REPLY

CHAPTER 11 AT TWILIGHT

Douglas G. Baird* & Robert K. Rasmussen**

INTRODUCTION

The traditional account of corporate reorganizations assumes a financially distressed business faces three conditions simultaneously: (1) It has substantial value as a going concern; (2) its investors cannot sort out the financial distress through ordinary bargaining and instead require Chapter 11's collective forum;

---

* Harry A. Bigelow Distinguished Service Professor, University of Chicago Law School.

** Professor of Law and Associate Dean, Vanderbilt Law School. First, we wish to thank Lynn LoPucki. In addition to posing a number of interesting questions that have required us to sharpen our own ideas, he has, with characteristic graciousness, helped us use the Bankruptcy Research Database (BRD). This large database of Chapter 11 reorganizations is one that LoPucki has assembled painstakingly over the course of many years, a database that has already yielded rich insights. The June 2003 BRD is our starting place throughout this Reply. All the aggregate figures we give can be replicated using it. We note explicitly anytime we code a particular case differently.

We also thank Ron Mann, John Pottow, and Bob Thompson for comments on an earlier draft. We thank Bethany Hollister for research assistance, and, for research support, we are indebted to the Dean's Fund at Vanderbilt as well as the John M. Olin Law and Economics Program at the University of Chicago Law School. The latter is supported in part by Visa, U.S.A., Inc., Verizon, Microsoft Corporation, the Sarah Scaife Foundation, and the Lynde and Harry Bradley Foundation.

and (3) the business cannot be readily sold in the market as a going concern. Remove any one of these conditions, and the standard account of corporate reorganization law falters. In *The End of Bankruptcy*, we showed that any one of these conditions is rarely found in a financially distressed business today. It is even less likely that all three of them will exist at the same time. Hence, modern Chapter 11 practice cannot be squared with the traditional account.[1] Regardless of whether the number of businesses entering Chapter 11 rises or falls,[2] something different is going on.

In his thoughtful Response, Lynn LoPucki urges us to provide a more rigorous empirical grounding for these ideas.[3] Part I of this Reply provides such a foundation. It reviews all the large Chapter 11 cases that concluded in 2002.[4] As we claimed in *The End of Bankruptcy*, traditional reorganizations have largely disappeared. Put concretely, in 84% of all large Chapter 11s from 2002, the investors entered bankruptcy with a deal in hand or used it to sell the assets of the business. In the remaining cases, going-concern value was small or nonexistent.[5]

Central to the ideas presented in *The End of Bankruptcy* was the relationship between the different sources of going-concern value and financial distress. Part II returns to this theme. It grounds our conception of going-concern value. We use a case LoPucki brought to our attention to illustrate why financially distressed businesses often have so little value as going concerns

---

1. Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751 (2002).

2. The number of aggregate Chapter 11 filings continues to drop. It has fallen in half over the last two decades, and the number continues to decline. According to figures available from the American Bankruptcy Institute, there were 3022 Chapter 11 filings in the first quarter of 2002, and 2487 in the first quarter of 2003, a decrease of 17.7%. These figures include a small number of Chapter 11 filings by individuals. For the 12 month period ending June 30, 2003, business filings were down by 5.2%.

3. Lynn M. LoPucki, *The Nature of the Bankrupt Firm: A Response to Baird and Rasmussen's* The End of Bankruptcy, 56 STAN. L. REV. 645 (2003).

4. There is no particular magic to this dataset, but it is one logical way to obtain a representative set of recent large Chapter 11s. LoPucki uses this same dataset at the start of his essay and returns to it a number of times.

5. Recently, many others have also come to recognize that Chapter 11 has undergone major change. *See, e.g.*, Elizabeth Warren & Jay L. Westbrook, *Secured Party in Possession*, 22 AM. BANKR. INST. J. 12, 12 (2003); Harvey R. Miller & Shai Waisman, The Erosion of Debtor Protections in the Face of Expanding Creditors Rights and Control, Remarks at the NYU Workshop on Bankruptcy and Business Reorganization (Sept. 2, 2003).

Measuring the precise extent of the changes and when they occurred is hard, but the BRD provides an easy, albeit approximate benchmark. According to the BRD, during the 1980s, 88% of the large businesses entering Chapter 11 began without either a prepackaged or prenegotiated plan and emerged as operating companies. By 2002, the percentage had fallen to 24%. As LoPucki notes, such comparisons, while useful, must be used with some caution. Among other things, the categories used in the BRD do not track the idea of asset sales or preexisting deals precisely and provide no measure for whether any business has value as a going concern. Nevertheless, the ability of the BRD to provide such comparisons quickly is one of its many strengths.

and why whatever value exists is usually best preserved through a sale.

In Part III, we revisit the control that creditors exercise before bankruptcy, during it, and afterward. The powers they enjoy reduce the work that Chapter 11 can perform as well as the powers that others (such as the board of directors) are able to exercise. Again, the facts speak for themselves. Even in the cases most resembling the traditional reorganization, creditor control is the dominant theme. Indeed, if the experience of large businesses leaving Chapter 11 in 2002 is any guide, those at the helm do the bidding of the creditors throughout the case. Moreover, by the end of the case, the creditors usually acquire the right to appoint a new board of directors. They commonly appoint themselves or others (such as their employees) whom they can trust to protect their interests. Corporate reorganizations today are the legal vehicles by which creditors in control decide which course of action—sale, prearranged deal, or a conversion of debt to a controlling equity stake—will maximize their return.

I. LARGE BUSINESS CHAPTER 11S IN 2002

In 2002, 93 large businesses completed their Chapter 11 proceedings.[6] Of these, 52 (or 56% of the sample) were sales of one sort or another. In 45 of these cases, there was a sale of assets such that the business did not even emerge intact as an independent entity under a plan of reorganization.[7] In

6. The BRD database shows 94 cases wrapped up in 2002. One, however, was an involuntary Chapter 11 case that was dismissed. In that case, the debtor, Huntsman, later reached a consensual restructuring with its creditors outside of bankruptcy.

LoPucki notes (on many occasions) that the number of large Chapter 11 cases has risen sharply in recent years. LoPucki's emphasis on this increase, however, is puzzling. *The End of Bankruptcy* claims we no longer need the Chapter 11 collective process to preserve the value of financially distressed businesses as going concerns. At the same time, it shows that Chapter 11 is playing other roles. Modern Chapter 11 is now an attractive place to sell a business as a going concern, and it allows creditors to overcome the problems created by the Trust Indenture Act. *See* Baird & Rasmussen, *supra* note 1, at 786-88. An increase in the number of large Chapter 11s that use bankruptcy for these or other nontraditional purposes is completely consistent with the idea that few financially distressed businesses have substantial going-concern value, cannot be sold, and have problems creditors cannot navigate outside a collective proceeding.

LoPucki also offers some explanations for the recent rise in Chapter 11 filings. He agrees that judges are increasingly willing to conduct sales. In addition, LoPucki suggests that ill-advised merger and acquisition activity may have also brought more cases to Chapter 11. We are less confident that this last observation and others he makes are on the mark. But even if they are, they do nothing to undercut (and indeed may even support) the central claim made in *The End of Bankruptcy*—that, in the current mix of cases in Chapter 11, there are vanishingly few financially distressed businesses that have going-concern value, require a collective proceeding, *and* cannot be sold as going concerns. Again, the traditional account depends upon a *conjunction* of these three conditions. Merely showing cases in which one or two of them exist is insufficient.

7. The BRD codes 43 of the corporations as "not emerging." In none of these was the business reorganized in the traditional sense. The assets of the business were sold or, in some cases, turned over to secured creditors. We have added the two cases that liquidated in

addition to these clear cases of asset sales, seven other cases were in substance sales even though the business did emerge as a stand-alone enterprise under a plan of reorganization.[8] We review each of these seven cases briefly. They provide a nice illustration of modern Chapter 11 practice.

Fruit of the Loom filed for Chapter 11 at the end of 1999. From the beginning, the senior creditors exercised control. They planned initially to take a controlling equity interest in the company, but when competing bidders appeared, they were content for the bankruptcy court to conduct a sale. Warren Buffett's Berkshire Hathaway proved to be the high bidder at $800 million in cash.[9] Similarly, George St. Laurent was the high bidder for Fine Air Services.[10]

In Sterling Chemicals, the court oversaw the sale of one-half of the company, and the proceeds went to the secured creditors. A new investor

---

Chapter 11—ProMedCo and Xpedior—that the BRD does not code as either "emerging" or "not emerging."

The BRD tries to measure whether a sale is contemplated at the time of the reorganization by looking primarily at SEC disclosures and public announcements in the press. It suggests that about 40% of the sales that took place in Chapter 11 were contemplated at the time of the petition. This figure is a lower bound. Financially distressed businesses often do not publicize sales in advance. (Among other things, giving the impression that you are committed to a speedy sale may dampen how much others are willing to bid.)

To give only one example, the BRD codes Budget's Chapter 11 sale as not planned in advance. Given the BRD's protocols, this coding is defensible, but it does not capture the dynamic in the case. Budget's Chapter 11 was intended from the start to consummate the sale to Avis. Budget's negotiations with Avis were public a month before it filed its petition, and Avis entered into a formal agreement to buy Budget only several weeks after the petition. A closer look shows that the Chapter 11 and the sale were conceived together. Among other things, the DIP financing was conditioned on the sale to Avis going through.

