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BANKRUPTCY COURTS?: REVIEW OF LYNN M.
LOPUCKI, "COURTING FAILURE: HOW
COMPETITION FOR BIG CASES IS CORRUPTING THE
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Is Forum-Shopping Corrupting America's Bankruptcy Courts?

Review of LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE 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's book argues that that current bankruptcy venue rules have spawned an improper "competition for big cases" that has "corrupted" America's bankruptcy courts. LoPucki argues 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 will try to flesh out in more detail the model and theoretical foundations that implicit underlie LoPucki's indictment of bankruptcy forum-shopping (and other forms of forum-shopping as well). Empirical evidence standing alone is insufficient to draw conclusions about whether forum-shopping is in general 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 clear 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, in that the competition may actually expedite the process of self-correction.

This review 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 LoPucki can be best explained as the outcome of improper forum-shopping competition. The essay then closes with an analysis of provisions of the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005, noting that many of the provisions in the legislation offer substantive responses to many of the problems identified by LoPucki.

Keywords: Bankruptcy, Corporate Reorganization, Chapter 11, Forum-Shopping

JEL Codes: B53, K00

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*.¹ Cornyn, then the sponsor of a later-withdrawn amendment to limit “forum-shopping” in bankruptcy cases, asked me for my opinion as to whether such forum-shopping should be prohibited (actually, he asked if bankruptcy forum-shopping “is a cancer on our bankruptcy system”). 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.”

Now I have read LoPucki’s insightful and entertaining book and I am prepared to provide a more definitive answer to Senator Cornyn’s question, “It *still* depends.” LoPucki’s case is bold and provocative, backed by his own pioneering empirical evidence that suggests that something is amiss with the current American bankruptcy system. He argues that “competition” for big bankruptcy cases is exacting a negative effect on the American and global bankruptcy systems. LoPucki provides a mixture of statistical and telling anecdotal evidence that 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 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.

This essay will try to flesh out in more detail the model and theoretical foundations that implicit underlie LoPucki’s indictment of bankruptcy forum-shopping (and other forms of forum-shopping as well). Empirical evidence standing alone is insufficient to draw conclusions about whether forum-shopping is in general 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 clear 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, in that the competition may actually expedite the process of self-correction.

The remainder of this essay proceeds as follows. Part I 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. In particular, although LoPucki’s discussion of the recently enacted “Bankruptcy Abuse Prevention and Consumer Protection Act of 2005” (“BAPCPA”) is cursory and largely negative, several of the reforms to the Chapter 11 system in that

¹ LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* (2005).

legislation address 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 by forum-shopping, by attacking the margins on which judges and bankruptcy filers can compete. Many of the chapter 11 provisions in BAPCPA address these substantive concerns directly, thereby avoiding the difficult and perhaps unnecessary question of whether they are attributable to forum-shopping. Part V concludes.

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.

In application, under subsection (1) venue in a bankruptcy case is appropriate in the district of the debtor's headquarters, principal place of business, or its "domicile" or "residence," the latter which has come to be interpreted to mean the district in which the debtor is incorporated. Under subsection (2), venue is appropriate in any district in which an "affiliate" of the debtor is headquartered, such as a subsidiary. In turn, the affiliate may file in any district in which venue qualifies under subsection (1), and once filed, the parent company and other subsidiaries can piggy-back into that same district. The effect is that for a large corporation with many subsidiaries spread throughout the country, these rules mean that the corporation can file in many districts in the country.

The thesis of LoPucki's book is that this opportunity for bankrupt corporations to choose the district in which they want to file has not simply offered bankrupt corporations a choice of filing locations, but has instead spawned an improper "competition for big cases" that has "corrupted" America's bankruptcy courts. LoPucki argues 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.²

LoPucki argues that the seeds of the current bankruptcy forum-shopping competition were planted in the 1978 Bankruptcy Code, which installed a regime that

² This review will focus on the domestic forum-shopping competition and its effects. Much of the analysis is equally applicable to the international bankruptcy system.

permitted incumbent management to remain in place during bankruptcy, while at the same time permitting this unfettered choice in deciding when and where to file bankruptcy. In the early days of the new Bankruptcy Code, this competition drew cases to the United State Bankruptcy Court for the Southern District of New York and, in particular, to the courtroom of Judge Burton R. Lifland.³ Lifland, LoPucki observes, drew a disproportionate number of the “big” bankruptcy cases of the era, and also drew the reputation as a “pro-debtor” or “pro-reorganization” judge.⁴ By the mid-1980s, however, New York’s run as the predominant venue for bankruptcy forum-shoppers came to an end.

Beginning in 1990, however, the bankruptcy system saw an unprecedented and overwhelming migration of large chapter 11 filings into the District of Delaware. Like New York’s early success, 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.⁵ 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 all of these corporations to file in Delaware.⁶ All they needed was a reason, which Balick soon provided through the adoption of numerous procedural innovations and substantive legal rulings that attracted numerous bankruptcy filings to her courtroom. By 1996, 13 of the 15 largest corporate bankruptcies filed in the nation that year were filed in Delaware.⁷

Few commentators doubt that the “rise of Delaware” was the result of conscious forum-shopping into Delaware by bankrupt corporations. The primary debate, therefore, has not been as to whether there has been a rise of Delaware, but rather whether this development has been generally good or bad for bankruptcy system and the economy.⁸ 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 terms of speed and expertise in dealing with large, complex cases.⁹ “Delaware skeptics,” championed by LoPucki, argue that the rise of Delaware has been a negative consequence of interjurisdictional forum-shopping and that Delaware’s rise represents an unconscionable sell-out to the “case placer” managers and professionals who choose where to file cases, and choose to file in those courts that are most friendly to them. Delaware’s rise, it is

³ LOPUCKI, *supra* note 1, at 45-47.

⁴ LOPUCKI, *supra* note 1, at 46.

⁵ See Barry E. Adler and Henry N. Butler, *On the “Delawarization of Bankruptcy” Debate*, 52 EMORY L.J. 1309 (2003).

⁶ *In re Ocean Props. Of Del., Inc.*, 95 B.R. 304, 305 (Bankr. D. Del. 1988).

⁷ LOPUCKI, *supra* note 1, at 49-50. In 1993, a second bankruptcy judge was added Delaware, Judge Peter J. Walsh. Walsh adopted many of Balick’s practices and case management techniques.

⁸ *But see* Adler & Butler, *supra* note 5, at 1316 (arguing that Delaware’s dominance may be more “apparent” than real).

⁹ See David A. Skeel, Jr., *What’s So Bad About Delaware?* 54 VAND. L. REV. 309 (2001) (distinguishing “Delaware Enthusiasts” and “Delaware Skeptics”).

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," incumbent management and bankruptcy professionals who control the decision of where to file a bankruptcy case. He argues that this ability to manipulate the place of filing has led to inefficient practices that protect (and sometimes even enrich) incumbent management, inefficient reorganizations and subsequent serial bankruptcy filings that benefit management and professionals and harm creditors and employees, and unwitting (or even witting) protection for managers who have been involved in the largest corporate frauds in American history.

LoPucki's claims are bold and provocative, and backed by extensive empirical data. The remainder of this essay will review them in more detail. As will be seen, some of LoPucki's criticisms seem sound, others less so. Several of his 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

Market competition can produce good or bad results, depending on the institutional structure surrounding it and the incentives of the parties partaking in it. In assessing whether competition is beneficial in any market, including a market for law, the relevant inquiry is first, whether the competition process efficiently matches consumer preferences with suppliers of services, and second, whether the competitive process generates positive externalities in terms of the information and feedback that it provides to other market actors to provide incentives to channel behavior and resources toward the satisfaction of some ends rather than others.¹⁰ Whether the outcomes generated a particular market competition will be good or bad on net, therefore, will be a function of the institutional constraints imposed on the actors and the incentives they confront.

Consider, for instance, the market for computers. In that market, retailers face a set of institutional constraints governed by contract law, bans on deceptive practices, transparency and competition in consumer choice, and the like. Sellers have the incentive to meet consumer choice and demand and to sell their product for a lower price than their rivals. From this interaction of institutional constraints and incentives, the market tends to the most efficient matching of consumer demand with product supply, and through the competitive process prices are generated that has the positive externality of enhancing competition, consumer choice, and overall economic efficiency.

Consider, by contrast, the market for heroin. Although the market for heroin has some of the same attributes of the computer market, the institutional constraints and incentives are very different. Lacking contract law, the institutional constraints in this market revolve around the use of violence and an absence of transparency. Although there is a perverse sort of efficiency to the buyers and sellers in this market, the costs of the market are borne by those harmed by the habit (presumably exceeding the actual benefits gained) and externalized on nonconsenting victims of crime. Thus, the net social

¹⁰ See F.A. Hayek, *The Use of Knowledge in Society*, 35 AM. ECON. REV. 519 (1945).

harm of the heroin market exceeds the benefits it generates. Moreover, if there is competition for the services in this market, it will tend to decrease the price of purchasing heroin, leading to an increase in demand and an accompanying increase in the social harm that flows from it.

The value of a well-functioning competitive market is that through its decentralized processes and experimentation, it can produce results that are “smarter” than any central planner or centralized law-maker by making use of dispersed information and small-scale experimentation and weeding out of less-efficient ways of doing things. Through the process of experimentation and selection through market competition, the market comes to sift and coordinate knowledge, driving a relentless process of learning to do things better and more efficiently.¹¹ It is the fact that this “spontaneous order” that arises from the decentralized decision-making within the constraints of the market process that commends market institutions as a superior system of social organization to top-down centrally-planned systems.¹² The same basic analysis applies to the development of law—decentralized competitive processes such as the common law,¹³ customary law, and constitutional federalism¹⁴ may be able to better make use of decentralized knowledge and local experimentation to devise new and better legal rules that further social cooperation and economic efficiency better than any ideas conceived by a centralized law-maker.

Moreover, the value of a competitive system is that it is dynamic and incorporates tacit knowledge that can be neither fully recognized nor fully articulated. As a result, the proper mode of analysis for determining the social utility of such a system cannot nor should not be whether the outcomes of the system generate the optimal rules in each situation. Rather, the proper test is a “structural” one—whether the institutional design of the process is such that it, *in general*, the competitive process will tend to the promotion of social welfare, rather than attempting to judge the efficiency of specific outcomes.¹⁵

As Hayek observes, if the “correct” or “efficient” answer to a given economic problem is known in advance, there would be little reason to use the competitive process to discover it. Competition is useful only when the best answer is *not* known in advance, but can be discovered only by trial-and-error and feedback. Competition is thus an evolutionary process, where constant innovation and experimentation with new methods of doing things winnows out poor ideas and allows good ideas to emerge. The value of

¹¹ See Armen A. Alchian, *Uncertainty, Evolution, and Economic Theory*, 58 J. POL. ECON. 211 (1950).

¹² Hayek, *Use of Knowledge*, *supra* note 10.

¹³ HAYEK, 1 LAW, LEGISLATION, AND LIBERTY: RULES AND ORDER (1972).

¹⁴ The classic argument analogizing the competitive process of federalism to the market is 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, 3111 (1932) (Brandeis, J., dissenting).

¹⁵ See A.C. Pritchard & Todd J. Zywicki, *Finding the Constitution: An Economic Analysis of Tradition’s Role in Constitutional Interpretation*, 77 N.C. L. REV. 409 (1999); see also Robert D. Cooter, *Decentralized Law for a Complex Economy*, 23 S.W. L. REV. 443-45 (1994) (describing “structural approach” to analyzing predicted efficiency of rules generated under different institutional structures); Robert D. Cooter, *Structural Adjudication and the New Law Merchant: A Model of Decentralized Law*, 14 INT’L REV. L. & ECON. 215, 217 (1994) (“[L]awmakers following the structural approach infer the efficiency or inefficiency of a norm, rather than measuring it directly.”).

competition is thus in its *process*, which if properly constructed, permits an *inference* that what emerges from the process is the most efficient solution to the problem. Competition is thus valuable in situations where the correct or best answer is not known in advance, but rather is discovered through the competitive process. As Hayek notes, “*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.”¹⁶ He 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.”¹⁷ 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”¹⁸ 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.”¹⁹ If the correct answer is known in advance, the trial-and-error process of competition is largely wasteful.

On the other hand, the outcomes of a well-functioning competitive market can be inferred to be efficient.²⁰ Thus, we can infer consumer preferences for the attributes of automobiles from the purchase decisions made by consumers in that market. A variety of combinations of price, styling, safety, and gas mileage are offered in the market and consumers can choose among them. 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. Similarly, although the federal government could enact a federal uniform corporate law or law of contracts, it has chosen not to, in part out of deference of permitting a more decentralized process of legal development that enables local experimentation and copying. It is only where it is thought that the benefits of federal uniformity outweigh the virtues of permitting local experimentation that federal action has generally been thought appropriate. The market for law, as captured in forum-shopping behavior, can be analyzed through the same lens.

