REVIEW ESSAY

Is Forum Shopping Corrupting America’s Bankruptcy Courts?

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ABSTRACT

In his new book, Courting Failure: How Competition for Big Cases Is Corrupting the Bankruptcy Courts, Professor Lynn LoPucki argues that current bankruptcy venue rules have spawned an improper “competition for big cases” that has “corrupted” America’s bankruptcy courts. LoPucki contends that this competition has harmed the bankruptcy system and the economy, transferring wealth from creditors and employees to incumbent management and bankruptcy professionals. He also argues that the competition that has corrupted the American bankruptcy system is being replicated internationally, resulting in a similar competition and similar harm on the global stage.

This Essay reviews LoPucki’s book and its central theoretical and empirical arguments. LoPucki offers powerful empirical evidence that something is amiss with much of current American bankruptcy practice. This Essay attempts to flesh out in more detail the model and theoretical foundations that implicitly underlie LoPucki’s indictment of bankruptcy forum shopping (and other forms of forum shopping as well). Although LoPucki correctly identifies several problem areas in the current Chapter II reorganization process, it is not at all certain that these problems can be clearly attributed to runaway forum shopping.

This Essay develops a model of the institutions and incentives governing the forum-shopping competition described by LoPucki in an effort to determine whether the empirical observations proffered by his book can be best explained as the outcome of improper forum-shopping competition. Finally, this Essay closes with an analysis of provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, noting that provisions in the legislation offer substantive responses to many of the more pressing problems identified by LoPucki.

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INTRODUCTION

In February 2005, while testifying before the Senate Judiciary Committee on the comprehensive Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 ("BAPCPA"), Senator John Cornyn (R-TX) waved about the new book by Professor Lynn LoPucki, Courting Failure: How Competition for Big Cases Is Corrupting the Bankruptcy Courts.

later-withdrawn amendment to limit “forum shopping” in bankruptcy cases, asked for my opinion as to whether such forum shopping “is a cancer on our bankruptcy system” that should be prohibited. In good lawyerly style and having not yet read the book, which had been published only a few weeks before, I courageously answered (in so many words), “It depends.”

I have now read LoPucki’s insightful and entertaining book and am prepared to provide a more definitive answer to Senator Cornyn’s question: “It still depends.” LoPucki’s argument that “competition” for big bankruptcy cases is exacting a negative effect on the American and global bankruptcy systems is bold and provocative, backed by his own pioneering empirical evidence. LoPucki’s mixture of statistical and telling anecdotal evidence leaves little doubt that bankruptcy filers routinely choose their venue deliberately. The charge that courts improperly compete for these cases, however, is not as clear. Moreover, LoPucki does not always clearly distinguish between good and bad forum shopping, so that although he offers much empirical evidence, the hypothesis he is testing is not always well-defined. Nonetheless, his book provides a wealth of data and analysis that will set the terms of future discussion.

This Essay will flesh out in more detail the model and theoretical foundations that implicitly underlie LoPucki’s indictment of bankruptcy forum shopping (and other forms of forum shopping as well). Empirical evidence alone is insufficient to draw conclusions about whether forum shopping is generally good or bad without a clearly-stated hypothesis to test. Instead, it is necessary to also have a theoretical model sufficient to generate testable hypotheses as a predicate, both for determining whether forum shopping is good or bad on net, as well as the likely effects of reform proposals. Although LoPucki identifies several problem areas in the current Chapter 11 reorganization process, it is not as certain that all of these problems can be clearly attributed to runaway forum shopping. Instead, they may simply be good-faith errors or mistakes, for which continued competition may be beneficial because it could expedite the process of self-correction.

Part I of this essay summarizes LoPucki’s argument. Part II lays out a forum-shopping model to examine the conditions under which forum shopping may lead to positive versus negative effects, focusing particularly on the institutional structure of the forum-shopping competition and judicial motivations. Part III reexamines LoPucki’s evidence in light of this more developed forum-shopping model. Part IV discusses possible policy responses to the negative effects of forum shopping, including an examination of how BAPCPA addresses many of LoPucki’s greatest substantive concerns about the negative effects of bankruptcy forum shopping. More generally, the problems associated with negative forum shopping can be addressed in two possible ways—either through procedural reforms that regulate the process of forum shopping or through substantive reforms that regulate the incentives to engage in forum shopping by attacking the margins on which judges and bankruptcy filers can compete.
I. BANKRUPTCY FORUM SHOPPING

28 U.S.C. § 1408 provides that venue for a bankruptcy case is appropriate in the district court for the district:

(1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States . . . have been located for the one hundred eighty days immediately preceding such commencement . . . ; or

(2) in which there is pending a case under title 11 concerning such person’s affiliate, general partner, or partnership.3

In application, venue ranges from the district in which the debtor is incorporated to any district in which an “affiliate,” such as a subsidiary, of the debtor is headquartered. For a large corporation with many subsidiaries, these rules allow a corporation to file in various districts throughout the country.

LoPucki argues that the ability of bankrupt corporations to choose the district in which they want to file has gone beyond offering convenience and has instead spawned an improper competition for big cases that has corrupted America’s bankruptcy courts.4 This competition has harmed the bankruptcy system and the economy, transferring wealth from creditors and employees to incumbent management and bankruptcy professionals.

LoPucki argues that the seeds of the current bankruptcy forum-shopping competition were planted in the 1978 Bankruptcy Code,5 which installed a regime that permitted incumbent management to remain in place during bankruptcy,6 while permitting broad discretion in deciding when and where to file bankruptcy.7 In the early days of the new Bankruptcy Code, litigants flocked to the United States Bankruptcy Court for the Southern District of New York and, in particular, to the courtroom of Judge Burton R. Lifland.8 Lifland, LoPucki observes, drew a disproportionate number of the “big” bankruptcy cases of the era and garnered the reputation as a “pro-debtor” or “pro-reorganization” judge.9 By the mid-1980s, however, New York’s run as the predominant venue for bankruptcy forum-shoppers came to an end.10

Beginning in 1990, however, the bankruptcy system saw an unprecedented

4. He also argues that the competition that has corrupted the American bankruptcy system is being replicated internationally, resulting in similar competition and harm on the global stage. See LoPucki, supra note 2, at 207–32. While this Essay will focus on the domestic forum-shopping competition and its effects, much of the analysis is equally applicable to the international bankruptcy system.
7. Id. at 30–35.
8. Id. at 45–47.
9. Id. at 46.
10. Id. at 47–48.
and overwhelming migration of large Chapter 11 filings into the District of Delaware. Like New York’s early experience, the story of the rise of Delaware turns on one person—bankruptcy judge Helen Balick. Delaware has long been the leading center for corporate chartering and corporate law; today over half of large, publicly traded American corporations are incorporated in Delaware. But it remained a sleepy one-judge bankruptcy district until 1988, when Balick ruled that a corporation’s residence or domicile for bankruptcy venue purposes is its state of incorporation, thereby potentially opening the door for corporations to file in Delaware. Balick soon created further incentive with the adoption of procedural innovations and substantive legal rulings that attracted numerous bankruptcy filings to her courtroom. By 1996, thirteen of the fifteen largest corporate bankruptcies filed in the nation that year were filed in Delaware.

Few commentators doubt that the “rise of Delaware” was the result of conscious forum-shopping by bankrupt corporations; instead the focus is on whether this development has been generally good or bad for the bankruptcy system and the economy. The so-called “Delaware enthusiasts” argue that Delaware’s dominance has been the result of a largely beneficial competitive process, where Delaware’s superior expertise, professionalism, and speed has made bankruptcy law more efficient in dealing with large, complex cases. “Delaware skeptics,” championed by LoPucki, argue that the rise of Delaware has been a negative consequence of interjurisdictional forum shopping, representing an unconscionable sellout to the “case placer” incumbent managers and bankruptcy professionals who choose to file in courts that are most friendly to them. Delaware’s rise, it is argued, is thus the rise of bankruptcy lawlessness and pandering to narrow special interests. Courting Failure is the manifesto of the Delaware skeptics.

LoPucki’s indictment of Delaware is wide-ranging. He argues that Delaware has exhibited an undue solicitude to the interests of so-called “case placers.”

11. Id. at 72–76.
14. One of these innovations is a first-day motion. First-day motions are requests, made at the immediate outset of the case, by the debtor in possession to take the steps necessary to get the case started and to keep the business operating—e.g., requesting authorization to borrow money on an emergency basis, use collateral, pay employees and critical suppliers, and to employ lawyers and financial advisors. LoPucki, supra note 2, at 38.
15. Id. at 50 fig.2. In 1993, a second bankruptcy judge was added in Delaware, Judge Peter J. Walsh. Walsh adopted many of Balick’s practices and case management techniques.
16. But see Adler & Butler, supra note 12, at 1316 (arguing that Delaware’s dominance may be more apparent than real).
17. See David A. Skeel, Jr., What’s So Bad About Delaware?, 54 VAND. L. REV. 309 (2001) (distinguishing between “Delaware enthusiasts” and “Delaware skeptics”).
18. LoPucki, supra note 2, at 17.
19. Id. at 18.
This ability to manipulate the place of filing has led to inefficient practices, inefficient reorganizations, and subsequent serial bankruptcy filings that benefit (and sometimes even enrich) management and professionals, providing unwitting (or even witting) protection for managers who have been involved in the largest corporate frauds in American history, while harming creditors and employees.

LoPucki’s claims are bold and provocative and backed by extensive empirical data. As will be illustrated in the remainder of this Essay, several of LoPucki’s criticisms appear to be well-founded, but it is not clear whether they can be laid at the foot of the forum-shopping dynamic that he invokes to explain them.

II. A MODEL OF COMPETITION IN LEGAL MARKETS

Forum shopping among courts can be modeled as a type of competition among competing legal suppliers, with litigants serving as demanders and judges as suppliers. Market competition can produce good or bad results, depending on the institutional structure surrounding it and the incentives of the parties partaking in it. Whether the outcomes generated by particular market competition will be socially beneficial or harmful depends on the institutional constraints imposed on the actors, the incentives to satisfy consumer preferences, and the accuracy of market signals that channel supplier responses.20

The value of a well-functioning competitive market is that through decentralized processes and experimentation, it can produce results that are “smarter” than any central planner or centralized lawmaker could procure by making use of dispersed information, small-scale experimentation, while weeding out less-efficient ways of doing things. The market comes to sift and coordinate knowledge, driving a relentless process of learning to do things better and more efficiently.21 The “spontaneous order” that arises from the decentralized decisionmaking within constraints of the market process commends market institutions as a superior system of social organization.22

The same basic analysis applies to the development of law—decentralized competitive processes such as the common law,23 customary law, and constitutional federalism24 may be able to better make use of decentralized knowledge and local experimentation to devise legal rules that further social cooperation and economic efficiency than a centralized lawmaker.

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20. See F.A. Hayek, The Use of Knowledge in Society, 35 Am. Econ. Rev. 519 (1945) (describing market competition as a process of decentralized adaptation to market signals that reflect consumer demand and relative scarcity of supply inputs).
22. Hayek, supra note 20, 527–28
24. For the classic argument analogizing the competitive process of federalism to the market, see Charles M. Tiebout, A Pure Theory of Local Expenditures, 64 J. Pol. Econ. 416 (1956). This role of experimentation in enabling this competitive process to occur is captured in Justice Brandeis’s famous call for states to act as “laboratories of democracy.” See New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).
Moreover, the value of a competitive or evolutionary system is that it is dynamic and incorporates tacit knowledge that can be neither fully recognized nor fully articulated. As a result, analysis determining the social utility of such a system cannot, and should not, be based on whether the system generates the optimal rules in each situation, because knowledge of the optimality of specific rules is outside the observer’s knowledge. Rather, the proper test is a “structural” one—whether the institutional design of the process is such that it, in general, the process that contains the tacit knowledge tends to promote social welfare.25 If the structures are sound, we can infer the efficiency of the results it produces even if we cannot fully articulate why.

As F.A. Hayek observes, if the “correct” or “efficient” answer to a given economic problem was known in advance, there would be little reason to use a competitive process to discover it.26 Competition is useful only when the best answer is not known in advance, but can be discovered only by trial-and-error and feedback. The value of competition is thus in its process, where constant innovation and experimentation with new methods of doing things winnows out poor ideas and allows good ideas to emerge. If properly constructed, such a process permits an inference that the most efficient solution to the problem will emerge. Competition is thus valuable in situations where the correct or best answer is not known in advance, but rather is discovered through the selection process. Hayek further observes, “In sporting events, examinations, the awarding of government contracts, or the bestowal of prizes for poems, not to mention science, it would be patently absurd to sponsor a contest if we knew in advance who the winner would be.”27 The value of competition, therefore, is that it is “a procedure for discovering facts which, if the procedure did not exist, would remain unknown or at least would not be used,”28 and because the outcomes generated by competition “are unpredictable and on the whole different from those that anyone would have been able to consciously strive for.”29 In addition, the outcomes produced by a well-functioning competitive market can be inferred to be efficient.30 Thus, we can infer consumer preferences for the attributes of automobiles from the purchasing decisions made by consumers in

26. In Hayek’s words, “Wherever we make use of competition, this can only be justified by our not knowing the essential circumstances that determine the behavior of the competitors.” F.A. Hayek, Competition as a Discovery Procedure, Q.J. AUSTRIAN ECON., Fall 2002, at 9, 9 (Marcellus S. Snow trans.) (lecture originally given in 1968).
27. Id.
28. Id.
29. Id. at 10.
30. Id.
that market. A variety of combinations of price, styling, safety, and gas mileage are offered, and those that most efficiently match consumer demand will grow market share; those that fail to do so will revise their products to become more similar to the successful brands in the market. In theory, the outcomes of competition among legal suppliers may similarly be inferred to be efficient and responsive to “consumer” preferences.31

Whether a particular market tends to the production of welfare-enhancing results is a function of the institutions and incentives that structure the interactions between buyers and sellers in the market.32 The first question looks at institutions to understand the nature of the constraints on the actors in the market and whether those institutions promote efficient market arrangements or inefficient arrangements that externalize costs. There are two necessary subsidiary questions: First, what are the institutions that govern choice with respect to the “supplier” of a given good or service to drive the market to the efficient matching of sellers and buyers? And second, if the supplier in question is a collective choice institution, such as a court or legislature, to what extent are the institutions arranged in such a manner to be insulated from rent-seeking pressure from well-organized groups trying to manipulate the collective decision outcomes so as to transfer wealth to themselves from others?33

The second question analyzes incentives confronting the actors in the relevant market and particularly whether those making the decisions face incentives that will tend to the production of either efficient law or inefficient law that systematically favors certain parties or even hinders the development of the law.

This Part will apply these two criteria—institutions and incentives—to examine three important examples of forum-shopping behavior and to see how they can be used to try to distinguish good forum-shopping regimes from bad. First, I will describe the beneficial forum-shopping regime that prevailed in Europe during the Middle Ages, which illustrates how the right set of institutions combined with the right judicial incentives can generate a good forum-shopping regime. Second, I will describe the forum-shopping regime of modern tort law, a system with both poor institutional constraints and poor judicial incentives, which has had a detrimental impact on the law. Finally, I will discuss a more ambiguous third forum-shopping regime, that of modern corporate law, where although the incentives are clear, the institutional constraints governing competi-

31. See Tiebout, supra note 24.
32. Compare the market for computers with the market for heroin. The computer market tends to promote economic efficiency and social welfare, as manufacturers and retailers face a set of institutional constraints that provide incentives to respond to consumer preferences and to sell their product for a lower price than their rivals. Although the market for illegal heroin also responds to consumer preferences and competition tends to reduce prices, the overall effect of the market is socially harmful, and the institutions that accompany it (crime and violence) on net generate negative social welfare. The different outcomes between the two markets are a result of the different institutions and incentives provided.
tion are sufficiently unclear so as to raise questions about the outcome of the competitive process.

To date, the forum-shopping debate has focused repeatedly on the third analogy—the Delawarization of corporate law. By looking at a broader cross-section of forum-shopping models, it will become possible to understand the dynamics of forum shopping more generally for purposes of application to bankruptcy forum shopping. Moreover, for reasons that will become clear, the corporate law analogy, while useful, is not necessarily the most apt analogy to the bankruptcy forum-shopping model.