8. The BRD codes a business as "emerging" if it emerged pursuant to a confirmed Chapter 11 plan as long as the formal transfer of ownership is done in a plan and as long as the buyer maintains the business as a discrete legal entity. For this reason, some businesses that are sold are coded as "emerging." For example, a buyer can buy the business for cash, but ask (typically for tax reasons) that, instead of a transfer of the physical assets, it acquire ownership of the equity of the reorganized business under a plan of reorganization. Hence, to identify all the cases of asset sales, one has to supplement the businesses that did not "emerge" within the meaning of the BRD with those that the BRD codes as "emerging" but which were nevertheless sold to a third party for cash.

9. In a similar vein, Seitel, whose primary business is selling seismic data to oil and gas companies, had assets that it valued at $398 million when it filed for bankruptcy on July 21, 2003. Under the terms of its prepackaged bankruptcy, Berkshire Hathaway is financing the plan of reorganization and will receive 100% of the equity of the reorganized business. *See* BANKR. WK., July 28, 2003, at 1, 5.

10. *See* Brendan Sobie, *New Partnership Forged in Competition to Buy Fine Air*, AIR TRANSPORT INTELLIGENCE, Jan. 30, 2002. It is worth noting that a minority investor who invested $2.5 million in the new corporation that proved to be the winning bidder was the old equityholder. He received a seat on the board and 24% of the equity in exchange. If one collapses the transactions together, Fine Air is, in effect, a new value plan that satisfies the requirements of *Bank of America v. 203 North LaSalle Street Partnership*, 526 U.S. 434 (1999).

acquired most of the equity of the remaining business, with the balance going to the unsecured creditors. The equity was wiped out, and, as provided in the plan of reorganization, the entire board of directors tendered their resignations. The new investor controlled the appointment of their successors.[11] Similarly, a distressed-debt fund acquired control of Classic Communications in Chapter 11 and became its owner as part of the reorganization plan.[12]

Global Crossing, one of the largest bankruptcies ever, was from the start a sale of the business to a new investor.[13] After delays and a search for other bidders, the bankruptcy court confirmed a plan of reorganization that consisted primarily of a purchase agreement under which the prebankruptcy suitor would receive 60% of the equity in exchange for several hundred million dollars in cash.[14]

Derby Cycle entered Chapter 11 as the second part of a plan, conceived by its investment bankers many months before, to sell its assets. The bankruptcy court approved the asset sale within five weeks of the petition. In the words of Derby's investment banker, "[B]ankruptcy can be a tool to get a transaction done . . . . This was a situation where it made a lot of sense for a lot of reasons to file for bankruptcy. But the primary reason was speed—we were just able to [do] the transaction a lot more quickly."[15]

XO Communications filed for Chapter 11 with two alternative plans in hand.[16] The first was a deal by which Fortsmann Little would make a

---

11. *See* Press Release, Sterling Chemicals, Sterling Chemicals Emerges from Bankruptcy with $60 Million in New Equity (Dec. 19, 2002), *available at* http://www.newswire.ca/en (last visited Nov. 29, 2003). Five of the nine-member board of Sterling consists of the members of Resurgence Asset Management, which invested $60 million in the business. Information on the board of directors can be found at http://www.sterlingchemicals.com (last visited Nov. 29, 2003).

12. Mike Farrell, *Classic Emerges with New Owners, $80M*, MULTICHANNEL NEWS, Jan. 6, 2003. In the plan, the buyer acquired a majority of the seats on the board, and its principal became chairman. Within six weeks of confirmation, the fund transferred the management of the company to an experienced cable operator. Jerri Stroud, *Kent Makes Another Comeback, Diving into Cable Business Again*, ST. LOUIS POST-DISPATCH, Feb. 13, 2003, at C1.

13. *See* Dennis K. Berman, Phillip Day & Henry Sender, *Global Crossing Ltd. Files for Bankruptcy*, WALL ST. J., Jan. 29, 2002, at A3; Christopher Palmeri & Lorraine Woellert, *Global Crossing: A Matter of National Security?*, BUS. WK., Aug. 11, 2003, at 32.

14. Like many acquisitions outside of bankruptcy, the sale took the form of the acquisition of a majority stake in the equity of the reorganized business. A number of terms changed (including a dramatic decrease in the amount of cash that the new buyer put on the table) because the financial condition of Global Crossing changed over the course of the chase. Global Crossing's Plan of Reorganization was confirmed on December 26, 2002. The Plan included a purchase agreement that set forth the terms of the acquisition, pending regulatory approval. *See* Ron Orol, *FCC Approves Global Crossing Sale*, DAILY DEAL, Oct. 10, 2003.

15. Mairin Burns, *Corporate Restructuring Takes a Transatlantic Turn; European Bicycle Maker Derby Cycle Reorganizes Stateside Via Chapter 11*, HIGH YIELD REP., Nov. 5, 2001.

16. XO Communications was a holding company. Its subsidiaries provided telephone

significant investment in exchange for control. The second was one that would wipe out equity and convert the bank debt to equity. Fortsmann Little decided not to go through with the deal, and Carl Icahn bought a majority of the company's debt. Ownership of XO Communications passed to him upon confirmation. The company exited Chapter 11 in early 2003, and Icahn remains its owner.

We now turn to the cases (less than half the population) that were not asset sales. In most of these, the principal investors reached agreement with each other on a plan of reorganization before the Chapter 11 was filed, and that plan or one very much like it was confirmed in Chapter 11. All told, the Chapter 11 of 26 of the 42 businesses that were not sold in Chapter 11 merely implemented a deal that was already reached among the principal players at the time the petition was filed.[17] Three of the cases were ones in which the bankruptcy judge confirmed a prepackaged plan.[18] In 19 others, a prenegotiated plan was confirmed with only minor modifications.[19] In four additional cases, the court

---

service. None of the operating subsidiaries filed for bankruptcy. *See* Roy Mark, *XO Files for Bankruptcy Protection*, (June 18, 2002), *at* http://www.isp-planet.com/news/2002/xo_02061 8.html (last visited Nov. 29, 2003).

17. XO Communications entered Chapter 11 with a prenegotiated plan, but that deal fell apart and the business was sold instead. It, too, is excluded from our count of businesses that entered Chapter 11 to implement preexisting deals. Again, there is no problem with the coding of the BRD, but it takes account only of whether a business enters with a deal in hand, not whether it was in fact implemented. Hence, we exclude it from our count of the Chapter 11s in which the judge implements a preexisting deal.

18. These were Leiner Health Products, APW Ltd., and Globix. The BRD identifies one other case—Glenoit—as a prepackaged plan, but the plan fell apart in bankruptcy. Hence, Glenoit was properly coded as a "prepackaged" Chapter 11 in the BRD but again should not be counted as a Chapter 11 that implemented a preexisting deal.

19. These businesses were AMF Bowling, Anchor Glass, Arch Wireless, Audio Visual Services, Chiquita, Guilford Mills, Impsat Fiber Network, ITC DeltaCom, Inc., Lason, McLeodUSA, Mpower Holding, NTL, Oxford Automotive, Stockwalk Group, USInterNetworking, Verado, Williams Communications, Worldtex, and York Research. The BRD codes all of these as prenegotiated plans except for Arch Wireless, Oxford, and York Research. These three cases, however, should also be seen as Chapter 11s in which the bankruptcy judge implemented a preexisting deal.

Arch Wireless's Chapter 11 implemented a plan negotiated with its secured creditors before the bankruptcy, under which the secured creditors received new notes and 90% of the equity of the reorganized business. Unsecured creditors received a few cents on the dollar and old shareholders received nothing. Leon Lazaroff, *Arch Wireless Plans Bankruptcy with Creditors' Backing*, DAILY DEAL, Dec. 6, 2001; *News Notes, Arch Wireless*, BANKR. DATASOURCE, Apr. 1, 2002.

Oxford Automotive spent a year planning its Chapter 11, and it filed to implement a debt restructuring agreement with CSFB Global. Before the Chapter 11 began, at a time when it held 80% of Oxford's outstanding bonds, Global agreed to exchange its bonds and invest $50 million for a majority equity interest in the reorganized company. The Chapter 11 put this deal in place. *Oxford Automotive Arranges for Significant Capital Investment*, PR NEWSWIRE, Jan. 18, 2002; Michael Strong, *Oxford Automotive: Ch. 11 Plan Will Pay Vendors in Full*, CRAIN'S DETROIT BUS., Jan. 28, 2002, at 33.

York Research, a developer of energy production facilities, entered into a restructuring

confirmed plans that adhered to the basic contours of the deal brokered before the petition was filed, albeit with some alterations.[20]

The large Chapter 11s of 2002 confirm our claim in *The End of Bankruptcy* that going-concern sales and implementation of prenegotiated deals now dominate the scene.[21] More precisely, 52 of the 93 large reorganizations in 2002 were sales of one sort or another. Of the remaining 41 cases, 26 (or 62%) were situations where the bankruptcy merely put in place a deal agreed to before the proceedings began. Combined, sales and preexisting deals account for 84% of the large Chapter 11s from 2002.[22]

---

agreement with 99% of its portfolio bondholders before filing, and this agreement was implemented in Chapter 11. As provided in the agreement, existing plants were sold (with proceeds going to the bondholders). Projects under development were to be placed into a new business owned by the creditors and the existing management. Shareholders were wiped out. *Plan Summary, York Research Corporation, et al.*, BANKR. DATASOURCE, Aug. 15, 2002; *York Announces Restructuring Agreement with Bondholders; Filing of Bankruptcy Petition*, BUS. WIRE, June 7, 2002.

