

DELAWARE’S RELEVANCE IN CHAPTER 22:  
WHO IS “COURTING FAILURE” NOW?

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***Introduction***

In 2001, Professor Lynn LoPucki and Sara Kalin released an influential study showing that between 1991 and 1996, large public corporations in Chapter 11 emerging from Delaware courts were six times more likely to fail than large, public corporations emerging from courts other than Delaware and New York.<sup>1</sup> This Article departs from the “overheated”<sup>2</sup> debate that followed the LoPucki/Kalin study by presenting evidence that in recent years, the failure rates have been approximately the same for cases filed in Delaware and in other jurisdictions.

While there are a variety of measures of reorganizational failure, this Article—like the LoPucki/Kalin study and its progeny—is premised on the notion that a Chapter 11 bankruptcy case fails when the debtor corporation refiles for bankruptcy after it emerges. As LoPucki and Kalin explain:

Refiling constitutes a failure of the bankruptcy process. First, the Bankruptcy Code condemns the necessity for refiling. Specifically, it provides that, as a condition of confirming the plan in the first case, the court must find that “confirmation of the

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<sup>1</sup> Lynn M. LoPucki & Sara D. Kalin, *The Failure of Public Company Bankruptcies in Delaware and New York: Empirical Evidence of a “Race to the Bottom,”* 54 VAND. L. REV. 231, 250 (2001).

<sup>2</sup> Stephen J. Lubben, *Delaware’s Irrelevance*, 16 AM. BANKR. INST. L. REV. 267, 268 (2008).

plan is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor.” Second, bankruptcy reorganization is an expensive and disruptive process. For a large, public company, the direct cost is probably about 1.5% to 6% of the company’s assets. . . . The indirect costs—damage to the reputation of the company, distraction of management, the loss of key employees, and the necessity to sell or abandon promising projects—are generally assumed to be much higher. When bankruptcy is repeated, these costs are incurred a second time.<sup>3</sup>

LoPucki and Kalin discovered that companies “emerging from reorganization in Delaware or New York were considerably more likely to refile than companies emerging from reorganization in other courts, whether the rate of filing is measured by the number of refilings or the number of refilings per year of following.”<sup>4</sup> Indeed, from 1991 to 1996, the “percent refiling from Delaware” was “six times the percent refiling from reorganizations in all other courts.”<sup>5</sup> This factual finding—that Chapter 11 bankruptcies for large, public corporations experience a much higher refiling rate when they emerge from Delaware than when they emerge from other courts—has not been disputed,<sup>6</sup> but has instead been confirmed by several studies.<sup>7</sup>

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<sup>3</sup> LoPucki & Kalin, *supra* note 1, at 235–36.

<sup>4</sup> *Id.* at 248.

<sup>5</sup> *Id.* at 250.

<sup>6</sup> See, e.g., Thomas J. Salerno, *Suggested Reading: Courting Failure: How Competition for Big Cases is Corrupting the Bankruptcy Courts*, AM. BANKR. INST. J., Feb. 2005, at 46, 69 (noting that LoPucki’s data “is fine as far as it goes”); Robert K. Rasmussen & Randall S. Thomas, *Whither the Race? A Comment on the Effects of the Delawarization of Corporate Reorganizations*, 54 VAND. L. REV. 283, 285 (2001) (“LoPucki and Kalin have increased our understanding of bankruptcy practice in Delaware. Firms that reorganize there often need a subsequent reorganization. We have no quarrel with their factual findings . . .”).

<sup>7</sup> See, e.g., Lynn M. LoPucki & Joseph W. Doherty, *Delaware Bankruptcy: Failure in the Ascendancy*, 73 U. CHI. L. REV. 1387, 1389 (2006) [hereinafter *Failure in the Ascendancy*]; Lynn M. LoPucki & Joseph W. Doherty, *Why are Delaware and New York Bankruptcy Reorganizations Failing?*, 55 VAND. L. REV. 1933, 1939 (2002) [hereinafter *Why are Delaware and New*

LoPucki has attributed the high refiling rate of Delaware cases to “the Delaware bankruptcy court’s laissez-faire approach to confirmation,”<sup>8</sup> and more generally, to the way “bankruptcy courts are competing for cases and that competition is corrupting the courts.”<sup>9</sup> Specifically, LoPucki has argued that “bankruptcy judges are under substantial pressure to attract cases,”<sup>10</sup> and that some of them “changed substantive rules and rulings to attract cases,”<sup>11</sup> that “some of those changes were harmful and made in bad faith,”<sup>12</sup> and that “‘corruption’ does not seem . . . too strong a word.”<sup>13</sup> LoPucki has referred to this line of argument as his Courting Failure thesis.<sup>14</sup>

From its inception, the Courting Failure thesis has been critiqued, but also defended. Professors Robert Rasmussen and Randall Thomas have argued, *inter alia*, that although Delaware’s prepackaged<sup>15</sup> reorganizations result in refiling, the first Chapter 11 filing is an efficient way for firms to determine the severity of their economic distress.<sup>16</sup> They have also argued that having prepackaged

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*York Bankruptcy Reorganizations Failing?*] (finding that firms emerging from Delaware reorganization were “more than ten times as likely to refile (42%) during [their first five years after emerging from bankruptcy] than were firms emerging from reorganization in Other Courts (4%) . . .”).

<sup>8</sup> LoPucki & Kalin, *supra* note 1, at 265. *See also* LYNN M. LOPUCKI, *COURTING FAILURE: HOW COMPETITION FOR BIG CASES IS CORRUPTING THE BANKRUPTCY COURTS* 103 (2005) (“Kalin and I attributed the elevated refiling rates to court competition. . . Intense examination of a few of the failed cases revealed that the Delaware court had adopted a laissez-faire approach to the confirmation of plans.”).

<sup>9</sup> Lynn M. LoPucki, *Where Do You Get Off? A Reply to Courting Failure’s Critics*, 54 *BUFF. L. REV.* 511, 512 (2006) [hereinafter *Where Do You Get Off?*].

<sup>10</sup> *Id.*

<sup>11</sup> *Id.* at 514.

<sup>12</sup> *Id.* at 516.

<sup>13</sup> *Id.* at 518.

<sup>14</sup> *Id.* at 512. I will refer to this general claim as the “Courting Failure thesis” for the purpose of convenience throughout this article, even when I refer to LoPucki’s argument during the period of time that preceded the publication of his 2005 book, “Courting Failure.”

<sup>15</sup> *See infra* text accompanying note 52.

<sup>16</sup> *See* Rasmussen & Thomas, *supra* note 6, at 294–295. *See also* Ayotte & Skeel, *infra* note 18.

cases all handled in a single court like Delaware could be efficient.<sup>17</sup> Professors Kenneth Ayotte and David Skeel have expanded upon this type of efficiency argument, explaining the discrepancy in refiling rates as:

a pure selection effect, with firms with preexisting differences selecting into distress resolution procedures that are best tailored to their circumstances. In this framework, the Delaware court (and prepackaged bankruptcy, regardless of venue) provides distressed firms with a forum to enact faster, and hence less costly, workout procedures when little would be gained by a long and expensive stay in Chapter 11. The Delaware option is valuable because it provides firms with more flexibility to resolve distress.<sup>18</sup>

Professor Todd Zywicki has also argued along efficiency lines that “[w]hile there may be some merit to LoPucki’s circumstantial evidence of ‘bad’ forum shopping (or what he refers to as ‘court competition’),” that it “seems equally plausible that this could be the result of good competition.”<sup>19</sup>

A second popular argument was that Delaware was handling the most difficult cases. Skeel argued the corporations going to Delaware may have “more complicated capital structures” than those corporations going to other states,<sup>20</sup> so that, as Harvey Miller suggested, “higher percentages of recidivism may be attributed to the complex and sophisticated Chapter 11 cases that gravitate toward Delaware and New York.”<sup>21</sup>

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<sup>17</sup> See Robert K. Rasmussen & Randall S. Thomas, *Timing Matters: Promoting Forum Shopping By Insolvent Corporations*, 94 NW. U. L. REV. 1357, 1388 (2000).