A. “GOOD” FORUM SHOPPING: COMPETING JURISDICTIONS IN THE MIDDLE AGES

The most famous and well-developed system of judicial forum shopping was the system that prevailed throughout Europe and England for hundreds of years during the Middle Ages. The law that emerged during this period arose from a long period of co-existence between the various government-created and sponsored courts competing with a variety of other jurisdictions, including courts of the Catholic Church, local courts, and even private courts, such as the *lex mercatoria* or law merchant. The common law courts eventually absorbed these rival courts, and “may have borrowed heavily from them in the process of aggrandizement.” The ecclesiastical courts of the Catholic Church were divided from the secular authorities with respect to all issues under their scope, claiming exclusive jurisdiction over issues of family law (such as marriage and divorce) and inheritance and concurrent jurisdiction over many other issues, including contract law. In addition, “[s]ecular law itself was divided into various competing types, including royal law, feudal law, manorial law, urban

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36. Berman, *supra* note 34, at 10; see also Daniel R. Coquillette, *The Anglo-American Legal Heritage: Introductory Materials* 183 (1999) (noting that Church courts were the most important rival to royal common law courts). As Harold Berman observes, “For some four hundred years these secular legal systems co-existed alongside the canon law, and alongside each other, within every territory of Europe.” Harold J. Berman, *The Western Legal Tradition in a Millennial Perspective: Past and Future*, 60 LA. L. REV. 739, 740 (2000). Hogue similarly observes:

Save when a matter of freehold was at issue, Englishmen were not compelled to present their causes before the king’s courts. Men were free to take their cases into the local courts of the counties, which administered local, customary law; men might seek justice from the church courts administering rules of canon law, which touched many matters, especially those related to wills and testaments, marriage and divorce, and contracts involving a pledge of faith; feudal barons might accept jurisdiction of a baronial overlord whose court applied rules of feudal custom; townsfolk might bring their causes before the court of a borough, which would judge them by rules of the law merchant.

law, and mercantile law.”

Although each was formally defined by a particular jurisdiction, their jurisdictional reaches often overlapped, and even where they did not, the limits were often evaded through the use of fictions designed to circumvent these formal limits.

“This arrangement, seemingly impracticable to modern eyes, was a feature of English public life for five centuries.”

Institutionally, this multitude of overlapping jurisdictions enabled private litigants free choice to forum-shop into those courts that best met their preferences. In turn, judges had an incentive to attract business to their courts because their salaries were paid in large part from the fees of litigants. The institutional structure of jurisdictional choice, combined with private incentives created a system of competition among courts for case filings, generated a competition to provide the speediest and fairest justice and compelled courts to be responsive to their litigant “customers” rather than external political pressures. Competition spurred innovation and creativity, as courts experimented with different practices in order to gain competitive advantage and freely copied and borrowed popular innovations from other courts’ systems. Innovative systems of pleading and evidence, along with efficient and equitable contract law doctrines, such as mistake, were recognized in the law merchant, ecclesiastical, and chancery courts far before they were recognized in the common law courts.

Reflecting upon this competition among courts, Adam Smith recognized that the beneficial operation of competitive markets for goods and services as

37. Berman, supra note 34, at 10. Within the royal court system alone there were seven types of courts: (1) General Eyres, (2) Common Pleas, (3) King’s Bench, (4) Exchequer, (5) Commissions of Assize, (6) Oyer and Terminer, and (7) Gaol Delivery, plus the equitable Chancery Court. Hogue, supra note 35, at 189; see also William Blackstone, 1 Commentaries *3, *3–27 (enumerating multiple types of law that applied in England as late as 1765). For instance, the Court of Exchequer had jurisdiction over debts owed to the King but not debts between two private parties. Nonetheless, it was said that if a creditor owed the King (such as for taxes), then the failure of a debtor to repay a debt imperiled the ability of the creditor to pay the King. As a result, it was said that the Exchequer could hear the dispute between the debtor and creditor. Zywicki, supra note 33, at 1585. For instance, Hadley v. Baxendale, a chestnut of first-year Contracts courses dealing with the recoverability of consequential damages for breach of contract, was decided by the Exchequer Court. (1854) 156 Eng. Rep. 145.


41. For instance, both bankruptcy law and partnership law were first created in the law merchant courts and were later adopted by other court systems. See 15 William S. Holdsworth, A History of English Law 97–100 (1965). As Plucknett observes, even though various courts were rivals, they “were, in fact, on intimate terms. It did not matter so much that they were usually terms of rivalry;” he stated, “for even then they kept close watch upon developments in other institutions, and competed in providing the best remedy.” Theodore F.T. Plucknett, A Concise History of the Common Law 650 (5th ed. 1956). This competition thereby tended to produce the positive externality of improving the intellectual quality of the law, thereby benefiting the public generally. See Zywicki, supra note 33, at 1586.
described in *The Wealth of Nations* also explained the beneficial development of English law. As he observed in *The Wealth of Nations*:

> The fees of court seem originally to have been the principal support of the different courts of justice in England. Each court endeavoured to draw to itself as much business as it could, and was, upon that account, willing to take cognizance of many suits which were not originally intended to fall under its jurisdiction.\(^{42}\)

Smith noted that through the use of legal *fictions*, courts could evade official limitations on their respective jurisdictions and thereby compete for the business of litigants. "In consequence of such *fictions*," Smith observed, "it came, in many cases, to depend altogether upon the parties before what court they would chuse [sic] to have their cause tried; and each court endeavoured, by superior dispatch and impartiality, to draw to itself as many causes as it could."\(^{43}\) Smith attributed the quality and modern nature of English law to the competition between the various courts:

> The present admirable constitution of the courts of justice in England was, perhaps, originally in a great measure, formed by this emulation, which anciently took place between their respective judges; each judge endeavouring to give, in his own court, the speediest and most effectual remedy, which the law would admit, for every sort of injustice.\(^{44}\)

According to Smith, the "rivalship . . . betwixt" the courts "tended to support the liberty of the people and render the proceedings in the courts very exact."\(^{45}\) Requiring judges to compete for fees induced them to work harder and more efficiently, thereby removing incentives for judges to shirk or to indulge their personal preferences at the expense of the parties or the public.\(^{46}\) Eventually, these multiple competing court systems were folded into the common law along with their practices and doctrines, absorbing much of the best of these rival jurisdictions and enabling improvement in the common law and the modernization of British commercial law.\(^{47}\)

The alignment of the institution of competing courts with judicial incentives to compete for business brought about a healthy competition that tended toward

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43. *Id.*

44. *Id.*


46. Smith, *Report of 1762–3, in Lectures on Jurisprudence*, supra note 45, at 241 ("Public services are never better performed than when their reward comes only in consequence of their being performed, and is proportioned to the diligence employed in performing them.").

47. See Zywicki, *supra* note 33, at 1599–1601.
the improvement of the law and the efficient matching of legal practice with litigant preferences. Judges had incentives to innovate, thereby developing many of the “efficient” doctrines of the common law. By contrast, the subsequent supplanting of this competitive regime with a monopolistic court system has stripped the common law of some of its vibrancy and opened the door to rent-seeking influences in the evolution of the law. But if plaintiffs could choose the court through the initiation of the case, why did this competition not lead to courts competing on the narrow ground of providing pro-plaintiff law rather than creating a competition to generate socially-beneficial, efficient legal rules?

The historical record indicates a variety of reasons why the courts did not converge on pro-plaintiff rules but rather competed on the basis of providing the fairest and speediest resolution of disputes. In some situations, as with the law merchant courts, it was a result of the reciprocal nature of the parties and disputes as legal disputes often reflected the reciprocal nature of inclusive customs. Because merchants were repeat-players and could never predict which side of a dispute they would be on, they tended to favor efficient rules that minimized transaction costs, rather than systematic, pro-plaintiff or pro-defendant rules. In others, the legal systems were tied together with trading fairs and the like, where the owner of the fair had the incentive to maximize the total revenue from the fair in general, rather than litigation fees alone, thereby giving the fair owner the incentive to provide a court system that tended to maximize the overall commerce of the fair through efficient trading rules. Similarly, the courts of the staple commodities exchanges in England had their own private dispute-resolution systems outside the official courts. The rel-

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48. Id. at 1593–95.
49. See id. at 1604; see also Paul H. Rubin & Martin J. Bailey, The Role of Lawyers in Changing the Law, 23 J. LEGAL STUD. 807, 815 (1994) (arguing that rent-seeking forces unleashed by the New Deal caused increases in tort litigation).
50. See Landes & Posner, supra note 40, at 255.
51. In fact, at the same time the narrowly defined common law tended to produce pro-plaintiff rules, the law merchant and other courts were recognizing novel and important defenses such as the doctrines of mistake and excuse. These innovations in other courts, as noted, were later absorbed into the common law. Zywicki, supra note 33, at 1594.
54. Id. at 1597–99.
55. Important commodities such as wool, leather, lead, and tin were traded on particular specialized exchanges called the “Staple” markets. See William Searle Holdsworth, The Development of the Law Merchant and Its Courts, in 1 SELECT ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY 289, 302–03 (Ass’n of Am. Law Sch. ed., The Lawbook Exchange, Ltd., 1968) (1907) (describing the Statute of Staple and two celebrated cases where the King used the statute to get merchants speedy justice). Under the Statute of the Staple, enacted in 1353, common law courts were specifically prohibited from hearing disputes arising from contracts made on the staple markets, and the staple courts were expressly instructed to apply commercial custom and their internal rules rather than the common law to resolve disputes. See id.; A.T. CARTER, A HISTORY OF ENGLISH LEGAL INSTITUTIONS 261–65 (1902); PLUCKNETT, supra note 41,
evant level of competition was among various fairs and markets not at the level of legal services narrowly defined. In still others (such as ecclesiastical courts) the evolution of the law was subject to external constraints imposed by religious doctrine that required fair and equitable results.

Although parties faced few formal constraints on where they could bring their suits, this choice of jurisdiction usually was made ex ante rather than ex post most of the time. When the parties chose their jurisdiction, they did not know whether they would be the plaintiff or the defendant in any subsequent litigation, so they would not prefer a biased court to an unbiased one. In some situations, such as with trading fairs and the staple courts, disputes that arose did so expressly under the rules and courts of the relevant exchange or market. In other situations there were no formal rules but a set of default expectations as to which court would hear a given case. For merchants, for instance, it was expected that the law merchant would hear disputes that arose unless some other court—such as a common law court—was expressly specified. And while a merchant might later refuse to abide by the ruling of the law merchant judge, he would later typically find himself ostracized from conducting business with other merchants, thereby ending his career. With forum choice ex ante, such institutional constraints on forum-selection will tend toward the promotion of efficient law.

Finally, this system of competition tended to minimize both the incentives and opportunity to engage in rent-seeking litigation designed to tap into the wealth of other parties. Rent-seeking litigation requires that those providing the wealth transfer must be unable to escape the wealth appropriation from the winning party. Competing jurisdictions reduced this ability—they could easily "vote with their feet" and exit those courts that attempted to impose biased or unreasonable law and thereby avoid subsidizing those who gained the preferential legal doctrines. Choice among competing jurisdictions, therefore, not only encouraged competition to improve the law but also enabled parties to escape

at 636 (describing how common law courts under Edward I in the fourteenth century abstained from contractual disputes because the matter was already in the hands of mercantile courts and the Church).

56. This is the relevant level with modern commodity and stock exchanges as well, which provide dispute-resolution services as an ancillary service to the competition among commodities trading markets. See generally Lisa Bernstein, Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions, 99 Mich. L. Rev. 1724 (2001) (describing the cotton industry’s opting out of the public legal system by creating a private legal system that has endured since the mid-1800s).

57. See Zywicki, supra note 33, at 1609–10.

58. Id.


backwards from inefficient courts and legal systems by choosing a more modern and fair forum to hear the dispute.62

B. “BAD” FORUM SHOPPING: FORUM SHOPPING IN STATE CLASS-ACTION LITIGATION

The modern American tort law forum-shopping system provides a second example of forum shopping, but one that appears to be “bad” forum shopping—i.e., forum shopping not driven by consent and efficiency concerns, but rather by rent-seeking opportunities for some interest groups to redistribute wealth to themselves from others. In fact, the problems created by this forum-shopping competition eventually grew so severe that Congress recently moved to rein-in the competition with the enactment of the Class Action Fairness Act of 2005.63

Forum shopping arises in the modern class action system as a result of the intersection of modern law with interstate commerce: Any major class action or products liability claim can be brought in any state where a single plaintiff lives because the defendant cannot prevent the goods it manufactures from moving in interstate commerce and thereby ending up in that state.64 The litigation in BMW of North America, Inc. v. Gore65 is illustrative. In BMW, the plaintiffs were a nationwide class of consumers who claimed they had suffered harm as the result of some of BMW’s cosmetic repairs to cars that had not been properly disclosed.66 Because of the combination of expansive choice-of-law rules and state long-arm statutes, plaintiffs could have brought suit in any number of states but chose Alabama, presumably because BMW could be punished under the legal standards of Alabama for conduct that would have been lawful conduct elsewhere.67 As a result of these factors, plaintiffs have an opportunity to “shop” for state court judges who are favorable to class actions. In addition,
because of diversity jurisdiction requirements, it is easy to prevent full diversity to ensure these cases remain in state court rather than being shifted to federal court. There is thus an opportunity for competition to attract litigants to state courts. But the incentives and institutions governing this competition tend to produce negative results, as competition results in pro-plaintiff rules and parties are unable to avoid providing wealth transfers.

In large class-action or products-liability cases, any such forum choice will tend to be ex post, after the harm has occurred, rather than ex ante. Goods are manufactured in one place but sold all over the country to consumers who can later move with those goods throughout the country. Thus, where goods move in interstate commerce, it becomes impossible to anticipate ex ante where liability will arise and thus to accurately price the risk of doing business in a particular state. Because manufacturers cannot tailor their prices to local liability regimes, each state has an incentive to increase liability for the benefit of its residents because it can externalize the resulting expenses on manufacturers and consumers of other states.  

The incentives of judges to provide these wealth transfers depend on the mechanism by which judges are selected. In particular, popularly-elected judges have an incentive to transfer wealth from out-of-state corporations to in-state plaintiffs. Just as elected Congress members have an incentive to direct tax dollars from around the country to pork projects in their home districts in order to “buy” votes, elected judges have an incentive to “buy” votes by redistributing wealth from out-of-state deep-pocket corporations to in-state plaintiffs. Economists Eric Helland and Alexander Tabarrok have found that plaintiffs in states with elected judges receive larger awards on average against out-of-state defendants than they do in states with appointed judges and that the disparity is most pronounced in states with partisan judicial elections.  

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69. Roughly half of the states have an elected judiciary of one type or another. See Eric Helland & Alexander Tabarrok, Exporting Tort Awards, 23 Regulation 21, 23 tbl.1 (2000).
70. As retired West Virginia Supreme Court Justice Richard Neely wrote, “As long as I am allowed to redistribute wealth from out-of-state companies to injured in-state plaintiffs, I shall continue to do so. Not only is my sleep enhanced when I give someone else’s money away, but so is my job security, because the in-state plaintiffs, their families, and their friends will reelect me.” Richard Neely, The Product Liability Mess 4 (1988). Justice Neely further observes, “[I]t should be obvious that the in-state local plaintiff, his witnesses, and his friends, can all vote for the judge, while the out-of-state defendant can’t even be relied upon to send a campaign contribution.” Id. at 62. As Tabarrok and Helland summarize, “[r]edistributing wealth from out-of-state defendants to in-state plaintiffs is a judge’s way of providing constituency service.” Alexander Tabarrok & Eric Helland, Court Politics: The Political Economy of Tort Awards, 42 J.L. & Econ. 157, 158 (1999).
71. Helland & Tabarrok, supra note 69, at 24 tbl.2. Helland and Tabarrok find, for instance, that in states with nonpartisan judicial elections, the average tort award against an out-of-state defendant is $384,540, whereas the average award against an in-state defendant is $207,957. Id. The disparity is even more striking for judges elected in partisan balloting: the average award against out-of-state defendants is $652,720, as compared to $276,320 for in-state defendants. Id. Subsequent research by Helland and Tabarrok finds even larger disparities—most of which can be explained by bias against
also observe this disparity disappears when cases are removed to federal court, suggesting that the mode of judicial selection explains the disparity because, under *Erie*, the same substantive law is applied in both courts. In-state plaintiffs vote and in-state lawyers contribute large amounts of money to judicial campaigns and out-of-state corporations and lawyers do not. Thus, heightened electoral competition actually tends to exacerbate the problem by increasing the incentives to “buy” votes through redistributing wealth to in-state plaintiffs. In addition, judges appear to be responsive to demands of voters generally, as jury awards are higher where the local poverty rate is higher, suggesting a tendency to use litigation to redistribute wealth from corporate defendants to poorer plaintiffs.