The first question is the nature of the constraints on the actors in the market, and whether those institutions tend to the promotion of economic efficiency versus cost externalization. In particular, do the institutions tend to promote efficient or inefficient market arrangements? In turn, there are two subsidiary questions that are necessary to answer with respect to that overarching question. 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

¹⁶ F.A. Hayek, *Competition as a Discovery Procedure*, 5 Q. J. AUSTRIAN ECON. 9, 9 (2002) (Marcellus S. Snow Trans.) (lecture originally given in 1968).

¹⁷ *Id.*

¹⁸ *Id.*

¹⁹ *Id.* at 10.

²⁰ *Id.*

well organized groups to try to manipulate the collective decision outcomes so as to transfer wealth to themselves from others.²¹

The second question is that of analyzing the incentives confronting the actors in the market under consideration, and particularly whether those making the decisions face incentives that will tend to the production of efficient law, or rather to partial law that systematically favors some parties and allows them to transfer wealth to themselves or to otherwise detrimentally impact the development of the law.

This Part of the article 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 third forum-shopping regime, that of modern corporate law, where the results of forum-shopping competition have been more ambiguous, in that although the incentives are clear, the institutional constraints governing the competition are sufficiently unclear 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.²² The law that emerged during this period arose from a long period of coexistence between the various government-created and sponsored courts competing with a variety of other jurisdictions, including Church courts, local courts, and even private courts, such as the *lex mercatoria* or law merchant. As the common law courts eventually absorbed these rival courts, “the common law ... absorbed much, if not all, of the judicial business of its competitors and may have borrowed heavily from them in the process of aggrandizement.”²³

²¹ See Todd J. Zywicki, *The Rise and Fall of Efficiency In the Common Law: A Supply-Side Analysis*, 97 NW. U. L. REV. 1551, 1581-1621 (2003).

²² See Zywicki, *supra* note 21; see also HAROLD J. BERMAN, *LAW AND REVOLUTION: THE FORMATION OF THE WESTERN LEGAL TRADITION* (1983); Tom Bell, *Polycentric Law* 7 HUMANE STUD. REV. 1 (1991), available at <http://www.theihs.org/libertyguide/hsr/hsr.php/12.html>.

²³ ARTHUR R. HOGUE, *ORIGINS OF THE COMMON LAW* 5 (1966).

As an initial matter, 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.²⁴ In addition, “Secular law itself was divided into various competing types, including royal law, feudal law, manorial law, urban law, and mercantile law.”²⁵ 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,²⁶ not to mention the equitable Chancery court. There were many courts, national and local, royal and ecclesiastical, public and private. Although each was formally defined by a particular jurisdiction, their jurisdictional reach often overlapped and even where they did not, the limits were often evaded through the use of fictions designed to circumvent these formal limits.²⁷ Still further, each of the common law courts shared jurisdiction over many disputes with the Court of Chancery. as late as 1765, Blackstone observed in his Commentaries that multiple types of law still prevailed in England, including natural law, divine law, the law of nations, the English common law, local customary law, Roman law (governing Oxford and Cambridge Universities), ecclesiastical law, statutory law, and the law merchant.²⁸ 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.”²⁹ “This arrangement, seemingly impracticable to modern eyes, was a feature of English public life for five centuries.”³⁰

This multitude of overlapping jurisdictions meant that private litigants could forum-shop into those courts that best met their preferences. In turn, judges competed to expand their jurisdictions and to attract business to their courts. The impetus for this

²⁴ BERMAN, *supra* note 22, at 10; DANIEL R. COQUILLETTE, THE ANGLO-AMERICAN LEGAL HERITAGE: INTRODUCTORY MATERIALS 183 (1999) (noting that Church courts were most important rival to royal common law courts).

²⁵ BERMAN, *supra* note 22, at 10.

²⁶ HOGUE, *supra* note 23, at 189. 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. See J.H. BAKER, AN INTRODUCTION TO ENGLISH LEGAL HISTORY 46 (1971). 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. 9 Ex. 341, 156 Eng. Rep. 145 (1845).

²⁷ See S.F.C. MILSOM, HISTORICAL FOUNDATIONS OF THE COMMON LAW 23-24 (2d ed. 1981).

²⁸ 1 WILLIAM BLACKSTONE, COMMENTARIES ON THE LAW OF ENGLAND 3-27 (1765) (reprinted 1966).

²⁹ Harold J. Berman, *The Western Legal Tradition in a Millennial Perspective: Past and Future*, 60 LA. L. REV. 739 (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; townsmen might bring their causes before the court of a borough, which would judge them by rules of the law merchant.” HOGUE, *supra* note 23, at 45.

³⁰ BERMAN, *supra* note 22, at 29.

competition was that judges' salaries were paid in large part from the fees of litigants.³¹ This gave judges the incentives to work harder and to draw more cases to themselves, in order to maximize fee income. Some courts, such as government-sponsored courts, drew partial subsidies from tax revenues; others, such as the private law merchant courts, drew no government subsidy and thus were wholly reliant on litigant fees. As a result, judges had an incentive to compete for business and draw cases to their courts.³²

The institutional structure of jurisdictional choice combined with private incentives of judges to compete for cases created a system of competition among courts for case filings, leading to competition to provide the speediest and fairest justice. This forced courts to be responsive to their customers, i.e., the litigants that came before them, rather than to respond to 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.³³ Innovative systems of pleading and evidence, along with more 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. As Plucknett observes, even though the 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.”³⁴ This competition thereby also tended to produce the positive externality of improving the intellectual quality of the law, thereby benefiting the public generally.³⁵

Adam Smith recognized the positive role played by this competitive process on the 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.”³⁶ 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 to have their cause tried; and each court endeavoured, by superior dispatch and impartiality, to draw to itself as many causes as it could.”³⁷ Smith attributed

³¹ See Zywicki, *Rise and Fall*, *supra* note 21, at 1583.

³² See JOHN HUDSON, *THE FORMATION OF THE ENGLISH COMMON LAW: LAW AND SOCIETY IN ENGLAND FROM THE NORMAN CONQUEST TO MAGNA CARTA* 26 (1996); BRUCE LYON, *A CONSTITUTIONAL AND LEGAL HISTORY OF MEDIEVAL ENGLAND* 443 (2d ed. 1980); BAKER, *supra* note, at 31; William M. Landes and Richard A. Posner, *Adjudication as a Private Good*, 8 J. LEGAL STUD. 235 (1979).

³³ 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).

³⁴ THEODORE F.T. PLUCKNETT, *A CONCISE HISTORY OF THE COMMON LAW* 650 (5th ed. 1956).

³⁵ Zywicki, *Rise and Fall*, *supra* note 21, at 1586.

³⁶ ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS* bk. V, ch. 1, pt. 22, at 241 (Edward Cannan ed., 1976).

³⁷ *Id.* at 241.

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.³⁸

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.”³⁹ 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.⁴⁰ 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, enabling improvement in the common law and the modernization of British commercial law.⁴¹

The alignment of the institution of competing courts with judicial incentives to compete for business brought about a healthy competition that tended to 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.⁴²

But if plaintiffs could choose the court through the initiation of the case, why didn't this competition lead to courts competing on the narrow ground of providing pro-plaintiff law, rather than generating a competition to generate socially-beneficial efficient legal rules?⁴³

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.⁴⁴ In some situations, as with the law merchant, it was a result of the reciprocal nature of the parties and disputes. In commercial courts, such as the law merchant courts, legal disputes were characterized by a high degree of reciprocity. Because merchant law was rooted in the customs of traders, this reflected the

³⁸ *Id.* at 241-42.

³⁹ ADAM SMITH, *Report of 1762-63*, in LECTURES ON JURISPRUDENCE 423 (R.L. Meek et al. eds., 1982); *see also id.* (“During the improvement of the law of England there arose rivalships among the several courts.”).

⁴⁰ Smith, *Report of 1762-63*, in LECTURES ON JURISPRUDENCE, *supra* note 39, 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.”).

⁴¹ *See Zywicki, Rise and Fall*, *supra* note 21, at 1599-1601.

⁴² *See Zywicki, Rise and Fall*, *supra* note 21, at 1604; *see also* Paul H. Rubin & Martin J. Bailey, *The Role of Lawyers in Changing the Law*, 23 J. LEGAL STUD. 807 (1994) (describing model of rent-seeking litigation).

⁴³ *See Landes & Posner*, *supra* note 32, at 255.

⁴⁴ In fact, at the same time the common law narrowly defined 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.

reciprocal nature of inclusive customs.⁴⁵ 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, rather than to develop pro-plaintiff rules. Similarly, the Courts of the Staple commodities exchanges in England had their own private dispute-resolution systems outside the official courts.⁴⁶ The relevant level of competition was among various fairs and markets, not at the level of legal services narrowly defined.⁴⁷ 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.

In addition, although parties faced few formal constraints on where they could bring their suits, this choice of jurisdiction was made *ex ante* rather than *ex post* most of the time.⁴⁸ When the parties chose their jurisdiction, therefore, they did not know whether they would be more likely to be the plaintiff or the defendant in any subsequent litigation and so would be unlikely to prefer a biased court over 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 common law) was expressly specified,⁴⁹ 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.⁵⁰ The Chancellor could act only if it could be shown that an inadequate remedy was available at common

⁴⁵ See Francesco Parisi, *Toward a Theory of Spontaneous Law*, 6 CONST. POL. ECON. 211 (1995).

⁴⁶ Important commodities (such as wool, leather, lead, and tin) were traded on particular specialized exchanges (called the "Staple" markets). 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 to resolve disputes, rather than the common law. See William Searle Holdsworth, *The Development of the Law Merchant and Its Courts*, in 1 SELECT ESSAYS IN ANGLO-AMERICAN LEGAL HISTORY 289, 302 (Association of American Law Schools ed., 1968); A.T. CARTER, A HISTORY OF ENGLISH LEGAL INSTITUTIONS 261-65 (1902); PLUCKNETT, *supra* note 34, at 636.

⁴⁷ As with modern commodity and stock exchanges as well. See Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001).

⁴⁸ See Zywicki, *Rise and Fall*, *supra* note 21, at 1609-10.

⁴⁹ See ELIZABETH BASILE ET AL., LEX MERCATORIA AND LEGAL PLURALISM: A LATE THIRTEENTH-CENTURY TREATISE AND ITS AFTERLIFE 24 (1998).

⁵⁰ See Bruce L. Benson, *The Spontaneous Evolution of Commercial Law*, 55 S. ECON. J. 644, 649-50 (1989).

law or application of common law would work an injustice, thereby further limiting its ability to compete for business through the provision of pro-plaintiff rules.⁵¹

Although largely unregulated, forum choice was generally *ex ante* and made when the parties were uncertain as to which would be the possible plaintiff or defendant under a subsequent suit. Under these institutional constraints forum-selection will tend toward the promotion of efficient law.⁵²

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 a competition to improve the law, but also enabled parties to escape backwards or inefficient courts and legal systems by choosing a more modern and fair forum to hear the dispute.

LoPucki describes another example of beneficial interjurisdictional competition in his book, but fails to recognize it as beneficial, which is the competition that arose among states regarding credit card regulations following the Supreme Courts opinion in the *Marquette* case in 1978.⁵³ Under *Marquette*, the terms of credit card contracts (such as usury restrictions) for nationally-chartered banks were determined to be regulated by the state of the bank that issued the card, rather than the state of the consumer’s residence. LoPucki criticizes this development as permitting states such as Delaware and South Dakota to enter the “usury facilitation” business by attracting credit card issuers to their states, which imposed no effective usury ceilings.⁵⁴ LoPucki seems to believe that this competition has had negative effects on consumers, but in reality, the effect has been a dramatic boon to consumers. Prior to *Marquette*, consumer choice in credit-card terms was limited by the restraints imposed by their home state. After *Marquette*, consumers (and issuers) could “forum shop” among the terms of cards issued by banks in all fifty states without leaving their living rooms. *Marquette* unleashed an unprecedented process of competition among credit card issuers for consumer market share, leading to a dramatic transformation of American shopping and financial practices in a generation.⁵⁵

After *Marquette*, therefore, consumers could choose among the products of states with very different regulatory regimes, ranging from those with heavily-regulated terms (as in Arkansas) to largely deregulated and set by market competition and freedom of contract (as in Delaware and South Dakota).⁵⁶ Credit cards from heavily-regulated states

⁵¹ See E. Allan Farnsworth, *The Past of Promise: An Historical Introduction to Contract*, 69 COLUM. L. REV. 576, 595 (1969).

⁵² Zywicki, *Rise and Fall*, *supra* note 21, at 1610; see also Robert K. Rasmussen & Randall S Thomas, *Timing Matters: Promoting Forum Shopping By Insolvent Corporations*, 94 NW. L. REV. 1357, 1357-59 (2000).