20. The four cases were Sunbeam, WKI Holding, Komag, and Pinnacle Holdings. In Sunbeam, out-of-the-money subordinated debenture holders were able to extract 1.5% of the equity by claiming rights arising out of prepetition financial misdeeds. *See Sunbeam Announces Court's Confirmation of Plan of Reorganization*, PR NEWSWIRE, Nov. 25, 2002. In WKI Holding, some bondholders increased their stake of the new equity from 5.1% to 8.35% by threatening to probe transactions between its parent and an affiliate of the parent that was also a secured lender to the debtor. *See* Soma Biswas, *World Kitchen Reorg Plan OK'd*, DAILY DEAL, Nov. 16, 2002. In Komag, the general outline of the plan remained the same even while a number of details changed. The senior lenders received less cash ($82.5 million instead of $85 million) and more stock (51.4% instead of 50.1%), and one class of claims was split into two. *Compare Plan Summary, Komag, Incorporated*, BANKR. DATASOURCE, Nov. 1, 2001, *with Plan Summary, Komag, Incorporated*, BANKR. DATASOURCE, Mar. 1, 2002. In Pinnacle Holdings, the prenegotiated plan provided for the acquisition of control of the equity by a new investor and a new credit facility. The plans for the new credit facility fell through, and the preexisting senior lenders did the postpetition financing instead. The change affected only the senior lenders (the ones involved in shaping the prenegotiated plan), and the essence of the plan—the transfer of control of the business to the specified third party—took place as contemplated and according to the terms agreed upon before the case was filed. *See* Jonathan Berke, *Pinnacle Banks to Vote on Plan*, DAILY DEAL, Sept. 25, 2002.

21. There is one other case that, while neither a sale nor a preexisting plan, evinces the same dynamic. WebLink Wireless planned to enter Chapter 11 in order to merge with another business. *Metrocall & WebLink Agree to Merge*, BUS. WIRE, Apr. 2, 2001. This deal fell apart, but WebLink entered Chapter 11 and continued to look for a buyer. *WebLink Wireless Prepares to File Plan to Emerge from Chapter 11*, PR NEWSWIRE, Oct. 31, 2001. Another deal with a different buyer fell through during the course of the case. *News Notes, WebLink Wireless, Inc.*, BANKR. DATASOURCE, July 1, 2002 (citing WebLink Wireless's January 31, 2002, announcement that it had filed a plan of reorganization and had signed a letter of intent with Sun Capital Acquisition). When WebLink emerged from bankruptcy, its secured creditor owned the equity and controlled the newly formed board of directors. Within four months, the secured creditor sold its controlling interest to a third party, which then took over the company. *Leucadia National Corporation Announces Six Month 2003 Results*, BUS. WIRE, Aug. 13, 2003. Just to be clear, we have not counted this case as either a sale or a preexisting deal in obtaining our 84% figure.

22. As we have already noted, the BRD provides an easy way to approximate this

We now turn to the handful that remain, the large Chapter 11 cases from 2002 that were neither sales nor preexisting deals. Only in these few cases might a traditional reorganization be found, yet they share in common one characteristic—a remarkable absence of going-concern value. We go through each of these cases in turn.

Two of the businesses—Viatel and Teligent—were so transformed during the course of the Chapter 11 that the emerging entities could hardly be considered the same businesses at all. Far from preserving going-concern value, whatever value the old businesses had as going concerns disappeared during the course of the reorganization. Viatel entered Chapter 11 as an international long-distance telecommunications business headquartered in New York with 2000 employees.[23] It emerged thirteen months later as a business, based in England, that employed only 73 workers and specialized in the sale of fiber optic capacity to long-distance carriers and large corporations. It no longer has any assets in the United States.[24] Teligent entered Chapter 11 with 2000 employees as a business trying to use wireless technology to compete with local telephone companies. It emerged as a company with fewer than 100 employees that is trying to use its wireless licenses to provide transport services to other carriers and point-to-point broadband access services for multilocation businesses.[25] What is going on in Chapter 11 in these cases may be entirely salutary, but it has nothing to do with preserving the businesses that entered Chapter 11.

Two other cases show a similar absence of going-concern value. In one (Glenoit), most of the business's plants located in the United States were shut down immediately after leaving Chapter 11. After leaving bankruptcy, production was moved to China, and the remaining sites in the United States are now used primarily as warehouses and distribution centers.[26] If the business

---

number. The percentage of cases in which the business emerges without a prepackaged or prenegotiated plan in hand at the outset is 24%. The remaining 76% corresponds (albeit imperfectly) to the 84% we find here. For reasons discussed earlier, the BRD is both underinclusive (e.g., Fruit of the Loom) and overinclusive (e.g., Glenoit).

23. Viatel was put up for auction. After the creditors committee rejected a $150 million bid as inadequate, the original bidder dropped out, and no other bids materialized. *See* Mitchell Pacelle & Richard B. Schmitt, *Bankruptcy Pro Seeks Career Reorganization*, *at* http://www.careerjournal.com/myc/killers/20020301-pacelle.html (last visited Nov. 29, 2003). There was also to be an auction for Teligent in the bankruptcy court, "but no one else showed up." *Teligent to Revamp According to Plan . . . Sort of*, *at* http://www.cedmagazine.com/cedailydirect/0201/cedaily020124.htm (last visited Nov. 29, 2003).

24. Leon Lazaroff, *Viatel Set to Exit Chapter 11*, DAILY DEAL, May 10, 2002.

25. Yuki Noguchi, *Teligent Exits Chapter 11 Debt-Free*, NEWSBYTES, Sept. 13, 2002; *Teligent Completes Its Reorganization—Company Exits Bankruptcy Fully Funded and Debt Free*, BUS. WIRE, Sept. 12, 2002. The general creditors, like the shareholders, received nothing. Indeed, the case was administratively insolvent. *See In re* Teligent, Inc., 282 B.R. 765 (Bankr. S.D.N.Y. 2002).

26. *See* Claudia H. Deutsch, *Burlington Made to Order for Investor Seeking a Test*,

had value as a going concern, it would not have shut down its domestic operations and recreated them abroad. Another case had little in the way of an ongoing business at all. FLAG's principal assets were three separate undersea fiber optic cables.[27] Each could have been sold separately or transferred to the creditor that held the senior interest in them. These assets have no synergies between them. If Chapter 11 did not exist, little would have been lost.

Six of the remaining businesses were little more than groups of discrete businesses, each of which could stand on its own. Three were a collection of nursing homes and residential care facilities,[28] one was managed vacation resorts scattered across the country, another was a chain of movie theaters.[29] Still another operated several dozen hotels under several different franchise names. This last business (Lodgian) nicely illustrates what is at stake in such cases.

A business such as Lodgian has value as a going concern only to the extent there are synergies when one company runs a Holiday Inn in Myrtle Beach, a Hilton in Fort Wayne, a Radisson in Phoenix, and many others scattered around the country. Independent of Lodgian, each hotel enjoys the services its own franchisor provides. Holiday Inn, Hilton, and Radisson each have their own national reservation systems as well as marketing and advertising programs. A creditor of Lodgian can foreclose on the equity Lodgian holds in the corporation that runs the Holiday Inn in Richfield, Ohio, and that Holiday Inn would still remain open for business, employing the same people.[30] The individual hotels are separate corporations that stand on their own.

To determine Lodgian's going-concern value, we have to isolate the business of Lodgian proper. Lodgian can enter into single contracts with food, telephone, and software providers. It can provide centralized accounting, tax, and payroll services. It can help train employees. If Lodgian can provide such services more cheaply than others, it may have value as a going concern. But we have to focus on these services, not on the underlying assets that stand on their own. Lodgian is a business employing the 118 people in Atlanta who oversee a portfolio of 97 hotels. Not at risk is the value of the hotels and their operations. These are discrete businesses that together employ 5000 people and

---

N.Y. TIMES, Aug. 14, 2003, at C1.

27. Tola Sargeant & Anthony Cox, *No Silver Lining for Subsea-Cable Industry as FLAG Files for Chapter 11*, TELECOM MARKETS, Apr. 22, 2002.

28. These were Sun HealthCare, Mariner Post-Acute Network, and CareMatrix.

29. These were Sunterra and Carmike Cinema respectively. Carmike Cinema was able to pay its creditors in full in large part because it was able to use Chapter 11 to extricate itself from real estate leases. Taking advantage of substantive rules in Chapter 11 that depart from the nonbankruptcy baseline rather than a need to preserve going-concern value seems to have driven its Chapter 11 filing.

30. As part of its reorganization plan, Lodgian returned several hotel properties, including its Holiday Inn in Richfield, Ohio, to its secured creditors. The one in Richfield remains a Holiday Inn. Nothing suggests that it is worse off now that it lacks Lodgian's services.

generate $400 million of revenue a year.[31]

Lodgian is emblematic of many of the businesses that emerged intact from Chapter 11 in 2002. They are not like nineteenth century railroads or the large factory in a small town frequently put forward as the archetypal Chapter 11. These businesses do not resemble a steel mill where the physical assets have little value and jobs disappear if the business shuts down. More often, the value that is being preserved is not the underlying hotel, theater, or nursing home but the value of having them under common ownership.

We are left with four cases. Going-concern value may exist in ICG Communications, Kitty Hawk, Metals USA, and Pillowtex. In these cases, however, one is hard put to find all the conditions that the traditional justification of corporate reorganizations requires. Creditors exercise control that investors in nineteenth century railroads could only dream of. Far from being a last resort, the sale gives creditors a benchmark they can use to assess whether they are better off converting their claims to equity and appointing a new board of directors to oversee the enterprise, at least for a time.

In ICG Communications, for example, we see senior creditors in control of the process. By the time it entered Chapter 11, a new CEO, recommended by one of the principal creditors, had been put in place.[32] Once in Chapter 11, the

---

31. In discussing the role that modern Chapter 11 is playing, it is useful to distinguish the legal entities in Chapter 11 from those that are not. The failure to do this will make it appear that Chapter 11 is playing a role that it is not. Enron provides an illustration. The bulk of Enron's assets were put up for sale shortly after it filed for bankruptcy. These asset sales raised $3.2 billion. *See* Enron Corp., Disclosure Statement for Amended Joint Plan of Affiliated Debtors 227-28 (Sept. 18, 2003).