Appointed judiciaries do not have this incentive to “buy” votes through wealth redistribution, but their insulation from political pressures may instead permit them to pursue their personal preferences and agendas instead of the desires of the litigants and the public. Judicial independence increases agency costs, providing judges with the opportunity and the incentive to consume leisure or to use the bench to impose out-of-state defendants, with the remainder explainable by generally higher awards against businesses in partisan-elected states. Eric Helland & Alex Tabarrok, *The Effect of Electoral Institutions on Tort Awards*, 4 AM. L. & ECON. REV. 341, 350–68 (2002) [hereinafter Helland & Tabarrok, *Effect*]. They find much smaller differences between judges appointed by nonpartisan elections and appointed state judges, suggesting a particular problem for judges elected by partisan elections. Id.  
73. Helland & Tabarrok, *Effect*, supra note 71, at 368. Note that the key provision in the Class Action Fairness Act of 2005 is the provision to give jurisdiction to federal district courts for any class action cases that exceed $5 million and have any diversity between plaintiffs and defendants. See 28 U.S.C.A. § 1332(d)(2) (West Supp. 2005). The legislation itself states that the reforms are responsive to legislative findings that State and local courts “sometimes act[] in ways that demonstrate bias against out-of-State defendants . . . .” Class Action Fairness Act of 2005, 28 U.S.C.A. § 1711(a)(4)(B).  
74. A study by the Florida Bar Association estimated that at least 80% of all campaign contributions to Florida judges are made by lawyers. Helland & Tabarrok, *supra* note 69, at 22. Looking solely at the candidates for the Texas Supreme Court in 1994 and 1996, more than 40% of the funds raised for their campaigns (approximately $3.7 million out of a total of $9.2 million) came from parties and lawyers with cases before the state Supreme Court or from those closely linked to those parties. Stephen B. Presser et al., *The Case for Judicial Appointments* (2000) (White Paper of the Judicial Appointments White Paper Task Force), available at http://www.fed-soc.org/Publications/White%20Papers/judicialappointments.htm.  
75. In fact, Helland and Tabarrok find that moving a case from a county with an average poverty level to a county with a poverty level one standard deviation above the mean raises the expected award by about 5% (about $32,500 at the mean). Helland & Tabarrok, *Effect*, supra note 71, at 358. This suggests statistically what many have believed anecdotally, that forum shopping is especially strong in poorer areas, such as the Bronx, and in poorer southern states, such as Mississippi and Alabama. See Eric Helland, Jonathan Klick, & Alexander Tabarrok, *Data Watch: Tort-uring the Data*, J. ECON. PERSP., Spring 2005, at 207, 212–13. States with elected judiciaries also are more likely to declare legislative tort reform enactments unconstitutional than are states with appointed judges. See Presser et al., *supra* note 74. Elected judges in Ohio and Illinois declared the tort reform legislation enacted there invalid in toto; other state judiciaries have invalidated only parts of the tort reform regime. See id. By contrast, states with appointed judges have tended to be more deferential toward legislative tort reform enactments. See id.  
their ideological preferences on society. Although not as blatant as with elected judiciaries, these ideological preferences and an accompanying desire to expand judicial power to enable a larger reach to impose these preferences may explain the development of liability-expanding doctrines even in states with appointed judiciaries. Thus, appointed judiciaries may lack incentives to promote efficiency or to be responsive to the desires of litigants.

C. AMBIGUOUS FORUM SHOPPING: DELAWARE CORPORATE LAW

A third example of forum shopping is the emergence of Delaware as the preferred state for corporate law and corporate chartering. A substantial majority of large public companies operating in the United States today are chartered in Delaware, even though few are headquartered or have substantial operations there. A voluminous literature has developed addressing the longstanding question of whether this “race to Delaware” is a “race to the top” or a “race to the bottom.”

Those supporting the “race to the top” view argue that Delaware’s dominance has arisen through a healthy process of interjurisdictional competition and that Delaware’s dominance is the result of developing and maintaining efficient corporate laws that maximize firm and shareholder value. They argue that the need to obtain capital at the cheapest cost provides incentives for managers to incorporate in states with the most-efficient laws that maximize firm value. Incorporating in a state with less-efficient corporate laws would increase the interest rates on debt and depress share prices, which reduces the value of those firms and eventually leads to the removal of those managers. As a result, they argue, managers’ private incentives will be aligned with the incentives of...
shareholders to maximize firm value rather than their private interests, creating a natural incentive to incorporate in the state that offers the most-efficient law that tends to maximize firm value, rather than states that permit managerial agency costs.84

Those who argue that Delaware evidences a “race to the bottom,” by contrast, contend that Delaware’s dominance reflects a “management-friendly” corporate law that caters to the managers who make the decision where the firm should incorporate, rather than the shareholders.85 The agency costs arising from the separation of ownership and control between shareholders and firm managers meant that managers had discretion to choose the state in which to incorporate and that they would act selfishly to select a jurisdiction with laws favorable to them, rather than the firm’s shareholders. Imperfections in the market for corporate control (many created by state anti-takeover legislation) may permit managers who chose states with inefficient corporate law to remain in charge. As a result, there is a “race to the bottom” in which the states competed to enact laws allowing corporate managers to fleece shareholders.86

Unlike the prior two forum-shopping regimes described above, it is not obvious as an a priori matter whether Delaware corporate law maximizes shareholder value, managerial agency costs, or some intermediate range. The issue turns on how much agency cost slippage there is in the relationship between managers and their shareholders in choosing the state of incorporation. Although capital markets appear to be highly efficient, the market for corporate control seems to be somewhat less so.87 Indeed, some scholars have even challenged the idea that there is meaningful state competition for incorporation charters at all, in that no state has made any meaningful effort to compete with Delaware for incorporations.88 So it seems plausible as an a priori matter either that agency costs could be present and sustainable in the corporate chartering system, or alternatively, they could be largely competed away.

The empirical evidence is ambiguous on the question of whether Delaware’s dominance is the result of a race to the top or the bottom.89 There is some evidence to

84. Professor Roberta Romano has been the leading recent advocate of the “race to the top” theory. See ROBERTA ROMANO, THE GENIUS OF AMERICAN CORPORATE LAW (1993).
86. See id. at 705.
87. For instance, there are many state and federal laws that inhibit hostile takeovers, thereby making it more difficult to force out poor corporate managers. See Securities Exchange Act of 1934 §§813(d), 14(d)–(e) (codified as amended as the Williams Act, 15 U.S.C §§ 78 m(d), 78 n(d)–(e)) (2000); Roberta Romano, The Political Economy of Takeover Statutes, 73 VA. L. REV. 111 (1987) (surveying state laws).
89. LoPucki seems to argue that existing empirical evidence supporting a race to the top or bottom theory in Delaware is invalid because markets are not perfectly efficient and shareholders may make mistakes in pricing equities and in the economic contribution of different states’ laws. See LOPUCKI, supra note 2, at 238–40. However, his criticisms are largely off point because for these empirical studies to be unreliable, it would need to be demonstrated that not only are there potential errors in
suggest that firms incorporated in Delaware have higher values than firms incorporated elsewhere, but other empirical evidence suggests that firms incorporated in Delaware do not seem to perform systematically better (or worse) than firms incorporated elsewhere. On the other hand, evidence does suggest that firms that reincorporate in Delaware from elsewhere do not suffer a decrease in firm value and may increase in value, which tends to undercut the race to the bottom hypothesis and provide some support for the race to the top view. On net, it remains somewhat uncertain whether the institutional mechanisms driving the evolution of the Delaware corporate-law race may predominantly promote managerial agency costs.

Whatever the institutional arrangements that structure decisionmaking by Delaware lawmakers, their incentives to compete are clear and strong. Whether responding primarily to shareholders or managers, Delaware’s lawmakers face strong incentives to be responsive to those driving the competition over the development of corporate law. A huge percentage of Delaware’s government budget revenues are derived from its corporate chartering business. This

pricing but that these errors are systematically biased in one direction or the other. If the errors are not systematically biased, then the price information generated by the market is sufficiently reliable to permit event studies and other empirical research based on stock prices. LoPucki offers little beyond speculation that shareholders are systematically and irrationally biased toward overvaluing Delaware firms relative to other states. See id. at 238. Similarly, his invocation of problems with electricity and savings and loan deregulation as examples of market failures ignores the fact that those problems came about as a result of the perverse incentives created by the deregulatory schemes set up in those situations, not by the introduction of competition itself. See id. at 239. Thus, in those situations the markets assessed all too well the “complex systems” of the regulatory rules established under the partial deregulation schemes. In particular, the deregulation of savings and loans coupled with the preexisting deposit insurance regime created the savings and loan debacle, and the deregulation of wholesale, but not retail, electricity prices was a primary cause of the electricity deregulation fiasco. See, e.g., John C. Coffee, Jr., What Caused Enron? A Capsule Social and Economic History of the 1990s, 89 CORNELL L. REV. 269, 278 (2004) (describing savings and loan crisis as moral hazard problem); Stephen J. Rassenti et al., Controlling Market Power and Price Spikes in Electricity Networks: Demand-side Bidding, 100 PROC. OF THE NAT’L ACADEMY OF SCI. 2998, 2998 (2003), available at http://www.pnas.org/cgi/reprint/100/5/2998 (describing problems with electricity deregulation).

93. LoPucki puts it at 27%. LoPucki, supra note 2, at 8. Others put it at 17%. See Jonathan R. Macey & Geoffrey P. Miller, Toward an Interest-Group Theory of Delaware Corporate Law, 65 TEX. L. REV. 469, 490 (1987). These estimates, while large in their own right, certainly underestimate the full value of Delaware’s dominance, as they exclude revenues generated from ancillary products like legal services and various travel and entertainment services such as hotels, restaurants, taxis, and rental cars.
heavy reliance on tax revenues generated by corporate chartering makes Delaware’s state legislatures highly attuned to preserving Delaware’s dominance in corporate chartering since legislation that reduces the number of firms incorporating in Delaware will reduce tax revenues.\(^{94}\) Judges appointed to the Delaware Chancery Court are also well aware that their power and prestige derives from Delaware’s home as the corporate capital of America.\(^ {95}\) In addition, a cluster of well-organized interest groups have grown up around Delaware’s corporate chartering “business,” especially corporate lawyers specializing in Delaware’s Chancery Court practice.\(^ {96}\) These interest groups have a direct incentive to lobby Delaware’s legislature and courts to preserve and promote Delaware’s status as the dominant forum for corporate law incorporations and legal practice. If firms choose to incorporate elsewhere, this would substantially reduce the demand for the services of this specialized sector of the economy and reduce the value of their specific skills (at a minimum, by reducing the demand for their services as local counsel in Delaware proceedings).

D. SUMMARY ON STRUCTURAL ANALYSIS OF FORUM-SHOPPING COMPETITION

Competition generally, and forum-shopping competition particularly, can produce good or ill effects depending on the institutional context in which it takes place. Where institutions and incentives are aligned properly, such as in the competing jurisdictions of the Middle Ages that spawned the modern common law, competition proves to be an impetus for innovation, flexibility, and individual preference matching. By contrast, the forum-shopping system of modern American tort law provides a dysfunctional incentive for judges—especially elected judges—to redistribute wealth to in-state individual plaintiffs at the expense of out-of-state corporate defendants. Moreover, because of the ability to forum-shop nationwide class actions into these plaintiff-friendly states, these states exert a disproportionate negative influence over law. In other situations, such as Delaware’s dominance in corporate law, the evidence is somewhat unclear as to whether forum shopping is a positive race to the top or a negative race to the bottom. Empirical evidence has tended to provide some support for the former, and lawmakers’ incentives are aligned to promote whatever the institutional arrangements suggest should be promoted. The remaining question is whether the institutions surrounding that competition tend to promote efficiency and shareholder welfare or managerial agency costs.

III. BANKRUPTCY FORUM SHOPPING

There is little doubt that forum shopping occurs in bankruptcy. The rapid rise of the Southern District of New York in the 1980s, followed by its equally rapid plunge and the rise of Delaware, makes it clear that bankruptcy filings are not

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94. See Rasumussen & Thomas, supra note 61, at 1385.
95. See id.
96. See Macey & Miller, supra note 93, at 503–06.
randomly distributed; instead, there is a conscious choice among different courts. The primary question to be asked is whether the outcomes of bankruptcy forum shopping are generally bad (as with modern tort law), generally good (as with interjurisdictional court competition during the Middle Ages), or ambiguous (such as the dominance of Delaware in modern corporate law).

LoPucki argues that modern bankruptcy forum shopping is an inevitable consequence of the institutions and incentives of the bankruptcy venue rules. Others have argued that Delaware’s dominance in large Chapter 11 cases has resulted from a healthy competition, as Delaware’s courts have won their dominant position through superior skill, speed, and predictability relative to their rivals. Still others argue that the effects of this forum-shopping practice are ambiguous.

This Part applies a structural analysis to bankruptcy court forum-shopping to try to determine whether the outcome of this competitive process is good, bad, or ambiguous. First, I will explore the institutional structure of the forum-shopping competition, focusing on the demand side of the market and the choice process by debtors. Second, I will turn to the supply side of the market to discuss the incentives of bankruptcy judges to respond to the forum-shopping desires of those choosing the court.

A. INSTITUTIONAL STRUCTURE OF COMPETITION

LoPucki argues that the institutional structure of bankruptcy court competition is driven by two groups—incumbent managers and bankruptcy professionals.97 Current bankruptcy venue rules, he argues, provide both of these groups with the opportunity to manipulate the bankruptcy process to their advantage and to the disadvantage of creditors, employees, and the public.

1. Incumbent Management and the Race to the Bottom

LoPucki turns his primary fire on incumbent management, arguing that the primary beneficiaries, and drivers, of the race to the bottom are incumbent managers. Echoing those who criticize state corporate law as a race to the bottom, LoPucki argues that incumbent management of a failing firm has both the opportunity and incentives to forum-shop the firm’s bankruptcy proceeding into a venue that will be responsive to their interests, rather than the firm’s creditors.98 LoPucki identifies three particular key institutional factors that he believes provide an incentive for management to engage in forum shopping and to seek out courts favorable to them: First, the propensity for a court to reorganize failing firms that should not be reorganized; Second, in scandal-ridden recent cases, the willingness of a court to implicitly acquiesce in a de

97. He also identifies DIP (debtor in possession) lenders as a third group influencing venue choice, but they seem to be largely reactive to the others rather than an independent force driving venue choice decisions. LoPucki, supra note 2, at 138.
98. Id. at 137–82.
facto cover up of the fraudulent activity by the management; and Third, the "flexibility" of a court in permitting the sale of an entire firm (or all of a firm’s assets) under § 363 (and outside the ordinary plan process). On each of these points, LoPucki makes a strong case that there may be serious problems with the current bankruptcy system, which enable corporate managers to manipulate the system to benefit themselves at the expense of creditors and the public. On the other hand, it is unclear whether this manipulation is attributable to competition among bankruptcy courts for big cases.

a. A Pro-Reorganization Bias? LoPucki’s primary criticism of the current forum-shopping system for bankruptcy is that it grants disproportionate influence in bankruptcy cases to incumbent management, which is usually reflected in a systematic bias toward the inefficient reorganization of economically failing and non-viable firms. If incumbent managers, rather than creditors, are controlling the decision as to where to file the firm’s bankruptcy, their self-interest generally will lead them to file in courts friendly toward reorganization of failing firms, rather than their liquidation or sale as a going concern. Reorganization, unlike liquidation, enables managers to potentially keep their jobs at the end of the day; at the very least, it enables them to remain employed during the pendency of the bankruptcy process and often provides an opportunity to receive substantial retention bonuses during that period.

In a series of articles over the past several years, LoPucki has developed a database of large Chapter 11 cases, which he has used for a variety of empirical tests of the hypothesis and which provide the basis for Courting Failure. LoPucki found a high correlation between the reorganization of firms that had filed in Delaware and New York during the forum-shopping heyday of their courts and the tendency for them to later refile in bankruptcy. LoPucki further argues that not only were firms that reorganized in Delaware and New York more likely to refile, the correlation was only found during the time when their courts were attracting a disproportionate share of large filings, thereby evidencing that “the elevated refiling rates were a product of intercourt competition.” In addition, he further notes that firms that emerged from Delaware and New York reorganizations during this period continued to lose money even after emerging from bankruptcy, in contrast to those firms reorganized elsewhere.