⁵³ See LOPUCKI, *supra* note 1, at 53-55.

⁵⁴ *Id.* at 53.

⁵⁵ See Todd J. Zywicki, *The Economics of Credit Cards*, 3 CHAPMAN L. REV. 79, 161-62 (2000).

⁵⁶ *Id.*

(such as Arkansas) placed strict caps on the interest rates that issuers could charge below the market rate of interest; on the other hand, these cards also featured very low acceptance rates (only the most credit-worthy consumers could qualify), high annual fees (to compensate for losses on below-market interest rates), low credit limits, and limited customer service and other customer benefits. As a result, few consumers qualified for these cards, and still fewer consumers desired a card with high annual fees and limited benefits, especially “transactor” consumers who do not revolve balances. By contrast the products offered by Delaware-based and similarly lightly-regulated issuers proved much more popular with consumers, as demonstrated by the rapid rise in the market share of issuers from these states. Issuers from these states could offer the terms demanded by consumers, rather than mandated by legislatures. In general, the most popular package of attributes desired by consumers were cards with low or no annual fees (especially valuable to those who do not revolve balances)⁵⁷, market rates of interest, and substantial customer benefits (such as 24-hour customer service, rental car insurance, and other benefits). Consumers overwhelmingly voted with their feet for one regulatory regime over the alternative, a powerful example of beneficial “forum-shopping” among alternative regulatory regimes.

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.

Forum-shopping arises in the modern class action system as a result of the intersection of modern law with interstate commerce, meaning that any major class action or products liability claim can be brought in almost any state court in the country.⁵⁸ The litigation in *BMW v. Gore* is illustrative.⁵⁹ There the plaintiffs were a nationwide class of consumers who claimed that they had suffered harm as the result of some cosmetic repairs to cars conducted by BMW, but not properly disclosed. Because of the combination of expansive choice-of-law rules and state long-arm statutes, plaintiffs have wide discretion to bootstrap a claim under almost any state’s law. In that case, the plaintiffs could have brought suit in any number of states, but chose Alabama, presumably because of the propensity of Alabama courts to award punitive damages in such cases.⁶⁰ As a result of these factors, plaintiffs have opportunity to “shop” for state court judges who are more favorable to class actions. In addition, because of diversity jurisdiction requirements, it is easy to prevent full diversity, so as to ensure that 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

⁵⁷ Except for those cards with “rewards” programs, such as frequent flyer miles.

⁵⁸ See DEBORAH R. HENSLER, ET. AL., CLASS ACTION DILEMMAS: PURSUING PUBLIC GOALS FOR PRIVATE GAINS (2000).

⁵⁹ 517 U.S. 559 (1996).

⁶⁰ See Edward R. Becker, et. al., *Civil Justice and the Plaintiffs’ Bar*, 41 N.Y.L. SCH. L. REV. 431, 447-48 (1997). It appears that consumer class actions are often brought to Alabama and mass tort actions are attracted to Louisiana. HENSLER, *supra* note 58, at 7.

institutions governing this competition tends to produce negative results, as competition tends to the production of pro-plaintiff rules, especially where those parties forced to provide wealth transfers are unable to avoid doing so.

As noted, in large class actions or products liability cases, it is possible to find a plaintiff and bring suit in almost any state court in the country. Any such forum choice, however, 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. Thus, a good may be manufactured in New York, but sold in Georgia to a tourist from Alabama who later moves to Oklahoma where the product malfunctions. Choice-of-law rules permit a plaintiff to sue wherever a state has an interest, thus the manufacturer can be liable even if it didn't know that the plaintiff was from out-of-state or subsequently moved to another state. Thus, where goods move in interstate commerce, it becomes impossible to anticipate *ex ante* where liability will arise and thus to respond to the risks of doing business in a particular state. Because manufacturers cannot tailor their prices to local circumstances, states have an incentive to increase liability and to externalize the resulting expenses on residents of other states.

Institutionally, this provides states with an opportunity to externalize the costs of their liability regimes on the residents of other states. "It follows from these factors that the cost of a given state's liability laws, as they apply to mass-market products, is borne by consumers nationwide. In effect, consumers in states with less generous products-liability laws pay a portion of the more generous recoveries won by plaintiffs in other states. This imbalance introduces an incentive for strategic behavior that would not be present if states made rules for themselves alone. Each state can profit at the expense of the others by expanding its scope of liability, at least until the others catch up."⁶¹ As a result, "A state's decision makers will therefore observe that nearly all the consumers injured in the state are local residents and constituents, while most of those who can be sued for making the products are residents of other states."⁶² Because goods can move in interstate commerce, the effects of an excessive tort regime will be borne by the residents of other states, creating a "race to the bottom" in tort law. As a result, it becomes impossible for those in other states to vote with their feet to avoid providing a wealth transfer. In some cases, punitive damages are awarded to punish conduct that is perfectly legal in other states.⁶³

The incentives of judges (and state legislatures) 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.⁶⁴ 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

⁶¹ See Michael W. McConnell, *A Choice-of-Law Approach to Products-Liability Reform*, in *NEW DIRECTIONS IN LIABILITY LAW* 90, 92-93 (Walter Olson ed., 1988).

⁶² *Id.*

⁶³ Edward R. Becker, et. al., *Civil Justice and the Plaintiffs' Bar*, 41 N.Y.L. SCH. L. REV. 431, 447-48 (1997).

⁶⁴ Roughly half of the states have an elected judiciary of one type or another. See Eric Helland & Alexander Tabarrok, *Exporting Tort Awards*, 23(2) REG. 21, T.1 (2000).

deep-pocket corporations to in-state plaintiffs.⁶⁵ Economists Eric Helland and Alexander Tabarrok have found that much of the tort “liability explosion” can be attributed to the desire of and opportunity for elected judges to transfer wealth from out-of-state corporations to in-state plaintiffs.⁶⁶ In general, plaintiffs in states with elected judges tend to receive larger awards against out-of-state defendants than where judges are appointed. Although this effect exists for judges elected in both partisan and nonpartisan elections, the negative treatment accorded out-of-state defendants is most pronounced in states with partisan judicial elections.⁶⁷ Helland and Tabarrok also observe that this disparity disappears when cases are removed to federal court.⁶⁸ Thus, even though the federal court is applying the same substantive state law under the *Erie* doctrine, the fate of an out-of-state defendant is much better under an appointed rather than elected judge. Heightened electoral competition tends to exacerbate the problem by increasing the incentives to “buy” votes through redistributing wealth to in-state plaintiffs.⁶⁹ The logic is straightforward—out-of-state corporations do not vote and rarely contribute money to state judicial campaigns. By contrast, in-state plaintiffs vote and in-state lawyers contribute large amounts of money to judicial campaigns. In addition, judges appear to be responsive to the demands of voters, as jury awards are higher where the local poverty

⁶⁵ 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, “it 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 donation.” *Id.* at 62. He adds, “Redistributing wealth from out-of-state defendants to in-state plaintiffs is a judge’s way of providing constituency service.” *Id.*

⁶⁶ Helland & Tabarrok, *Exporting*, *supra* note 64.

⁶⁷ 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. 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. Helland & Tabarrok, *Exporting*, *supra* note 64, at T.2. Subsequent research by Helland and Tabarrok finds even larger disparities—most of which can be explained by bias against out-of state defendants, and the remainder explainable by generally higher awards against businesses in partisan-elected states. 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. Eric Helland & Alex Tabarrok, *The Effect of Electoral Institutions on Tort Awards*, 4 AM. LAW & ECON. REV. 341, 350-68 (2002).

⁶⁸ Helland & Tabarrok, *Effect*, *supra* note 67.

⁶⁹ A study by the Florida Bar Association estimated that at least 80 percent of all campaign contributions to Florida judges are made by lawyers. 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. Helland & Tabarrok, *Exporting*, *supra* note, at 22. Elected judges do not have an ethical duty to recuse themselves when a donor appears before them. Stephen B. Presser, et. al., *The Case for Judicial Appointments* (Judicial Appointments White Paper Task Force, Stephen B. Presser, Chair, The Federalist Society, Washington, D.C. 2000) available at <http://www.fed-soc.org/judicialappointments.htm>.

rate is higher, suggesting a tendency to use litigation to redistribute wealth from corporate defendants to poorer plaintiffs.⁷⁰

Where judges are appointed, this incentive to engage in wealth redistribution is not present, but other negative incentives may be present, and institutional constraints may be weak on ensuring that judges are responsive to the preferences of litigants and the public, rather than their personal preferences. Judicial independence increases agency costs. Thus, although appointed judges may not have incentives to engage in wealth redistribution, they may have the opportunity and incentive to consume leisure or to use the bench to impose their ideological preferences on society.⁷¹ Although not as blatant as with elected judiciaries, these ideological preferences, and the accompanying desire to expand the power of the judiciary to enable a larger reach to impose these preferences, may explain the development of liability-expanding doctrines even in states with appointed judiciaries.⁷² Thus, although appointed judiciaries do not face incentives to engage in wealth redistribution, they also lack incentives to promote efficiency or to be responsive to the desires of litigants. Moreover, institutional constraints to reduce judicial agency costs or to restrict their ability to pursue their private ends and to impose their views on society are weak.

C. Ambiguous Forum-Shopping: Delaware Corporate Law

A third example of forum shopping is the emergence of Delaware as the dominant 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 of them are headquartered there or have substantial operations there.⁷³ A voluminous literature has developed addressing the question of whether this “race to Delaware” is a “race to the top” or a “race to the bottom.” Those who argue that it is a race to the top 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.

⁷⁰ 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). This suggests statistically what many have believed anecdotally, that forum-shopping is especially strong into poorer areas, such as the Bronx and poorer southern states, such as Mississippi and Alabama. See Helland & Tabarrok, *Effect*, *supra* note 67, at 358; see also Eric Helland, Jonathan Klick, and Alexander Tabarrok, *Data Watch: Tort-uring the Data*, 19 J. ECON. PERSPECTIVES 207, 212-13 (2005). States with elected judiciaries also are more likely to declare legislative tort reform enactments unconstitutional than are appointed judges. 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. By contrast, states with appointed judges have tended to be more deferential toward legislative tort reform enactments. See Presser, *supra* note.

⁷¹ Stephen F. Williams, Book Review, 73 NOTRE DAME L. REV. 1599 (1998); see also RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW §19.6, at p. 543 (arguing that judges may be motivated by desire to impose views on society). The process for appointing judges, whether vested in the Governor, state legislature, or merit selection panel is invariably riddled with ideological politics as well. See Presser, *supra* note.

⁷² George L. Priest, *The Modern Expansion of Tort Liability: Its Sources, Its Effects, and Its Reform*, 5(3) J. ECON. PERSP. 31 (1991); see also George L. Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law*, 14 J. LEGAL STUD. 461 (1985).

⁷³ LOPUCKI, *supra* note 1, at 8.

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 protects the managers who make the decision where the firm should incorporate, rather than the shareholders. Because of the agency costs inherent in the manager-shareholder relationship, it is argued, the law is responsive to the interests of managers rather than shareholders. This underlying ambiguity as to whether the competition is driven by responsiveness to shareholders or managers creates a deep uncertainty as to whether the competition tends to generate efficient or inefficient law.

The debate over the efficiency of the Delaware corporate law race is longstanding.⁷⁴ In 1974 William Cary argued that the preference for Delaware resulted from firm managers seeking out the jurisdiction that best protected their interests, often at the expense of shareholders.⁷⁵ 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. As a result, Cary believed that there was a "race to the bottom" in which the states competed to enact laws allowing corporate managers to fleece shareholders.⁷⁶

On the other hand, other scholars have argued that the race to Delaware is actually a "race to the top" and that Delaware law increases firm value for the benefit of shareholders.⁷⁷ Winter argued that the need to obtain capital at the cheapest cost provides incentives for managers to incorporate in states with 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. As a result, those managers that chose states with less efficient corporate laws would see a reduction in the value of the firm, leading to them being pushed out as managers of the firm.⁷⁸ As a result, it is argued, manager's private incentives will be aligned with the incentives of shareholders to maximize firm value rather than their private interests, and therefore will have 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.⁷⁹

Unlike the prior two forum-shopping regimes that have been described, it is not obvious as an *a priori* matter whether Delaware corporate law maximizes shareholder value, managerial agency costs, or some intermediate range. In fact, if it were the case that managers and shareholders incentives for corporate law were aligned, then it would be difficult to explain the substantial number of corporations *not* incorporated in Delaware. The question turns on the empirical question of how much agency cost slippage there is in the relationship between managers and their shareholders. Although capital markets appear to be highly efficient, the market for corporate control seems to be

⁷⁴ See Rasmussen & Thomas, *supra* note 52, at 1382-83 for a summary of the debate.