There are only three assets of any consequence that will not be sold. These are the equity stakes Enron holds in two small pipeline companies, one based in the United States and one based abroad, and a utility company in Oregon. Enron's equity interest in these businesses is likely to be distributed to creditors as part of Enron's plan of reorganization. *See, e.g.*, Press Release, Enron Corp., Enron Board Approves Proposal to Create New International Company (May 9, 2003) (on file with authors). The BRD will classify Enron as an entity that successfully emerges from Chapter 11 on the ground that these three businesses will not be sold. But one should not conclude that Enron's Chapter 11 is doing anything to preserve the value of these discrete businesses as going concerns. The utility company and the small pipeline companies in question are stand-alone corporations. They are not in Chapter 11. They are solvent and not in need of reorganization. There is not and has never been a threat to *their* value as going concerns. Everyone—including their creditors—is free to treat them as if Enron's Chapter 11 had never happened. A creditor of Microsoft is indifferent to whether someone who owns a share of Microsoft files for bankruptcy. Creditors of these three business are in the same position.

The relevant asset here is Enron's equity interest in these businesses. The only question is how Enron's Chapter 11 will dispose of this asset: Will the stock be sold directly to an outside purchaser or will it be distributed to Enron's creditors, who could then sell their shares on the market? In neither case is Enron's Chapter 11 doing anything to preserve these corporations as going concerns.

32. *See* Kris Hudson, *Step One: Finding a New Leader*, DENV. POST, June 9, 2002, at K-04. The decision to hire the turnaround formally rested with the board, but the board recognized that their fiduciary duties were owed to the creditors: "Realizing that their

new CEO hired Dresdner Kleinwort Wasserstein to shop the business and decided not to sell it only because it did not "create[] the most value for the creditors."[33] The board of directors of the new corporation consists of the CEO, two members appointed by the postpetition lender, and two members appointed by prepetition creditors. Creditors were in control from beginning to end.

The air cargo carrier Kitty Hawk spent two years in Chapter 11, during which time it pared back on its operations. When it emerged, the creditors ended up in control of the business, the CEO was gone, and the equity was wiped out. The possibility of an outright sale was present at every stage in the reorganization process.[34] Metals USA was formed in the 1990s as an amalgamation of a number of different metal processors. Industry experts raised doubts about whether these businesses should have been brought together in the first place.[35] In its Chapter 11 case, Metals sold assets worth over $70 million, refocused on its core operations, converted debt into equity, and put in place a new board of directors.

At this point, we have reviewed all but one of the large Chapter 11 cases from 2002. The one that remains is Pillowtex. Pillowtex on its face seems the 2002 case that would support the traditional account of Chapter 11. The manufacturer of some well-known textiles—Fieldcrest, Cannon and Charisma sheets and Royal Velvet towels—Pillowtex filed for bankruptcy in 2000 in order to "create a sustainable capital structure, improved manufacturing operations, and profitability."[36] After some pruning of its assets, it emerged in 2002. The business continued to run the same plants, employ the same workers, and maintain the old relationships.

But Pillowtex in the end does little to support the traditional account of corporate reorganizations either. Pillowtex likely had little value as a going concern. The going-concern value of Pillowtex cannot exceed the costs of outsourcing the manufacture, sale, and distribution of their sheets and towels. It cost millions to build Pillowtex's factories, hire its thousands of employees, and create all the relationships needed for its manufacturing process, but these have no value as a going concern in a world in which the towels, pillows, and sheets can be made under the same label for less offshore. The "successful" Chapter 11 from which Pillowtex emerged in 2002 only postponed the inevitable. Pillowtex filed for Chapter 11 again in July 2003, and in this one its

---

allegiance needed to shift from ICG's shareholders to its creditors as ICG's financial condition worsened, the directors made Curran their new chief executive officer . . . ." *Id.*

33. *See* Jeff Smith, *ICG Hires Firm to Seek Buyers for Telecom*, ROCKY MOUNTAIN NEWS (Denver), Nov. 18, 2000, at 1B.

34. *See* Haynes & Boone Press Release, Coming Out of the Clouds: Kitty Hawk Emerges from Bankruptcy (Sept. 30, 2002).

35. *See* Corinna C. Petry, *Metals USA: The Unravelling of a Rollup*, METAL CENTER NEWS, Oct. 1, 2002.

36. *See Chapter 11 Filed, D.I.P. Financing Announced, Pillowtex Corp.*, BANKR. DATASOURCE, Nov. 13, 2000.

assets are being sold off piecemeal.[37]

The lack of traditional reorganizations in the 2002 dataset does not prove that they have disappeared altogether. It may be possible to find another dataset that shows less dramatic change. The number of sales and preexisting deals in 2002 may have been unusually high and the number without apparent going-concern value unusually low. But these basic features—high levels of sales and preexisting deals and low going-concern value—will likely show up in any dataset. While writing *The End of Bankruptcy*, we vetted our observations against the large cases in the BRD that were filed in calendar year 2000, and the picture was much the same. Moreover, the interviews we conducted then with reorganization lawyers confirmed these findings and their experience extended across a wide range of cases over the course of multiple years.

Take any set of large Chapter 11 cases and the changes appear. Consider, for example, the seven largest cases filed in 2002.[38] Four of these cases now have emerged from bankruptcy—NTL, Conseco, Global Crossing, and Kmart. They tell the same story as the larger dataset of cases ending in 2002. Two of these, NTL and Conseco, were prearranged bankruptcies. Global Crossing was a sale. Kmart is a business that likely has little value as a going concern in a world in which it must compete against businesses such as Target and Wal-Mart.[39] Moreover, Kmart illustrates the extent of creditor control in modern Chapter 11 cases. Indeed, Kmart left Chapter 11 with the CEO of its principal creditor as the chairman of its board.[40]

Three of the largest seven cases that filed for Chapter 11 in 2002 are still in bankruptcy. The massive frauds in two of these cases—Adelphi and Worldcom—made going-concern sales infeasible. United's Chapter 11 was driven in the first instance by the special rules that give debtors (inappropriately, in our view) a chance to shortchange employees and lessors. We do not see asset sales or preexisting deals here, but none of these cases can be considered paradigmatic reorganizations either. All three have a dynamic

37. Details of the auction are available at http://www.pillowtex.com (last visited Nov. 29, 2003).

38. To give another example: Bankruptcy Week reports on all bankruptcy filings by publicly traded firms and large privately held firms on a weekly basis. The last issue that was in print at the time of this Reply reports three filings. One (Reback Networks) is a prenegotiated bankruptcy under which creditors will receive 95% of the equity of the reorganized business. The other two (Piccadilly and Radio Unica) are going-concern sales. *See Bankruptcy Filings*, BANKR. WEEK 2, Nov. 3, 2003. Indeed, Bankruptcy Week has a column each week devoted to "Purchase Agreements." *See id.* at 3.

39. We discuss Kmart explicitly in *The End of Bankruptcy*. *See* Baird & Rasmussen, *supra* note 1, at 765; *see also Kmart's Toughest Sell*, BUSINESSWEEK ONLINE (May 15, 2003), *available at* http://uk.news.yahoo.com/030515/244/e02wv.html (quoting an industry analyst as opining that "Kmart wasn't viable when they went into bankruptcy, and they aren't viable now") (last visited Nov. 29, 2003).

40. Kmart's chairman and CEO is Edward Lambert. He is the Founder, Chairman, and Chief Executive Officer of ESL Investments, a hedge fund that acquired a major stake in Kmart by buying up its debt. We discuss Kmart in greater detail below.

utterly different from what we saw only a few years ago.

Rather than being dispersed and unable to work together, the creditors are firmly in control. In Adelphia, the board hired a new CEO with an enormous benefits package at the direction of the creditors' committee and over the strong opposition of the shareholders. Early in the case WorldCom's board had to hire a chief restructuring officer. The DIP financing agreement insisted that the board hire such an officer but left the choice entirely up to the board—as long as it was a person on the list of three offered by the DIP lender. In United, the board oversaw the renegotiations with the unions, but the sword of Damocles was held by J.P. Morgan through the financial covenants in its DIP financing agreement.

As others have pointed out, many of the characteristics of Chapter 11 persist even as the purpose it serves changes.[41] Negotiations still take place in Chapter 11, and part of the judge's job is to keep these negotiations on track.[42] Eliminating out-of-the-money creditors and resolving intracreditor fights have long been part of Chapter 11. One can find a Pillowtex here and there. But none of this should obscure the magnitude of what has changed or the need to explore why this change has taken place. The most important of the long-term changes has been the change in the value financially distressed businesses have as going concerns.

II. ASSET SALES AND GOING-CONCERN VALUE

Preservation of going-concern value rests at the heart of the standard justification for Chapter 11. A going-concern surplus exists to the extent that the expected value of the business's ongoing operations exceeds the value that could be generated by putting the assets to some other use. LoPucki asserts that *The End of Bankruptcy* takes a view of going-concern value that is too narrow and that neglects some of the ways in which a business can have it. In particular, he argues that fungible assets and relationships are a source of value to many financially distressed businesses and that close study will show how Chapter 11, as traditionally understood, will preserve them. We look at fungible assets and relationships in turn.

A. *Fungible Assets*

In this section, we accept LoPucki's invitation to focus on a particular case, *In re 26 Trumbull Street*.[43] We use it to examine the extent to which a

41. *See, e.g.*, Michele Dickerson, *The Many Faces of Chapter 11: A Reply to Professor Baird*, 12 AM. BANKR. INST. L. REV. (forthcoming 2004).