<sup>18</sup> See, e.g., Kenneth Ayotte & David A. Skeel, Jr. *Review: An Efficiency-Based Explanation for Current Corporate Reorganization Practice*, 73 U. CHI. L. REV. 425, 437 (2006).

<sup>19</sup> Todd J. Zywicki, *Is Forum Shopping Corrupting America’s Bankruptcy Courts?*, 94 GEO. L.J. 1141, 1172 (2006).

<sup>20</sup> David A. Skeel, Jr., *What’s So Bad About Delaware?* 54 VAND. L. REV. 309, 319 (2001).

<sup>21</sup> Harvey R. Miller, *Chapter 11 Reorganization Cases and the Delaware Myth*, 55 VAND. L. REV. 1987, 2004 (2002).

A third critique of LoPucki's reasoning relied on the issue of timing. LoPucki had reported that from 1997-2000, both Delaware and non-Delaware courts had a refiling rate of 46%, a big difference from 1991-1996, during which the Delaware refiling rate was ten times higher than that of non-Delaware courts.<sup>22</sup> LoPucki proposed that the change in comparative refiling rates occurred because of four events that took place from 1996-1997: the National Bankruptcy Review Commission proposal to end forum shopping, growing awareness of Delaware's near monopoly on large case filings, a Federal Judicial Center report on venue and the District Court's revocation of the reference to the Delaware bankruptcy court shortly after the release of the Federal Judicial Center report.<sup>23</sup> Professor Melissa Jacoby argued in response that there was not enough time between the four events and the dramatic increase of non-Delaware refiling rate to support a causal connection.<sup>24</sup>

The most recent critique of the Courting Failure thesis was released by Professor Stephen Lubben, who "challenges the faith that Delaware plays a key role in the problem of refiling," and argues against using whether a case is filed in Delaware as "the proper criterion."<sup>25</sup> Although Lubben admits that his "model does not conclusively prove Delaware's irrelevance to the issue of whether or not a case will enter bankruptcy again,"<sup>26</sup> his article is nevertheless titled "Delaware's Irrelevance."

Each of the principal critiques of the Courting Failure thesis, with the exception of Lubben's most recent critique, has been either refuted by LoPucki<sup>27</sup> or "dispatched quickly" by his data.<sup>28</sup> In

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<sup>22</sup> LOPUCKI, *supra* note 8, at 120 tbl. 7; *id.* at 122.

<sup>23</sup> *See id.* at 121-22. *See also* Melissa B. Jacoby, *Fast, Cheap, and Creditor-Controlled: Is Corporate Reorganization Failing?* 54 BUFF. L. REV. 401, 414 (2006).

<sup>24</sup> *See* Jacoby, *supra* note 23, at 414 ("Could courts have reacted so quickly to be responsible for a repeat filing rate skyrocketing from 4% to 46% practically overnight?").

<sup>25</sup> Lubben, *supra* note 2, at 268-69.

<sup>26</sup> *Id.* at 269.

<sup>27</sup> *See generally* *Why are Delaware and New York Bankruptcy Reorganizations Failing?*, *supra* note 7; *Where Do You Get Off?*, *supra* note 9. These two articles were written in response to challenges to and follow-up questions about the 2001 LoPucki & Kalin study. In *Why are Delaware and New York Bankruptcy Reorganizations Failing?*, LoPucki and Doherty conclude that "Delaware-reorganized firms were . . . significantly more likely to go out of business as a result of their financial distress, and

addition to these principal critiques, LoPucki has also countered other arguments raised to indirectly challenge the Courting Failure thesis,<sup>29</sup> but they are beyond the scope of this discussion. A different

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significantly less likely to perform successfully under their plans of reorganization. They also had significantly lower post-bankruptcy earnings.” *Id.* at 1947. LoPucki and Doherty conclude that the different failure rates were attributable to Delaware, not characteristics of the firms. *See id.* at 1982–83 (noting that “these data suggest that pre-filing characteristics of the firms filing in Delaware cannot explain Delaware’s high failure rates.”). They also reject the proposal that Delaware’s speed of processing cases makes up for the costs of repeat filings. *Id.* at 1963–67. *Where Do You Get Off?* addresses challenges set forth by, *inter alia*, the Hon. Robert D. Martin, Charles Tabb, Mechele Dickerson, and some of the other critics described in *infra* note 29. It also specifically addresses Jacoby’s timing issue:

Three of the four 1997 Other Court confirmations took place in the last quarter of that year—late enough for the cases to have been influenced by events that took place at the beginning of that year. Although the formal changes adopted by courts in response to Delaware were implemented in the period 1998-2002, informal changes actually causing the increase in failure rates may have been implemented sooner. All that necessarily had to happen was for a few judges to change their attitudes toward the competition and communicate that to a few key members of the local bar. In such a small legal community, word could travel very quickly.

*Id.* at 528–29. *See also* LOPUCKI, *supra* note 8 at 97–122.

<sup>28</sup> Lubben, *supra* note 2, at 267–68.

<sup>29</sup> *See, e.g.*, Hon. Robert D. Martin, *Courting Failure? The Effects of Venue Choice on Big Bankruptcies*, 54 BUFF. L. REV. 503, 504–05 (2006) (defending the integrity of bankruptcy judges); Charles J. Tabb, *Courting Controversy*, 54 BUFF. L. REV. 467, 484 (2006) (accusing LoPucki of “character assassination”); Jacoby, *supra* note 23, at 427 (pointing out the “transactional” view of bankruptcy judging as changing the judge’s obligations in Chapter 11 cases); Mechele Dickerson, *Words that Wound: Defining, Discussing, and Defeating Bankruptcy “Corruption,”* 54 BUFF. L. REV. 365, 368 (2006) (protesting the use of the word “corruption”); Michael St. James, *Why Bad Things Happen in Large Chapter 11 Cases: Some Thoughts About Courting Failure*, 7 TRANSACTIONS: TENN. J. BUS. L. 169, 176 (2006) (arguing that the “greatest flaw in Courting Failure is LoPucki’s inability to present a plausible motivation to justify his frequent use of the adjective ‘corrupt’ to describe the bankruptcy bench”). The St.

kind of argument is posed in the “seat-of-the-pants rejoinder” argument: that even if the Courting Failure thesis is correct, things have changed since 1996. In addressing this argument, LoPucki notes that “a prominent bankruptcy lawyer . . . reluctantly conceded that the Delaware bankruptcy court confirmed bad plans in the period 1991-96. But . . . ended the interview by assuring me that the problem had been solved.”<sup>30</sup>

This Article contributes new data analysis to this debate, for more recent years, thereby addressing the “seat-of-the-pants rejoinder” argument. It presents evidence that in recent years, the failure rates have converging for cases filed in Delaware as for those filed in other jurisdictions.

In this study, I analyze data from 292 public companies that emerged from large bankruptcy reorganizations in the United States from 1992 to 2004 and run logistical regressions to study the factors that cause refiling. When I separate the time period into two parts—what I refer to as the “Courting Failure” era (1992-1996), and more recent years (1997-2004)—a new pattern emerges. I find that in the more recent years, Delaware cases have similar failure rates as non-Delaware cases. In the process, I point out several flaws in Lubben’s recent critique of the Courting Failure thesis. My findings differ from Lubben’s claims because I present models that split the time period, and conclude that Delaware cases refile at a similar rate as non-Delaware cases *only* for the most recent years. Lubben studies the entire time period covered by his model, 1992-2002, and implies that Delaware is irrelevant for the entire time period.