LoPucki’s intuition seems to be that inherently viable firms with a good

99. Id. at 167–80.
100. See id. at 97–122.
101. Not in all cases, however. LoPucki argues that there may be situations where incumbent management might favor a sale of the company if they are able to negotiate a sweetheart buy-out or compensation package with the acquiring firm. Id. at 174.
102. See id. at 151–56.
103. LoPucki found that the refiling rate for firms that reorganized in Delaware or New York was roughly three times higher than for all other states. See id. at 100.
104. Id. at 101; see id. at 110–14.
105. See id. at 113.
prospect of reorganizing can file in almost any court and do well, becoming inframarginal demanders of court competition who will be able to choose their venue on the basis of convenience, cost, and other considerations. Weak firms with poor reorganization prospects, by contrast, will have the greatest incentives at the margin to seek out courts most receptive to dubious or speculative reorganization cases, and bankruptcy judges in turn will have the incentive to compete for these marginal cases.\(^{106}\)

Overall, there seems to be minimal disagreement with LoPucki’s statistical finding that Delaware reorganizations are more likely to fail than reorganizations from other courts; disagreement instead centers on conflicting interpretations of that evidence, such as the possible explanation that the greater failure rate results from the greater complexity or difficulty of the particular reorganizations.\(^{107}\) Leaving aside the details of these arguments, all of these alternative explanations share the common feature of attributing the gravitation toward Delaware as reflecting a race to the top, rather than a race to the bottom. Delaware is winning, it is argued, because of its expertise, innovative and talented judges, willingness to tackle difficult cases, and general experience with large Chapter 11 cases. Once a given court develops expertise and a favorable reputation, these same forces tend to create a path dependency effect that magnifies small comparative advantages and makes them larger through reinforcement. In other words, once Delaware gained a slight edge over other courts, this relative advantage became self-reinforcing, leading subsequent filers to choose Delaware over alternative courts, and leading to a still greater relative advantage for Delaware in terms of experience and expertise. The race to Delaware’s bankruptcy courts, LoPucki’s critics argue, is driven not by incumbent managers seeking to escape accountability, but rather by creditors and other stakeholders seeking the speed and expertise offered by Delaware.\(^{108}\)

The leading defender of Delaware has been Professor David Skeel, who argues that the gravitation to Delaware is better understood as promoting benign

\(^{106}\) More precisely, LoPucki seems to suggest that the problem lies not in the economic troubles of the reorganized firms themselves, but rather in the nature of the plans approved by Delaware and New York courts that cause the firms to fail and refile. E-mail from Lynn LoPucki to author, (Sept. 3, 2005 11:35:18) (on file with author). If there is such a mechanism, it is not exactly clear what this mechanism is. LoPucki suggests some possible explanations elsewhere. See Lynn M. LoPucki & Joseph W. Doherty, Why Are Delaware and New York Bankruptcy Reorganizations Failing?, 55 Vand. L. Rev. 1933, 1983–84 (2002). Moreover, if the fault lies with the plan process in those courts rather than the economic viability of the firms themselves, then it is not clear why firms would want to forum-shop into those courts in the first place if it simply increases the likelihood of failure. For purposes of this Essay, it is not clear that this particular distinction is analytically important. Given this, and the ambiguity in what exactly is intended, I will refer in the text to a “pro-reorganization” bias, notwithstanding that the term might be a slightly inaccurate statement of LoPucki’s thesis.

\(^{107}\) For LoPucki’s response to these critiques, see LoPucki, supra note 2, at 113–15.

\(^{108}\) Id.
In general, Skeel argues that Delaware’s bankruptcy court has emerged as the leader of the interjurisdictional competition because of its superior judges and practices. Delaware has, in fact, been an innovator in a number of different practice areas—from the development of first-day orders designed to deal with emergency issues at the outset of a case, to “prepackaged” bankruptcy filings—some of which have been met with general acclaim, while others have been more controversial.110

In a forthcoming article, Skeel and his co-author Kenneth M. Ayotte argue that Delaware’s dominance results from its superiority to other courts in dealing with large Chapter 11 cases.111 They conclude that Delaware’s popularity is not driven by managers or equity holders seeking a procedure friendly to their interests but rather by the speed and expertise of Delaware’s bankruptcy courts. They find that Delaware reorganizations are completed substantially faster than those in other courts and argue that the primary beneficiaries of speedy reorganizations tend to be secured creditors.112 They also find that firms are more likely to choose Delaware if the home venue of the firm is less experienced. Overall, they conclude that permitting bankruptcy forum shopping is generally healthy, in that it not only encourages competition, but more importantly, it affords firms otherwise trapped in mediocre or inexperienced courts access to more skilled courts. Thus, for many firms, forum shopping is less the result of forum-shopping into Delaware as it is forum-shopping out of an inexperienced local court. They conclude that the responsiveness to secured creditor interests and evidence of forum-shopping into Delaware was unlikely the result of undue responsiveness to managerial or equity influence but instead was efficiency-driven and beneficial. They therefore see “no tangible benefit to restricting choice and competition for bankruptcy cases.”113

Ayotte and Skeel acknowledge, however, that there are some problems with using secured creditors as a proxy for welfare effects of jurisdictional competition.114 In particular, it could be that the influence of secured creditors leads to a transfer of wealth to themselves from other stakeholders (such as unsecured creditors), rather than an enlargement of overall firm value. This problem could be exacerbated if secured creditors and incumbent management strike an implicit bargain to collude against unsecured creditors to redistribute wealth from...
unsecured creditors to secured creditors. For instance, pre-bankruptcy secured creditors often also provide post-petition Debtor in Possession (“DIP”) financing, and thus, depending on the terms of the DIP lending package, pre-bankruptcy secured creditors could conceivably share an incentive with equity holders to push for an inefficient reorganization of the firm. LoPucki also notes that faster reorganizations also tend to be more likely to fail and require refiling later,\textsuperscript{115} while Ayotte and Skeel argue that repeated failures could simply indicate mere uncertainty about a firm’s going-concern value rather than a negative assessment of the firm’s value.\textsuperscript{116}

LoPucki also ignores the possibility that a decision not to forum-shop away from the home district may also be a form of forum shopping itself. In many cases, firms file in their home districts because they believe the local court will be more responsive to local managers and employees who want to keep their jobs and thus have a strong pro-reorganization bias. Especially where a given firm plays a disproportionately large role in the local community, such as a small-town steel mill in that declining industry, there may be strong public pressure on a judge to reorganize the firm, even if the reorganization is economically inefficient. In such a case, Delaware or some other court may have less of a pro-reorganization bias than the home forum. Though LoPucki may respond that this effect is not borne out in the statistical aggregates, it may be important at the margin in the decision of some firms not to file in Delaware.

\textit{b. Forum Shopping and Corporate Scandals.} LoPucki makes a second, controversial argument that a new motivation for forum shopping has arisen in recent years with the influx of scandal-ridden mega-bankruptcies such as Enron, WorldCom, and Global Crossing. LoPucki charges, in scathing terms, that the new breed of forum shopping has been driven by efforts of corrupt corporate managers to select bankruptcy courts that would make it easier for them to avoid detection and prosecution for their misdeeds. For instance, LoPucki argues that one reason why Enron filed its mega-bankruptcy case in New York rather than Delaware was that in the \textit{Marvel} case (filed shortly before Enron’s bankruptcy and affirmed by the Third Circuit\textsuperscript{117}) one of Delaware’s judges had

\begin{itemize}
\item \textsuperscript{115} LoPucki, supra note 2, at 117.
\item \textsuperscript{116} Ayotte & Skeel, supra note 111, at 16 (citing Matthias Kahl, \textit{Economic Distress, Financial Distress, and Dynamic Liquidation}, 57 J. Fin. 135 (2002)). Ayotte and Skeel note, for instance, that an all-equity capital structure would reduce the refailure rate but not indicate anything about the long-term viability of the firm. On the other hand, capital structure is likely to be at least somewhat endogenous to such considerations, and a firm with highly unpredictable profitability is likely to be able to raise equity capital at a lower cost than debt capital in the first place. Thus, it seems probable that not only would the firm be less likely to end up in bankruptcy repeatedly, but for the same reasons would be less likely to end up in bankruptcy in the first place. Moreover, LoPucki notes that Delaware firms are disproportionately prone to being unprofitable immediately upon emerging from bankruptcy, so it is not clear whether unpredictable profitability can explain this phenomenon.
\item \textsuperscript{117} In re Marvel Entm’t Group, Inc., 140 F.3d 463, 472 (3d Cir. 1998).
\end{itemize}
appointed a trustee based on a relatively low legal and factual standard.118

Once Enron filed in New York, several major creditors requested the appointment of a trustee. According to LoPucki, Bankruptcy Judge Arthur J. Gonzalez “delayed a hearing [on the motion to appoint a trustee] until he brokered a deal that left most of Enron’s management in place.”119 Instead of a trustee, the court acquiesced in the appointment by Enron’s directors of turnaround expert Stephen Cooper as Enron’s new CEO. LoPucki argues that this left Ken Lay and other members of incumbent management in office through the early stages of the case and enabled them to guide the choice of their own successors when they finally departed.120 Although the court appointed an examiner to investigate the fraud, the authority to sue was delegated not to the examiner, but to the creditors’ committee, which made the decision on a case-by-case basis.121 This created what LoPucki refers to as a “three-way division of authority” between the new CEO Cooper, the examiner, and the creditors’ committee, the effect of which was to “bureaucratize and ultimately cripple the effort to hold Enron’s corrupt executive civilly and criminally accountable.”122 The configuration was much less effective than would have been a trustee vested with wide-ranging authority to investigate wrongdoing.

LoPucki’s assessment is biting and sweeping:

As a result, the investigators remained on the outside for the duration of the Enron case. For a management engaged in massive fraud, it was the best bankruptcy result for which one could hope. The government took almost three years putting together a case sufficient to indict Lay. Lay has still not been sued for his mismanagement of Enron, and it seems likely he never will be. The New York bankruptcy court had proven itself a trustworthy protector of managements accused of fraud.123

LoPucki argues that the leniency exhibited by New York’s bankruptcy court in Enron compared to the tougher standard prevailing in the Third Circuit created a swift and devastating race to the bottom. Within a short time after

118. LoPucki, supra note 2, at 13–14. LoPucki also notes that Delaware’s bankruptcy courts were also facing a significant backlog at this time and thus probably could not have been as responsive as necessary to the case. Id. at 13.

119. Id. at 14.

120. That Cooper was chosen at Lay’s behest, however, is open to question. It may be that he was chosen at the request of creditors, and given his prominence as a turnaround expert, that he would almost certainly have been a leading candidate for the position.

121. LoPucki, supra note 2, at 147.

122. Id.

123. Id. at 14. In a hearing in the recently filed Winn-Dixie case, one of New York’s bankruptcy judges vehemently denies the charge that New York’s judges have “gone easy” on fraud-ridden bankruptcy cases in order to encourage forum-shopping into New York. See Transcript of Apr. 12, 2005 Hearing at 164–65, In re Winn-Dixie Stores, Inc., No. 05-11063 (Bankr. S.D.N.Y. 2005) [hereinafter Winn-Dixie Transcript] (on file with author). Note that the Winn-Dixie case was subsequently transferred to the Middle District of Florida. See infra notes 226–27 and accompanying text.
Enron landed in New York, Global Crossing (a Bermuda and Los Angeles, California corporation), Adelphia Communications (Coudersport, Pennsylvania), and Worldcom (Clinton, Mississippi) all filed in New York’s bankruptcy court. Although each scandal-ridden corporation appeared to be an appropriate subject for the appointment of a trustee, in each case incumbent management was able to remain in control during the early “crucial stages of the case[] and to choose their own successors.”

Although sharp, LoPucki’s attack has some prima facie merit. Under the clear text of the Bankruptcy Code, the failure to appoint a trustee considering the scope of these cases involving corporate fraud and managerial malfeasance is inexplicable. LoPucki adds sarcastically that through its “deft handling” of these four huge and scandal-ridden cases, “the New York bankruptcy court surpassed Delaware in 2002 to become the nation’s most attractive bankruptcy court.”

It is possible that all four coincidently chose to file in New York rather than in Delaware or each corporation’s home district for wholly neutral reasons, such as Delaware’s overburdened caseload, the proximity of lawyers and financial advisors to New York, or the relative expertise of New York’s court (although these firms easily could have filed in Houston, Los Angeles, Philadelphia, or Northern Virginia, all of which have handled other large cases). Another possibility is that the extralegal system of corporate governance in Chapter 11 devised in these cases is theoretically preferable to the statutorily-contemplated remedy of appointing a trustee. Nonetheless, LoPucki’s argument that in each case incumbent management was looking for a court that would take a relatively hands-off approach to their scandals is certainly plausible at first glance.

It is not clear, however, that this evinces improper court competition, at least as argued by LoPucki in the remainder of Courting Failure. Enron may have filed in New York rather than Delaware because of Delaware’s perceived easier standard for the appointment of a trustee. And it is also reasonable to conclude that Global Crossing, Adelphia, and Worldcom followed Enron into New York because of the court’s Enron decision. But it is not clear that the problems that flow from this can be directly laid at the forum-shopping doorstep. Although Judge Gonzalez’s decision not to appoint a trustee in Enron may have been wrongheaded or erroneous under the Code, there is no concrete evidence that it was motivated by a corrupt desire to attract subsequent, similarly-troubled cases in the future. While the ability of debtors to choose their forum exacerbates the problem, the problem can also be attributed to the particular decision of the New York bankruptcy court, which, while perhaps incorrect, does not appear to

124. LoPucki, supra note 2, at 14.
125. See 11 U.S.C.A. § 1104 (West Supp. 2005) (“[T]he court shall order the appointment of a trustee . . . for cause, including fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case . . . .”).
126. LoPucki, supra note 2, at 14.
127. See Todd J. Zywicki, CROs, DIPs, and Trustees: Modern Corporate Governance in Chapter 11 (unpublished manuscript, on file with author).
be spawned by a desire to secure mega bankruptcies of troubled firms.  

LoPucki’s larger point is highlighted because these cases were directed away from Delaware and to New York—the choice in these cases may have been influenced in part, and perhaps exclusively, by the incumbent management rather than the interests of creditors (many of whom sought the appointment of a trustee) or “other interests of the estate” as required by the statutory language of the Bankruptcy Code. From that perspective, there is certainly some reason to share LoPucki’s concern that bankruptcy forum shopping may not be advancing efficiency goals.

c. § 363 Sales. A third source of managerial self-dealing identified by LoPucki relates to the practice of selling a company pursuant to § 363 of the Bankruptcy Code rather than through the Chapter 11 process. Under § 363 of the Bankruptcy Code, the debtor in possession may sell property of the estate outside the ordinary course of business. Typically, this provision is used to sell particular property or assets of the debtor, such as a pizza parlor selling a pizza oven that is subject to a security interest. But in some instances, it has been used to permit the sale of an entire business as an operating entity to new owners through a court-sponsored auction process. In some cases, courts have held that a sale through the expedited process of § 363 is inappropriate and that the sale instead should be conducted only through the full Chapter 11 plan process, except where there is a pressing need or “good business reason” to do otherwise.

LoPucki argues that permitting the sale of an entire business under § 363 improperly shortchanges the notice and other protections associated with Chapter 11. Sale of the entire business in the context of a Chapter 11 plan confirmation requires substantial notice, disclosures of the debtor’s financial condition, reasons for sale, alternatives to sale, “ulterior motives” for the sale, and voting by all unsecured creditors. By contrast, a sale pursuant to § 363 only requires a relatively summary disclosure of the terms of the sale to the unsecured creditors’ committee and the court. Moreover, LoPucki notes that when the sale is consummated through the plan process, the plan also must disclose how the sales proceeds will be distributed to the creditors if the sale goes

128. In addition, BAPCPA requires the appointment of a trustee in any case where there are “reasonable grounds to suspect” that the firm committed securities or accounting fraud. See 11 U.S.C.A. § 1104(e) (West Supp. 2005).


131. See In re Lionel Corp., 722 F.2d 1063, 1071 (2d Cir. 1983) (determining that witness testimony revealed “no good business reason” to justify the § 363 sale).

132. See LoPucki, supra note 2, at 168 (although LoPucki does not appear to be opposed to the sale of a business per se, he objects to the sale of a business outside the Chapter 11 process). In recent years, over one-half of large companies that file Chapter 11 are essentially sold. See Douglas G. Baird & Robert K. Rasmussen, Chapter 11 at Twilight, 56 STAN. L. REV. 673, 675–76 (2003) (noting that approximately half of these companies did not remain independent entities after Chapter 11 filings in 2002).
through. LoPucki argues that the ability to end-run the more transparent plan process and to effectuate a sale through a summary § 363 sale creates an opportunity for improper self-dealing by incumbent management by allowing them to sell the company to themselves for a below-market price in a “sweetheart” deal. In addition, once the sale is entered, it is final and no appeal from the sale is permitted.

LoPucki argues that this combination of factors—speed, lack of transparency, and finality—creates the possibility of opportunistic or corrupt management purchasing the company at the expense of the creditor body. In addition, he contends that this opportunism combines with strategic bidding behavior by managers to exacerbate these structural problems:

Managers seeking to deliver a company to themselves or their accomplices at a bargain price tend to announce their intention to sell only at the last minute and then seek to conclude the sale as quickly as possible. This minimizes the opportunity for discovery of the true identities of the buyers or the emergence of other bidders for the company.