⁷⁵ William L. Cary, *Federalism and Corporate Law: Reflections upon Delaware*, 83 YALE L.J.663 (1974).

⁷⁶ *Id.* at 705.

⁷⁷ See Ralph K. Winter, *State Law, Shareholder Protection, and the Theory of the Corporation*, 6 J. LEGAL STUD. 251 (1977); see also RALPH K. WINTER, *THE GOVERNMENT AND THE CORPORATION* (1978).

⁷⁸ See Winter, *State Law*, *supra* note 77, at 256.

⁷⁹ Professor Roberta Romano has been the leading recent advocate of the "race to the top" theory. ROBERTA ROMANO, *THE GENIUS OF AMERICAN CORPORATE LAW* (1993).

somewhat less so.⁸⁰ Thus, it is not obvious that managers who consume agency costs will automatically be forced from power; it seems even less obvious that they invariably will be forced from power when the source of the agency costs is the relative inefficiency of the corporate law of the state of incorporation, especially if the overwhelming number of the firm's rivals are incorporated in the same state and thus pay the same corporate law "tax." Indeed, some scholars have even challenged the idea that there is a meaningful competition for incorporation charters at all, in that no state has made any meaningful effort to compete with Delaware for incorporations.⁸¹ 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 could be largely competed away. The question is thus empirical in nature.

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.⁸² There is some evidence to suggest that firms incorporated in Delaware have higher values than firms incorporated elsewhere,⁸³ but other empirical evidence suggests that firms incorporated in Delaware do not seem to perform systematically better (or worse) than firms incorporated elsewhere.⁸⁴ On the other hand, evidence does tend to suggest that firms that reincorporate in Delaware from elsewhere do not suffer a decrease in firm value and may increase in value, tending to undercut the race to the bottom hypothesis and providing

⁸⁰ For instance, there are many state and federal laws that inhibit hostile takeovers, thereby making it more difficult to force out poor corporate managers.

⁸¹ See Marcel Kahan & Ehud Kamar, *The Myth of State Competition in Corporate Law*, 55 STANFORD L. REV. 679 (2002).

⁸² LoPucki seems to argue that existing empirical evidence on the question of whether Delaware incorporation is invalid because markets are not perfectly efficient and that shareholders may make mistakes in pricing equities and in the economic contribution of different states' laws. See LOPUCKI, *supra* note 1, at 238-39. His criticisms, however, 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 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. He 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. Thus, the markets assessed all too well in those situations the "complex systems" of the regulatory rules established under the partial deregulation schemes. *Id.* 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 & loan crisis as moral hazard problem); Stephen J. Rasantini, Vernon L. Smith, and Bart J. Wilson, *Controlling Market Power and Price Spikes in Electricity Networks: Demand-side Bidding*, 100 PROCEEDINGS OF THE NATIONAL ACADEMY OF SCIENCES 2998-3003 (March 4, 2003) (describing problems with electricity deregulation).

⁸³ See Robert Daines, *Does Delaware Law Improve Firm Value?*, 62 J. FIN. ECON. 525 (2001).

⁸⁴ See Lucian Bebchuk et al., *Does the Evidence Favor State Competition in Corporate Law?* 90 CALIF. L. REV. 1775, 1820 (2002) ("the evidence does not establish that Delaware incorporation produces an increase in share value"); Lucian Arye Bebchuk, *Federalism and the Corporation: The Desirable Limits on State Competition in Corporate Law*, 105 HARV. L. REV. 1437 (1992).

some support for the race to the top hypothesis.⁸⁵ On net, it remains somewhat uncertain whether the institutional mechanisms driving the evolution of the Delaware corporate law race tend to the production of efficient or inefficient corporate law, a question for which the resolution turns primarily on the degree of agency costs that exists between managers and shareholders in choosing the state of incorporation, and the extent to which the decision over the state of incorporation is driven by the maximization of agency costs rather than shareholder value.

Although it remains unsettled whether the institutional structure of corporate law forum-shopping tends to the promotion of efficient law, the incentives of lawmakers to ensure that those goals are well-understood. In other words, whether lawmakers are responding institutionally to the demand of shareholders or managers, there is little doubt that their incentives are aligned to be highly responsive to the relevant constituency.

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.⁸⁶ This heavy reliance on tax revenues generated by corporate chartering makes Delaware's state legislatures highly-attuned to preserving Delaware's dominance in corporate chartering, as enacting legislation that reduces the number of firms incorporating in Delaware will reduce tax revenues that will have to be compensated for either by reduced spending or other tax increases.⁸⁷ 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.⁸⁸ 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.⁸⁹ 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).

⁸⁵ See ROMANO, *supra* note, at 17-18 (summarizing studies); Roberta Romano, *Competition for State Corporate Law*, 1 NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 364, 367-68 (1998) (summarizing studies); see also Jeffery Netter & Annette Poulsen, *State Corporation Law and Shareholders: The Recent Experience*, 18 FIN. MGMT. 29 (1989); Michael Bradley & Cindy A. Schipani, *The Relevance of the Duty of Care Standard in Corporate Governance*, 75 IOWA L. REV. 1 (1989); Robert Romano, *Law as a Product: Some Pieces of the Reincorporation Puzzle*, 1 J. L. ECON. & ORG. 225 (1985); Peter Dodd & Richard Leftwich, *The Market for Corporate Charters: "Unhealthy Competition" vs. Federal Regulation*, 53 J. BUS. 259 (1980).

⁸⁶ LoPucki puts it at 27 percent, LOPUCKI, *supra* note 1, at 8, others put it at 17 percent, see Jonathan R. Macey & Geoffrey P. Miller, *Toward an Interest-Group Theory of Delaware Corporate Law*, 65 TEX. L. REV. 468, 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 an increase from ancillary products such as legal services and various travel and entertainment services such as hotels, restaurants, taxis, and rental cars.

⁸⁷ See Rasmussen & Thomas, *supra* note 52, at 1385.

⁸⁸ Rasmussen & Thomas, *supra* note 52, at 1385.

⁸⁹ See Macey & Miller, *supra* note 86, at 503-06.

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 competition jurisdictions in the Middle Ages that spawned the modern common law, competition proved 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 on whether the forum-shopping in that situation 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 that remains is whether the institutions surrounding that competition tend to the promotion of 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, followed by its equally rapid plunge and the rise of Delaware makes it clear that bankruptcy filings are not randomly distributed, but that 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 in the Middle Ages), or ambiguous (such as the modern corporate law Delaware dominance).

In brief, LoPucki argues that modern bankruptcy forum-shopping is driven by corrupt motives to abuse the chapter 11 process and has had a negative effect on bankruptcy law and practice. 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 of the article applies a structural analysis to bankruptcy court forum-shopping to try to determine whether the outcome of this competitive process is likely to be good rather than bad. First, I will explore the institutional structure of the forum-shopping competition, focusing on 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 the bankruptcy court competition is driven by two groups—incumbent managers and bankruptcy professionals. 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 under 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 the interests of managers, rather than the firm's creditors. 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 the court to implicitly acquiesce in a *de 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 section 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 that 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 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 creates a systematic bias toward the inefficient reorganization of failing and non-viable firms.⁹⁰ If incumbent managers, rather than creditors, are controlling the decision as to where to file the firm's bankruptcy, their self-interest will lead them to file in courts that are more 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 to receive substantial retention bonuses during that period.⁹¹

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. LoPucki found a high correlation between the reorganization of firms that had filed in Delaware and New York during the forum-shopping heyday of those courts, and the tendency for them to later refile in bankruptcy.⁹² 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 those courts were attracting a disproportionate share of large filings, thereby evidencing that "the elevated refiling rates were a product of intercourt competition."⁹³ In addition, he further found that firms

⁹⁰ See LOPUCKI, *supra* note 1, at Chapter 4.

⁹¹ *Id.* at 151-56.

⁹² LoPucki found that the refiling rate for firms that reorganized in Delaware or New York was roughly three times higher than for all other courts. *Id.* at 100.

⁹³ *Id.* at 101, 110-14.

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.⁹⁴

LoPucki's intuition seems to be that inherently viable firms with a good prospect of reorganizing can file in almost any court and do fine. Weak firms with poor reorganization prospects, by contrast, will seek out courts most receptive to dubious or speculative reorganization cases. Thus, bankruptcy forum-shopping in LoPucki's eyes is similar to forum-shopping in the modern tort system—a race to the bottom, driven by incumbent management seeking to protect their jobs at the expense of their creditors.

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. On the other hand, scholars have offered contrary interpretations of that evidence, such as the possible complexity or difficulty of the reorganizations cases involving these firms.⁹⁵ Leaving aside the details of these arguments, all of these alternative explanations share the common feature that they all see 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. Then, once a given court develops expertise and a favorable reputation, these same forces tend to create a path-dependency effect that tends to magnify small comparative advantages and make 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.

The leading defender of Delaware has been Professor David Skeel, who argues that the gravitation to Delaware is better understood as promoting benign forum-shopping.⁹⁶ In general, Skeel argues that Delaware's Bankruptcy Court has emerged as the leader out of the interjurisdictional competition because of the superiority of its 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 meet with general acclaim and others that have been more controversial.

In a forthcoming article, Skeel and his co-author Kenneth M. Ayotte, argue that Delaware's dominance results from its superiority to most other courts in dealing with large Chapter 11 cases.⁹⁷ They find no evidence that Delaware's popularity was driven by managers or equity holders seeking a procedure friendly to their interests. Instead,

⁹⁴ *Id.* at 113.

⁹⁵ LoPucki responds to these critiques at LOPUCKI, *supra* note 1, at 113-115.

⁹⁶ See Skeel, *supra* note 9; David A. Skeel, Jr., *Bankruptcy Judges and Bankruptcy Venue: Some Thoughts on Delaware*, 1 DEL. L. REV. 1 (1998).

⁹⁷ Kenneth M. Ayotte and David A. Skeel, Jr., *Why Do Distressed Companies Choose Delaware? An Empirical Analysis of Venue Choice in Bankruptcy* (working paper, Oct. 18, 2004) (on file with author).

they conclude that firms choose Delaware for its speed and expertise. They find that Delaware reorganizations are completed substantially faster than in other courts, and note that the primary beneficiaries of speedy reorganizations tend to be secured creditors.⁹⁸ They also find that firms are more likely to choose Delaware the less experienced is the home venue of the firm. Overall, they conclude that permitting bankruptcy forum-shopping is generally healthy, in that it not only encourages competition, but more importantly, provides a choice for firms otherwise trapped in mediocre or inexperienced courts to be able to exit those courts in order to gain 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 to be the result of undue responsiveness to managerial or equity influence, but instead, probably efficiency-driven and beneficial. They see “no tangible benefit to restricting choice and competition for bankruptcy cases.”⁹⁹

Ayotte and Skeel acknowledge, however, that there are some problems with using secured creditors as a proxy for the welfare effects of jurisdictional competition. In particular, it could be that the influence of secured creditors is reflected in a transfer of wealth to themselves from other firms stakeholders (such as unsecured creditors), rather than enlarging 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 away from them to secured creditors. For instance, pre-bankruptcy secured creditors are often also DIP lenders, and thus, depending on the terms of the DIP lending package, may share an incentive with equity holders to push for an inefficient reorganization of the firm. As for LoPucki’s response that faster reorganizations also tend to be more likely to fail and require refiling later,¹⁰⁰ Ayotte and Skeel argue that repeated failures could simply reflect mere uncertainty about a firm’s going-concern value rather than a negative assessment of the firm’s value.¹⁰¹

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 files in their home districts because they believe that the local court will be more responsive to local managers and employees who want to keep their jobs, and so that the local court may 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 case, Delaware or

⁹⁸ Ayotte and Skeel find a positive correlation between the amount of secured credit in a firm’s balance sheet and the speed of the reorganization.

⁹⁹ *Id.* at 16.

¹⁰⁰ LOPUCKI, *supra* note 1, at 117.

¹⁰¹ Ayotte & Skeel, *supra* note 97, at 16 (citing Matthias Kahl, *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 a highly unpredictable profitability is more 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. Thus, it is not clear how far the argument goes.

some other court may have less of a pro-reorganization bias than the home forum. LoPucki may respond that this effect may not be borne out in the statistical aggregates, but it may be important at the margin.

b. Forum-Shopping and Corporate Scandals

LoPucki makes a second, controversial argument that a new front 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 by 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 because in the *Marvel* case (filed shortly before Enron's bankruptcy) one of Delaware's judges had appointed a trustee based on a relatively low legal and factual standard, a decision that had been affirmed by the Third Circuit.¹⁰²

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," including Ken Lay.¹⁰³ Instead of a trustee, the Court acquiesced in the appointment by Enron's directors of turnaround expert Stephen Cooper as Enron's new CEO. This left Lay and other members of incumbent management in place through the early stages of the case and enabled them to guide the choice of their own successors when they finally departed. The Court did appoint an examiner to investigate the fraud, but gave the examiner no authority to sue anyone.¹⁰⁴ Instead, the decision whether to sue was delegated to the creditors' committee to decide on a case-by-case basis, creating 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,"¹⁰⁵ and 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.