Part I of this Article describes the methodology I employed. Part II sets forth my findings. For 1992 to 2004 cases, I find that the Delaware court’s refiling rate decreased and the non-Delaware courts’ filing rates increased. Failure rates have recently converged. I also affirm that from 1992-1996, whether a case was filed in Delaware was a significant predictor of whether there would be refiling within five years. Part III discusses the implications of these findings for the debates over Delaware’s effect on reorganizational refilings. The Article concludes that while Delaware’s high failure rate was significant during the “Courting Failure” era, more recent

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James Article also examines Thomas J. Salerno’s critique of LoPucki in an unpublished presentation, where Salerno’s general approach “rests on an *ad hominem* ‘those who can’t do, teach’ argument.” *Id.* at 179.

<sup>30</sup> See LOPUCKI, *supra* note 8, at 117–22.

data shows that Delaware cases are no more likely to fail than non-Delaware cases.

## ***I. Methodology***

### **A. The Cases Studied**

The companies studied are all of the principal operating companies emerging<sup>31</sup> from the bankruptcy reorganizations of large, public companies that were confirmed between January 1, 1992, and December 31, 2004 in United States bankruptcy courts.<sup>32</sup> The set of all large, public companies that reorganized during that period was identified from the Bankruptcy Research Database.<sup>33</sup> The Bankruptcy Research Database includes all Chapter 11 bankruptcy cases filed by or against a debtor group that has assets worth \$100 million or more at the time of filing, and is required to file Form 10-K's with the Securities and Exchange Commission.<sup>34</sup> Of these cases, I was only interested in cases that either (1) emerged and refiled within five years of confirmation, or (2) emerged and did not refile within five years of confirmation. The emerging company is considered as having refiled if clearly more than half of the operations of the

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<sup>31</sup> See *infra* note 32. According to the BRD Data Protocols, a company is counted as “emerging” if it “should fairly be counted as refiling if it filed a later bankruptcy.” *Id.* A company acquired by another at confirmation is included if it is maintained as a separate business, even if the acquirer contributes capital or credit enhancements. *Id.* “[The] reasoning is that the emerging company is as much a ‘stand alone’ company as one that received an infusion of capital from a new investor—at confirmation or immediately after.” *Id.* Furthermore, (1) dismissals of involuntary filings; (2) dismissals for not filing in good faith; and (3) if the business survives past confirmation, with provisions that enable it to operate permanently, but the odds of permanent operation are small; are all not classified as emerging and not included in the study. *Id.* If only a non-filing subsidiary survives, the firm did not emerge. *Id.* If the business survives past confirmation, but “only for the purpose of orderly liquidation,” it is considered “not emerging.” *Id.*

<sup>32</sup> See Lynn M. LoPucki, UCLA-LoPucki Bankruptcy Research Database (“BRD”), <http://lopucki.law.ucla.edu> (data requested Sep. 14, 2010). This dataset of all large public companies that filed for reorganization after October 1979 is maintained and continually updated by Professor Lynn M. LoPucki.

<sup>33</sup> *Id.*

<sup>34</sup> *Id.* (BRD Data Protocols may be requested at <http://lopucki.law.ucla.edu>).

emerging company are included in the refiling. As a result, I dropped all cases that were pending in bankruptcy, cases that emerged and only partially refiled, cases where data was not available, cases where no company emerged, cases that were confirmed less than five years ago and cases where the business was not classified after bankruptcy. I also removed two cases that were statistical outliers in terms of business assets.<sup>35</sup>

I limit the study to only cases confirmed after January 1, 1992, to be consistent with Professor Stephen J. Lubben's most recent empirical study on the impact of Delaware on Chapter 11 failure rates.<sup>36</sup> Lubben chooses 1992 as a starting point because "inclusion of cases from the period between 1980 and 1991 would seem to hold too great a risk of prejudicing the sample inasmuch as these debtors may have been subjected to economic or other factors that, by definition, could not have influenced firms filing in Delaware."<sup>37</sup> He also notes that:

Professor LoPucki convincingly argues that Continental Airlines' 1990 filing in Delaware was the first case to illuminate the possibility of Delaware venue. . . . [O]ne might expect that the key players. . . would have waited to see how Continental fared in its chapter 11 case. . . . At the very least, we need to acknowledge that the bankruptcy community could not and did not instantaneously absorb news of Continental's filing. For that reason, I adopt 1992 as the relevant starting year for the period of Delaware's "dominance."<sup>38</sup>

This reasoning is sound, and inasmuch as my study follows up on his, I chose to begin with cases from 1992.<sup>39</sup>

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<sup>35</sup> I dropped corporations that had assets over \$200 million dollars because they were statistical outliers (that is, they fell more than 1.5 times the interquartile range above the third quartile or below the first quartile). This only eliminated two cases.

<sup>36</sup> See generally Lubben, *supra* note 2.

<sup>37</sup> *Id.* at 272.

<sup>38</sup> *Id.* at 276.

<sup>39</sup> Furthermore, my newest findings deal with the *recent* trend of cases in the post "Courting Failure" era, and the issue of whether to include cases from 1991 does not bear on those findings.

I limit the study to only cases confirmed before December 31, 2004, because of the necessity to wait a sufficient period of time to see how cases would fare after leaving Chapter 11. The Bankruptcy Research Database tracks cases after they emerge and records whether they refile or not. Because I am defining failure as refiling for bankruptcy within five years of confirmation from the first Chapter 11, the most recent companies in my study have to have been confirmed in their initial Chapter 11 bankruptcy at least five years ago.

### B. The Variables Used

Information for all of my variables, except for *S&P500 at Year Confirmed* and *Interest Rate at Year Confirmed*, were drawn from the Bankruptcy Resource Database. As a starting point, I looked to Lubben's most recent study.<sup>40</sup> Lubben executed a logistic regression, using the same dependent variable I use—*Failure*, as measured by refiling for bankruptcy within five years after confirmation. In his regression, he used twenty-three independent variables.<sup>41</sup> He explains that “five variables capture characteristics of the debtor and its bankruptcy case, six variables indicate whether or not the debtor's primary business operations relate to industries that frequently appear in the sample, and the remaining variables capture underlying economic conditions at the start and conclusion of the debtor's chapter 11 case.”<sup>42</sup>

My study does not include all of Lubben's variables, because the better practice is to include independent variables that highly

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<sup>40</sup> See generally Lubben, *supra* note 2.

<sup>41</sup> *Id.* at 281. The variables are *Forum Shopping*, *Prepackaged Case*, *Fraud in Case*, *Log of Assets in 2006 Dollars*, *Log of Employees*, *S&P500 at Start of Case*, *S&P500 at End of Case*, *10 Year Bond Rate at Start of Case*, *10 Year Bond Rate at End of Case*, *NASDAQ at Start of Case*, *NASDAQ at End of Case*, *Communications*, *Industrial and Commercial*, *Machinery and Computer*, *Equipment*, *Business Services*, *Food Stores*, *Textile Mill Products*, *General Merchandise Stores*, *High Yield Fund Value at Start*, *High Yield Fund Value at End*, *T-Bill Bond Rate at Start of Case*, and *T-Bill Bond Rate at End of Case*. Explaining each of these variables is beyond the scope of this Article, because I do not use all of them in my study. For more details, see *id.*

<sup>42</sup> *Id.* at 275.

correlated with each other in the same model.<sup>43</sup> Models with highly correlated independent variables face the problem of multicollinearity, a statistical phenomenon that results in potentially invalid results about any individual predictor, or about which predictors are redundant with respect to other predictors. Also, running a regression with a large number of independent factors, especially those that correlate with each other, tend to obscure which variables are really significant.<sup>44</sup> As a result, my model includes only the following variables.

### 1. Filed in DE

*Filed in DE* indicates whether a case was filed in the United States Bankruptcy Court for the District of Delaware, which sits only in Wilmington. Although Lubben found that his “model’s predictive power does not change upon the inclusion of Delaware,”<sup>45</sup> and argues against including it as an independent variable, I found that including Delaware does improve my model, and is a significant variable in predicting failure.<sup>46</sup> Thus, I have chosen to include it as an independent variable.