42. Miller and Waisman, *supra* note 5, focus on these in their response to *The End of Bankruptcy*.

43. 77 B.R. 374 (Bankr. D. Conn. 1987).

financially distressed business' value as a going concern can arise from its fungible assets and the extent to which a traditional reorganization (as opposed to a going-concern sale) is needed to preserve it.

The restaurant that occupied the space at 26 Trumbull Street, in Hartford, Connecticut, went through bankruptcy twice during the 1980s.[44] In both cases, the same trustee was appointed to dispose of the assets. The time between the two sales was quite short, and the individual assets themselves did not change appreciably. Nevertheless, the first time a single buyer was willing to pay a premium to acquire the restaurant's equipment and furnishings along with the lease of the space, while the second time the assets were sold piecemeal for merely a small fraction of the price received at the first sale. The difference between the first and second bankruptcy shows how going-concern value comes into being, how it can be lost, and why traditional reorganizations can do so little to preserve it.

The story begins well before the first bankruptcy. *Hubbard's Park* opened its doors in 1980. At first, it thrived. *Hubbard's* was both the place where politicos hung out and the center of nightlife in the city.[45] All was well for several years. Then the restaurant changed hands and its fortunes plummeted. Within a year, the restaurant closed and filed for bankruptcy. At the time of the first bankruptcy, it seemed the problems of *Hubbard's* could be tied to the bad management that had run the restaurant for just a short time. Replace them, and the winning formula would return.

What was being sold at the first auction was a restaurant with an established track record, not only used restaurant furnishings and equipment. A buyer only had to dust everything off and then open for business. The menu could stay the same. The furniture, the bar, the espresso machine, and the décor all worked together. The only thing the space at 26 Trumbull Street needed was a return to competent management. Instead of buying an empty shell and spending hundreds of thousands of dollars outfitting the place, one could acquire a "turn-key operation"—a restaurant with an established track record for less than $200,000.[46]

At the time of its first bankruptcy, *Hubbard's* appeared to be a viable business that could generate more than the value of its hard assets in a piecemeal sale. But the cause of the financial distress that brought about the

---

44. LoPucki discusses only the first bankruptcy. As the discussion below makes clear, we believe that one must look at both, as well as at the other restaurants that later occupied the site, to understand why few financially distressed businesses have going-concern value and why sales are the best way to preserve it even when they do.

45. Interview with John Neil, 26 Trumbull Bankruptcy Trustee (July 24, 2003); *see also Closed City Restaurant May Reopen*, HARTFORD COURANT, June 5, 1992, at D4.

46. The trustee in both cases, John Neil, used exactly this expression—"turn-key operation"—to distinguish the first bankruptcy case from the second. Interview with John Neil, *supra* note 45. The cost for refurbishing a restaurant at a location like that at 26 Trumbull Street usually ranges between $500,000 and $1 million. Interview with Robert Maffuci (Sept. 9, 2002).

bankruptcy—the bad managers—*required* a sale to preserve whatever going-concern value existed. The claim of *The End of Bankruptcy* was both that financially distressed businesses typically have little or no going-concern value *and* that, even when they do, sales provide the simplest and often the best way of preserving it. The going-concern sale of the restaurant at 26 Trumbull Street vividly illustrates the second idea.

The speedy failure of the restaurant after the first bankruptcy suggests that *Hubbard's* did not have any going-concern value after all. But even if the restaurant had value as a going concern, that value had little to do with the hard assets themselves. The original cost of the carpeting or the wall covering is irrelevant. The cost of bringing these together bears no necessary relation to how much going-concern value exists. Moreover, their value anywhere else is almost nonexistent. What matters is whether together at this location they create a mood that leads people to want to eat there.

The trustee conducted a piecemeal sale in the second bankruptcy. By this time potential investors realized that this restaurant's moment had passed. There was no shortage of people who wanted to run a restaurant at 26 Trumbull Street, but no one wanted to run *this* restaurant. The equipment and furnishings no longer had any value kept together. Piecemeal sales are the order of the day for restaurants that close their doors.

In the case of 26 Trumbull Street, a succession of new owners failed to find a winning formula. *Jonathan's* became *Metro Park Café*, which in turn became the *Blue Star Café*. In none of them was there any going-concern value. A business that cannot generate enough money to pay its ongoing expenses is worthless, no matter how much it cost to build. Increasingly, those who try to open a stand-alone restaurant and run it with the management system they develop on their own fail. Successful restaurants are more often the creation of those who have opened other restaurants and have a management system that they can replicate.[47]

The space at 26 Trumbull Street became successful only when Rob Maffuci and his family acquired it in 1996. Already the owners of a number of successful restaurants, they brought their knowledge to the space and opened *Vito's by the Park*. Maffuci redid the dining space to take maximum advantage of the view, including a large mural that mirrored the view of Bushnell Park through the restaurant's windows.[48] Maffuci added a piano bar and created a carry-out business during lunch. Complimentary pizza has made it one of the favorite happy hour spots in Hartford. Today it is a successful business that employs thirty-five. Already seven years old, *Vito's* is now well into middle

47. We made this point explicitly in *The End of Bankruptcy* and used restaurants as one of our examples. *See* Baird & Rasmussen, *supra* note 1, at 764 n.66 (citing Shirley Leung, *Food Fight: Local Restaurants Find Big Chains Eating Their Lunch*, WALL ST. J., July 9, 2002, at A1).

48. Part of Maffuci's genius included his ability to do an initial makeover of the restaurant on a tiny budget ($120,000) within a small time frame (40 days).

age.

The experience Maffuci and his family gained running their other restaurants allowed them to open *Vito's* with the smallest possible capital investment and then keep overhead low. The motivated and loyal staff is smaller than at restaurants of comparable size. Much of *Vito's* value as a going concern depends upon Rob Maffuci remaining in place. Maffuci is a creative Italian chef who offers traditional *osso bucco* along with his own creations such as apricot shrimp. He has a prominent place in Hartford's civic life. Notwithstanding his passion and enthusiasm, Maffuci is not a dreamer. Trained as an electrical engineer, Maffuci has put systems in place that have kept food costs down and waste to a minimum. In addition, he continuously develops sidelines to the business (such as take-out and lunchtime deliveries) that add to the bottom line. The combination of skills that Maffuci brings to *Vito's* is hard to teach. If they could be easily learned, far fewer restaurants would fail.

Vito's depends on Maffuci, and Maffuci will not work there for someone else.[49] *Vito's* today has going-concern value, and this value likely cannot be preserved in a going-concern sale. But this chapter in the history of 26 Trumbull Street provides no comfort to someone looking to justify the traditional account of corporate reorganizations. Maffuci is in no need of Chapter 11. *Vito's* is thriving.

The lesson to be drawn from 26 Trumbull Street is a general one. Small businesses in Chapter 11 have little going-concern value, and sales are usually the best way to preserve whatever value exists. Chapter 11 reorganizations do not save businesses in the way that the equity receivership saved nineteenth century railroads.[50] Edward Morrison has looked at all operating corporations that filed Chapter 11 petitions in the Eastern Division of the Northern District of Illinois in 1998.[51] Morrison uses interviews and other techniques to take the pulse of each business and concludes that these small businesses, like large ones, have little in the way of going-concern value. The typical business is a construction subcontractor who has no equipment beyond a truck and hand tools. With no permanent employees, she hires people for specific jobs after winning a contract. The owner-manager has many relationships with other builders and suppliers, but these relationships reside with the owner-manager. They do not depend upon the continued existence of the corporation she is now running. They continue whether she runs the corporation that files for bankruptcy or a new one created shortly thereafter. When we survey this

49. As we note in Douglas G. Baird & Robert K. Rasmussen, *Control Rights, Priority Rights, and the Conceptual Foundations of Corporate Reorganizations*, 87 VA. L. REV. 921, 923-24 (2001).

50. Douglas G. Baird & Robert K. Rasmussen, *Boyd's Legacy and Blackstone's Ghost*, 1999 SUP. CT. REV. 393, 402–06.

51. *See* Edward R. Morrison, Bankruptcy Decision-Making: An Empirical Study of Small Business Bankruptcies (Aug. 2003) (unpublished Ph.D. dissertation, University of Chicago) (on file with authors).

landscape, the elements needed for the traditional reorganization are missing with respect to these businesses too. As Morrison puts it, "There are no railroads here."[52]

B. *Relationships*

We do see large businesses, such as Revere and Greyhound, go through Chapter 11 and continue as operating entities for many years. That such businesses continue as going concerns for an extended period after emerging from Chapter 11 suggests that they have *some* value as going concerns.[53] If they had none, there is no reason for them to stay together. Moreover, we can identify potential sources of going-concern value. Large businesses have thousands of employees. Each employee has multiple relationships with each other and with the business' many suppliers and customers. This vast web of relationships constitutes the firm. Large investments were required to bring it into being and investments on a similar scale would be needed to replicate it.

The idea of value flowing from relationships fits with the conception of the firm that Ronald Coase established long ago. A "firm," as Coase understood it, consists of the "system of relationships which comes into existence when the direction of resources is dependent on an entrepreneur."[54] Instead of the price mechanism directing the flow of resources, an entrepreneur takes command of them. The relationships, not the assets, are the firm.[55]

---

52. *See id.* at 47.

53. Even here, however, we have to be careful. Many of the companies that LoPucki identifies as successful reorganizations of the past completed Chapter 11 at a time when asset sales were not as common as they are today. It may well be the case that, had these cases occurred today, the business would have been sold to the highest bidder.

