not maximize the value of the business. Starting with important dicta in the *Credit Lyonnais* decision in 1988, scholars had begun to recognize the potential distortions in shareholder

61. LoPucki & Whitford, *Compensating Unsecured Creditors*, *supra* note 4.

62. *Id.* at 1149.

63. If a strategy would harm shareholders and benefit creditors, shareholders would be the ones entitled to a risk compensation payment. *Id.* at 1147. But in most cases in the 1980s, the perceived harm was to unsecured creditors. LoPucki and Whitford were somewhat leery of payments to shareholders.

64. *Id.* at 1148.

65. *Id.* at 1145–46.

66. Douglas G. Baird, *Chapter 11's Expanding Universe*, 87 TEMP. L. REV. 981, 984 (2015) ("The median Chapter 11 lasted about 900 days during the 1980s. But beginning in the 1990s until the present, the median ranged between 460 and 605 days."); *see also* Lynn M. LoPucki, *Changes in Chapter 11 Success Levels Since 1980*, 87 TEMP. L. REV. 995, 1002 (2015) (observing that "failed cases averaged 686 days in duration, which is 31% longer than the successful case average of 522 days," while "the time from case filing to plan confirmation is considerably longer in 363 sale cases").

decision making, even while a company was solvent.[67] The risk compensation proposal was one of the first efforts to take the distortions seriously, and to try to correct for them. Subsequently, scholars suggested other correctives, the most common being suggestions that corporate directors should have a duty to maximize the value of the firm, not just to pursue shareholders' interests.[68] Whether these proposals will ever be implemented, much less effective, remains unclear.[69] But one prominent scholar suggests that shareholder expropriation of value from creditors may become the most important issue in corporate law, surpassing traditional concerns about conflicts of interest between managers and shareholders.[70]

Second, the proposal anticipates one of the most hotly debated issues in current bankruptcy practice: whether secured creditors are entitled to the entire proceeds of a sale of the company's assets in bankruptcy. In many cases, secured creditors make at least a token payment to unsecured creditors, and several important cases and a new wave of articles suggest that secured creditors should not receive all of the proceeds.[71] These cases seem to me to raise two intertwined issues. The first is whether a secured creditor's floating lien on all of a debtor's assets gives it the right to the going concern value of the business, or simply to the value of the collateral apart from some or all of the going concern value. The second is how to determine the amount of the payment to which unsecured creditors should be entitled. In my view, a secured creditor's blanket lien ordinarily should include any going concern value.[72] This suggests that unsecured creditors should not be entitled to compensation in connection with a section 363 sale. The risk compensation proposal bears a family resemblance to the most persuasive proposal made by those who do advocate compensating unsecured creditors.[73] The principal practical shortcoming of each, in my view, is the difficulty of making the necessary judicial valuation, given the largely speculative nature of the determination.

CONCLUSION

If Bill Whitford had never written another article, the corporate governance project would have merited a permanent place in the legal scholarship of the past generation—

67. Credit Lyonnais Bank Nederland v. Pathe Commc'ns Corp., Civ. A. No. 12150, 1991 WL 277613 (Del. Ch. Dec. 30, 1991).

68. Thomas A. Smith, *The Efficient Norm for Corporate Law: A Neotraditional Interpretation of Fiduciary Duty*, 98 MICH. L. REV. 214 (1999).

69. For an argument that the maximization-of-firm value concept may have expressive value, even if it is not implemented doctrinally, see Jonathan C. Lipson, *The Expressive Function of Directors' Duties to Creditors*, 12 STAN. J.L. FIN. & BUS. 224 (2007).

70. Edward B. Rock, *Adapting to the New Shareholder-Centric Reality*, 161 U. PA. L. REV. 1907 (2013).

71. *See, e.g.*, *In re* Residential Capital, LLC, 501 B.R. 549 (Bankr. S.D.N.Y. 2013); Edward Janger, *The Logic and Limits of Liens*, 2015 U. ILL. L. REV. 589. The first of the articles calling for limitations on the scope of a secured creditor's lien was Anthony J. Casey, *The Creditors' Bargain and Option-Preservation Priority in Chapter 11*, 78 U. CHI. L. REV. 759 (2012).

72. At least if it covers all of the debtor's assets. For an excellent analysis of the limitations of secured creditors' liens, see Janger, *supra* note 71.

73 Casey, s*upra* note 71. Casey frames unsecured creditors' entitlement as a right to the option value of their claims. The American Bankruptcy Institute's study commission recently called for a version of this proposal. AMERICAN BANKRUPTCY INSTITUTE COMMISSION TO STUDY THE REFORM OF CHAPTER 11, FINAL REPORT AND RECOMMENDATIONS 207-224 (2014).

and a Symposium like this one could easily have focused entirely on the corporate governance project. The project was a worthy successor to the most ambitious empirical projects of the legal realists, the touchstone for our understanding of large-scale corporate reorganization cases after the enactment of 1978 Bankruptcy Code, and an inspiration for the next generation of sociological empirical scholarship.

Although many legal scholars would be hesitant to describe what we do as a search for truth, that is what we do—or at the least what we should be trying to do. Bill Whitford has been an exemplar in this regard throughout his career.

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