### 2. Year Confirmed

*Year Confirmed* is an important variable because it reveals information about the trend of Chapter 11 failure over time. My model reveals that the timing of confirmation for a case is predictive of failure rate. Because the amount of time that a corporation will stay pending in Chapter 11 varies, *Year Confirmed* is a more consistent measure than, for example, the year a case is filed. For any given case, *Year Confirmed* is measured as the year that the judge signed the order confirming a plan of reorganization. The five-year period during which I monitor whether a corporation refiles or not begins at the time of confirmation.

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<sup>43</sup> For statistical methods, see *infra* Part II.C.

<sup>44</sup> See *infra* text accompanying notes 67–69.

<sup>45</sup> Lubben, *supra* note 2, at 276.

<sup>46</sup> See *infra* Table 2.

### 3. Assets

The variable *Assets* is a way to describe the size of the corporation. Although in his study LoPucki ultimately did not “find any relationship between the sizes of firms or their industries and the firms’ likelihood of successful reorganization,”<sup>47</sup> Skeel and Ayotte’s theory about the effect of a corporation’s complexity<sup>48</sup> suggests that *Assets* should still be controlled for, if only to determine whether it has become more significant in more recent years. *Assets* is measured in current dollars, and the unit is a billion dollars.<sup>49</sup>

### 4. Forum Shopping

The model controls for *Forum Shopping* because it is an ever-present consideration in literature about Delaware and Chapter 11 failure rates.<sup>50</sup> LoPucki, for example, has found that, for forum shopping, there is “a highly permissive venue statute, an imaginative array of strategies for taking advantage of the statute, and a high judicial tolerance for those who simply ignored the statute and filed their cases where they pleased.”<sup>51</sup> Because so many cases from 1992-2004 are forum-shopped to Delaware, *Filed in DE* and *Forum Shopping* are highly correlative variables. As such, I present models with and without *Forum Shopping* as an independent variable.

A case is considered to have been forum-shopped if it was filed in a way that chose one panel of judges over another. This means that the corporation filing the case is forum shopping if it (1) filed in a clerk’s office other than the clerk’s office for the district or division in which the headquarters were located, or (2) filed such that court would be held in a city other than the city for the district or division in which the headquarters were located.

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<sup>47</sup> *Why are Delaware and New York Bankruptcy Reorganizations Failing?*, *supra* note 7, at 1956.

<sup>48</sup> *See supra* text accompanying note 18.

<sup>49</sup> The Bankruptcy Research Database measures assets in millions of dollars, but I converted the unit to billions to produce larger coefficients in my model. The unit does not make a difference in the findings.

<sup>50</sup> *See, e.g.*, Miller, *supra* note 21.

<sup>51</sup> LOPUCKI, *supra* note 8, at 30.

## 5. Prenegotiated and Prepackaged

*Prepackaging* has also received a lot of attention in the Chapter 11 context. Professors Douglas Baird and Robert Rasmussen have suggested that prepackaged cases should be omitted from this type of regression because prepackaged plans “have a dynamic that is different from other cases. Hence combining prepackages with other types of cases in Delaware is suspect.”<sup>52</sup> However, omitting prepackaged cases would leave too few cases “to draw any conclusions at all.”<sup>53</sup> Furthermore, LoPucki has defended his choice to include prepackaged cases in his models, noting that the “refiling rate for Delaware’s non-prepackaged, non-prenegotiated cases was almost identical to Delaware’s overall refiling rate” for 1991-1996 cases.<sup>54</sup> So instead of omitting the prepackaged cases, my model includes prepackaging as a separate independent variable. As a result, the models control for prepackaging as a potential variable driving failure.

The Bankruptcy Research Database includes data on whether a case is *Prepackaged*, *Prenegotiated* or *Neither*. A case is *Prepackaged* if the “debtor drafted the plan, submitted it to a vote of the impaired classes, and claimed to have obtained the acceptances necessary for consensual confirmation before filing the case. No class rejects the plan or the class that rejects is minimal.”<sup>55</sup> These are often the fastest cases.<sup>56</sup>

A case is *Prenegotiated* if the “debtor negotiates the plan with less than all groups or obtains the acceptance of less than all groups necessary to confirm before the bankruptcy case (voluntarily or involuntary) is filed, even if no vote was taken on the plan.”<sup>57</sup> Also, having “a contract to sell the business is not a prenegotiation unless the creditors have agreed to the sale.”<sup>58</sup>

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<sup>52</sup> See Douglas G. Baird & Robert K. Rasmussen, *Beyond Recidivism*, 54 BUFF. L. REV. 343, 349 (2006) (“To establish a race to the bottom, we should focus on the comparison involving the cases that were neither prepackaged nor prenegotiated.”).

<sup>53</sup> *Where Do You Get Off?*, *supra* note 9, at 534.

<sup>54</sup> *Id.* at 535.

<sup>55</sup> See Data Protocols, Bankruptcy Research Database, *supra* note 32.

<sup>56</sup> See, e.g., *Where Do You Get Off?*, *supra* note 9, at 534 (“Speed was an integral part of what Delaware was selling, and the prepackaged cases were the ultimate in speed.”).

<sup>57</sup> See Data Protocols, Bankruptcy Research Database, *supra* note 32.

<sup>58</sup> *Id.*

## 6. Tort Cause

*Tort Cause* describes a case that would not have been filed had the tort debt not existed—in other words, the tort debt caused the bankruptcy filing. The tort debt may arise from product liability claims, fraud claims, pension claims, environmental claims, patent infringement claims and other tort claims against the debtor. All of these are considered tort cause.

I control for *Tort Cause* because it is a variable that captures something about the *reasonwhy* a corporation has for filing for bankruptcy. It is my only variable that measures a reason why a corporation would file for bankruptcy.

## 7. S&P500 at Year Confirmed and 10-Year Bond Rate at Year Confirmed

Lubben has included variables designed to “capture underlying economic conditions at the start and conclusion of the debtor’s chapter 11 case.”<sup>59</sup> His study included data for six economic variables (*NASDAQ*, *T-Bill*, *S&P500*, *High-Yield Bond Rate*, *CPI* and *10-Year Bond Rate (interest rate)*) for the closing date of each year a case was filed, as well as for each year a case emerged, creating twelve variables in all.<sup>60</sup>

Because the twelve economic variables are highly correlative, the better practice is to include all of them in my model. Therefore, I used stepwise regressions<sup>61</sup> to choose the most significant, non-correlative variables relevant to the dependent variable of failure. The two most significant, non-correlative variables were *S&P500 at Year Confirmed* and *InterestRate at Year Confirmed*, so I added them to my model.

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<sup>59</sup> Lubben, *supra* note 2, at 268.

<sup>60</sup> *See id.* at 281.

<sup>61</sup> In statistics, stepwise regression includes regression models in which the choice of predictive variables is carried out by an automatic procedure. I began with no independent variables in the model, trying the models one by one and including them if they were statistically significant at a  $p \leq .05$  level. For more information on stepwise regressions, see R. R. Hocking, *The Analysis and Selection of Variables in Linear Regression*, 32 *BIOMETRICS* 1-49 (1976); NORMAN R. DRAPER & HARRY SMITH, *APPLIED REGRESSION ANALYSIS* (2d ed. 1981).

## 8. Failure

The *Failure* variable is defined as refiling for bankruptcy within five years of confirmation from Chapter 11 bankruptcy. LoPucki has been using refiling rates to measure failure, arguing that “[r]efiling constitutes a failure of the bankruptcy process,”<sup>62</sup> a practice that has been adopted by other commentators.<sup>63</sup> This is a sound measure of whether or not a case has failed, especially in light of the purpose of Chapter 11.<sup>64</sup> Indeed, the law *requires* that a bankruptcy judge confirm a plan under Chapter 11 *only if* the confirmation “is not likely to be followed by the liquidation, or the need for further financial reorganization, of the debtor or any successor to the debtor under the plan, unless such liquidation or reorganization is proposed in the plan.”<sup>65</sup> The Bankruptcy Research Database keeps track of corporations after they emerge, and indicates whether they have refiled for bankruptcy within five years.