¹⁰² LOPUCKI, *supra* note 1, at 13-14. LoPucki also notes that Delaware's bankruptcy courts were also facing a significant backlog at this time, thus probably could not have been as responsive as necessary to the case. *Id.* at 13.

¹⁰³ *Id.* at 14.

¹⁰⁴ *Id.* at 147.

¹⁰⁵ *Id.* at 147.

The New York bankruptcy court had proven itself a trustworthy protector of managements accused of fraud.¹⁰⁶

LoPucki argues that the leniency exhibited by New York's bankruptcy court versus Delaware's tougher approach created a swift and devastating race to the bottom. Within a short time after Enron landed in New York, Global Crossing (a Bermuda-Los Angeles corporation), Adelphia Communications (Coudersport, Pennsylvania), and Worldcom (Clinton, Mississippi) all filed in New York's bankruptcy court. Although each scandal-ridden corporation appeared appropriate subjects for the appointment of a trustee, in each case incumbent management was able to remain in control during the early "crucial stages of the cases and to choose their own successors."¹⁰⁷ 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."¹⁰⁸

Although sharp, LoPucki's attack has some *prima facie* merit. Under the clear text of the Bankruptcy Code, the failures to appoint a trustee in these cases involving corporate fraud and managerial malfeasance on the scope of these cases, is inexplicable.¹⁰⁹ It is possible that all four coincidentally 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 could have easily filed in Houston, Los Angeles, Philadelphia, or Northern Virginia, all of which have handled other large cases). It may also be that the extralegal system of corporate governance in chapter 11 devised in these cases may be theoretically preferable to the statutorily-contemplated remedy of appointing a trustee in these cases.¹¹⁰ Nonetheless, that each of these troubled firms filed in New York may be more than coincidence. 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 evidences improper forum-shopping competition, at least in the manner used by LoPucki in the remainder of the book. 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 decision in Enron. But it is not clear that the problems that flow from this can be

¹⁰⁶ *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 Hearing in Winn-Dixie case (on file with author).

¹⁰⁷ LOPUCKI, *supra* note, at 14.

¹⁰⁸ *Id.* at 14.

¹⁰⁹ *See* 11 U.S.C. §1104 ("the 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").

¹¹⁰ *See* Todd J. Zywicki, *CROs, DIPs, and Trustees: Modern Corporate Governance in Chapter 11* (working paper).

directly laid at the forum-shopping doorstep. Although Judge Gonzalez’s decision in Enron not to appoint a trustee may have been wrongheaded or erroneous under the Code, there is no 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 seems to be more properly attributable to the particular decision of the New York Bankruptcy Court, which although perhaps incorrect, does not appear to be spawned by a competition to secure megabankruptcies of troubled firms.¹¹¹

But in a larger sense, the fact that these cases were originally directed away from Delaware and to New York does spotlight LoPucki’s larger point—in these cases, at least, the choice may have been influenced in part, and perhaps exclusively, by the incumbent management in place in each of those cases, rather than creditors (many of whom sought the appointment of a trustee) or the “public interest” as reflected in 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 driven by efficiency goals.

c. Section 363 Sales

A third source of managerial self-dealing identified by LoPucki relates to the practice of selling a company pursuant to section 363 of the Bankruptcy Code, rather than through the Chapter 11 plan process. Under section 363 of the Code, the debtor in possession may sell property of the estate outside the ordinary course of business.¹¹² 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 section 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 sell the firm through the section 363 process.¹¹³

LoPucki argues that permitting the sale of an entire business under section 363 improperly shortchanges the notice and other protections associated with chapter 11.¹¹⁴ Sale of the entire business in the context of a chapter 11 plan confirmation would require substantial notice and disclosure and voting by all unsecured creditors. By contrast, a sale pursuant to § 363 would only require a relatively summary disclosure of the terms of the sale to the unsecured creditors’ committee and the court. By contrast, securing approval for the sale through the chapter 11 plan confirmation process would mandate extensive disclosures of the debtor’s financial condition, reasons for sale, alternatives to sale, and “ulterior motives” for the sale. Moreover, he notes that when the sale is consummated through the plan process, the plan also must disclose how the sales

¹¹¹ 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. §1104(e).

¹¹² 11 U.S.C. §363(b).

¹¹³ *See In re Lionel Corp.* 722 F.2d 1063, 1071 (2d Cir. 1983).

¹¹⁴ LOPUCKI, *supra* note 1, at 168.

proceeds will be distributed to the creditors if the sale goes through.¹¹⁵ LoPucki argues that the ability to end-run the more transparent plan process and to effectuate a sale through a summary section 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 made and the final order is entered, no appeal from the sale is permitted. The sale is final when entered.

LoPucki argues that this combination of factors—speed, lack of transparency, and finality—combine to present an opportunity for opportunistic or corrupt management to purchase the company at the expense of the creditor body. In addition, he contends that this opportunism is combined with strategic bidding behavior by managers that exacerbates 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.¹¹⁶

LoPucki finds a rise in the frequency of section 363 sales beginning in the 1990s, and then increasing rapidly beginning in 2000.¹¹⁷ He argues that this rapid increase in the frequency of section 363 sales was initiated by Delaware’s enthusiastic embrace of section 363 sales, and especially so-called “quick sales” that take place within 130 days of filing. LoPucki suggests that these “quick sales” are evidence of forum-shopping, as this period of time is “short enough to suggest that the debtor had sale in mind when it chose the court.”¹¹⁸ 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 of those 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.¹¹⁹

Beginning in 2000-2001, however, he argues that the scourge of “quick sales” spread to courts in other districts, which he sees as being a response by other districts competing to attract these cases to their courts. Beginning in January 2001, he finds that over half of the quick sales that occurred did so outside Delaware, which he interprets as evidence that these courts were competing to attract forum-shopping cases into their districts.

Others have objected that this emphasis on the procedural protections of a sale through the plan process is fundamentally misguided. Relying on an analogy to the efficient market hypothesis, these procedural regularities are said to 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

¹¹⁵ LOPUCKI, *supra* note 1, at 168.

¹¹⁶ LOPUCKI, *supra* note 1, at 169.

¹¹⁷ LOPUCKI, *supra* note, at 168-70.

¹¹⁸ LOPUCKI, *supra* note 1, at 168-69.

¹¹⁹ LOPUCKI, *supra* note 1, at 169.

accurate or higher sales price.¹²⁰ 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, there is no evidence that this is the case, and indeed, further delay might have the effect of worsening firm’s financial condition. At the time of the section 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 likely that the value produced at a quick sale early in the case is likely to be substantially higher than would be generated through further delay and expense.¹²¹

This position was articulated in a dissenting opinion by Judge Ralph Winter in *Lionel*. In *Lionel*, the debtor held 82% of the stock of Dale Electronics, Inc., which it sought to sell through a section 363 sale. As Winter observes there was no evidence that the estate would be disadvantaged by permitting a speedy and final section 363 sale at the outset of the case, rather than a late sale through the plan process.¹²² On the other hand, Winter notes, requiring the sale to be made through the plan process would provide equity holders with undue leverage to extract wealth from creditors in exchange for surrendering their veto over the sale. In the end, Judge Winter argues, 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.¹²³ At the very least, the delay in the sale raises the 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 section 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.¹²⁴

LoPucki suggests that an argument like Judge Winter’s “efficient markets” argument, even if possibly correct theoretically, would be inapplicable in practice to most section 363 sales, which he claims are plagued by a lack of transparency as well as gamesmanship and self-dealing on behalf of incumbent management in making the sale. As a result, contrary to the arguments of those such as Winter, who argue that the price generated at such an auction is inherently the best estimate of the firm at the time of the

¹²⁰ See *Lionel*, 722 F.2d at 1067 (Winter, J., dissenting).

¹²¹ *Id.*

¹²² *Id.*

¹²³ 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.”).

¹²⁴ *Id.* at 1065.

sale, LoPucki argues that the price that emerges from this flawed auction is fundamentally unreliable. LoPucki's builds his argument on several cases involving section 363 sales that combined several factors that made the sales appear suspicious.¹²⁵ First, the 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.¹²⁶ 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 sales 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, LoPucki argues for greater procedural protections and transparency in the auction process.

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 section 363 sale requires notice to the Creditors' Committee, the Committee itself may have its own conflicts of interest and does not represent all of the claimants in the case. Thus, for instance, the effect of the sale may be to alter or cancel the rights and privileges of employees or tax authorities, neither of which are represented on the Committee. Running the proposed sale through the plan confirmation process, would provide these constituencies 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 open the door to allowing peripheral constituencies to object to the sale for strategic and improper reasons. 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 section 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' committees 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, as they would seem to have the appropriate incentives to insure that the sale maximized the price and minimized the expense and risk associated with converting the assets to cash.¹²⁷ It is less clear, however, whether the problems with section 363 sales that he identifies are evidence of forum-shopping, and especially "bad" forum-shopping. While there may be some merit to LoPucki's circumstantial evidence of "bad" forum-shopping with

¹²⁵ LOPUCKI, *supra* note 1, at 172.

¹²⁶ LOPUCKI, *supra* note 1, at 174.

¹²⁷ Creditor 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 from the book whether LoPucki's concern about section 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.

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 that 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.¹²⁸ By and large, the judge in such cases are little more than glorified auctioneers, sweeping up the leftovers of an empty corporation. There seems to be little glory or intrinsic interest in such cases. Local professionals seemingly gain little from such cases either. 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 summary quick sale of the corporation followed by a liquidation.

Most troublesome, however, are those cases where the court orders the sale over an objection by the creditors’ committee, such as in the Polaroid case, and permits the sale to go through notwithstanding the evidence that the sales price may be insufficient.¹²⁹ LoPucki describes the problem in the book through some well-chosen anecdotes, but does not provide a definitive answer.¹³⁰ 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 the 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 that there had been a rise in sales over creditors’ objections would provide possible evidence of a forum-shopping problem. As it stands, however, LoPucki has posed the problem and suggested his predictions, and 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 that will be relatively generous on professional fee awards (both in terms of permissible rates and scrutiny of allowed fees and expenses) and, where applicable, relaxed on standards for conflicts of interest. The decision 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 debtor’s management to districts that look more favorably upon professional’s fee applications than other districts. In other words, the firm can say

¹²⁸ The incentives of bankruptcy judges to engage in forum-shopping are discussed *infra* in Section B of this Part of the article.

¹²⁹ See LOPUCKI, *supra* note 1, at 173-81.

¹³⁰ He states that he has an ongoing research project to gather more information about the terms of these sales. LOPUCKI, *supra* note 1, at 174.

to the debtor, “If you file in District A [which is known as being more generous on fee awards or lax on conflicts of interest standards] we will represent you. If you file in District B [which is more tight-fisted], however, we will 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’s fees on the one hand, and that also tend to be relatively “pro-debtor” on the other.¹³¹ LoPucki suggests that Delaware is one such instance. Thus, the venue preferences of the debtor’s management and attorneys will usually amplify rather than contradict each other. This correlation of mindset may not be a 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 primarily privately and through private negotiation. This same mindset may lead these same courts to taking a relatively hands-off approach to matters of fees and conflicts of interest. Finally, 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 margins on which professionals will pursue their preferences for one court over another: attitudes toward hourly rates, scrutiny of bills for fee awards, and conflict of interest standards. First, they will prefer courts that are willing to award fees at higher billing rates than in other courts. Second, they will prefer courts that take a relatively hands-off approach to scrutinizing the contents of bills. Third, where applicable, some professionals will have a preference for judges with a looser 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 can give rise to the “bad” forum-shopping pressures identified by LoPucki.

a. Billing Rates

The first factor in which professionals will be interested is the billing rates at which a give court will award fees. Regardless of where they are filed, “big cases” usually draw in professionals from all over the country, and thus are drawn from regions with a variety of different prevailing billing rates, with New York-based attorneys and professionals typically billing market rates that exceed the rates prevailing elsewhere in the country. Moreover, unlike private clients, businesses reorganizing in bankruptcy do not directly pay their attorneys, but instead the debtor’s professionals are paid by the estate. Although large to the professionals themselves, in a large bankruptcy case the fees paid to bankruptcy professionals are a relatively small portion of the overall money

¹³¹ See Rasmussen & Thomas, *supra* note 52, 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”).

involved in the case.¹³² 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 on this basis.¹³³ As a result, bankruptcy filers have an incentive to choose the “best” firm available with little consideration of cost or location.