LoPucki finds a rise in the frequency of § 363 sales beginning in the 1990s and then increasing rapidly beginning in 2000. He argues that this rapid increase in the frequency of § 363 sales was initiated by Delaware’s enthusiastic embrace of § 363 sales, especially so-called “quick sales” that take place within 130 days of filing. LoPucki suggests that “quick sales” are evidence of forum shopping because this period of time is “short enough to suggest that the debtor had sale in mind when it chose the court.” Beginning in the 1990s, he finds that Delaware uniquely specialized in these “quick sales” relative to sales in other districts where the time elapsed was consistently longer. Indeed, he finds that some companies that were the subject of “quick sales” in Delaware had already contracted to sell the business prior to filing bankruptcy and filed only to obtain an order from the court approving the sale. Beginning in 2000–2001, however, he argues that the scourge of “quick sales” spread to courts in other districts, which he sees as a response by other districts competing to attract these cases to their courts. Beginning in January 2001, half of the quick sales that occurred did so outside Delaware, which LoPucki interprets as evidence that these courts changed to compete with Delaware.

Others have objected that this emphasis on the procedural protections of a

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133. See LoPucki, supra note 2, at 168 (contrasting the § 363 sale that does not require disclosure of proceeds).
134. See id. at 169 (explaining that § 363 sales allow corrupt managers to get “bargain price[s]”); id. at 174 (asserting that the buyers and managers arrange “sweetheart deals”).
135. Id. at 169.
136. Id. at 168–70.
137. Id. at 168–69.
138. See id. (noting that from 1992–2000 all “quick sales” were made through Delaware).
139. Id. at 169.
sale through the plan process is fundamentally misguided. This response relies on an analogy to the efficient market hypothesis, contending that these procedural regularities offer little more than “procedure for procedure’s sake” and simply increase the cost and delay associated with a sale with no evidence that following those procedures would actually result in a more accurate or higher sales price. Under this view, the “correct” price for the firm is what it fetches at an open auction. While it is true that further delay and more expensive procedures might increase the value secured at auction, they argue, there is no evidence that this is the case, and indeed, further delay might have the effect of worsening a firm’s financial condition. At the time of the § 363 sale, the price produced at an open auction among sophisticated parties is likely to be the best estimate of the present value of the long-term value of the firm. There is no reason to believe that bankruptcy judges acting through the plan process are in any better position to estimate the value of a firm than those engaged in a real auction with their own money on the line. Indeed, given the inherently “iffy” prospect of confirming a reorganization plan in any given case, it is possible that the value produced at a quick sale early in the case could be higher than would be generated through further delay and expense.

This position was articulated in a dissenting opinion by Judge Ralph Winter in *In re Lionel Corporation*. In *Lionel*, the debtor held 82% of the stock of Dale Electronics, Inc., which it sought to sell through a § 363 sale. Winter observed that there was no evidence that permitting a speedy and final § 363 sale at the outset of the case rather than a late sale through the plan process would disadvantage the estate. Winter also noted that requiring the sale to be made through the plan process would provide equity holders with undue leverage to extract wealth from creditors due to their power to veto the sale. In the end, Judge Winter argued that the stock sale still will be made—just later rather than sooner—and there is no evidence that requiring further procedural protections and delay will increase the value of the sale. It will, however, increase the risk and expense associated with such a sale and will provide equity holders with improper leverage to extort concessions in exchange for surrendering their veto over the reorganization.

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140. See *In re Lionel Corp.*, 722 F.2d 1063, 1072 (2d Cir. 1983) (Winter, J., dissenting) (arguing that the court’s refusal to recognize the § 363 sale will only result in protracted negotiations and unnecessary economic risk).

141. See id. (noting that the record indisputably refutes the proposition that a higher sales price could be achieved through a later sale).

142. Id.

143. See id. (“The effect of the present decision is thus to leave the debtor in possession powerless as a legal matter to sell the Dale stock outside a reorganization plan and unable as an economic matter to sell it within one. This, of course, pleases the equity holders who, having introduced no evidence demonstrating a disadvantage to the bankruptcy estate from the sale of the Dale stock, are now given a veto over it to be used as leverage in negotiating a better deal for themselves in a reorganization.”); id. (“The equity holders offered no evidence whatsoever that the sale of Dale now will harm Lionel or that Dale can in fact be sold at a reasonable price as part of a reorganization plan.”).
possibility that the property to be sold will fluctuate in value over time with any upside risk accruing to equity holders, while downside risk accrues to creditors. Indeed, the § 363 sale in Lionel was supported by the creditors’ committee in the case, suggesting that creditors believed the sale to be in their best interests; only equity holders objected to the sale.\footnote{Id. at 1065–66 (majority opinion).}

LoPucki suggests that an argument like Judge Winter’s “efficient markets” argument—even if possibly correct theoretically—would be inapplicable in practice to most § 363 sales, which he claims are plagued by a lack of transparency, gamesmanship, and self-dealing on behalf of incumbent management in making the sale. As a result, contrary to those who argue that the price generated at such an auction is inherently the best estimate of the firm at the time of the sale, LoPucki argues the price that emerges from this flawed auction is fundamentally unreliable. LoPucki builds his argument on several cases involving § 363 sales that had several factors, which made the sales appear suspicious.\footnote{See LOPUCKI, supra note 2, at 172–73 (suggesting that, in some “quick sales,” the insistence on a “quick sale” may be disingenuous and prevents competing bidders from making an offer).} First, sales were made to incumbent management, or incumbent management directly benefited from the sale, often with minimal disclosure of the identity of the purchasers. In those cases where the incumbent management is not the purchaser, they often get some sort of benefit from the sale, such as an employment or consulting contract from the buyer, as well as stock in the company. Second, the sales were made in an unnecessarily speedy fashion with no apparent need for such haste. Third, there were few or no rival outside bidders against the bid from incumbent management. Fourth, LoPucki identifies conflicts of interest among the investment bankers in these cases that chilled the bidding and resulted in “bargain” prices in the end. Finally, LoPucki argues that in several of these insider sales, the final sale price was unreasonably low. As a result, LoPucki sees the market model as having little relevance to these sales. In order to maximize the value of the sale and to minimize the risk of self-dealing evident in these cases, LoPucki argues for greater procedural protections and transparency in the auction process.\footnote{See id. at 169–77 (exposing the failures of § 363 “quick sales” and the need for procedural protections).}

LoPucki also suggests that there is inherent value in running momentous decisions such as the sale of the business through the Chapter 11 process. For instance, although a § 363 sale requires notice to the creditors’ committee, the committee may have its own conflicts of interest and does not represent all of the claimants in the case. Running the proposed sale through the plan confirmation process would provide unrepresented constituencies, such as employees or tax authorities, with a greater opportunity to review and object to the sale. On the other hand, as Winter noted in his Lionel dissent, the plan process also opens the door for peripheral constituencies to object to the sale for strategic and
improper reasons.\textsuperscript{147} Thus, it is far from clear that the benefit of the voice given
to these constituencies in the Chapter 11 plan process is an unalloyed benefit.

LoPucki raises some powerful questions about the validity of § 363 “quick
sales,” especially where such sales are made without adequate notice and over
the objection of the creditors’ committee. In cases where the creditors’ commit-
tee has an opportunity to review the sale and chooses not to object, this should
be sufficient protection against, at least, the charges of improper insider dealing
by management; this would seem to provide the appropriate incentives for
managers to insure that the sale maximized price and minimized expense and
risk associated with converting the assets to cash.\textsuperscript{148} It is less clear, however,
whether the problems with § 363 sales that he identifies are actually evidence of
forum shopping and especially “bad” forum shopping. While there may be
some merit to LoPucki’s circumstantial evidence of “bad” forum shopping (or
what he refers to as “court competition”) with respect to the growing tendency
to permit “quick sales,” it is by no means obvious that this is the only or
necessarily the most persuasive interpretation of these trends. It seems equally
plausible that this could be the result of good competition if other courts thought
the expedited and potentially less expensive process of a swift and final sale of
the business was the most efficient way to produce value for creditors and
perhaps to arrest any decline in the companies’ fortunes.

Moreover, it is unclear why judges would want to compete for these cases.
Based on any plausible model of judicial motivations to engage in forum-
shopping competition, these cases would seem to have little appeal for an
enterprising judge.\textsuperscript{149} By and large, judges in such cases seem to be little more
than glorified auctioneers, sweeping up the leftovers of an empty corporation
with little glory or intrinsic interest in such cases. Local professionals also
seemingly gain little from such cases. Indeed, the incentives of enterprising
judges and professionals seem to push in the alternative direction, toward a
more drawn-out, expensive, and elaborate reorganization, rather than a sum-
mary quick sale of the corporation followed by liquidation.

Most troublesome, however, are cases where the court orders the sale over an
objection by the creditors’ committee, such as in the Polaroid sale, and permits
the sale notwithstanding evidence the sales price may be insufficient.\textsuperscript{150} Lo-

\textsuperscript{147.} See In re Lionel, 722 F.2d at 1072 (arguing that equity holders have undue leverage in
negotiations due to their veto power).

\textsuperscript{148.} Creditors’ committee approval, on the other hand, would not resolve the problem of tax
creditors, employee interests, and the like. Thus, it is probably probative only in one direction—
creditors’ committee approval may not be definitive (but should be weighty), but creditors’ committee
objection should be very weighty. It is unclear whether LoPucki’s concern about § 363 sales is limited
only to those situations where the sale is authorized over the objection of the unsecured creditors’
committee, or to such sales in general.

\textsuperscript{149.} See infra Part III.B (discussing the incentives of bankruptcy judges to engage in forum
shopping).

\textsuperscript{150.} See LoPucki, supra note 2, at 173–81 (noting that Delaware approved the Polaroid sale for
arguably below-market value despite objections from Polaroid stockholders and retirees).
Pucki describes the problem through some well-chosen anecdotes but does not provide a definitive answer, nor am I aware of any other systematic research that looks at the procedures and terms of these sales in detail. LoPucki does, however, suggest a hypothesis: the relevant question, it would seem, is not simply the rise in the number of “quick sales” over time but whether the rise is tied to a greater willingness of bankruptcy judges to approve the sales over the objection of creditors. Given the potential for opportunism and self-dealing present in those situations, a finding of a rise in sales over creditors’ objections would provide strong evidence of a forum-shopping problem. As it stands, however, LoPucki has posed the problem and suggested his predictions, but future research is needed to test the hypothesis.

2. Professionals

Under the current institutional framework, bankruptcy professionals may also have the opportunity to influence forum selection for their private benefit. Professionals representing Chapter 11 filers will prefer courts with relatively generous professional fee awards (in terms of permissible rates, scrutiny of allowed fees and expenses, and frequency of fee payment) and, where applicable, relaxed standards for conflicts of interest. The decision of where to file the case is a collaborative one between the debtor and its professionals. The decision of which law firm will be retained is coterminous with the decision of where to file the case. Thus, at the time the case is being contemplated, the proposed law firm can steer the debtor’s management to districts that look more favorably upon a professional’s fee applications than other districts that may not.

In theory, a debtor may thus be forced into the choice between its preferred counsel and preferred forum; in practice, the debtor is unlikely to have an independent preference for any given venue and the debtor’s preference is shaped by the lawyers’ advice. In all likelihood, the bankrupt company will have a stronger preference for a particular law firm to handle the case than for a particular court. There also seems to be some correlation between those courts that are deferential to professional fees, on one hand, and those that also tend to be relatively “pro-debtor” on the other. LoPucki suggests that Delaware is an example of such a forum. Thus, the venue preferences of the debtor’s management and attorneys will usually amplify rather than contradict each

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151. See id. at 174 (relying on “preliminary results” from his studies).
152. This does not necessarily imply the converse—although an objection by the creditors’ committee is strong evidence of the creditors’ disagreement with the sale, a failure to object may not necessarily imply creditor contentment with the sale, as the creditors’ committee may go along with the sale if, for instance, the debtor is in some way able to maneuver them into believing they have no alternative but to acquiesce.
153. See Rasmussen & Thomas, supra note 61, at 1372 (noting that the bankruptcy courts of the Southern District of New York were known as both “debtor friendly and relatively liberal in approving fee requests”).
154. LoPucki, supra note 2, at 137–82.
other. This correlation of mindset may not be coincidence, as the overriding mindset of such courts may be to treat bankruptcy proceedings as primarily multi-party private actions and to permit the parties to work out matters privately through negotiation. This mindset may lead these same courts to take a relatively hands-off approach to matters of fees and conflicts of interest. Indeed, there is a relatively small group of elite law firms, headed by Weil Gotshal and Skadden Arps, that have the resources and experience to handle large, complicated Chapter 11 cases with a national (or even international) reach. As a result, these firms can exert a tremendous amount of leverage over the choice of venue by a troubled firm, especially in the bewildering and frantic days that precede a Chapter 11 filing.

There are three basic attributes professionals will consider in preferencing one court over another: attitudes toward hourly rates, scrutiny of bills for fee awards, and conflict of interest standards. First, they will prefer courts willing to award fees at higher billing rates. Second, they will prefer courts that take a relatively hands-off approach to scrutinizing the contents of bills. Third, where applicable, some professionals prefer judges with a relaxed standard for conflicts of interest. Each of these three forces can be a powerful motivator driving forum selection and there is some evidence that at least some of them give rise to the “bad” forum-shopping pressures identified by LoPucki.

These “bad” forum-shopping pressures include professionals’ interest in the billing rates at which a given court will award fees and reimburse expenses. Regardless of where they are filed, big cases usually draw in professionals from all over the country who bill at different rates, with New York-based attorneys and professionals typically billing market rates that exceed the rates prevailing elsewhere in the country. Although some courts will award fees based on the prevailing fees in their home market (e.g., New York), others will cap the fees at the rates prevailing in the local market.155 If New York firms are not paid standard rates, they may decline the representation; knowing this, the debtor has

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155. Some courts, such as those in Oklahoma City, Denver, and Nashville, expressly adopted as their standard whether the fees were “reasonable” in light of the prevailing rates in attorneys’ home jurisdictions. But other judges felt that it was unnecessary and wasteful to pay New York rates (plus travel costs) for work that they felt could be done just as well by local counsel, who charged both lower fees and would not incur expensive travel costs. For instance, LoPucki notes that during the 1980s, the Philadelphia bankruptcy court refused to approve fees in excess of $200 per hour for senior partners, while the bankruptcy court in New York was approving fees as high as $450 per hour. Through this, judges attempted to conserve the estate’s resources for the benefit of creditors rather than professionals. LoPucki describes, for instance, the controversial decision by a Miami bankruptcy judge in 1986 to cut by one-third the fees of a leading New York bankruptcy firm, noting in a published opinion that the quality of work done by the opposing firm in the case was “markedly superior” to that of the New York firm. Such rulings did not endear Miami’s judges to national law firms considering where to file their bankruptcy cases. LoPucki, supra note 2, at 44 (citing In re Evans Prods., 69 B.R. 68 (Bankr. S.D. Fla. 1986)). LoPucki suggests that the popularity of Oklahoma City, which somewhat inexplicably was the second most-popular venue for Chapter 11 filings, may have resulted from the statement of one of the judges that “outside counsel may charge rates normally charged clients in their respective regional areas for counsel time expended in these proceedings.” Id. at 45.
an incentive to file the case in a court that will award standard fees. LoPucki
notes the comment by a leading New York-based bankruptcy lawyer who
“readily admitted steering his clients to venues that will pay his going rate, but
added that he explains to clients that his partners will not allow him to work for
less.”156 Moreover, unlike private clients, businesses reorganizing in bankruptcy
do not pay their attorneys directly, but instead the estate pays the debtor’s
professionals, thus the debtor has no reason to consider the billing rates in
choosing the firm to represent it.157 Although significant to the professionals
themselves, the fees paid to bankruptcy professionals in a large bankruptcy case
are a relatively small portion of the overall money involved in the case.158 Still
smaller in the overall scheme of the case is the marginal difference between the
fees awarded by a “tough” court versus a “soft” court. An additional $50–$75
million in attorneys’ fees may be a relatively small amount of money in a
multibillion dollar Chapter 11 case (perhaps less than one cent on the dollar to
creditors). To the professionals involved, however, this is a substantial marginal
difference. Thus, whereas creditors face a substantial collective action problem
in opposing forum shopping on this basis, professionals have strong incentives
to engage in forum shopping.