## II. Findings

I make four principal findings. First, from 1992-2004, cases filed in Delaware failed more often than cases not filed in Delaware. Second, from 1992-2004, the failure rate increased over time for cases not filed in Delaware. Third, from 1992-2004, the failure rate decreased over time for cases filed in Delaware. Fourth, I found that in the past few years, the failure rate has been approximately the same for cases filed in Delaware and for cases filed in other jurisdictions. This means that while Delaware courts experienced significantly higher failure rates for their cases than other jurisdictions experienced from 1992-1996, the failure rates have since then converged. In recent years, there is no significant difference between cases in Delaware and cases in other jurisdictions.

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<sup>62</sup> LoPucki & Kalin, *supra* note 1, at 235. *See also* *Where Do You Get Off?*, *supra* note 9 (still using Delaware Refiling as a measure of failure).

<sup>63</sup> *See, e.g.*, Lubben, *supra* note 2, at 268 (presenting a model “that predicts whether a large chapter 11 case will reenter bankruptcy within five years.”).

<sup>64</sup> *See supra* text accompanying note 3.

<sup>65</sup> 11 U.S.C. §1129(a)(11) (2010).

**A. From 1992-2004, Delaware Reorganizations Failed More Often Than Non-Delaware reorganizations.**

The cross-tabulation in **Table 1** shows that from 1992-2004, Delaware reorganizations failed more often than non-Delaware reorganizations. Refer to the third category of columns of **Table 1** (“All Cases: 1992-2004”) to see that from 1992-2004, Delaware reorganizations failed more often than non-Delaware reorganizations. From 1992-2004, there were 183 cases in jurisdictions other than Delaware. Of these cases, 24 refiled within five years after confirmation, constituting a failure rate of 13% for cases not filed in Delaware. In contrast, from 1992-2004, there were 109 cases in Delaware. Of these cases, 31 refiled within five years after confirmation, constituting a failure rate of 28% for cases filed in Delaware. Based on these statistics, the probability that there is no difference between Delaware and the other states—that this differential was a product of chance—is less than one in one thousand (0.1%).

<b>Table 1</b> <b>Chapter 11 Failure by Delaware Filing, Comparing 1992-1996 to 1997-2004 Time Periods</b>												
	Cases: 1992-1996 (N=111)				Cases: 1997-2004 (N=181)				All Cases: 1992-2004 (N=292)			
	Failure	Success	Total	Failure rate	Failure	Success	Total	Failure rate	Failure	Success	Total	Failure rate
Not Filed in DE	4	79	83	5%	20	80	100	20%	24	159	183	13%
Filed in DE	10	18	28	36%	21	60	81	26%	31	78	109	28%
Total	14	97	111		41	140	181		55	237	292	
	$\chi^2$ (Chi2)= 18.131, p < 0.001				$\chi^2$ (Chi2) = 0.896, p < 0.344				$\chi^2$ (Chi2)= 10.495, p < 0.001			

Failure is defined as refiling Chapter 11 within five years. Data drawn from Prof. LoPucki’s Bankruptcy Research Database for all large, public company bankruptcy cases filed in the United States for years 1992-2004.

**Table 2** consists of four logistic regression models that evaluate the factors driving failure. Logistic regressions are predictive models that use independent variables to predict the outcome of a binary dependent variable.<sup>66</sup> The models predict

<sup>66</sup> A “binary” variable is one that only has two possible outcomes. For example, my variable *Failure* is binary because the only possible values for Failure are “Yes—Failed” (in other words, the corporation refiled within five years) and “No—Not Failed” (in other words, the corporation did not refile within five years).

whether a case has failed or not based on the set of independent variables.

<b>Table 2</b>				
<b>Determinants of Refiling in Large Public Company Bankruptcies, Plans Confirmed 1992-2004 (Dependent Variable is Failure)</b>				
	(1)	(2)	(3)	(4)
VARIABLES	Model with only DE Filing	Model without Variables Insignificant in Model (4)	Model without DE Filing	Model with All Variables
Year Confirmed			0.0866 (0.10343)	0.09341 (0.10359)
Assets in Current Dollars			-0.00004 (0.00005)	-0.00004 (0.00005)
Forum Shopping			-0.09688 (0.35595)	-0.78319 (0.51018)
Filing in DE	0.96813** (0.30554)	0.83053** (0.31266)		1.01527** (0.50751)
Prenegotiated			-0.64779 (0.43372)	-0.50553 (0.44949)
Prepackaged			-0.22985	-0.11448

			(0.47729)	(0.48923)
Tort Cause			-0.76779	-0.62050
			(0.71607)	(0.72043)
S&P500 in Year Confirmed			0.00042	0.00020
			(0.00094)	(0.00096)
Interest Rate in Year Confirmed		0.36562***	0.44313***	0.42539***
		(0.09124)	(0.12907)	(0.13059)
Constant	-1.89085	-3.16112	-175.90470	-189.39540
	(0.21936)	(0.44005)	(206.18710)	(206.49610)
N	292	292	292	292
AIC	276.37390	259.79540	265.67030	263.2533

Robust standard errors in parentheses.

† $p \leq 0.1$ , \* $p \leq 0.05$ , \*\* $p \leq 0.01$ , \*\*\* $p \leq 0.001$

Failure is defined as refiling Chapter 11 within five years.

Data from Prof. LoPucki's Bankruptcy Research Database for all large, public company bankruptcy cases filed in the United States for years 1992–2004.

Multicollinearity is a statistical phenomenon in which two or more independent variables in a model are highly correlated. Multicollinearity may cause coefficients to change erratically in response to small changes in the model or the data, so that the estimate of one independent variable's impact on dependent variable while controlling for the others tends to be less precise than if predictors were

uncorrelated with one another.<sup>67</sup> In order to avoid multicollinearity problems, I only used independent variables that did not significantly correlate with each other.<sup>68</sup> Then I used Akaike Information Criterion (“AIC”) testing to pick the best model.<sup>69</sup>

AIC measures the “goodness of fit” of a statistical model. “Goodness of fit” describes how well a statistical model fits a set of observations. In practical terms, the AIC measures the relative amount of information lost when a model is used to describe reality.<sup>70</sup> Furthermore, because simple models are preferable,<sup>71</sup> AIC adjusts for the number of variables used by penalizing for each additional independent variable.<sup>72</sup> Because AIC measures the relative amount of information lost, the smaller the AIC value a model has relative to another model, the better that model is. Thus, AIC is a model-selecting tool that awards the lowest AIC value to the

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<sup>67</sup> See A. AGRESTI & B. FINLAY, *STATISTICAL METHODS FOR THE SOCIAL SCIENCES* 438 (Prentice Hall 3rd ed., 1997).

<sup>68</sup> For binary variables, I tested for correlation by using Phi-testing. For linear variables, I used Pearson correlation. Depending on whether the variables to be tested are linear, ordinal, or binary, different tests for correlation are called for. See David Krus, *The Phi Coefficient of Correlation*, VISUALSTATISTICS.NET, <http://www.visualstatistics.net/visual%20statistics%20multimedia/crosstabulation.htm> (last visited March 2011); Udney Yule, 75 J. ROYAL STATISTICAL SOC. 579 (1912). See also *Choosing a Correlation Test*, CHANGINGMINDS.COM, [http://changingminds.org/explanations/research/analysis/choose\\_correlation.htm](http://changingminds.org/explanations/research/analysis/choose_correlation.htm) (last visited May 2011).

<sup>69</sup> See *supra* Table 2.

<sup>70</sup> See Hirotugu Akaike, *A New Look at the Statistical Model Identification*, 19 IEEE TRANS. AUTOMAT. CONTR. 716 (1974).