Even putting this aside, one cannot accept uncritically the notion that much going-concern value existed in these cases. For example, at the time it filed, Revere was best known for its copper-bottomed cooking ware. Revere sold this division to a business that ultimately became WKI, one of the large businesses emerging from Chapter 11 in 2002. By this time, RevereWare's manufacturing operations had been outsourced to a factory in Indonesia. No matter how much it cost to build and no matter how much it cost to establish the relationships, the value of a firm that makes RevereWare can never be more than the cost of producing the same goods offshore. This division (albeit only a part of Revere) once again illustrates the dynamic at work in cases such as Pillowtex and Glenoit.

54. *See* Ronald H. Coase, *The Nature of the Firm: Origin*, *in* THE NATURE OF THE FIRM: ORIGINS, EVOLUTION, AND DEVELOPMENT 22 (Oliver E. Williamson & Sidney G. Winter eds., 1993).

55. LoPucki states that we argue "going-concern value can exist only in conjunction with firm-specific assets." LoPucki, *supra* note 3, at 652; *see also id.* at 659 ("Asset-specificity is at the heart of Baird and Rasmussen's concept of the firm."). But our view is in fact to the contrary. Specialized hard assets are not what generates going-concern value in most businesses. This is the gist of our discussion of Ermen & Engels and the Ford Motor Company. *See* Baird & Rasmussen, *supra* note 1, at 760-62, 769-72. *Vito's* provides a further illustration. *See also* Douglas G. Baird, *In Coase's Footsteps*, 70 U. CHI. L. REV. 23, 31 (2003) ("The reasons for bringing Fisher within GM's orbit had nothing to do with asset-specificity and everything to do with minimizing production costs.").

All firms have relationships; not all firms, however, have going-concern value. Chapter 11 is traditionally defended on the grounds that it is needed to preserve businesses with going-concern value, not all firms. To make the case that a business has substantial value as a going concern, one must establish both that the business' relationships are costly to replicate and that the business is itself sound. Neither is necessarily true.

First, relationships may be relatively inexpensive to put in place. Nothing about Coase's theory of the firm requires that the relationships that constitute the firm be costly to create or replicate. Indeed, Coase's theory tells us that unless these costs are low, production will take place outside the firm.[56] Moreover, as transaction costs go down, the upper bound on the value of relationships of the firm goes down as well. The cost of hiring a janitorial service puts a limit on the value a janitor brings to a firm.

Those who move to new jobs do incur transition costs. You need to find where the water coolers are. But these costs can be exaggerated. Law professors can move back and forth to teach at different schools in several jurisdictions over the course of a few months. CEOs are regularly hired from outside the industry.[57] Forming a business is, of course, hard. There is a critical mass of relationships that takes time to develop. If you open a new restaurant, even at a location that used to be a restaurant, it takes a number of months to train the workers, obtain suppliers, gain customers, adjust the menus, and so forth. But these costs, too, are easy to overstate.[58] A restaurant has relationships with a variety of vendors, but switching to new vendors is easy and cheap.[59] The Internet has made it even easier and cheaper. Moreover, the same forces that make these relationships easier to establish make it easier to sell a business as a going concern.

Even where relationships would be expensive to build anew, one needs a sound business plan to create going-concern value.[60] An absence of going-concern value is a common characteristic of many of the businesses that were

56. As noted, one of the businesses LoPucki cites as having going-concern value—Revere—provides a nice illustration of the point. The same cooking ware can be made by a third party through contract as by the business itself.

57. WorldCom and United's CEOs, hired just after or just before the Chapter 11 filing, are examples.

58. In 1913, when Ford Motor Company was one of the most profitable companies in the world, it had an employee turnover rate of 380%. *See* DAVID A. HOUNSHELL, FROM THE AMERICAN SYSTEM TO MASS PRODUCTION 1800-1932: THE DEVELOPMENT OF MANUFACTURING TECHNOLOGY IN THE UNITED STATES 257 (1984).

59. Even among the restaurants that *fail* in Chapter 11, old owners are able to establish another restaurant quickly more than a third of the time. *See* Douglas G. Baird, *The New Face of Chapter 11*, 12 AM. BANKR. INST. L. REV. (forthcoming 2004).

60. LoPucki slights the difficulty of crafting a successful business plan when he offers that "[s]imply by itself adopting a better operating plan, the reorganizing firm can save its low-level, firm-specific knowledge and expertise." LoPucki, *supra* note 3, at 655. Mainline carriers in the airline industry still have yet to "simply adopt" an operating plan that generates going-concern value.

liquidated in Chapter 11 in 2002. WebVan's infrastructure cost hundreds of millions to put in place, but it could not deliver groceries in a way that competed successfully with ordinary supermarkets. Iridium spent billions putting satellites in orbit and creating a vast network of receiving stations on the ground.[61] Relationships were established with telephone companies throughout the world, but Iridium proved to be worthless. Its value as a going concern turned on whether it could compete with other technologies and it could not.

In the end, one cannot rest Chapter 11 on the need to preserve relationships. Not all relationships have value. Even in financially distressed firms that have potentially costly and valuable relationships—firms that are hard to find—a traditional Chapter 11 proceeding is not necessary to preserve such relationships.

C. *Asset Sales and Absolute Priority*

A business that has developed an efficient way to manage dozens of different hotel franchises does not usually encounter financial distress—its competitors do. Even when the expertise does exist and the business is in distress, creditors are better able to prevent fights among themselves that put the assets in jeopardy. If all else fails, we can usually preserve going-concern value with a going-concern sale. Creditors no longer fear that the failure to reach a deal with current managers will lead to a piecemeal breakup of the business in which value is lost. As we showed in Part I, the dominant feature of the large corporate Chapter 11 today is the asset sale. A large corporation that files for bankruptcy is in play. Selling a business in Chapter 11 is no longer a last resort but an option to be exercised at any time if it is in the creditors' interest.

Asset sales preserve a business' going-concern value in a way that undercuts the liquidation/reorganization dichotomy that marks much discussion about bankruptcy law. Bankruptcy scholars for years have viewed the choices facing a corporation as either to reorganize consensually in order to preserve going-concern value or have its assets sold piece by piece for a fraction of their value. Such a fear is largely misplaced. We see sales of discrete divisions and units, but only because they are thought to maximize value.[62] Creditors may at

61. Like WebVan, Iridium is discussed in Baird & Rasmussen, *supra* note 1, at 767-68.

62. Comdisco reached an agreement to sell one of its principal businesses to Hewlett Packard for $610 million before filing for bankruptcy. As has become commonplace, the bankruptcy judge insisted that others have the chance to bid. An auction ensued and this division was ultimately sold for $835 million to another buyer within several months of the petition. *See* Kevin Murphy, *SunGard Wins Comdisco Bid, Awaits Antitrust Ruling*, COMPUTERWIRE, Nov. 12, 2001. Comdisco then proceeded to find buyers for the rest of its assets. *See* Thania Markes, *Comdisco Plan Wins Court Approval*, FIN. TIMES, Aug. 1, 2003, at 23.

times decide that the market for a group of assets is depressed,[63] but, across the broad range of cases, asset sales do not destroy going-concern value. Rather, asset sales are a way to preserve what going-concern value may exist by putting the corporation's assets into new hands.

Sales, as LoPucki points out, do place a value on the business today, thus eliminating the option value of junior investors.[64] When there is an asset sale, the proceeds are often less than what the most senior creditors are owed. Those junior to them are often wiped out. If the sale had not taken place, the values might have increased. Junior interests have value as long as there is no day of reckoning.

This collapsing of all future possibilities into present value, however, is not unique to asset sales. Regardless of whether there is an actual sale or the hypothetical sale that takes place in a traditional reorganization, the absolute priority rule requires a valuation in every case. This valuation collapses future values to the present and fixes everyone's rights. Hence, even when we do not have asset sales in large Chapter 11 cases, equityholders typically get wiped out.[65] This effect of the absolute priority rule generates strategic behavior that

---

63. *See* Andrei Shleifer & Robert W. Vishny, *Liquidation Values and Debt Capacity: A Market Equilibrium Approach*, 47 J. FIN. 1343 (1992).

64. LoPucki focuses on how sales extinguish the rights of equityholders. As we note below, however, equity is nearly always wiped out in modern, large Chapter 11s, even when there are not asset sales. Nevertheless, LoPucki's observation about the importance of taking the option value of junior investors into account is surely correct and applies equally to junior creditors.

65. LoPucki's dataset once again makes this point clear. Of the businesses that emerged with a plan formed in Chapter 11, equity is unequivocally wiped out in 17 of the 23 cases: Arch Wireless, CareMatrix, Classic Communications, Fruit of the Loom, Global Crossing, ICG Communications, FLAG Telecom, Kitty Hawk, Mariner Post-Acute Network, Pillowtex, Sun HealthCare, Teligent, Sterling Chemical, Sunterra, Weblink Wireless, Viatel, and York. Equity is also wiped out in Fine Air (with the caveat, noted above, that the old equityholder was a minority investor in the company that was the high bidder at the auction conducted by the bankruptcy judge).

Equity did hold on to some stock in Oxford Automotive and perhaps in Derby Cycle as well. Both, though coded as entering without prenegotiated plans, implement deals struck before bankruptcy. In Carmike Cinema, equityholders retained some stock, but in that case creditors were paid in full.

Metals USA is interesting in that it is one of the few corporations in which equity was not wiped out. Old stockholders were given warrants. The exercise price of the warrants, however, was so high that the old shareholders would exercise them only if the stock proved valuable enough to pay the creditors in full. *See Plan Summary, Metals USA, Inc.*, BANKR. DATASOURCE, Oct. 1, 2002. Although the warrants would give the equityholders only 15% of the equity in the end, the basic structure of the plan resembles not so much a traditional one as one that implements Bebchuk options. *See* Lucian Arye Bebchuk, *A New Approach to Corporate Reorganizations*, 101 HARV. L. REV. 775 (1988).