As a result, courts (other than New York itself) hearing large bankruptcy cases are confronted with a decision at the outset—in determining the “reasonable compensation” for professional services under section 330 of the Code, the Court must decide whether the appropriate billing rate to be applied is that which prevails in the local area where the case is being heard or whether it is reasonable in light of the rates prevailing in the firm’s home city for comparable work. Because billing rates are substantially higher in New York than say, Houston, for the same services, the Court’s decision on this point can be quite important. 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 locally-based 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.¹³⁴ 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.¹³⁵ Such rulings did not endear Miami’s judges to national law firms considering where to file their bankruptcy cases.

But this view gave rise to a problem—if the debtor wants the New York firm, and if the judges in the local district are unwilling to pay New York rates to New York lawyers, then New York lawyers will be “losing money” by accepting the case, and will turn away the representation. LoPucki notes the comment by a leading New York-based

¹³² See Lynn M. LoPucki & James W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases*, 1 J. EMPIRICAL LEGAL STUD. 111 (2004) (finding that professional fees are generally less than two percent of the firm’s assets); Stephen J. Lubben, *The Direct Costs of Corporate Reorganization: An Empirical Examination of Professional Fees in Large Chapter 11 Cases*, 74 AM. BANKR. L.J. 509 (2000) (finding that professional fees incurred in traditional Chapter 11 cases average 1.2% of total firm size and 2.5% of assets); Stephen P. Ferris & Robert M. Lawless, *The Expenses of Financial Distress: The Direct Costs of Chapter 11*, 61 U. PITT. L. REV. 629 (2000) (finding that in median case in sample, bankruptcy costs consumed 4.7% of total distributions and 3.5% of total assets)

¹³³ See MANCUR OLSON, *THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS* (1965).

¹³⁴ LOPUCKI, *supra* note 1, at 44.

¹³⁵ LOPUCKI, *supra* note 1, at 44 (citing *In re Evans Products*, 69 B.R. 68 (Bankr. S.D. Fla. 1986)).

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.”¹³⁶ As a result, the bankrupt business must decide whether to file in New York (or a district that will also recognize New York rates) in order to file with their preferred counsel, or find other counsel and file in the local district. Given this choice, and given the limited incentives of the bankruptcy filer to minimize professional fees, many debtors would elect to keep their preferred counsel and file elsewhere.

And, indeed, 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 forum-shopping venues preferred by bankruptcy professions. LoPucki points to surveys conducted by himself and William Whitford in the 1980s that “other courts’ reluctance to approve fees at New York rates was a principal reason for the forum-shopping to New York.”¹³⁷ 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.¹³⁸ LoPucki suggests that the self-interest of professionals may also explain anomalies that might otherwise be difficult to reconcile with common sense, such as the surprising popularity of Oklahoma City’s bankruptcy court as the second-most popular venue for large chapter 11 cases. LoPucki suggests that Oklahoma City’s popularity may have owed in part to a statement by one of the judges there that “outside counsel may charge rates normally charged clients in their respective regional areas for counsel time expended in these proceedings.”¹³⁹

LoPucki persuasively argues that courts have encouraged forum-shopping behavior on this front, noting the remarkable phenomenon of the Houston bankruptcy court making a 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 permit higher fees than it had in the past.¹⁴⁰ As LoPucki notes, this process was rapidly replicated in numerous other cities in the following years, including Boston, Dallas, Chicago, Los Angeles, Minneapolis, Baltimore, and other cities, all at the request of local bankruptcy lawyers and often with a public announcement by judges of the change in policy.¹⁴¹

b. Scrutiny of Bills

In addition to the more general issue of the blanket “reasonableness” of hourly billing rates, a second concern of professionals that may be reflected in forum-shopping will be the court’s scrutiny of bills and the reasonableness of the total fees and expenses requested for performing various services.¹⁴² Outside bankruptcy, such issues are

¹³⁶ LOPUCKI, *supra* note 1, at 141.

¹³⁷ LOPUCKI, *supra* note 1, 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).

¹³⁸ Marcus Cole, “*Delaware Is Not a State*”: *Are We Witnessing Jurisdictional Competition in Bankruptcy?*, 55 VAND. L. REV. 1845, 1866 (2002).

¹³⁹ LOPUCKI, *supra* note 1, at 45.

¹⁴⁰ LOPUCKI, *supra* note 1, at 13, 125-26.

¹⁴¹ LOPUCKI, *supra* note 1, at 126, 142.

¹⁴² See 11 U.S.C. §330. 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

resolved through the normal give-and-take of an attorney-client business arrangement, where “reasonableness” is established through the scrutiny and negotiations with the client.¹⁴³ Inside bankruptcy, however, 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. 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.

The massiveness of the overall fee requests, the thousands of line-itemized tasks to be cross-references, and the sparse detail for each entry (in part in order to protect attorney-client privilege and other confidences) makes it almost impossible for courts to exercise any coherent supervision over the content of fee requests.¹⁴⁴ 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.¹⁴⁵ Nor do the other parties in the case have an incentive to object—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 turned when the time comes for their own fee requests.

c. Ethical and Conflicts of Interest Standards

Given the practical impossibility of providing oversight over 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 given matter. Given that these limits were largely arbitrary, it was little wonder that they quickly broke down. In fact, judges appear to exercise little oversight over the details of fee allowances. Research conducted by LoPucki with co-author Joseph Doherty found that in cases concluded from 1998-2002, judges approved almost 98 percent of the amounts

work performed, as well as the reasonableness of the number of hours and expenses incurred in carrying out the representation.

¹⁴³ For instance, how many hours is a “reasonable” amount of time to spend on a motion to lift 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?

¹⁴⁴ See LOPUCKI, *supra* note 1, at 41-44. LoPucki calls this approach “hopeless” noting that, “No mechanisms exist by which judges can evaluate each of the thousands of charges that may comprise a single application.” LOPUCKI, *supra* note 1, at 142.

¹⁴⁵ For example, in the Enron case the judge appointed a fee examiner who was paid \$300 per hour and who approved 95 percent of the fees and expenses requested in the case. See Robert Manor, *United Airline Bankruptcy Gives Lawyers, Consultants Plenty of Business*, CHICAGO TRIBUNE (Dec. 17, 2002), available in 2002 WLNR 11951756.

for which professionals applied, and Delaware judges approved more than 99 percent.¹⁴⁶ Moreover, LoPucki describes a new forthcoming study that finds that professional fees in large public company bankruptcies increased by 47 percent from 1998 to 2003.¹⁴⁷

A third area in which professional driven forum-shopping might occur is with respect to ethical standards and conflicts of interest regarding professionals. Under section 327(a) of the Bankruptcy Code, a professional or attorney employed by the debtor must be a “disinterested person,” a concept defined in section 101(14) as requiring that the attorney “does not have an interest materially adverse to the interest of the estate.”¹⁴⁸ As with determining the “reasonableness” of fee awards, what constitutes a “materially adverse interest to the interest of the estate” varies from one court to another, and therefore, a lucrative representation that an attorney would be eligible to accept in one court may not be permitted in another. In a large chapter 11 case, there can be several thousand creditors of the debtor. This huge number of banks, trade creditors, and other parties in interest can make it extremely difficult for a law firm, and especially a large law firm, to alleviate all potential conflicts of interest with the debtor, such as representing a creditor in a completely unrelated matter in a different situation. Thus, much turns on the court’s classification of what will or will not constitute a disqualifying conflict of interest, as well as the punishment a court will impose in the event of the failure to disqualify a conflict of interest.

The effect of ethical standards on forum-shopping behavior may be larger than LoPucki or others have recognized. For instance, in a headline-grabbing case in 1994, 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.¹⁴⁹ 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 *Granite Partners* case, where the court imposed sanctions and a substantial disallowance of fees for a failure to fully disclose relevant conflicts of interest.¹⁵⁰ Interestingly, LoPucki’s data on forum-shopping patterns suggests that the 1994-1996 period marks a clear breaking point in the forum-shopping wars, marking a seismic shift from New York to Delaware as the bankruptcy capital.¹⁵¹ According to LoPucki, in 1993, 5 large cases were filed in Delaware and 21 everywhere else (mainly New York); in 1994, 4 in Delaware and 7 elsewhere; in 1995, 9 and 11; and in 1996, 13 in Delaware and just 2 elsewhere. LoPucki also notes that from 1991 to 1996, New York lawyers filed the large majority of the cases filed in Delaware during that period. In other words,

¹⁴⁶ Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases*, 1 J. EMPIRICAL LEGAL STUDIES 111, 136 (2004).

¹⁴⁷ See LOPUCKI, *supra* note 1, at 143. See also Lynn M. LoPucki & Joseph W. Doherty, *The Determinants of Professional Fees in Large Bankruptcy Reorganization Cases Revisited* (July 17, 2005) (copy on file with author).

¹⁴⁸ See Todd J. Zywicki, *Mend It, Don’t End It: The Case for Retaining the Disinterestedness Requirement for Debtor in Possession’s Professionals*, 18 MISS. COL. L. REV. 291 (1998).

¹⁴⁹ *In re The Leslie Fay Cos.*, 175 B.R. 525 (Bankr. S.D. N.Y. 1994).

¹⁵⁰ *In re Granite Partners, L.P.*, 219 B.R. 22 (Bankr. S.D. N.Y. 1998).

¹⁵¹ LOPUCKI, *supra* note 1, at 90, Fig. 3.

beginning in 1994 New York lawyers were overwhelmingly filing in Delaware rather than their home court.¹⁵² In other words, the transition from New York to Delaware was not gradual, as might be expected—rather, there appears to have been a relatively clear break in filing trends beginning in 1994 and tipping to Delaware strongly in 1996.¹⁵³ 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 *Leslie Fay* 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 interests 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.”¹⁵⁴ In a typical bankruptcy case, the debtor files bankruptcy and then proposes a plan of reorganization that it hopes will gain the consent of sufficient number of creditors to confirm the plan. In a prepackaged bankruptcy, the debtor contacts creditors *prior* to filing bankruptcy and describes its proposed plan of reorganization and requests the creditors’ votes 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.¹⁵⁵ 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.¹⁵⁶

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 proceeding.¹⁵⁷ 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 hold were the firm 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

¹⁵² I do not know how many of those cases were filed by Weil Gotshal, the firm penalized in *Leslie Fay*, but given its prominence, one suspects that it was involved in a substantial number of those cases.

¹⁵³ 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 *Granite Partners* was decided.

¹⁵⁴ Rasmussen & Thomas, *supra* note 52, at 1374.

¹⁵⁵ See Rasmussen & Thomas, *supra* note 52, at 1386-89; LOPUCKI, *supra* note 1, at 74.

¹⁵⁶ See Rasmussen & Thomas, *supra* note 52, at 1387-89.

¹⁵⁷ LOPUCKI, *supra* note 1, at 70-74.

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.”¹⁵⁸ 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 leads to tangible harm, as evidenced by a higher failure rate for prepackaged bankruptcies as compared to traditional filings¹⁵⁹ and greater losses by those companies that fail and must refile again¹⁶⁰.

Rasmussen and Thomas have expressed skepticism about LoPucki’s argument that prepackaged bankruptcies differ in any important substantive way from traditional bankruptcy filings.¹⁶¹ They suggest that what matters in the end 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 acceptance 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 acceptance of prepacks can be laid at the doorstep of improper forum-shopping behavior. In fact, Delaware’s prepacks are no speedier than prepacks in other courts and “rubber-stamping” prepackaged bankruptcies require no special skill by the court.¹⁶² 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 section 363 quick sales, it is hard to understand why judges would have the incentive to *want* to compete for prepackaged cases.¹⁶³ These cases do not seem to provide the type of ego boost, fame, or inherent degree of interest that have been described as the motives for why judges might want to engage in competition for cases. Nor do they appear to be

¹⁵⁸ LOPUCKI, *supra* note 1, at 162-63.

¹⁵⁹ See Lynn M. LoPucki & Joseph W. Doherty, *Why Are Delaware and New York Bankruptcy Reorganizations Filing?* 55 VAND. L. REV. 1333, 1373 (2002) (finding that prepackaged bankruptcies were significantly more likely to fail than nonprepackaged bankruptcies).

¹⁶⁰ See Lynn M. LoPucki, *Can the Market Evaluate Legal Regimes? A Response to Professors Rasmussen, Thomas, and Skeel*, 54 VAND. L. REV. 331, 336-38 (2001) (showing that operating losses between bankruptcies averaged 23 percent for prepackaged bankruptcies leading to refiling but only 11 percent for nonprepackaged bankruptcies leading to refiling).

¹⁶¹ See Rasmussen & Thomas, *supra* note 52, at 1390.

¹⁶² LOPUCKI, *supra* note 1, at 160.

¹⁶³ The incentives of judges to engage in forum-shopping competition are discussed in the next Section.

especially lucrative for local counsel, as most of the work is done prior to the filing the case, and there would seem to be little role for local counsel in such cases.¹⁶⁴ 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.