LoPucki notes that exactly this dynamic occurred throughout the 1990s,
providing some of the spark for the rise of New York and later Delaware as
venues preferred by forum-shopping bankruptcy professionals. He points to
surveys conducted by himself and William Whitford in the 1980s finding that
“other courts’ reluctance to approve fees at New York rates was a principal
reason for the forum-shopping to New York.”159 Research by Marcus Cole
found that a majority of the attorneys he interviewed acknowledged that fee
awards affected the decision of where to file the case.160 In addition, LoPucki
presents anecdotal evidence that courts have encouraged forum shopping behav-
ior and notes the remarkable phenomenon of the Houston bankruptcy court’s
public pronouncement in the early 1990s that in response to a recommendation
by a local bar committee the court would intentionally change its policy to

156. Id. at 141.
Costs of Chapter 11, 61 U. Pitt. L. Rev. 629, 651 (2000) (finding that in the median case in sample,
bankruptcy costs consumed 4.7% of total distributions and 3.5% of total assets); Lynn M. LoPucki &
James W. Doherty, The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases,
1 J. Empirical Legal Stud. 111, 113 (2004) (finding that professional fees are generally less than 2% of
the firm’s assets); Stephen J. Lubben, The Direct Costs of Corporate Reorganization: An Empirical
(finding that professional fees incurred in traditional Chapter 11 cases average 1.2% of total firm size
and 2.5% of assets).
159. LoPucki, supra note 2, at 141 (citing Lynn M. LoPucki & William C. Whitford, Venue Choice
and Forum-shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies, 1991 Wisc.
L. Rev. 11, 32–33).
160. Marcus Cole, “Delaware Is Not a State”: Are We Witnessing Jurisdictional Competition in
permit higher fees than it had in the past. As LoPucki notes, this process was rapidly replicated in numerous other cities in the following years, including Boston, Dallas, Chicago, Los Angeles, Minneapolis, Baltimore, all at the request of local bankruptcy lawyers and often with a public announcement of the change in policy by judges.

Professionals will also be concerned with the courts’ scrutiny of bills and the reasonableness of the total fees and expenses requested for performing various services. Outside bankruptcy, such issues are resolved through the normal give-and-take of an attorney-client business arrangement, where “reasonableness” is established through negotiations with and the scrutiny of the client. Within bankruptcy, where the professional’s fees are paid by the estate and approved by the judge, the judge’s views as to how much staffing or how much time it is “reasonable” to reimburse for particular services becomes crucial. The massiveness of the overall fee requests, the overwhelming pages of information unrelated to fees, and the need for sophisticated, highly technical analysis makes it almost impossible for courts to exercise any coherent supervision over the content of fee requests. Nor do the other parties in the case have an incentive to object to excessive fees—the professionals employed by the creditors’ committee are paid from the estate as well, thus they will have little incentive to object to excessive fees for unnecessary work for fear that the tables may turn when the time comes for their own fee requests.

Given the practical impossibility of providing oversight of the details of fee applications, some courts instead tried to impose rule-of-thumb caps on the fees and expenses that would be permitted as reasonable in any given case or for any

162. See id. at 126, 142–43.
163. See 11 U.S.C.A. § 330 (West Supp. 2005). Under the Code, the Court may award only “reasonable” fees and costs, which would encapsulate both the blanket question of the reasonableness of the hourly rate charged in light of the work performed as well as the reasonableness of the number of hours and expenses incurred in carrying out the representation.
164. For instance, how many hours is a “reasonable” amount of time to spend on a motion to lift a stay or a brief on a complex matter of law? How many attorneys from a given law firm is it “reasonable” to take to a hearing or deposition, or to participate in a conference call?
165. Not only is there an obvious and direct financial hit to the lawyer if fees are disallowed, but there may also be additional harm to the professional’s reputation that results from a judge’s disallowance of reimbursement for particular fees or expenses and the implicit (and occasionally explicit) finding of inappropriate “bill padding” that underlies such a finding. Attorneys will seek to avoid those judges who are prone to disallowing fees and meting out such embarrassment.
166. See LoPucki, supra note 2, at 42. LoPucki calls this approach “hopeless,” noting that “[n]o mechanism exists by which judges can evaluate each of the thousands of charges that may comprise a single application.” Id. at 142. Some judges have employed fee examiners or fee committees to review professionals’ applications, but the absence of any comprehensible standard by which to adjudge the reasonableness of fees remains; thus contracting out the responsibility not only does not solve the problem but adds still another layer of administrative professionals charging fees to the estate, simply to review the fees of other professionals. In the Enron case, for example, the judge appointed a fee examiner who was paid $300 per hour and who approved 95% of the fees and expenses requested in the case. See Robert Manor, Bankruptcy Won’t Come Cheap: Carrier Paying for Top Advisors, Chi. Trib., Dec. 17, 2002, at N1.
given matter. Because these limits were largely arbitrary, it was little wonder that they quickly broke down. In fact, judges appear to exercise little oversight of the details of fee allowances. LoPucki, with co-author Joseph Doherty, found that in cases concluded from 1998 to 2002, judges approved almost 98% of the amounts for which professionals applied, and Delaware judges approved more than 99%. Moreover, LoPucki describes a new forthcoming study that finds that professional fees in large public company bankruptcies increased by 47% from 1998 to 2003.

Third, professionals may encourage forum shopping with respect to the ethical and conflict of interest standards. Under § 327(a) of the Bankruptcy Code, a professional or attorney employed by the debtor must be a “disinterested person,” a concept defined in § 101(14) as requiring that the attorney “does not have an interest materially adverse to the interest of the estate,” a vague and highly fact-intensive standard. The effect of ethical standards on forum-shopping behavior may be larger than LoPucki or others have recognized. For instance, in the 1994 headline-grabbing In re The Leslie Fay Companies, Bankruptcy Judge Tina Brozman forced the law firm of Weil Gotshal to disgorge approximately $1 million in fees and expenses that it had been paid because of a failure to disclose an interest later determined to be materially adverse to the estate. At the time, Brozman’s sharp language and the substantial size of the penalty imposed were interpreted as a strong signal that New York’s bankruptcy court intended to “get tough” on conflicts of interest. This perception was reinforced a few years later in the In re Granite Partners case, where the court imposed sanctions and a substantial disallowance of fees for a failure to fully disclose relevant conflicts of interest.

Interestingly, LoPucki’s data on forum-shopping patterns suggests that the 1994–1996 period marks a clear breaking point in the forum-shopping wars, indicating a seismic shift from New York to Delaware as the bankruptcy capital. According to LoPucki, in 1993, five large cases were filed in Delaware and twenty-one filed elsewhere (mainly New York); in 1994, four in Delaware and seven elsewhere; in 1995, nine and eleven; and in 1996, thirteen in Delaware and just two elsewhere. LoPucki also notes that from 1991 to 1996, New York lawyers filed the vast majority of the cases that were filed in Delaware. In other words, beginning in 1994, New York lawyers were over-

167. See LoPucki, supra note 2, at 142.
169. See LoPucki, supra note 2, at 143; see also Lynn M. LoPucki & Joseph W. Doherty, The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases Revisited (July 17, 2005) (unpublished manuscript, on file with author).
173. LoPucki, supra note 2, at 90 fig.3.
whelmingly filing in Delaware rather than in their home state. The transition from New York to Delaware was not as gradual as might be expected—rather, there appears to have been a relatively clear break in filing trends from 1994 to 1996, shifting strongly from New York to Delaware. LoPucki does not appear to provide any precise explanation for the rapid nature of this transition. One possible explanation that might be considered in future research is the possible impact of the high-profile punishment administered in the *Leslie Fay* case on the willingness of New York attorneys, and Weil Gotshal in particular, to file in New York—especially if Delaware’s judges were perceived as being less strict on conflicts of interest and fees.

3. Prepacks

One of the more intensely-studied topics of the bankruptcy forum-shopping debate is the efficiency of so-called pre-packaged bankruptcies, or “prepacks,” an innovation that explains much of Delaware’s rise and helped to generate its status as the leading center for bankruptcy filings. A prepackaged bankruptcy has been described as “a hybrid of the options normally associated with financial distress: an out-of-court restructuring and a full-blown Chapter 11.” In a typical bankruptcy case, the debtor files bankruptcy and then proposes a plan of reorganization that it hopes will gain the consent of a sufficient number of creditors to confirm the plan. In a prepackaged bankruptcy, the debtor contacts creditors prior to filing bankruptcy, describes its proposed plan of reorganization, and requests the creditors’ support in an effort to secure a sufficient number of promised votes to confirm the plan in filing bankruptcy. The firm then files a bankruptcy petition and, at the same time, its plan of reorganization. Prepacks offer numerous potential advantages over traditional bankruptcy filings, including a relatively consensual process of reorganization, speed, and a dramatic reduction in expenses. Prepackaged filings have risen rapidly over time, and Delaware has dominated this competition. This combination of factors has led some to conclude that Delaware’s solicitude of prepackaged bankruptcies thus reflects good forum shopping, permitting reorganization of financially-troubled firms at minimal cost.

LoPucki disagrees. In a nutshell, he sees prepacks as an improper end-run around the salutary procedures of the Bankruptcy Code, which are designed to resolve financial distress in a public, transparent, judicially-supervised proceed-

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174. I do not know how many of those cases were filed by Weil Gotshal, the firm penalized in *In re The Leslie Fay Cos.*, but given its prominence, one suspects that the firm was involved in a substantial number of those cases.

175. Moreover, other districts reestablished themselves in 1997 and 1998, but in 1999 the balance tipped decidedly back to Delaware. This was, of course, the year immediately after *In re Granite Partners* was decided.

176. See LoPucki, supra note 2, at 161 tbl.10.

177. Rasmussen & Thomas, supra note 61, at 1374.

178. See id. at 1386, 1389; LoPucki, supra note 2, at 74.

179. See Rasmussen & Thomas, supra note 61, at 1387–89.
Prepacks, he fears, are too often used to short-circuit the procedures of the Code and to entrench management. He argues that permitting debtors to negotiate with creditors outside bankruptcy provides improper leverage to debtors that they would not have if the firm were reorganized inside bankruptcy, and the lack of transparency enables some creditors to benefit at the expense of other creditors and stakeholders. Unlike the consensual process of a prepack, LoPucki argues that bankruptcy law provides that the determination as to what creditors desire must be made “by an adversary process.” The reason, he argues, “is to protect the typically large majority of creditors who voted against the plan, voted for the plan without attempting to understand it, or did not participate in the voting at all.” Short-circuiting the Code’s procedures, he argues, thus leads to inferior vetting of the merits of the plan and its effects on creditors and other stakeholders. Moreover, LoPucki argues that this outcome leads to tangible harm, as evidenced by a higher failure rate for prepackaged bankruptcies as compared to traditional filings and greater losses by those companies that fail and must refile again.

Rasmussen and Thomas have expressed skepticism about LoPucki’s argument that prepackaged bankruptcies differ in any important substantive way from traditional bankruptcy filings. They suggest that what matters in a bankruptcy case is not the procedures imposed by bankruptcy courts but rather the bottom line—whether creditors have sufficient information to knowingly consent to a plan. They argue that creditors, as a group, are unlikely to consent to a prepackaged plan if they will be “shortchanged” as a result and are unlikely to consent to a plan whose primary beneficiary will be incumbent management. Thus, they argue, it is hard to see how prepackaged bankruptcies could be a reflection of agency costs rather than an efficiency-enhancing innovation. Instead, they suggest prepackaged bankruptcy filings, and the higher risk that they entail, evidence a rational tradeoff by creditors between the expected greater speed and lower cost of a prepackaged filing versus the reduced vetting and procedural safeguards provided by the Code.

The puzzle is that although Delaware took an early lead in prepacks, most other leading bankruptcy courts have come to accept prepacks as well and appear to have adopted Delaware’s procedures and deferential attitude toward them. Even if LoPucki is correct that prepacks are inefficient, it is unclear
whether the widespread judicial acceptance of prepacks results from improper judicial competition. In fact, Delaware’s prepacks are no speedier than prepacks in other courts, and rubber-stamping prepackaged bankruptcies requires no special skill by the court.\textsuperscript{187} The scrutiny afforded to prepacks in Delaware does not appear to be any different from elsewhere.

Moreover, given the routine nature of prepack cases, as with § 363 quick sales, it is hard to understand why judges would have the incentive to want to compete for prepackaged cases.\textsuperscript{188} These cases do not seem to provide the type of ego boost, fame, or inherent degree of interest that have been described as motives for why judges might want to compete for cases.\textsuperscript{189} Nor do they appear to be especially lucrative for local counsel, as most of the work is done prior to filing the case, leaving little role for bankruptcy and other local counsel in such cases.\textsuperscript{190}

As a result, the question of whether prepacks are efficient or inefficient does not address the underlying question of whether the resultant efficiency (or inefficiency) is the consequence of conscious court competition (LoPucki’s thesis) or simply a competitive experiment that may or may not eventually stand the test of time. Little research has been done that would help to answer that question.

B. INCENTIVES OF JUDGES TO COMPETE

The second factor in analyzing whether a competitive forum-shopping model will tend to produce “good” versus “bad” results is the incentives of judges to compete. As noted above, the incentive structure for decisionmakers in other forum-shopping models is clear and well-understood, even where the institutional structure is less clear. In the interjurisdictional competition of the Middle Ages, judges had a strong incentive to compete because they were paid in part or in whole from fees paid by the parties. In the competition of current judges in

\textsuperscript{187} See LoPucki, supra note 2, at 160.

\textsuperscript{188} The incentives of judges to engage in forum-shopping competition are discussed in the next section.

\textsuperscript{189} Indeed, from a judge’s individual perspective, prepackaged cases seem to only have the downside risk that the prepack might fall apart and spiral downward into a messy traditional case with little upside benefit. The collapse of a prepack is generally considered to be a failure for all involved, including the attorneys who constructed it and the judge who presided over it. On the other hand, even if the benefits are small, if they exceed the costs in terms of resources expended, it may still be rational for judges to compete for these cases. See Letter from Lynn LoPucki to author (Aug. 3, 2005) (on file with author). Moreover, given the high refiling rate of prepackaged cases, it is possible that competing for prepacks might actually be a way of buying an “option” on a later full-blown Chapter 11 filing if debtors that go through prepacks are more likely to later refile in the same court that presided over the prepack. Approximately 53% of prepack refilers choose the same court and 47% choose a different court.

\textsuperscript{190} The postpetition costs incurred in seeking court approval of a prepack appear to be trivial in comparison to the prepetition costs incurred in negotiating the prepack. See Lubben, supra note 158, at 515 (finding bankruptcy costs of prepacks as only 0.35% of assets, as compared to total costs of 1.85%–2.9% of assets, including pre-bankruptcy negotiation costs).
the liability explosion, elected judges—especially those elected in partisan elections—have an incentive to redistribute wealth from out-of-state interests—especially “deep pockets”—to in-state plaintiffs. Appointed judges, by contrast, do not appear to have these incentives and thus seem to act differently, notwithstanding the otherwise identical institutional constraints, such as the substantive law they apply, confronting them. The potential problem that arises with appointed state judges is that their independence will enable them to pursue their own private interests, such as using the power of their position to impose their ideological preferences on society. Finally, although the institutional structure of the competition for corporate charters is ambiguous, the incentive structure is clear—whether it is managers, shareholders, or professional interest groups to which the Delaware legislature is responding, Delaware’s heavy dependence on tax revenues generated by its dominance in the corporate chartering business makes the legislature extremely responsive to the demands of the relevant decisionmaking group. Thus, here too, Delaware has strong financial incentives to compete for corporate-chartering business.

The incentive for bankruptcy judges to compete for Chapter 11 cases is unclear. Formally, federal bankruptcy judges are selected by the circuit judges who preside over the district in which the court sits. They serve fourteen-year terms, which can be renewed. Relatively few judges seek to serve more than fourteen years, in part because if they leave office after even a single fourteen-year term, they receive a full federal pension. It appears that in most cases, bankruptcy judges who seek a second term usually have their request granted. Some bankruptcy judges have been promoted to positions as federal district or circuit court judges, but it is unlikely that this possibility motivates more than a small number of bankruptcy judges, and even if so, it is difficult to see how this would encourage those judges to engage in forum-shopping competition. In general, therefore, it is doubtful that the reappointment exerts a large influence on the incentives of bankruptcy judges. Thus, the best model may be that of an independent judge, which is a model that does not obviously manifest itself in forum-shopping competition. Richard Posner argues that independent judges are

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191. See supra notes 76–78 and accompanying text.
192. Adler and Butler note, “Unlike Delaware’s interest in corporate charters, from which Delaware earns significant tax revenue, the benefit to Delaware from bankruptcy filings is limited primarily to professional compensation, in fees and prestige, of the bar and bench.” Adler & Butler, supra note 12, at 1322. Adler and Butler argue that the narrowness of the special interests to which bankruptcy forum-shopping appeals makes it more expensive to cater to this constituency as opposed to the more broad-based constituency for corporate chartering tax revenues. Id.
194. One study concludes that approximately 8% of bankruptcy judges who applied for reappointment during the 1998–2002 period were not reappointed. See LoPucki, supra note 2, at 21 (citing Stan Bernstein, The Reappointment of Bankruptcy Judges: A Preliminary Analysis of the Present Process (unpublished manuscript)).
motivated by goals such as leisure, prestige, personal satisfaction, and the desire to impose their personal preferences on society. Because good and bad judges, conscientious and lazy judges all earn the same salary, Posner argues that if judges are motivated to do a good job, and especially to voluntarily take on more work, it must be because of this desire for prestige or personal satisfaction. The idea that judges may compete for large cases is counterintuitive in that attracting such cases means more work and stress for the judge (and foregone leisure) with no corresponding increase in pay. Although some judges may be motivated by the desire to impose their ideological worldview on society, this seems a highly unlikely motivation for a bankruptcy judge, at least with respect to Chapter 11 cases (although perhaps more plausible for consumer bankruptcy cases).