Lodgian was the only insolvent business that entered bankruptcy without a preexisting deal in which the equityholders received some equity. Here the equityholders mounted a challenge to the rights of one creditor class to reach across different corporate entities. The dispute resulted in a deal in which the equityholders received 3% of the new equity and warrants. (The plan itself nominally wiped out the equity. Equity received its share as a

is hard to overcome.[66] Hence, alternatives to the absolute priority rule (such as relative priority) may make more sense. Bankruptcy scholars have paid too little attention to this feature of the absolute priority rule. Understood in this way, LoPucki's observation is well-taken, but it is not an objection to asset sales.[67]

Nor is it right to think that junior creditors resist sales. Under current law, when a reorganization is imminent, the junior creditors, far from fearing a sale, sometimes encourage it. By putting the business in play and stirring up competition among potential buyers, they can end up with more than they would in a traditional reorganization. In Budget's Chapter 11, for example, the junior creditors were the ones pushing the sale.[68] The sale to Avis generated a premium commonly seen in corporate control transactions outside of bankruptcy and left the general creditors with more than would a traditional reorganization.

III. CONTROL RIGHTS IN CHAPTER 11

LoPucki envisions a Chapter 11 process where the board mediates the interests of various constituencies. The board of directors is calling the shots. The residual owners of the business cannot be identified with certainty, and the board is well-positioned to take the interests of all into account.[69] LoPucki,

---

result of a side-deal with the creditor class.) This routine elimination of equity is yet another way in which extant Chapter 11 practice deviates from that of fifteen years ago. *See* Lynn M. LoPucki & William C. Whitford, *Bargaining Over Equity's Share in the Bankruptcy Reorganization of Large, Publicly Held Companies*, 139 U. PA. L. REV. 125 (1990).

66. Donald Bernstein sets out the various forms of strategic behavior at work here in Donald Bernstein, Presentation to the American College of Bankruptcy Lawyers, Washington, D.C. (Mar. 28, 2003). He argues that, in large cases, financial instruments can remove the costs associated with collapsing future values to the present in Chapter 11. His approach, however, can be used when assets are sold as well as when businesses are reorganized.

67. The importance of taking the option value of junior investors into account has, of course, been known for a long time. Robert Swaine developed this idea during the 1920s. *See* Robert T. Swaine, *Reorganization of Corporations: Certain Developments of the Last Decade*, 27 COLUM. L. REV. 901, 912-23 (1927). In a previous paper, we examined Swaine's contribution to the law of corporate reorganizations. *See* Baird & Rasmussen, *supra* note 50, at 401-08. It would also be a mistake to think that this feature of bankruptcy law is something that we have neglected. We provide a detailed account in Baird & Rasmussen, *supra* note 49.

68. The majority of the unsecured creditors were strong supporters of this deal. Indeed, they were willing to sign a lock-up agreement with Avis before the petition committing themselves to supporting the sale, but they did not sign such an agreement as it was not in Avis' interest. Such a lock-up agreement would disqualify them from service on the creditors' committee. Their claims were large enough to ensure them of representation on the committee and, by being on the creditors' committee, they could ensure that the sale would go through without a hitch.

69. Someone must affirmatively govern the firm. Bankruptcy reorganization solves the governance problem by leaving the directors in control of the firm and imposing on them

however, overstates the difficulty in ensuring that decisions are placed in the right hands, understates the constraints under which the boards of financially distressed corporations operate, and fails to acknowledge the realities of current practice. We address each in turn.

A. *Residual Owners*

The law of corporate reorganizations offers a solution to the collective action problem that exists when too many creditors chase too few assets. But financial distress can be anticipated, and debtors can arrange their affairs in such a way that minimizes this collective action problem. No collective action problem exists when a business has a sole owner and no creditors. No legal regime is needed to preserve relationships in this environment, no matter how valuable they are. Most businesses have multiple parties with a stake in the assets. For businesses that have few debts relative to their assets, we can again look to the shareholders to make sensible decisions. They enjoy the benefits and bear the costs of almost any decision they make.[70] Similarly, a business may be so hopelessly insolvent that a single senior creditor is effectively the residual owner.

As LoPucki properly points out, we must confront those situations in which there is no readily identifiable residual owner. By the time WebVan shut down, the unsecured creditors received less than fifty cents on the dollar. Hence, for some period of time, they were the residual owners of the business but at no point were they involved in decisionmaking. The person making the decision about whether to keep the business running, whoever it was, could not have been the residual owner. Observing that no residual owner existed, however, does not itself tell us that the decisionmaking that took place was bad. Nor does it suggest the decisions were inconsistent with the interests of the general creditors.

It is easy to criticize WebVan for its initial missteps and the wasteful spending of its CEO, but none of this had anything to do with the choice facing WebVan in its last months—how long to keep the business running. As its founders observed early on, WebVan was the kind of business that would be worth ten billion dollars or nothing.[71] The risks and the potential returns were high. In such an environment, one of the most important issues in designing the allocation of control rights is ensuring the shutdown decision is made at the right time. You do not want to give up on a huge capital investment, but, at

---

fiduciary duties to all parties in interest. Under the loose supervision of a disinterested judge, the directors impose their decisions on the usually hopelessly conflicted parties. *See* LoPucki, *supra* note 3, at 665.

70. Of course, this is true only at first approximation. Any debt in a firm's capital structure creates an overinvestment incentive. By and large, creditors can protect their interest via price and contract terms.

71. *See* RANDALL E. STROSS, EBOYS 43 (2000).

some point, you have to cut your losses.

At the time they invested, WebVan's general creditors, like everyone else, wanted to ensure that this decision was made at the optimal time. But they would not necessarily bargain for the right to make this decision themselves the moment they became residual owners. Among other things, they likely lack the expertise to make this decision at the optimal time. But the locus of the decision does not need to reside with them. Nor does the mechanism even have to entrust this decision to a single person. A variety of mechanisms can be put in place outside of bankruptcy to induce value-maximizing decisions.[72]

In the case of WebVan, the decision to close WebVan was formally entrusted to equityholders or those beholden to equityholders. They have an incentive to keep the business running too long. But this picture is too simple. Start-up businesses like WebVan require cash. The managers running WebVan ultimately closed it down because they could not find additional providers of cash to keep it running. The managers would have a bias in favor of keeping the business running. The senior creditors would have a bias towards shutting it down. Providers of new cash, however, at first approximation, have exactly the right incentive. They will be willing to provide an additional dollar as long as the risk-adjusted return on that dollar yields them a competitive return. WebVan might lack anyone who is a residual owner, but it can nevertheless create a mechanism that yields sensible decisions by forcing those in control to return to capital markets to keep it running.

WebVan's unsecured creditors did not receive repayment in full, but this itself tells us *nothing* about whether control rights were allocated in a way that ensured it was shutdown at the right time. The optimal time to shut WebVan down turns on its liquidation value relative to the discounted present value of its future earnings, not on the relationship of liquidation value to the amount the unsecured creditors were owed.[73] To the extent that unsecured creditors would tend to shut the business down at the wrong time, one should not expect them

---

72. We develop the idea that control rights can be allocated coherently even when multiple parties possess powers to affect decisionmaking in Baird & Rasmussen, *supra* note 49. We do not rest on the idea that a single residual owner exists in every case. Hence, the argument that such creatures do not exist is neither here nor there.

In this respect, LoPucki seems to focus too heavily on the work one of us did in the early 1980s. *See, e.g.*, Douglas G. Baird & Thomas H. Jackson, *Corporate Reorganizations and the Treatment of Diverse Ownership Interests: A Comment on Adequate Protection of Secured Creditors in Bankruptcy*, 51 U. CHI. L. REV. 97, 108-09 (1984). That work, while discussing the need to create mechanisms that allow disparate owners to act as one, emphasized the advantages of ensuring that decisionmakers were residual owners who bore the costs and benefits of any decision they made.

73. Shutting a business down at the right time is an optimal-stopping problem. In comparing the liquidation value and the going-concern value, one needs to take into account the option value associated with waiting. As a result, a business should be kept running even when the discounted value of its future earnings is *less* than its liquidation value. Douglas G. Baird & Edward Morrison, *Bankruptcy Decisionmaking*, 17 J.L. ECON. & ORG. 356 (2001). For a formal proof, see Morrison, *supra* note 51, at 54-55.

to have the power to do so.[74]

The law allows parties great freedom to craft investment contracts in a way that is to their liking. People learn with time. The investment contracts in the typical large case are the product of careful design. Investors in large businesses allow capital structures to emerge in which those who have the power to make decisions are likely to make good ones. Moreover, the tensions that might exist in cases such as WebVan if its control rights were allocated incoherently, however, should not be exaggerated. Large businesses do not ordinarily find themselves in situations in which the senior creditors want to shut them down, while the junior ones do not.[75]

More often, the decision is one that, if correctly made, will benefit senior and junior creditors alike. The business needs to find a chief restructuring officer. The question is who the best person is. Creditors with diverse interests can often agree on such questions or defer to someone who has more experience. To say that control rights tend to be allocated coherently is to say that those who have a voice in making this decision have both the skill and the incentive to make it correctly.[76] Enron is one of the most expensive and contested bankruptcies ever, but there was almost no disagreement with respect to the single most important decision at the start of the case—a decision to sell its trading operation to UBS. The sale went through without objection even though UBS was not willing to offer any cash for a business that, at the time, appeared to many to be worth billions.[77]

Nor should we assume that residual owners are hard to find in large Chapter 11 cases. As a large business encounters financial distress, for example, multiple institutional creditors often morph into a single revolving credit facility. When we look at recent large, prenegotiated Chapter 11 cases, one commonly observes that the senior bondholders are in fact the residual owners for all practical purposes. They use Chapter 11 not because there is a collective action problem but because it is the easiest way for them to extinguish junior stakeholders that are out of the money. These are more than half of all the nonliquidating Chapter 11s involving large businesses. The

74. One needs to be careful here. The right to call a loan, which many creditors have merely when there are reasonable grounds for insecurity, is not the same as saying that this right will be exercised whenever there is a default. Ordinarily, defaults merely set the stage for negotiations. Even when they do not, they can force a shutdown only if the entrepreneur is unable to return to the capital markets.