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 result of conscious forum-shopping (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 decision-makers in other forum-shopping models is in each case 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 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 appear to act differently, notwithstanding the otherwise identical institutional constraints confronting them (such as the substantive law they apply). 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 corporate chartering business makes the legislature extremely responsive to the demands of the relevant decision-making group. Thus, here too, Delaware has strong financial incentives to compete for corporate-chartering business.¹⁶⁵

¹⁶⁴ 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 132, 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 for total costs, including pre-bankruptcy negotiation costs).

¹⁶⁵ 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 5, 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.

The incentive of bankruptcy judges to engage in forum-shopping competition is unclear. Formally, federal bankruptcy judges are selected by the Circuit Judges who preside over the district in which the court sits. They serve 14 year terms, which can be renewed. Relatively few judges seek to serve more than 14 years, in part because if they leave office after even a single 14-year term, they receive a full federal pension.¹⁶⁶ It appears that in most cases, bankruptcy judges who seek a second term usually have their request granted.¹⁶⁷ 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.¹⁶⁸ 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 motivated by goals such as leisure, prestige, personal satisfaction, and the desire to impose their personal preferences on society.¹⁶⁹ Because good and bad judges, lazy and conscientious judges all earn the same salary, he 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.¹⁷⁰ 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 (or at least Delaware's judges) to compete for cases? LoPucki

¹⁶⁶ LOPUCKI, *supra* note 1, at 20.

¹⁶⁷ LoPucki cites the instance of Bankruptcy Judge David Scholl of Philadelphia, who was denied reappointment in 2000. LoPucki implies Scholl was not reappointed because Philadelphia bankruptcy courts were unduly stingy on fee awards. See LOPUCKI, *supra* note 1, at 44. In fact, the decision by the United States Court of Appeals not to reappoint him was much more complicated, including concerns that he had an unduly pro-debtor and anti-creditor bias and a "habit of defying the courts that reversed him by trying to find creative ways to reach the same result again." Shannon P. Duffy, *Fox Reappointed: No Controversy Over This Bankruptcy Judge*, 222, No. 128 LEGAL INTELLIGENCER 3 (July 5, 2000). Other reports stated that the decision not to reappoint Scholl to a second term was supported by all but one of the judges on the Third Circuit and that the decision was made because Scholl was perceived as being "totally arbitrary and capricious" in his ruling. Jim Smith, *Bankruptcy Judge Is Booted from Bench*, PHILA. DAILY NEWS 8 (May 27, 2000), available in 2000 WLNR 1702766. Others have speculated that Scholl's high-profile role in a lawsuit against the government and his insurance carrier to increase his insurance coverage for the purchase of Viagra pills may have also contributed to the decision, but this was denied. *Id.* Thus, it is far from clear that Scholl was bounced from the bench because of undue strictness on fee awards. The decision of the circuit court not to reappoint Scholl appears to be a relatively unusual situation.

¹⁶⁸ See also Richard S. Higgins & Paul H. Rubin, *Judicial Discretion*, 9 J. LEGAL STUD. 129 (1980) (considering promotion motive as model of judicial behavior); Mark A. Cohen, *The Motives of Judges: Empirical Evidence from Antitrust Suits*, 12 INT'L REV. L. & ECON. 13 (1992) (same).

¹⁶⁹ Richard A. Posner, *What Do Judges and Justices Maximize? (The Same Thing Everybody Else Does)*, 3 SUP. CT. ECON. REV. 1, 13-15, 31 (1994); RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* §19.6, pp. 532-45 (6th ed. 2003)

¹⁷⁰ LOPUCKI, *supra* note 1, at 20.

argues that there are a variety of factors might explain why bankruptcy judges actively compete for large cases, even going so far, he believes, to bend the law and procedure in order to compete for cases. This 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, and the like. Presiding over big cases will also give the judge a degree of celebrity, especially in the bar. It will also likely improve the judges' 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 the norms and peer pressure of the local community of lawyers and bankruptcy professionals who benefit from these cases. These professionals exert a form of peer pressure on the judge that causes the 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.¹⁷¹

Marcus Cole provides a similar explanation of the judicial incentives of Delaware's judiciary that spurs them to compete.¹⁷² Cole argues that the behavior of Delaware's judges can be modeled as a form of "professional competition"—"a race between professionals to perform their service effectively and efficiently, without regard to tangible rewards or compensation for their superior service."¹⁷³ Cole argues that Delaware's legal environment is characterized by "a culture of service"¹⁷⁴ or "service and responsiveness"¹⁷⁵ 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."¹⁷⁶ Delaware then "puts its culture to work, aligning the interests of the professional judges with those of the community."¹⁷⁷ 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.¹⁷⁸ Indeed, at one point a non-Wilmingtonian (Judge Walrath) was appointed to the Delaware bench specifically to try to rid this Delaware bankruptcy bar of this coziness, but was soon assimilated into the local norms.¹⁷⁹

¹⁷¹ LOPUCKI, *supra* note 1, at 20.

¹⁷² See Cole, *supra* note 138, at 1890-92.

¹⁷³ *Id.* at 1890.

¹⁷⁴ *Id.* at 1890.

¹⁷⁵ *Id.* at 1891.

¹⁷⁶ *Id.* at 1890.

¹⁷⁷ *Id.* at 1890.

¹⁷⁸ Cole notes that the lawyers in his survey noted that in a small community like Wilmington, bankruptcy judges are part of the community, and so not only are they frequently seen in court, but at parties, restaurants, and the like. *Id.* at 1891.

¹⁷⁹ *Id.* at 1892.

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 engage in the forum-shopping race appear to be more *post hoc* explanations for what seems to be observed, rather than 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. In contrast to Delaware, LoPucki notes, for instance, that Boston's judges refused pleas by Boston bankruptcy attorneys to be more aggressive in competing for cases.¹⁸⁰ Yet it is hard to imagine that Boston's bankruptcy judges are less "professional," conscientious, or self-aggrandizing than Delaware's judges, or that their bankruptcy bars are substantially less close-knit than Delaware's.¹⁸¹ In short, explanations that are 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.¹⁸² None of these theories seem to generate meaningful predictions about why Delaware judges behave so differently, and compete aggressively, as opposed to New York, Boston, Houston, or Chicago judges. 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. Thus, they seem to have relatively weak explanatory power.

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. Then 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 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 makes it easier to solve the collective actions problems typically associated with norm creation and enforcement, as opposed to larger jurisdictions, such as Boston, New York, or others. If so, then this might explain the difference. 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. Even on a bench as small as five judges, for instance, if four judges are considered to be very able (or willing to compete) and one is not, then each potential filer has a twenty percent chance of drawing the disfavored judge.¹⁸³ Thus, even if most of the 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. Adding the important component of the size and, hence, predictability

¹⁸⁰ LOPUCKI, *supra* note 1, at 20-21.

¹⁸¹ For instance, I personally practiced in Atlanta during my time in private practice. Much of what LoPucki and Cole say about the supposed distinctiveness of the Wilmington bar seem equally applicable to my experience practicing in Atlanta.

¹⁸² See Zywicki, *Rise and Fall*, *supra* note 21, at 1564.

¹⁸³ 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.

of the local culture may help to 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 does not necessarily distinguish Delaware from other small bankruptcy benches, although the combination of small size with other factors (such as Delaware’s prominence in corporate law¹⁸⁴) might.

But 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” versus “bad” forum-shopping. Indeed, LoPucki and Cole observe essentially the same phenomenon and come to radically opposite interpretations. LoPucki argues that the shows an improper responsiveness and incentive to satisfy Delaware professionals and their narrow economic self-interest. Cole argues that the evidence 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 that are 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 the incentives that they confront tend to lead them to engage in 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 bit cases is “corrupting” the American bankruptcy system, what should be done about it, if anything? 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 to 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 second form of regulation is substantive regulation. Substantive regulation essentially places certain possible market outcomes off limits and prevents those outcomes from being adopted. Thus, for instance, in a lending market, a substantive limitation on outcomes may prohibit charging above a given interest rate, even if fully disclosed and justified by market conditions. These substantive limitations may be imposed either for external moral reasons, or alternatively, because certain outcomes are thought to be presumptively or irrebuttably evidence of a market failure. Substantive

¹⁸⁴ See Skeel, *supra* note 9 (arguing that there is a natural synergy between Delaware’s corporate law and bankruptcy reorganization).

regulations leave the process of competition largely unaffected, but then intervene only if the process generates a prohibited outcome.

Similarly, there are two basic approaches to mitigating the ills of forum-shopping, procedural reforms and substantive. LoPucki's proposed reforms are primarily procedural; as will be discussed, it may be that substantive reforms will be 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 "correct" 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.¹⁸⁵ As a practical problem, 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 days and the professionals involved in the case are hired and get up and running.¹⁸⁶ A motion to transfer venue probably cannot be decided until several weeks or months into the case. And if LoPucki is correct that judges will bend the law to engage in forum-shopping competition, then they are unlikely to rigorously apply the rules governing transfer of cases. As a result, by the time the motion can be heard and ruled upon, the case may be fairly well along, 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.¹⁸⁷ Numerous parties filed motions to transfer venue in the case from New York to Houston, including the Attorney General of Texas.¹⁸⁸ 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 venue in the location of its physical assets may be important in a chapter 7 liquidation case, but not in a chapter 11 reorganization. Finally, the court held that venue transfer was not supported in the "interest of justice." The Court held that the "interest of justice" was not an independent analysis from the convenience of the parties, but that "the considerations involved with the interest of justice are intertwined with the economic and efficient administration of the estate."¹⁸⁹

In addition, the court noted that in determining 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."¹⁹⁰ The Court noted that it "has gained

¹⁸⁵ See LOPUCKI, *supra* note 1, at 38.

¹⁸⁶ *Id.*

¹⁸⁷ *In re Enron*, 274 B.R. 327 (Bankr. S.D. N.Y. 2002).

¹⁸⁸ 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 venue-shopping.

¹⁸⁹ *Enron*, 274 B.R. at 349.

¹⁹⁰ *Id.*

familiarity” with the issues in the case, ruled on several important motions, and handled many of the emergency issues that already arose 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.”¹⁹¹ 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 they also acquired the assets of a defunct company in order to try to sustain venue in New York.¹⁹² 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.¹⁹³

LoPucki thus argues that current law provides insufficient 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 that 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.¹⁹⁴ 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. He would instead permit members of a corporate group to reorganize together only at the location of the parent company or the group.¹⁹⁵ The effect 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.”¹⁹⁶ He admits, however, that companies would still “more their headquarters or principal assets to the district in which they chose to file. This 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 that hoped to attract them.”¹⁹⁷

¹⁹¹ *Id.* at 350.

¹⁹² See *Winn-Dixie Transcript*, *supra* note 106; see also M. Natasha Labovitz & Craig A. Bruens, *You Can Still Shop after Winn-Dixie: The Right to Choose Venue Survives the Transfer to Fla.*, 24(6), AM. BANKR. INST. J. 16 (July/Aug. 2005).

¹⁹³ 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.

¹⁹⁴ LOPUCKI, *supra* note 1, at 252.

¹⁹⁵ *Id.*

¹⁹⁶ *Id.*

¹⁹⁷ *Id.* at 252.

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 effect of also eliminating good forum-shopping and thereby eliminating the information that is produced through the competitive process of court choice.¹⁹⁸ 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.”¹⁹⁹ 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 system likely to be effective in preventing 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.” 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 in order to receive soft treatment for corporate executives, it seems unlikely that this sort of forum-shopping would be among those 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.”²⁰⁰ Each of the specialized courts would serve a specified territory for all cases properly arising under its jurisdiction.

One potential problem with this proposal is that while it 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 have the negative consequence of stifling this competition and the innovation that it generates.²⁰¹ To the extent that current rules are the result of error rather than negative forum-shopping, the costs of creating such a monopoly or oligopoly in terms of reduced decentralization might well exceed the benefits of eliminating court competition. Both

¹⁹⁸ 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.

¹⁹⁹ LOPUCKI, *supra* note 1, at 252-53.

²⁰⁰ *Id.* at 253.

²⁰¹ LoPucki also provides no details on how appeals in such a system would be allocated among federal district and circuit courts consistent with *Marathon*. Perhaps he has in mind something like the Federal Tax Court and the treatment of patent law by the Federal Circuit.

proposals also face formidable political difficulties, namely the opposition of Delaware's United States Senators, who over time have opposed every effort to prohibit forum-shopping into Delaware because of the political implications it would have for major Delaware interest groups.²⁰²

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. 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.²⁰³ Similarly, usually laws prohibit charging interest rates above a certain statutory cap.