<sup>71</sup> This is the principle of model parsimony. See Karl Popper, *The Logic of Scientific Discovery* 121–32 (2d ed. 1992). See, e.g., F.N. KERLINGER, *BEHAVIORAL RESEARCH: A CONCEPTUAL APPROACH* 179 (1979) (“Scientists are curious. They want to know what’s there and why. They want to know what is behind things. And they want to do this in as parsimonious a fashion as possible. They do not want an elaborate explanation when it is not needed. . . . This ideal we can call the principle of parsimony.”). *Parsimonious models are better because they allow the dependent variable to be explained by a smaller number of independent variables that matter the most, rather than allowing the dependent variable to be explained by many, many independent variables that may not be so important individually.*

<sup>72</sup> See Akaike, *supra* note 70.

model with the best “goodness of fit.”<sup>73</sup> By the AIC criterion, Model 2 (Model with Only *Filing in DE* and *Interest Rate in Year Confirmed*) is the best predictive model for failure, followed by Model 4 (“Model with All Variables”).

Model 4 (“Model with All Variables”) shows that from 1992-2004, controlling for *Year Confirmed*, *Assets*, *Forum Shopping*, *Prenegotiation*, *Prepackaging*, *Tort Cause*, *S&P500 at Year Confirmed* and *Interest Rate at Year Confirmed*, that filing in Delaware is an independent factor that significantly drives failure. Model 1 (“Model with Only *DE Filing*”) demonstrates that Delaware is still a significant driving force for failure in a univariate model. Model 2 (“Model without Variables Insignificant in Model (5)”) keeps only the independent variables that were significant in the regression with all of the variables tested in this study, and also presents Delaware as a significant factor driving failure. Model 3 (“Model without *DE Filing*”) shows that a model without *DE Filing* as an independent variable does not change the significance of other variables. All four models of **Table 2** demonstrate that from 1992-2004, Delaware was a significant factor in the failure of a case. Interestingly, the *Interest Rate in Year Confirmed* is highly statistically significant. This is a new finding that, while beyond the scope of this study, should be examined further in the future. Furthermore, *Assets*, *Forum Shopping*, *Prenegotiation*, *Prepackaging*, *Tort Cause* and *S&P500 in Year Confirmed* were not significant variables, despite what existing literature might suggest.

Thus, my findings, as presented in **Tables 1** and **2**, show that from 1992-2004, cases filed in Delaware were more likely to fail than cases not filed in Delaware.

### **B. From 1992-2004, for Cases Not Filed in Delaware, Failure Rate Increased over Time**

From 1992-2004, cases not filed in Delaware have been failing at a decreasing rate. Refer to the cross-tabulation presented in **Table 1**. The first row “Not Filed in DE” presents the failure rate of cases not filed in Delaware over time. The first group of columns (“Cases: 1992-1996”) presents data for cases confirmed between January 1, 1992 and December 31, 1996. During this period, only

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<sup>73</sup> This means that given several competing regression models, the AIC assesses a model by how close the dependent variable values are to the values predicted by the independent variables according to the model.

5% of cases not filed in Delaware failed, for cases not filed in Delaware. The second column (“Cases: 1997-2004”) presents data for cases confirmed between January 1, 1997 and December 31, 2004. During this period, 20% of cases failed, for cases not filed in Delaware. In summary, **Table 1** shows that for 1992-1996 cases not filed in Delaware, the failure rate was 5%, but that for 1997-2004 cases not filed in Delaware, the failure rate jumped to 20%.

**Table 3** also shows that for cases not filed in Delaware, failure rate has been increasing over time. **Table 3** presents a regression with only cases filed in jurisdictions other than Delaware. Controlling for *Year Confirmed*, *Assets*, *Pre negotiation*, *Prepackaging*, *Tort Cause*, *S&P500 in Year Confirmed* and *Interest Rate in Year Confirmed*, the model shows that *Year Confirmed* is a significant variable in predicting failure. The more recently a case emerged from bankruptcy in a non-Delaware jurisdiction, the more likely it was to fail.

**Table 4** also shows that for cases not filed in Delaware, failure rate has been increasing over time because Column 6 (“Non-DE Filed Cases: 1992-2004”) has *Year Confirmed* as a significant independent variable in predicting failure, with a positive coefficient.

Thus, the findings presented in **Table 1**, **Table 3**, and **Table 4** show that for cases not filed in Delaware, failure rate increased over time.

<b>Table 3</b> <b>Factors Predicting Chapter 11 Failure in Non-Delaware Cases (Dependent Variable is Failure)</b>	
VARIABLES	Non-DE Filed Cases: 1992-2004 (N=183)
Year Confirmed	0.26640† (0.13776)
Assets in Current Dollars	-0.00013 (0.00014)
Prenegotiated	0.02216 (0.87469)
Prepackaged	0.08225 (0.99099)
Tort Cause	-0.79705 (1.01726)
S&P500 in Year Confirmed	-0.00016 (0.00143)
Interest Rate in Year Confirmed	0.54536* (0.19553)
Constant	-535.68500 (274.66510)
N	183

Robust standard errors in parentheses.

† $p \leq 0.1$ , \* $p \leq 0.05$ , \*\* $p \leq 0.01$ , \*\*\* $p \leq 0.001$

Failure is defined as refiling Chapter 11 within five years.

Data drawn from Prof. LoPucki's Bankruptcy Research Database for all large, public company bankruptcy cases filed in the United States for years 1992-2004.

**C. From 1992-2004, for Cases Filed in Delaware,  
Failure Rate Decreased over Time**

**Table 4** presents data that for cases filed in Delaware, failure rate decreased over the course of time from 1992-2004. Model 1 (“DE Filed Cases: 1992-1996”) shows that for cases in Delaware between January 1, 1992 and December 31, 1996, the year a case is confirmed is not a significant variable in predicting failure. This means that although failure rate was high overall from 1992 to 1996, as compared with the failure rate for cases not filed in Delaware, the specific year a case was confirmed within this time period (for example, 1992 versus 1994) was not a driving factor of failure. Model 2 (“DE Filed Cases: 1997-2004”) shows that for cases in Delaware between January 1, 1997 and December 31, 1996, the year a case is confirmed is a significant variable in predicting failure. Since the sign of the coefficient is negative, the more recent the year confirmed is, the less likely the case is to fail. In other words, from 1992-2004, cases in Delaware are failing at a decreasing rate.

Model 3 (“DE Filed Cases: 1992-2004”) extends this finding to the entire period of time from 1992-2004. The year a case is confirmed (*Year Confirmed*) is significantly and negatively correlated with failure rate. From 1992-2004, cases filed in Delaware, failure rate decreased over time.

<b>Table 4</b>						
<b>One-Variable Regression of Chapter 11 Failure in Delaware and Non-Delaware Cases Over Time (Dependent Variable is Failure)</b>						
	(1)	(2)	(3)	(4)	(5)	(6)
Variables	DE Filed Cases: 1992-1996 (N=28)	DE Filed Cases: 1997-2004 (N=83)	DE Filed Cases: 1992-2004 (N=109)	Non-DE Filed Cases: 1992-1996 (N=83)	Non-DE Filed Cases: 1997-2004 (N=100)	Non-DE Filed Cases: 1992-2004 (N=183)
Year Confirmed	-0.120 (0.278)	-0.445** (0.148)	-0.146* (0.061)	0.548 (0.395)	-0.301* (0.118)	0.095† (0.051)
Constant	239.596 (556.260)	889.297 (297.117)	291.296 (122.620)	-1097.131 (788.587)	602.384 (237.652)	-193.461 (103.730)
N	28	83	109	83	100	183

Robust standard errors in parentheses.

† $p \leq 0.1$ , \* $p \leq 0.05$ , \*\* $p \leq 0.01$ , \*\*\* $p \leq 0.001$

Failure is defined as refiling Chapter 11 within five years.

Data drawn from Prof. LoPucki's Bankruptcy Research Database for all large, public company bankruptcy cases filed in the United States for years 1992-2004.