75. As we have noted, small Chapter 11s are significantly different in this respect.

76. We elaborate on these points in other work. *See* Baird, *supra* note 59; Douglas G. Baird & Robert K. Rasmussen, Corporate Governance, State-Contingent Control Rights and Financial Distress (2004) (unpublished manuscript, on file with authors); Robert K. Rasmussen, Secured Credit, Control Rights and Real Options (2003) (unpublished manuscript, on file with authors).

77. Enron's massive trading operations reported earnings of $3 billion. At the time of the filing, some might have suspected these were exaggerated, but few thought the business was worthless.

railroads of the nineteenth Century had dozens of different bonds covering many different types of collateral. Capital structures today are better designed. The direction of the change is unmistakable and it takes us away from the traditional reorganization.

B. *The Board of Directors*

Inside of bankruptcy and out, directors formally make the important decisions about the future of the business. One should not, however, mistake this formal power with the question of whose interests are being served. Directors look to the creditors when the business is in trouble. Even if the directors are not actively involved in the business before it encounters financial distress, they wake up when it does, and, at this point, their concerns about their own liability (and the potential shortfall in the company's D & O insurance) ensure that they take the interests of the creditors to heart.[78]

Perhaps more importantly, while some businesses may emerge from Chapter 11, the directors of these businesses do not survive. The board often turns over during the course of the Chapter 11 case.[79] In any event, by the end of the case, the plan of reorganization brings with it a new set of directors, usually appointed by the creditors.[80] The old creditors typically hold a

78. *See supra* note 69.

79. For example, the largest Chapter 11s to date—WorldCom, Global Crossing, and Adelphia among them—had a complete turnover of directors.

LoPucki properly points out that, in WorldCom, the directors, while newly appointed, were independent of the creditors. WorldCom, however, is a special case. The creditors there needed directors of stature and impeccable integrity to calm the regulatory waters and fend off efforts of its competitors to shut it down. Verizon's general counsel, a former Attorney General of the United States, testified against WorldCom before Congress. Under such circumstances, it is hardly surprising that the creditors would have brought on board another former Attorney General of the United States, rather than some run-of-the-mill vulture investor. To preserve the value of their collateral, they needed to fight fire with fire. *Compare The Worldcom Case: Looking at Bankruptcy and Competition Issues, Hearing Before the S. Comm. on the Judiciary*, 108th Cong. (2003) (testimony of William Barr, Executive Vice President and General Counsel, Verizon Communications), *with The Worldcom Case: Looking at Bankruptcy and Competition Issues, Hearing Before the S. Comm. on the Judiciary*, 108th Cong. (2003) (testimony of Nicholas Katzenbach, Board Member, MCI Telecommunications).

The appointment of independent directors in WorldCom hardly suggests that creditors in the case had no control. Indeed, if a significant number of creditors in WorldCom had been foolish enough to want to displace Katzenbach, all they would have had to do was invoke their right to elect a trustee to run the business. A creditor can insist on the appointment of a trustee as a matter of right in the presence of fraud. *See* 11 U.S.C. § 1104 (2003). Bankruptcy judges resist such a move if a stray creditor or two makes the motion but not when the creditors' committee or any other significant constituent demands it.

80. Among the Chapter 11s that emerged in 2002 that did not come into bankruptcy with a prenegotiated plan, we see creditors appointing a new board in the majority of cases. Metals USA is a representative example. In that case, the plan provided for a new board of directors, appointed by the creditors committee. Their first task was to look for a new CEO.

controlling interest in the equity of the new company and use this right to install a new board. The people they appoint are not independent people of stature chosen to mediate among competing groups, but rather those whose loyalty they can count on. Indeed, the creditors often pick themselves or their employees.

Kmart's nine-member board of directors upon emergence from Chapter 11 is altogether typical. ESL Investments is the hedge fund that emerged with control of Kmart.[81] The reorganization plan gave it the right to appoint four directors. Edward Lampert, the head of ESL Investments, appointed himself, two of his employees, and a major investor in ESL. The next largest investor, Third Avenue Management, was able to place one of its employees on the board. Together, they controlled the board and ensured the election of Lampert as chairman.[82] During the months since Kmart's emergence from Chapter 11, Lampert has exercised control and appointed a number of ESL employees to key management positions.[83] Many of the changes are long overdue financial controls that benefit everyone, but nothing suggests that Lampert is doing anything other than watching out for his own majority stake in the reorganized business.

Even when the business remains publicly traded (and it often does not), creditor control is much in evidence. Pillowtex provides a representative example. Its board upon emergence from bankruptcy consisted of seven members. Three were executives from Oak Tree Capital, the vulture fund that acquired a large stake in the business during Chapter 11, and another was a senior vice president of Lehman Brothers, a large secured creditor in the case.[84] One can imagine a world in which legal rules with teeth ensured that board members looked beyond their narrow self-interest, but this is simply not the world facing the vast majority of the businesses that emerge from Chapter 11 today.[85] Under current law, vulture investors and those who work for them do

---

Nelson Antosh, *Metals USA Shrinks, Exits Bankruptcy*, HOUSTON CHRON., Nov. 5, 2002, at Bus. 1. Creditors also appointed new boards in FLAG Telecom, Kitty Hawk, Lodgian, Mariner Post-Acute Networks, Pillowtex, Sun HealthCare, Sunterra, and Weblink Wireless. This list is not exhaustive. However desirable it might be to have a reorganization law that uses a board to preserve relationships, current Chapter 11 as practiced does not do this, at least not by the time the case is over.

81. ESL acquired control by buying up $400 million of Kmart's debt and agreeing to invest an addition $100 million after the case emerged from Chapter 11.

82. *See Edward S. Lampert Appointed Chairman of the Board, Kmart Holding Corp.*, PR NEWSWIRE, May 6, 2003.

83. Karen Dybis, *Kmart Adds Financial Control*, DETROIT NEWS, Sept. 9, 2003, at 1C.

84. *See* Leticia Leizens, *Creditors Set to Take Over Pillowtex as It Exits Chapter 11*, HOME FURNISHINGS NEWS, May 6, 2002, at 5; Leticia Leizens, *Investment Bank is Betting on Big Payoff with Pillowtex*, HOME FURNISHINGS NEWS, Jan. 14, 2002, at 28.

85. Directors are almost never held liable for violating their duty of care. *See* Edward B. Rock, *Saints and Sinners: How Does Delaware Corporate Law Work?*, 44 UCLA L. REV. 1009 (1997). Moreover, to the extent the case law speaks expansively of fiduciary duties, it is to underscore the obligations that directors of distressed businesses owe to creditors. *See,*

not act as if they owe any duty to the world at large. They are not an altruistic or sentimental lot, and they are most unlikely to face legal liability from advancing their own agenda to the exclusion of others.[86] The Board may be in the saddle, but the whip is in the creditors' hands.

CONCLUSION

When we examine the large businesses that enter Chapter 11 today, we can no longer rest on the comfortable homilies of the past. Modern bankruptcy judges oversee auctions of going concerns and implement prenegotiated plans of reorganization with consummate professionalism, and we should admire the work they do. But Chapter 11 no longer serves anything like the role commonly ascribed to it. A court-conducted sale of Fruit of the Loom in which the high bidder is Warren Buffett bears no resemblance to an equity receivership. Even in those cases that look most like a traditional large corporate reorganization, the stakes are quite small. A collection of Marriotts and Holiday Inns is nothing like a railroad.

In examining the nature of the change in the large corporate Chapter 11s of 2002, we see that fundamental forces at work in the economy have made the traditional reorganization increasingly obsolete. Railroads had enormous going-concern value and incoherent capital structures, while facing primitive capital markets. Today's businesses can be replicated with virtual businesses that organize production through the marketplace over the Internet. Any going-concern surplus can be captured for creditors via a sale.

Of all the cases to leave Chapter 11 in 2002, the one that most resembles a traditional reorganization is Pillowtex. Many plants were in small communities that depended mightily on them. Pillowtex's Chapter 11 reorganization was a two-year long effort to mediate the relationships among employees, suppliers, and others. It brought together diverse interests, and a plan emerged that gave the business its best chance going forward. But forces are at work that even the best intentioned cannot stop. In the end, there was nothing bankruptcy could do to save Pillowtex. The value it once had as a going concern was gone. For better or for worse, the role that Chapter 11 can play in today's economy has little or nothing to do with reorganizing railroads or saving factories in small towns. Traditional reorganizations are all but gone. The end of bankruptcy is indeed upon us.

---

e.g., Geyer v. Ingersoll Publ'ns Co., 621 A.2d 784, 787 (Del. Ch. 1992).

86. Dictum in the case law suggests boards should look out for others, as do any number of normative theories. But our focus here is descriptive, and directors in the position that these vulture investors occupy are not, as a practical matter, ever found liable for violating their duty of loyalty. Among other things, there are few decisions where these directors would be subject to conflicting loyalties.

***