What then are the incentives and motivations of bankruptcy judges that supposedly lead them—at least in Delaware—to compete for cases? LoPucki advances a variety of factors that might explain why bankruptcy judges actively compete for large cases, even going so far as to bend the law and procedure in order to compete for cases. One of these factors includes the power and status that comes with being at the center of a large bankruptcy case, with all of its trappings of highly-paid, prestigious professionals. Presiding over big cases will also give the judge a degree of celebrity, especially in the bar. It will also likely improve the judge’s prospects for post-judicial employment and a higher salary in a law firm after leaving the bench.

Finally, LoPucki argues that the main reason that judges compete for big cases is because of norms and peer pressure of the local community of lawyers and bankruptcy professionals who benefit from these cases, causing judges to seek these large cases:

The most important reasons that the judges want the big cases, however, are more subtle. Each bankruptcy judge is a member of a community. In any large city in the United States, there are 100 or more lawyers and other professionals specializing in bankruptcy practice. Those professionals interact daily as they resolve cases in the local bankruptcy court. The professionals in a city typically form an association that meets regularly for lunch and occasionally for multiday conferences. Many of the members become close friends.

Marcus Cole provides a similar explanation of the incentives that spur Delaware’s judiciary to compete. Cole argues that the behavior of Delaware’s judges can be modeled as a form of “professional competition”—a race be-

197. See LoPucki, supra note 2, at 20.
198. Id. at 127.
199. Id. at 20.
tween professionals to perform their service effectively and efficiently, without regard to tangible rewards or compensation for their superior service.”

Cole argues that Delaware’s legal environment is characterized by “a culture of service” or “service and responsiveness” that applies equally in areas such as corporate law and bankruptcy law. As a result, “lawyers and judges in Delaware... provide service that is hard to find anywhere else.” Delaware then “puts its culture to work, aligning the interests of the professional judges with those of the community.”

Echoing LoPucki, Cole notes that Wilmington is a small community, thereby enabling lawyers to exercise the type of peer pressure on judges that LoPucki describes. Indeed, at one point Judge Walrath, a non-Wilmingtonian, was appointed to the Delaware bench specifically to try to rid the Delaware bankruptcy bar of this coziness, but he was soon assimilated into the local norms.

While each of these explanations is plausible, none of them is wholly persuasive. Whereas other forum-shopping models specify relatively clear incentives to engage in forum shopping, the models that have been put forth to explain the willingness of Delaware judges to encourage the forum-shopping race appear to be post hoc explanations rather than providing an ex ante predictive model. Whatever the motivations of Delaware’s judges, the question arises as to why those motivations are unique to Delaware’s judges and their willingness to compete for big cases. LoPucki notes, for instance, that in contrast to Delaware, Boston bankruptcy judges refused pleas by Boston bankruptcy attorneys to be more aggressive in competing for cases. Yet it is hard to imagine that Boston judges are less “professional,” conscientious, or self-aggrandizing than Delaware judges, or that their bankruptcy bars are substantially less close-knit than Delaware’s. In short, explanations grounded in unobservable judicial tastes or preferences seem to quickly collapse into ex post explanations for what is observed, rather than ex ante theories subject to generating robust predictions and hypothesis testing. Whatever the motives or incentives of Delaware’s judges, one would expect that these motives or incentives would play out predictably across all other judges around the country, rather than being unique to Delaware.

One distinction between Delaware and other courts may be the small size of
the Delaware bench, which may make possible the development and maintenance of robust social norms. As LoPucki stresses, during the period of the “rise of Delaware” the court had only one bankruptcy judge, Helen Balick.211 When the bench was expanded to two judges, both judges adopted the same basic judging style, practice, and substantive approach to bankruptcy law. As noted above, even when Balick retired from the bench, her replacement (Judge Walrath) was soon assimilated into the “Delaware way” of doing things. One possible explanation for Delaware’s distinctiveness, therefore, may be that the small size of the Delaware bench in comparison to larger jurisdictions, which may solve the collective action problems typically associated with norm creation and enforcement. As LoPucki and others have noted, much of Delaware’s early rise has to do with the “predictability” that was offered first by Balick as the sole judge and later by two judges with very similar views.212 Even if most judges on a given court think alike, larger benches are more likely to have a distribution of views; thus smaller, more homogeneous benches may be preferred.213 The important component of the size and, hence, predictability of the local culture may overcome the seemingly ex post explanatory nature of the “distinctive Delaware culture” theory and turn it into a more scientific predictive theory of judicial incentives. Nonetheless, this still does not necessarily distinguish Delaware from other small bankruptcy benches, although the combination of small size along with other factors (such as Delaware’s prominence in corporate law)214 might.

Even if we assume that Delaware’s judiciary has a distinctive local culture of responsiveness and professionalism, this alone does not resolve the underlying question of whether Delaware’s bankruptcy judges will engage in “good” or “bad” forum shopping. Indeed, LoPucki and Cole observe essentially the same phenomenon and come to radically opposite interpretations. LoPucki argues essentially that the evidence shows an improper responsiveness and incentive to satisfy Delaware professionals and their narrow economic self-interest, while Cole argues that the same behavior shows a commitment to excellence, professionalism, and reputation that transcends the narrow economic self-interest of the professionals themselves. It is difficult to disentangle the two explanations. Moreover, it remains unclear why either theory produces results seemingly unique to explaining the behavior of Delaware’s judges but not others.

On the whole, the incentives of bankruptcy judges in general, and Delaware’s bankruptcy judges in particular, remain ambiguous. As a result, given the institutional constraints that they face, it is not clear whether incentives they

211. LoPucki, supra note 2, at 72.
212. Id. at 133.
213. In a similar vein, recall that for some period of time Oklahoma City, another small bench, was the second most popular venue for large Chapter 11 cases, ahead of such natural rivals as Dallas and Denver.
214. See generally Skeel, supra note 17 (arguing that there is a natural synergy between Delaware’s corporate law and bankruptcy reorganization).
confront tend to lead to a degenerative forum-shopping competition as LoPucki predicts or a “race to the top” as Cole predicts.

IV. REFORMS

Assuming that LoPucki is correct in his conclusion that forum shopping and competition for big cases is “corrupting” the American bankruptcy system, what, if anything, should be done about it? In dealing with a system grounded in competition, there are two different types of regulatory approaches that are available to try to steer the competitive process toward a welfare-enhancing result rather than a negative result. The first approach is procedural. This approach focuses on the structure and nature of the competitive process to ensure that it tends toward the promotion of positive outcomes, such as rules permitting freedom of contract but requiring certain disclosures. The idea is that if the process of free competition is preserved, then the results of the competitive process will tend toward welfare-enhancing results. The provisions of the Class Action Fairness Act of 2005 that provide for federal jurisdiction over certain diversity cases can be seen as procedural regulations that leave undisturbed the substantive law to be applied (under *Erie*) but change the venue for certain actions.

The second form of regulation is substantive regulation, which essentially places certain possible market outcomes off limits and prevents those outcomes from being adopted. These substantive limitations may be imposed either for external moral reasons, or alternatively, because certain outcomes are thought to be presumptively or irrebuttable evidence of a market failure. Substantive regulations leave the process of competition largely unaffected, intervening only if the process generates a prohibited outcome.

Either of these two basic approaches, procedural reforms and substantive regulation, could mitigate the ills of forum shopping. LoPucki’s proposed reforms are primarily procedural; as will be discussed, it may be that substantive reforms will provide a more productive response to the problem.

A. PROCEDURAL TOOLS

Under current law, forum shopping is regulated primarily by the authority of a court to transfer a case that is filed in an “improper” court to a “proper” court. Under 28 U.S.C. § 1412, a court may transfer venue if the transfer is “in the interest of justice or for the convenience of the parties.” As LoPucki notes, parties rarely request transfer of a case and when they do, courts rarely order transfer. As LoPucki notes, once a case is filed in a given court, it “quickly grows roots there” as the judge familiarizes herself with the case in its early

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218. See LoPucki, *supra* note 2, at 38.
days, and the professionals involved in the case are hired and begin work.\footnote{See id.} A motion to transfer venue probably cannot be decided until several weeks or months into the case. If LoPucki is correct that judges will bend the law to engage in forum-shopping competition, they will be unlikely to rigorously apply the rules governing transfer of cases. As a result, the case may be fairly well along by the time the motion can be heard and ruled upon, and transferring venue at that point will likely be highly disruptive to the case.

The effort of interested parties to transfer venue in the Enron case is illustrative.\footnote{See In re Enron Corp., 274 B.R. 327 (Bankr. S.D.N.Y. 2002).} Numerous parties filed motions to transfer venue in the case from New York to Houston, including the Attorney General of Texas.\footnote{At the time, the Attorney General of Texas was John Cornyn, who is now Senator from Texas and sponsor of the federal legislation to restrict bankruptcy venue-shopping.} The court refused to transfer venue for the convenience of the parties on the ground that many of the major parties in the case (bankers and professionals) were located in New York and that non-New York parties could participate without physical appearance by telephone or video conferencing. The court also noted that venuing the case in the location of its physical assets may be important in a Chapter 7 liquidation case but not in a Chapter 11 reorganization.\footnote{In re Enron, 274 B.R. at 347–48.} Finally, the court held that venue transfer was not supported in the “interest of justice.” “Interest of justice” was not an independent analysis from the convenience of the parties, but “the considerations involved with the interest of justice are intertwined with the economic and efficient administration of the estate.”\footnote{Id. at 349.}

In addition, the court noted that to determine whether it was proper to transfer venue, it is necessary to consider the “learning curve” associated with the case, i.e., “the time and effort spent by the current judge and the corresponding effect on the bankruptcy case in transferring venue.”\footnote{Id.} The court noted that it had “gained familiarity” with the issues in the case, ruled on several important motions, and handled many of the emergency issues that had already arisen in the case. Indeed, the court even noted that the emergency nature of these motions meant that they needed to take priority over any motion to transfer venue. The court writes:

Thus, although the Movants filed a timely request for the transfer of venue, diverting the Debtors’ and Committee’s attention to the motion for transfer of venue would have been counterproductive to the needs and interests of these cases during the initial stages of these cases . . . . Thus, while the Movants were not dilatory, the necessities of this case resulted in an accrual of knowledge by the Court.\footnote{Id. at 350.}
In short, the court established a standard for ordering transfer that is almost impossible to meet and is rife with contradictions, such as the seeming Catch-22 of treating a venue transfer motion as a non-emergency motion while using the need to rule on emergency motions (and the “learning curve” effect associated with such rulings) as a rationale for denying the postponed ruling on venue transfer.

The recent bankruptcy filing of Winn-Dixie illustrates the current approach of judges to limit improper forum shopping. In Winn-Dixie, the debtor formed a brand new subsidiary to establish venue in New York, and later acquired the assets of a defunct company in order to try to sustain venue there. Even under these extreme facts, the New York bankruptcy court still believed it to be a “close case” as to whether to order transfer of venue in the interests of justice but finally decided that the formation of the New York subsidiary with no economic substance, and simply to establish venue, was sufficiently improper to mandate transfer.

LoPucki thus argues that current law provides insufficient procedural tools for restricting bad forum shopping in bankruptcy. Nonetheless, his proposed responses to the problem are also predominantly procedural rather than substantive. For instance, he suggests adopting the recommendation of the National Bankruptcy Review Commission, which would eliminate the debtor’s place of incorporation from the list of proper venues and require mandatory transfer of misfiled cases to the proper venue. He would also eliminate the “venue hook” that permits a parent company to file in the court where the bankruptcy of a subsidiary is pending and permit members of a corporate group to reorganize together only at the location of the parent company or the group. The result of these changes, he notes, would be to “effectively require a company to file its bankruptcy at the location of the company’s headquarters or principal assets.” He admits, however, that companies could still “move their headquarters or principal assets to the district in which they chose to file. That means some shopping could continue, enabling companies to escape particularly bad courts. But,” he adds, “such shoppers would not exist in sufficient numbers to corrupt courts that hoped to attract them.”

The problem with imposing a limit of this sort on proper venue for bankruptcy filing is that even if it eliminates bad forum shopping, it has the negative

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227. One justification given by the Court was the adoption of electronic case filing, which substantially reduces the cost of transferring the case to a new court. See Winn-Dixie Transcript, supra note 123, at 160.

228. See LOPUCKI, supra note 2, at 252.

229. Id.

230. Id.

231. Id.
effect of also eliminating good forum shopping and thereby also eliminating the information that is produced through the competitive process of court choice. \(^{232}\) Indeed, LoPucki recognizes this:

> One problem with requiring companies to file in their local bankruptcy courts is that few of those local courts would have much expertise in the reorganization of large public companies. To put the same point another way, the big-case expertise of the American bankruptcy courts would be spread among so many judges that few or none could develop substantial expertise. \(^{233}\)

Given the value of expertise and resources in processing these large, complicated cases, this is likely to be a substantial loss to the bankruptcy system.

Nor is this rule likely to be that effective in preventing bad forum shopping. LoPucki acknowledges that some forum shopping will continue but seems to believe that the remaining forum shopping will be largely benign in that it will be predominantly by firms seeking to “escape particularly bad courts.” \(^{234}\) He provides little explanation for this assertion, and, in fact, this optimism seems unwarranted. Instead, if his model is correct, then forum shopping will continue by those who have the most to gain from forum-shopping into a different court, rather than those who have the most to lose by staying at home. If it is true, for instance, that large firms were forum-shopping into New York to receive soft treatment for corporate executives, it seems unlikely that this sort of forum shopping would be deterred by LoPucki’s proposed new regime. Moreover, given the cost associated with relocating corporate headquarters, it may be that those who relocate prior to filing bankruptcy may simply be those that can most easily afford it rather than those who would benefit most from exiting the home district.

Given the expertise problem that LoPucki himself acknowledges, he suggests an alternative possible solution to the problem of forum shopping: the establishment of “specialized bankruptcy courts at three or four locations in the United States to handle only the largest cases.” \(^{235}\) Each of the specialized courts would serve a specified territory for all cases properly arising under its jurisdiction.

While this proposal would eliminate the problems of forum shopping, it would also eliminate the benefits of decentralization and competition by replacing the current process with several regional monopolies. If there are actually benefits that flow from some degree of interjurisdictional competition, such as valuable feedback and innovation, then replacing competition with monopoly will negatively stifle this competition and the innovation that it generates. To the extent that current rules are the result of error rather than improper court

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232. It would also do nothing about the “reverse forum shopping” by firms that remain at home in order to impose community pressure on the judge to reorganize the company.
233. LoPucki, supra note 2, at 252–53.
234. Id. at 252.
235. Id. at 253.
competition, the costs of creating such a monopoly or oligopoly might well exceed the benefits of eliminating court competition. Both proposals also face formidable political difficulties, namely the opposition of Delaware’s United States Senators, who have opposed every effort to prohibit forum-shopping into Delaware because of the potential impact it would have on major Delaware interest groups.236

B. SUBSTANTIVE LIMITS: EFFECTS OF BANKRUPTCY REFORM LEGISLATION

Alternatively, rather than limiting forum shopping directly, one could alter the incentives to engage in forum shopping through substantive changes to the bankruptcy code that restrain the ability of courts to compete on “bad” terms and encourage courts instead to compete on “good” terms.237 Where there is competition in legal markets, it is quite common for regulators to put certain results out-of-reach of the competitive process, as evidenced by constitutionally imposed protections for personal liberties that states cannot infringe upon and certain limits on “extreme” choice-of-law contractual provisions.238 Although LoPucki spends little time discussing substantive regulation as one means for limiting the ills of forum shopping, the limitations of procedural responses make it worth considering whether substantive regulations are appropriate. Moreover, unlike the political problems associated with trying to directly limit forum-shopping into Delaware, the recently-enacted bankruptcy reform legislation includes numerous provisions that regulate many of the forum shopping outcomes about which LoPucki is most concerned. LoPucki makes little mention of BAPCPA239 in the book240 except to criticize the provisions in the

236. At the hearing described at the outset, Delaware Senator Joseph Biden testily challenged Senator Cornyn immediately after Cornyn questioned me and the other panelists about his proposed legislation.