**D. In the Past Few Years, the Failure Rates Have Been Approximately the Same for Cases Filed in Delaware and for Cases Filed in Other Jurisdictions**

In **Table 4**, Model 3 (“DE Filed Cases: 1992-2004”) suggests that cases filed in Delaware are failing at a decreasing rate over time, while Model 6 (“Non-DE Filed Cases: 1992-2004”) suggest that cases not filed in Delaware are failing at an increasing rate over time. Given that Delaware cases began with a higher failure rate at the beginning of the years in the study, this suggests that the failure rates might be converging at the end of the years in the study.

This suggestion—that cases filed in Delaware are experiencing increasingly similar failure rates as cases not filed in Delaware—is supported also by **Table 1**. From 1992-1996, the failure rate for cases not filed in Delaware is 5%, much smaller than the 36% failure rate for cases filed in Delaware. The probability that so great a difference arose by chance is smaller than one in a thousand ( $p \leq 0.1\%$ ). From 1997-2004, the difference is much smaller: the failure rate for cases not filed in Delaware is 20%, compared to the 26% failure rate for cases filed in Delaware. The probability that this difference occurred by chance is around one in three (34.4%), which means there is no statistically significant difference between the two groups.

This finding from **Table 1**—that the failure rate for cases filed in Delaware is growing increasingly similar to the failure rate for cases not filed in Delaware—is visually evident in **Figure 1**. **Figure 1** presents the same data as **Table 1**, tracing the failure rates of Delaware cases as compared to non-Delaware cases over time. In 1992, on the left-hand side of **Figure 1**, the failure rate for cases filed in Delaware (the solid line) is much higher than the failure rate for cases not filed in Delaware (the dotted line). By 2004, on the right-hand side of **Figure 1**, the failure rate for cases filed in Delaware (the solid line) is very close to the failure rate for the cases not filed in Delaware (the dotted line). This shows that although there was a large discrepancy in failure rates between the cases filed in Delaware and the cases not filed in Delaware at the beginning of 1992-2004, that near the end of 1992-2004, the failure rates have become similar.

### III. Discussion

This study produced four main findings: (1) from 1992-2004, cases filed in Delaware failed more often than cases not filed in Delaware, (2) from 1992-2004, for cases not filed in Delaware, failure rate increased over time, (3) from 1992-2004, for cases filed in Delaware, failure rate decreased over time, (4) in the past few years—beginning from around 1997—the failure rates have been approximately the same for cases filed in Delaware and for cases filed in other jurisdictions. Each of these four findings has implications for the critiques of the “Courting Failure” theory.<sup>74</sup>

#### A. Delaware’s Relevance from 1992-1996

A trend running through the four main findings is that from 1992-1996, being filed in Delaware was significantly positively correlative with failure. I found this while controlling for *Year Confirmed*, *Assets*, *Prepackaging*, *Prenegotiation*, *Tort Cause* and several economic variables. This finding refutes Lubben’s 2008 critique of the “Courting Failure” theory.<sup>75</sup> Lubben “challenges the faith that Delaware plays a key role in the problem of refileing” and questions “whether Delaware is the root cause of the problems ascribed to it.”<sup>76</sup> My findings counter Lubben’s claim that Delaware was not a proper criterion, because from 1992-1996, Delaware was a significant factor in predicting failure, and did not change until 1997-2004.

There are two main reasons that Lubben concludes Delaware might be irrelevant. First, he notes that a “model that includes only the Delaware variable does not increase our ability to predict refileing at all.”<sup>77</sup> In other words, a regression with only one independent variable, Delaware, does not better predict failure in comparison with Lubben’s full model. But Lubben’s full model includes over twenty independent variables. For logistic regressions, adding many more

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<sup>74</sup> See summary *supra* Part I.

<sup>75</sup> See generally Lubben, *supra* note 2.

<sup>76</sup> *Id.* at 269.

<sup>77</sup> *Id.* at 275. He expresses the same idea in his Introduction: “Interestingly, the model [Lubben’s regression model with over twenty independent variables] also performs much better than a simple model that tries to predict refileing solely based upon whether or not a case is filed in Delaware.” *Id.* at 268.

independent variables will always increase the ability for the model to predict the dependent variable, but may not reveal which of the independent variables actually have the biggest impact on the dependent variable—that is, which independent variable is the most important.<sup>78</sup>

Furthermore, it violates the interest in parsimonious modeling: seeking a minimum set of independent variables to predict variation in a dependent variable.<sup>79</sup> The AIC measure of testing models, for example, penalizes for each additional independent variable added.<sup>80</sup> **Table 2** presents evidence that a model with only *DE Filing* and *Interest Rate in Year Confirmed* is the best model. The model without *DE Filing* had the second-to-worst AIC, which means it is not the model which best predicts failure. Thus, the findings here counter Lubben’s findings.

Lubben also notes that “adding Delaware to the model either reduces or has no effect on the model’s predictive power.”<sup>81</sup> My regression refutes this claim, because the model with the lowest AIC had filing in Delaware as a significant variable. Perhaps Lubben’s analysis was hindered by the many correlative independent variables that were included together in his models.<sup>82</sup>

My study shows that for the entire span of 1992-2004, Delaware is the most significant variable driving failure, even controlling for variables such as *Assets*. Insofar as *Assets* represent

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<sup>78</sup> See *supra* text accompanying note 71.

<sup>79</sup> *Id.*

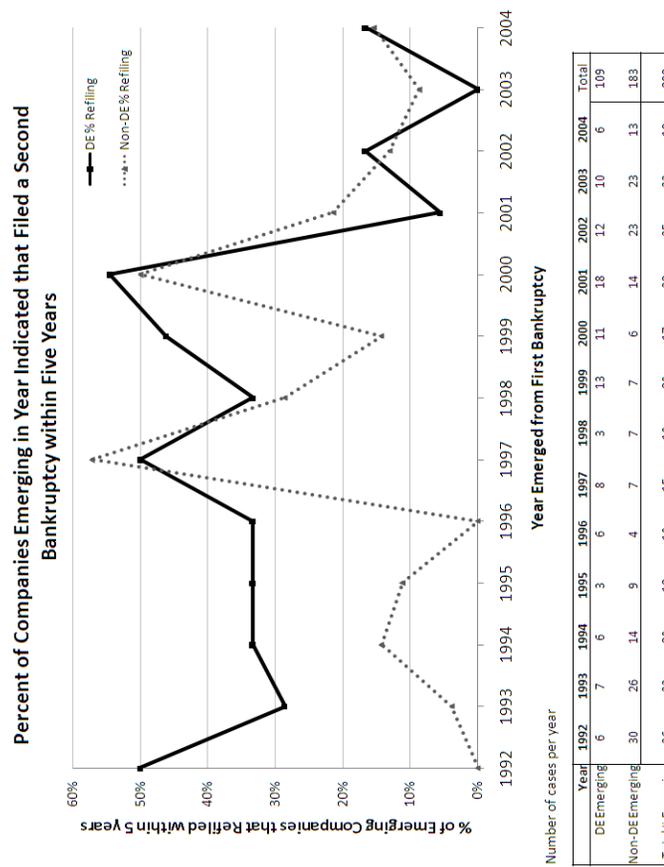
<sup>80</sup> *Id.*

<sup>81</sup> Lubben, *supra* note 2, at 275. In his article, Professor Lubben does not explain what statistical test he uses to measure predictive power. In correspondence, he has kindly answered my questions about the issue and said that he used a different test of predictive power—a “pre” command in STATA.

<sup>82</sup> *But cf. id.* at 275 n.29 (“There is undoubtedly a good deal of correlation among some of the independent variables, particularly the economic variables. Nevertheless, the model does not show any of the typical signs associated with [multicollinearity] problems (e.g., extreme standard errors).”). On the other hand, my model does not have any significant correlation among the independent variables, and I found that the best model was the one with Delaware as a very significant driver of Failure. See *supra* Table 2.

the complexity of a firm, my findings affirm LoPucki and Doherty's 2002 refutation of the "Delaware gets the hardest cases" challenge.<sup>83</sup>

Figure 1



<sup>83</sup> See generally *Why are Delaware and New York Bankruptcy Reorganizations Failing?*, supra note 7.