It is quite common where there is competition in legal markets for regulators to put certain results out-of-reach of the competitive process. So, for instance, although federalism allows the states to experiment with varying constitutional protections for personal liberties and the like, the federal Constitution and the Supreme Court put a floor underneath the substantive results generated by this interjurisdictional competition, permitting greater, but not less, constitutional protection for individual rights. Similarly, there is a substantial degree of contractual choice-of-law for contract disputes, yet there are some substantive regulations that underlie this competition and prohibit certain results that are thought to be “extreme.”²⁰⁴

LoPucki spends little time discussing substantive regulation as one means for limiting the ills of forum-shopping. But given the problems with the procedural regulations currently in place, and questions about whether new procedural regulations would prove any more effective, it is 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 BAPCPA in the book, except to note the provisions in the legislation that will increase the number of bankruptcy judges in Delaware.²⁰⁵ LoPucki is concerned that this provision will exacerbate the current forum-shopping problems by giving Delaware an even greater capacity to compete for cases by eliminating the capacity constraint on their

²⁰² 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.

²⁰³ See *Henningson v. Bloomfield Motors, Inc.*, 161 A. 2d 69 (N.J. 1960). Whether this should be the case as a policy matter is a different question.

²⁰⁴ See Erin A. O'Hara & Larry E. Ribstein, *From Politics to Efficiency in Choice of Law*, 67 U. CHI. L. REV. 1151 (2000).

²⁰⁵ LOPUCKI, *supra* note 1, at 245-49.

ability to hear and process cases.²⁰⁶ 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.

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.

1. Exclusivity

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.²⁰⁷ Under Section 1121(d), the Court may extend the exclusivity “period” for cause beyond the 120 days if it believes that the debtor needs more time. In practice, judges would often extend the exclusivity period indefinitely, even for years in some cases. Extending the debtor’s exclusivity period is valuable to the debtor, because so long as the debtor in possession remains the only party that can propose a plan of reorganization, this gives the upper-hand in the case to the debtor. 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.”²⁰⁸ Once a plan is confirmed, by contrast, the debtor must begin repayment. As a result, extensions of exclusivity increases the leverage held by debtors over creditors in confirming a plan of reorganization because each day of delay reduces the present value of the creditors’ claims in the case. Moreover, it permits incumbent management to remain in place during the bankruptcy case, extending their job tenures. 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.²⁰⁹ On the other hand, as David Skeel has noted, this explanation seems inconsistent with the later forum-shopping experience of Delaware, in that Delaware’s courts are speedier at confirming plans than other courts, not slower.²¹⁰ Thus, while the willingness of courts to grant extensions to the exclusivity period could theoretically contribute to improper

²⁰⁶ Of course, to the extent that the Delaware bench expands in size, this may reduce its predictability and uniformity, thus expanding the size of the court may naturally restrain the forum-shopping competition that he is concerned about.

²⁰⁷ 11 U.S.C. § 1121(b). Or 180 days for the confirmation of the plan that is filed. 11 U.S.C. § 1123 (c)(3).

²⁰⁸ LOPUCKI, *supra* note 1, at 41.

²⁰⁹ LOPUCKI, *supra* note 1, at 41.

²¹⁰ See Skeel, *What’s So Bad*, *supra* note 9, at 327. Skeel argues that managers are more likely to keep their jobs in a speedy reorganization, rather than a protracted one, especially in a prepackaged bankruptcy. Indeed, the speediness of Delaware’s reorganization procedures is the linchpin of LoPucki’s argument against Delaware.

forum-shopping, there are empirical questions about whether this bias explains observed forum-shopping behavior.

Nonetheless, if LoPucki is correct, BAPCPA imposes new limits on extreme and open-ended extensions of the exclusivity period, by imposing an outer limit of 18 months on extensions of exclusivity for cause.²¹¹ Although LoPucki's argument might support more strict limitations on exclusivity, this outer-limit on the extension of exclusivity 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 the cases that are most prone to extended exclusivity periods because of minimal creditor involvement and oversight.²¹² This will force debtors to propose a plan and courts to confirm them (or convert the case) within a relatively short time after it is filed, thereby generating timely distributions to creditors.

2. Forum Shopping by Wealthy Individuals

LoPucki also criticizes provisions of bankruptcy law that he sees as promoting forum-shopping by wealthy individuals. For instance, he criticizes those states that permit homestead exemptions and Delaware (and a few other states) that have permitted self-settled "asset protection trusts." The latter objection is easily answered—in practice these trusts appear to be unenforceable in bankruptcy against creditors under current fraudulent transfer law.²¹³ Indeed, it seems to be primarily intended as a tax dodge, not a vehicle for protecting assets from creditors in bankruptcy. Nonetheless, the legislation adds a new section 548(e) which creates under the Bankruptcy Code a 10-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.²¹⁴

LoPucki also notes the problem of corporate executives abusing unlimited state homestead exemptions to "stash[] the loot in a place from which even judgment creditors couldn't get it back."²¹⁵ He provides the example that three of the prime suspects in the Enron case started building new multimillion dollar homes in a tony Houston neighborhood around the time that they could have reasonably been expected to be sued. Under Texas's homestead law, they may be able to protect their expensive homes from

²¹¹ See 11 U.S.C. § 1123(d)(2)(A) (revised 2005). Extensions of the 180 day period similarly can be extended to 20 months. 11 U.S.C. § 1123(d)(2)(B).

²¹² See 11 U.S.C. § 1123(e).

²¹³ See Todd J. Zywicki, *Bankruptcy Reform, The New York Times, and Real v. Hypothetical Homestead Abuse*, http://volokh.com/archives/archive_2005_03_27-2005_04_02.shtml#1112359704 (April 1, 2005); see also Melanie Leslie, 231 *New York Law Journal* (Feb. 14, 2005); compare Engel *Does Asset Protection Planning Really "Work"?*, 4 *J. OF ASSET PROT.* No. 1 (Sept/Oct 1998) (arguing that notwithstanding legal unenforceability).

²¹⁴ 11 U.S.C. §548(e). 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.

²¹⁵ LOPUCKI, *supra* note 1, at 149.

the claims of creditors in securities fraud and other lawsuits.²¹⁶ 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.²¹⁷ Moreover, the Code expressly adds a 10 year statute of limitations to challenge any acquisition of a homestead exemption with intent to hinder, delay, or defraud a creditor.²¹⁸ Finally, the Code places a cap on the ability to increase the amount of property protected by a homestead exemption in the 40 months prior to bankruptcy.²¹⁹ In other words, the revisions to the Code appear to address the abuse that LoPucki is specifically concerned about, namely the fraudulent use of homestead exemptions to engage in fraud by loading up the value of the homestead exemption.

3. Critical Vendor Payments

LoPucki also criticizes the development of so-called “critical vendor payments.” “Critical vendors” are those suppliers that a debtor “cannot replace or can replace only at great expense,”²²⁰ 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 held that the refusal to deal postpetition because of outstanding prepetition debt violated the automatic stay.²²¹ 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 notes that 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.²²² LoPucki argues that this ratchet effect toward greater allowance of critical vendor orders was thus the result of forum-

²¹⁶ 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.

²¹⁷ 11 U.S.C. § 522(q)(1).

²¹⁸ 11 U.S.C. § 522(o).

²¹⁹ 11 U.S.C. § 522(p).

²²⁰ LOPUCKI, *supra* note 1, at 163.

²²¹ LOPUCKI, *supra* note 1, at 164.

²²² 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 reorganized Kmart. *Id.* at 869.

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 about whether this can be traced to forum-shopping, it appears that the recent bankruptcy code reforms will do much to mitigate any improper competition on critical vendor orders by establishing some 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 20 days of the filing of the case so long as sold in the ordinary course of the debtor's business.²²³ Although this may be good or bad policy, it should eliminate most of the forum-shopping problem expressed by LoPucki by imposing a uniform rule for all creditors that supply goods within 20 days for the bankruptcy filing.²²⁴ The reforms also codify the reclamation rights of creditors, providing a right to reclamation if the goods are received by an insolvent debtor within 45 days of bankruptcy.²²⁵ Again, this establishes a bright-line rule that replaces the more ambiguous reclamation provisions that previously prevailed. So while there may still be some claims that fall outside these statutory provisions, the scope of critical vendor orders has been substantially narrowed.

4. Managerial Retention Bonuses

LoPucki also criticizes the dubious 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.²²⁶ As LoPucki observes, traditionally retention bonuses were 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.²²⁷ But 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 the managers of failed enterprises have other employment alternatives, such that the payment of retention bonuses is necessary.²²⁸ Moreover, LoPucki finds that bankrupt companies that replace old management do better in bankruptcy than those that do not, raising doubts about the overall wisdom of undertaking extraordinary measures to try to retain incumbent management in the first place.²²⁹ 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.

²²³ 11 U.S.C. § 503(b)(9).

²²⁴ 11 U.S.C. §503(b)(9).

²²⁵ 11 U.S.C. § 546(c)(1). In the alternative, the creditor that does not request reclamation is automatically entitled to administrative priority under the terms of amended section 503(b)(9). 11 U.S.C. §546(c)(2).

²²⁶ See LOPUCKI, *supra* note 1, at 151-56.

²²⁷ *Id.* at 152.

²²⁸ See *id.* at 151-52 (citing Stuart C. Gilson, *Management Turnover and Financial Distress*, 25 J. FIN. ECON. 241 (1989)).

²²⁹ See LOPUCKI, *supra* note 1, at 156. LoPucki states that "the data indicate[]" this, but does not provide any further citation or supporting information. *Id.*

BAPCPA substantially restricts the ability of bankruptcy courts to award 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,²³⁰ and that the continued services of the employee are essential to the survival of the business²³¹. 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.²³²

In part, LoPucki’s oversight regarding these substantive provisions of the legislation that seem to address many of his concerns may be based on some confusion about the process and content of BAPCPA. Although the legislation was pending for several years, most attention was focused on the consumer bankruptcy provisions of the legislation, and little attention was paid during that period to the business provisions. In fact, the business provisions were included in the legislation precisely to clean-up many of the problems that LoPucki points out in his book, regardless of whether motivated by forum-shopping.

LoPucki also has somewhat of a confused understanding of the political process that spawned the legislation. He writes, for instance, that the legislation was an “unpopular” piece of legislation and that 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.²³³ In fact, the provisions to add more judges were part of the larger BAPCPA pretty much from the beginning of the process. Moreover, the legislation itself was actually quite popular, and over time passage was frustrated by efforts of congressional leaders to attach more controversial legislation to the bankruptcy bill, rather than the other way around.²³⁴

5. Eliminating the “Venue Hook” By Requiring Insolvency

Other substantive regulations could 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.²³⁵ As LoPucki notes, in both of these notorious cases, it appears that the subsidiary that provided the initial venue hook may not have been insolvent at the time the

²³⁰ 11 U.S.C. § 503(c)(1)(A).

²³¹ 11 U.S.C. § 503(c)(1)(B).

²³² 11 U.S.C. § 503(c)(1)(C).

²³³ LOPUCKI, *supra* note 1, at 130.

²³⁴ The legislation consistently drew over 70% support of both houses of Congress 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*, NATIONAL REV. ON-LINE (march 16, 2005), available in <http://www.nationalreview.com/comment/zywicki200503160744.asp>.

²³⁵ See LOPUCKI, *supra* note 1, at 36-37;

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 because of the fear that this would tend to chill the 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.²³⁶ 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 interpreted the bankruptcy code to require insolvency as a condition for filing bankruptcy, in fact there is a strong case to be made that the Bankruptcy Clause of the Constitution²³⁷ requires insolvency as a condition for bankruptcy,²³⁸ 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, not by doing so directly by limiting venue (as LoPucki advocates), but instead by 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 major margins on which forum-shopping occurs.

V. Conclusion

In *Courting Failure*, Lynn LoPucki has thrown down the gauntlet on bankruptcy forum-shopping, laying many of the ills of the current bankruptcy system at its feet. He makes a powerful case supported by volumes of important and original empirical research. The leading Delaware Skeptic has nailed his 99 Theses to the door of Delaware's Bankruptcy Courthouse. 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.

²³⁶ See, e.g., *SGL Carbon*, 200 F.3d 154; see also Robert J. Keach, *Solvent Debtors and the Myth of Good Faith and Fiduciary Duty*, 23-JAN AM. BANKR. INST. J. 36 (Dec./Jan. 2005).

²³⁷ See Art. I, § 8.

²³⁸ See Thomas E. Plank, *Bankruptcy and Federalism*, 51 FORDHAM L. REV. 1063, 1093-95 (2002) (arguing that insolvency is a constitutional precondition for filing bankruptcy); Thomas E. Plank, *Constitutional Limits of Bankruptcy*, 63 TENN. L. REV. 487, 529-32, 545-49 (1996) (same). But see *In re Marshall*, 300 B.R. 507, 517 (2004) (holding that insolvency is not required by Constitution). Most believe that the Code does not independently require insolvency as a condition for filing; *In re SGL Carbon Corp.*, 200 F.3d 154, 163(3d Cir. 1999) (same).