237. This is a conventional approach to regulation in markets. Thus, for instance, competition on the basis of certain types of product warranties or liability disclaimers are prohibited or heavily limited by tort and contract law protecting consumers. So, for instance, manufacturers of unreasonably dangerous products are not permitted to compete on the basis of liability disclaimers for proper operation of a product, even if such disclaimers would lead to a lower price or the opportunity to provide alternative benefits instead. See Henningsen v. Bloomfield Motors, Inc., 161 A.2d 69 (N.J. 1960). Similarly, usury laws prohibit charging interest rates above a certain statutory cap. Whether these substantive regulations are appropriate as a policy matter is a different question.


240. In part, this failure to discuss BAPCPA in more detail may merely reflect the uncertain prospects of the legislation at the time the book was written. LoPucki writes that the legislation was “unpopular” and in order to “increase support for the omnibus bill among reluctant rank and file members of Congress, congressional leaders were forcing any popular piece of legislation related to bankruptcy to be included in the omnibus bill,” including the bill to add more bankruptcy judgeships. See LoPucki, supra note 2, at 130. In fact, the provisions to add more judges were part of the larger BAPCPA from the beginning of the process. Moreover, the legislation itself was actually quite popular and passage was frustrated by efforts of congressional leaders seeking to attach unrelated and more controversial legislation to the bankruptcy bill, such as abortion-related regulations, rather than the other way around. The legislation consistently drew support from over 70% of both houses of Congress.
legislation that will increase the number of bankruptcy judges in Delaware. But BAPCPA amends the code in several ways that will alleviate many of the excesses of the current system that LoPucki attributes to runaway forum-shopping competition. These include such elements of bankruptcy practice as the willingness of judges to extend the exclusivity period for the debtor to file a plan of reorganization, generous protections for corporate executives accused of involvement in malfeasance (such as unlimited homestead protections and asset protection trusts), and critical vendor orders.

The “exclusivity period” is the statutory period provided by the Code, which provides that during the first 120 days of the case, the debtor in possession retains the exclusive right to file a plan of reorganization, and no other party in the case (including the creditors) is permitted to propose an alternative plan. Under § 1121(d), the court may extend the exclusivity “period” for cause beyond the 120 days if it believes that the debtor needs more time to propose a plan. In practice, judges will often extend the exclusivity period indefinitely, even for years in some cases. So long as the debtor in possession remains the only party that can propose a plan of reorganization, its management can remain in place and it need not commence payment on its debts, thereby giving it leverage over creditors in plan negotiations. LoPucki finds that during the period of New York’s prominence as a forum-shopping target, New York’s judges were significantly more likely to extend the exclusivity period than other courts.

BAPCPA imposes new limits on extreme and open-ended extensions of the exclusivity period during the entire period it was under consideration. See Todd J. Zywicki, The Past, Present, and Future of Bankruptcy Law in America, 101 Mich. L. Rev. 2016 (2003); Todd J. Zywicki, Credit Worthy, Nat’l Rev. Online, Mar. 16, 2005, http://www.nationalreview.com/comment/zywicki200503160744.asp. LoPucki’s argument against expanding the size of the Delaware Bankruptcy Court seems to be that this would give it an even greater capacity to compete for cases by eliminating the capacity constraint on its ability to hear and process cases. This is a curious argument in that it suggests that the way to deal with forum shopping is to ration access to the Delaware court regardless of whether the court may have the greatest expertise in a given case. To the extent that the Delaware bench expands in size, its predictability and uniformity may be reduced; thus, expanding the size of the court may have a natural offsetting effect of restraining the very forum-shopping competition he is concerned about.

241. See LoPucki, supra note 2, at 245–49. LoPucki’s argument against expanding the size of the Delaware Bankruptcy Court seems to be that this would give it an even greater capacity to compete for cases by eliminating the capacity constraint on its ability to hear and process cases. This is a curious argument in that it suggests that the way to deal with forum shopping is to ration access to the Delaware court regardless of whether the court may have the greatest expertise in a given case. To the extent that the Delaware bench expands in size, its predictability and uniformity may be reduced; thus, expanding the size of the court may have a natural offsetting effect of restraining the very forum-shopping competition he is concerned about.

242. 11 U.S.C.A. § 1121(b) (West Supp. 2005). If the debtor’s plan is not confirmed within 180 days of filing, creditors may file their own plan. Id. § 1121(c)(3).

243. Id. § 1121(d).

244. As LoPucki observes, “As long as the court continues to grant extensions of exclusivity, what happens in the absence of agreement is that the debtor remains in bankruptcy and continues to pay nothing to its creditors. The creditors cannot move the case forward because the creditors cannot propose a plan.” LoPucki, supra note 2, at 41.

245. See id. David Skeel has argued that if Delaware’s courts are speedier at confirming plans than other courts, then it is not clear how important the willingness to extend exclusivity is to court competition. See Skeel, supra note 17, at 327. Skeel further argues that managers are more likely to keep their jobs in a speedy reorganization, rather than a protracted one, especially in a prepackaged bankruptcy. On the other hand, a court’s willingness to extend the exclusivity period may be relevant at the margin in a case where the debtor does in fact seek an extension, and on this count Delaware is comparable to other courts.
exclusivity period, by imposing an outer limit of eighteen months on extensions of exclusivity for cause.\textsuperscript{246} Although LoPucki’s argument might support strict limitations on exclusivity, this outer limit should rein in the most egregious cases of long exclusivity extensions. Moreover, the bill imposes even stricter exclusivity time limits on small business bankruptcies, which are perceived to be cases most prone to extended exclusivity periods due to minimal creditor involvement and oversight.\textsuperscript{247} This will force debtors to propose a plan and courts to confirm them (or convert the case) within a relatively short time after filing, thereby generating timely distributions to creditors.

LoPucki also criticizes provisions of bankruptcy law that he sees as promoting forum shopping by wealthy individuals. For instance, he criticizes states that permit wealthy corporate executives to abuse state unlimited homestead exemptions to “stash[] the loot in a place from which even judgment creditors couldn’t get it back.”\textsuperscript{248} He provides the example of the three prime suspects in the \textit{Enron} case, who started building new multimillion dollar homes in a tony Houston neighborhood around the time they could have reasonably been expected to be sued.\textsuperscript{249} Under Texas’s homestead law, they may be able to protect their expensive homes from claims of creditors in securities fraud and other lawsuits. The reform legislation shuts this loophole. First, the reformed Code expressly places a new cap on the assertion of a homestead exemption against any claim arising from the violation of the securities law or other felony.\textsuperscript{250} Moreover, the Code expressly adds a ten-year statute of limitations to challenge any acquisition of a homestead exemption with intent to hinder, delay, or defraud a creditor.\textsuperscript{251} Finally, the Code places a cap on the ability to increase the amount of property protected by a homestead exemption in the forty months following the filing of the bankruptcy petition.


\textsuperscript{247} See \textit{id.} § 1121(e).

\textsuperscript{248} LoPUCKI, \textit{supra} note 2, at 149. He also criticizes the ability of wealthy individuals to protect property using self-settled “asset protection trusts” as a “haven” activity in which Delaware participates. \textit{Id.} at 55. In practice, however, these trusts appear to be unenforceable in bankruptcy against creditors under current fraudulent transfer law. See Posting of Todd J. Zywicki to The Volokh Conspiracy, \textit{Bankruptcy Reform, The New York Times, and Real v. Hypothetical Homestead Abuse}, http://volokh.com/archives/archive_2005_03_27-2005_04_02.shtml (Apr. 1, 2005, 7:48 EST); see also Melanie Leslie, \textit{Asset Protection Trusts Find a Home in the United States}, N.Y.L.J., Feb. 14, 2005, at S1. Nonetheless, the legislation adds a new § 548(e), which creates under the Bankruptcy Code a ten-year reachback period to avoid the transfer of any property to a “self-settled trust or similar device,” where the transfer was intended to avoid having the assets seized for violation of the securities laws. 11 U.S.C.A. § 548(o)(1)(A) (West Supp. 2005). The amendment seems to be aimed at addressing the hypothetical abuse that a corporate manager involved in securities fraud litigation (such as Kenneth Lay or Scott Sullivan) could not establish a self-settled trust to protect assets. I have located no cases that uphold the validity of such a trust against creditors.

\textsuperscript{249} Even under pre-reform law, a bankruptcy court may have had the power to either disallow the exemption or deny the debtor’s discharge if it was determined that the homestead was acquired with fraudulent intent, but any ambiguity is resolved by the reform legislation.


\textsuperscript{251} \textit{Id.} § 522(o).
prior to bankruptcy. In other words, the revisions to the Code appear to address the abuse that LoPucki is specifically concerned about, namely the use of homestead exemptions to engage in fraud and abuse by loading up the value of the homestead exemption.

LoPucki also criticizes the development of so-called “critical vendor payments.” “Critical vendors” are suppliers that a debtor “cannot replace or can replace only at great expense,” but which may be reluctant to deal with the debtor following the bankruptcy case if the critical vendor has an outstanding prepetition claim. Some courts approved critical vendor payments, which would permit these critical vendors to have their prepetition claims paid in full so as to induce them to deal with the debtor postpetition. Traditionally, LoPucki notes, bankruptcy courts were skeptical about these claims by particular creditors to gain more than their pro rata share as unsecured creditors and often held that the refusal to deal postpetition because of outstanding prepetition debt violated an automatic stay. In general, critical vendor orders are found in cases involving retailers and manufacturers that depend on dealing with many suppliers for inventory and parts.

In the 1990s, the Delaware bankruptcy court began authorizing “critical vendor” payments to certain important prepetition creditors. As LoPucki notes, this created an endogeneity problem, as an increasing number of creditors demanded that they be included on the critical vendor list as a condition for continuing to deal with the debtor postpetition. In turn, debtors were drawn to filing in courts that would approve critical vendor orders in order to avoid the real risk that a truly critical vendor might in fact make good on its threat to terminate postpetition sales if it were not afforded critical vendor status. LoPucki argues that this ratchet effect toward greater allowance of critical vendor orders was thus the result of forum-shopping behavior, as debtors who wanted to pacify truly critical vendors would self-select for those courts that took a tolerant attitude towards them.

Again, leaving aside LoPucki’s conclusion that this problem can be traced to improper court competition, the recent bankruptcy code reforms will do much to mitigate improper competition on critical vendor orders by establishing rules for the treatment of creditors who ship goods to the debtor in the period preceding bankruptcy. Section 503(b)(9), for instance, creates an automatic administrative expense priority for any goods received by the debtor within

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252. Id. § 522(p).
253. LoPucki, supra note 2, at 163.
254. See id. at 163–64.
255. See id. at 164–65.
256. In the Kmart case, for instance, Chicago’s bankruptcy judge authorized $200–$300 million to be paid out to critical vendors, each of whom received 100 cents on the dollar for their outstanding claims. The order was later reversed by the Seventh Circuit, which held that the bankruptcy court’s order was an excessive deviation from the Code. See In re Kmart Corp., 359 F.3d 866 (7th Cir. 2004). Other unsecured creditors received ten cents on the dollar, mostly in stock of the reorganized Kmart. Id. at 869.
twenty days of the filing of the case so long as they were sold in the ordinary course of the debtor's business.257 Although the substantive merits of these reforms are open to question, the enactment of a bright-line rule will eliminate much of the forum-shopping problem by imposing a uniform rule for all creditors that supply goods within twenty days for the bankruptcy filing.258 The reforms also codify the reclamation rights of creditors, providing a right to reclamation if the goods are received by an insolvent debtor within forty-five days of bankruptcy.259 While there may still be claims that fall outside these statutory provisions, the scope of critical vendor orders has been substantially narrowed.

LoPucki also criticizes the practice of awarding “retention bonuses” to incumbent management to induce them to remain at a failed firm during the time the firm is going through bankruptcy.260 Retention bonuses were traditionally paid to employees in short supply, such as airline pilots or nurses, or to employees whose jobs were to be terminated at some fixed date in the future, in order to encourage them to stay with the company until that time.261 Over time, the concept was stretched to make the payment of retention bonuses a routine part of many Chapter 11 cases, with the largest and most frequent bonuses being awarded to incumbent management. As LoPucki notes, the need for these bonuses was peculiar, as there is little evidence in either the abstract or in particular cases that managers of failed enterprises have other employment alternatives, such that the payment of retention bonuses is necessary.262 Moreover, LoPucki finds that bankrupt companies that replace old management do better in bankruptcy than those that do not, raising doubts about the wisdom of undertaking extraordinary measures to try to retain incumbent management in the first place.263 LoPucki argues that to the extent that managers influence the decision of where to file bankruptcy, the willingness of a particular court to award retention bonuses to retain management will be a relevant margin on which managers will forum-shop, and therefore, on which bankruptcy courts will compete for business.

BAPCPA substantially restricts the ability of bankruptcy courts to award

258. See id.
259. Id. § 546(c)(1). In the alternative, the creditor that does not request reclamation is automatically entitled to administrative priority under the terms of amended § 503(b)(9). Id. § 546(c)(2)(A).
260. See LoPucki, supra note 2, at 151–56.
261. Id. at 152.
262. See id. at 151–52 (citing Stuart C. Gilson, Management Turnover and Financial Distress, 25 J. Fin. Econ. 241 (1989)). Other scholars have defended retention bonuses as appropriate in some instances and have even argued that they may be favored by creditors. See Douglas G. Baird & Robert K. Rasmussen, The End of Bankruptcy, 55 Stan. L. Rev. 751, 775–76 (2002); David A. Skeel, Jr., Creditors’ Ball: The “New” New Corporate Governance in Chapter 11, 152 U. Pa. L. Rev. 917, 927–28 (2003); David A. Skeel, Jr., Employees, Pensions, and Governance in Chapter 11, 82 Wash. U. L.Q. 1469, 1474–75 (2004).
263. See LoPucki, supra note 2, at 156. LoPucki states that “the data indicate[]” this, but he does not provide any further citation or supporting information. Id.
retention bonuses to incumbent management. Under BAPCPA, a bankrupt employer may award a retention bonus only if it is essential to retain the “insider” employee, because the employee has and will accept a “bona fide job offer” from another business at the same or greater salary and because the continued services of the employee are essential to the survival of the business. In addition, the amount of the retention bonus may not exceed ten times the amount of similar payments made to nonmanagement employees during the year, or if no such payments were made, may not exceed 25% of the amount of any similar payment made to the insider for any purpose during the previous calendar year.

Other substantive regulations may be brought about through judicial interpretations of the existing Code, rather than through statutory amendment. For instance, LoPucki notes the misuse of the “venue hook” in cases such as Enron, Eastern Airlines, and LTV Corp. to forum-shop cases into New York’s bankruptcy court by filing the case of a subsidiary there and then sweeping in the larger entity through the affiliate rules. As LoPucki notes, in these notorious cases, it appears that the subsidiary that provided the initial venue hook may not have been insolvent at the time the bankruptcy was filed. Requiring insolvency as a precondition for filing bankruptcy would remove this venue hook.

On the other hand, courts have been reluctant to interpose an insolvency requirement as a precondition to filing out of fear that this would chill early and timely resolution of financial distress by troubled debtors, such as Manville and Texaco, which were not insolvent at the time of filing but were clearly headed toward insolvency. As a result, courts have been reluctant to tie Congress’s hands by requiring insolvency but instead have policed good faith and insolvency on a case-by-case basis. Although courts generally have not required insolvency as a condition for filing bankruptcy, there is a strong case to be made that the Bankruptcy Clause of the Constitution requires insolvency as a condition for bankruptcy and that perhaps the Code should require insolvency as a condition for filing bankruptcy.

Each of these reforms will tend to ameliorate the problem of forum shopping, albeit not directly by limiting venue (as LoPucki advocates), but instead by

265. See id. § 503(c)(1)(B).
266. Id. § 503(c)(1)(C).
267. See LoPucki, supra note 2, at 36–37.
269. See U.S. Const. art. I, § 8, cl. 4.
creating new substantive limits on forum-shopping competition which will reduce the incentives for judges and debtors to engage in forum shopping by constraining some of the primary margins on which forum shopping occurs.

**CONCLUSION**

In *Courting Failure*, Lynn LoPucki has nailed his ninety-nine theses to the door of Delaware’s bankruptcy courthouse, blaming many of the ills of the current bankruptcy system on improper forum-shopping competition. He makes a powerful case supported by volumes of important and original empirical research. Many of the provisions included in the recently-enacted bankruptcy reform legislation address some of LoPucki’s concerns; others remain unaffected. In the meantime, the jury remains out on the validity of his thesis, but with this book, LoPucki frames the future terms of debate.