### B. Timing of Convergence

I found that for the time period from 1997-2004, the cases not filed in Delaware have been failing at an increasing rate over time. This confirms LoPucki's thesis in Chapter 5 of his "Courting Failure." In this chapter, LoPucki noted the increase in failure rate for cases not filed in Delaware after 1996; he attributed this increase in failure rate to court competition caused by: (1) rejection of the National Bankruptcy Review Commission proposal to end forum shopping, (2) growing awareness of Delaware's near monopoly on large case filings, (3) a Federal Judicial Center report on venue, and (4) the District Court's revocation of the reference to the Delaware bankruptcy court shortly after the release of the Federal Judicial Center report.<sup>84</sup> These events made it clear that neither Congress, nor anyone else, would protect the non-Delaware courts from Delaware's poaching of the cases. The non-Delaware courts felt they had to protect themselves by becoming more similar to Delaware. In doing so, they began competing for cases by changing court practices.<sup>85</sup> These changes included:

1. The courts lost control over professional fees.
2. Failed managers tightened their grips on their jobs and companies.
3. Corporate debtors had more difficulty recovering money taken by failed managers.
4. Failed managers began paying themselves huge retention bonuses.
5. The courts began rubber stamping prepackaged plans.
6. So-called critical vendors began grabbing the shares of other unsecured creditors.
7. Managers began selling their companies at inadequate prices for personal benefit instead of reorganizing them.<sup>86</sup>

LoPucki's explanation for the increase in failure rate for cases not filed in Delaware has been criticized on the grounds of timing—that the jump was too quickly to have been results of events

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<sup>84</sup> See LOPUCKI, *supra* note 8, at 121–22.

<sup>85</sup> *Id.*

<sup>86</sup> *Id.* at 137–81. See also Jacoby, *supra* note 23, at 416–17.

that occurred from 1996-1997.<sup>87</sup> Melissa Jacoby has remarked that “[i]t is hard to imagine that courts could implement changes quickly and completely enough to be responsible for such a steep rise in repeat filing rates among firm emerging in 1997-2000.”<sup>88</sup> Furthermore, Jacoby argues that the seven court practice changes are supported by “a variety of anecdotes and allegations, but . . . almost never is helpful to explain the repeat filing trends among firms emerging from bankruptcy in the 1990s in general, and the jump in repeat filings in 1997 in particular.”<sup>89</sup>

LoPucki has responded to this concern, arguing that “[t]hree of the four 1997 Other Court confirmations took place in the last quarter of that year—late enough for the cases to have been influenced by events that took place at the beginning of that year” and that although “the formal changes adopted by courts in response to Delaware were implemented in the period 1998-2002, informal changes actually causing the increase in failure rates may have been implemented sooner.”<sup>90</sup> This is consistent with the elevated failure rate for 1997-2004 cases not filed in Delaware, as well as the apparent convergence of failure rates between cases filed in Delaware and cases not filed in Delaware during this period of time.

With regard to the increase in failure rates for cases not filed in Delaware from 1997 forward, Jacoby noted that a “relatively small number of cases fit the study’s parameters, so one must interpret this finding with caution.”<sup>91</sup> Jacoby’s article was published in 2006, and she was referencing Table 7 in “Courting Failure,” which has 19 cases total for cases filed in “Other Courts” (courts other than Delaware or New York from 1997-2000).<sup>92</sup> My findings resolve this concern. With more years included in my study, I have 100 non-Delaware cases in my study from 1997-2004. So by including a much larger number of observations, my study affirms the increase in failure rates of non-Delaware cases from 1997-2004.

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<sup>87</sup> See Jacoby, *supra* note 23, at 414.

<sup>88</sup> *Id.* at 416.

<sup>89</sup> *Id.* at 417.

<sup>90</sup> *Where Do You Get Off?*, *supra* note 9, at 528.

<sup>91</sup> Jacoby, *supra* note 23, at 412.

<sup>92</sup> *Id.*

### C. Open Questions

My findings show that from 1997-2004, the Delaware court's failure rate is converging with non-Delaware courts' failure rate. This impacts the argument that the high failure rate of cases filed in Delaware between 1992-1996 was efficient.<sup>93</sup> If it was efficient to use Delaware prepackaging for firms to assess economic distress,<sup>94</sup> why did it cease to be efficient to do so in recent years? If it is efficient for one court to handle all the prepackaged cases, why has the failure rate for Delaware and non-Delaware courts converged? If firms were using Delaware to determine whether they were in economic distress, versus financial distress, and the magnitude of the distress,<sup>95</sup> why is Delaware's failure rate decreasing over time in recent years? Declining failure rates in Delaware suggest that the Delaware court is learning, not that it was an oracle to begin with.

### Conclusion

It has been suggested that the bankruptcy law world is inappropriately obsessed with Delaware.<sup>96</sup> However, such obsession is not without reason—from 1992-1996 especially, and from 1992-2004 generally, cases that were filed in Delaware failed at a significantly higher rate than cases that were not filed in Delaware. When I model the factors that predict Chapter 11 failure, the inclusion of Delaware improves the predictive power of the model, even when penalizing the model for the inclusion of additional variables. Thus, my model affirms that during the “Courting Failure” period of time from 1992-1996, the concern over Delaware was well-justified, and that Delaware was not irrelevant as a variable driving failure.

However, two trends have emerged in cases after 1996. For cases not filed in Delaware, failure rate has increased over time. For cases filed in Delaware, failure rate has decreased over time. These two trends produce a new result: at the end of the period from 1992-2004, the failure rate have been approximately the same for cases filed in Delaware as for cases not filed in Delaware. This means that

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<sup>93</sup> See *supra* text accompanying notes 12–16.

<sup>94</sup> See Rasmussen & Thomas, *supra* note 17, at 1388.

<sup>95</sup> See Rasmussen & Thomas, *supra* note 16, at 294–95.

<sup>96</sup> See generally Lubben, *supra* note 2.

in recent years, and perhaps in the future, cases filed in Delaware are not generally more likely to fail than cases not filed in Delaware.

For the past decade, Delaware’s role in Chapter 11 failure has conjured heated discussions from academics and practitioners alike, invoking name-calling,<sup>97</sup> poetry,<sup>98</sup> “linguistic hand wringing,”<sup>99</sup> a guarded apology,<sup>100</sup> and multiple responses.<sup>101</sup> The last argument was advanced by Professor Lubben, questioning “the uncertainty over whether there really is a Delaware effect.”<sup>102</sup> This Article confirms that there *was* a Delaware effect—past tense—from 1992-1996. However, in recent years, the failure rate for cases filed in Delaware has converged with the failure rate for cases not filed in Delaware. This study moves the “Courting Failure” debate affirmatively forward by documenting that in recent years, and likely going forward, Delaware is no longer courting failure more than any other court.

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<sup>97</sup> See Lubben, *supra* note 2, at 280 n.41 (“Of course, it is equally unhelpful to essentially call Professor LoPucki names.”).

<sup>98</sup> See Ayotte & Skeel, *supra* note 18, at 429 (quoting several lines of “The Second Coming” by W.B. Yeats, and commenting that the “same sense of impending disaster infuses almost every page of *Courting Failure*.”).

<sup>99</sup> Lubben, *supra* note 2, at 280 n.41 (“I doubt it is helpful to engage in extensive linguistic hand wringing over LoPucki’s use of the word ‘corruption.’”); Dickerson, *supra* note 29.

<sup>100</sup> See, e.g., *Where Do You Get Off?*, *supra* note 9, at 524 (“Tabb charges that [a sentence from ‘Courting Failure’] imputes an improper motive to Judge Sonderby without an adequate basis for knowing that was in fact her intention. Tabb is correct, and I apologize to Judge Sonderby for the sentence. . . . I am now hoping that Tabb will send me an apology as well.”).

<sup>101</sup> See generally Lynn M. LoPucki, *Can the Market Evaluate Legal Regimes? A Response to Professors Rasmussen, Thomas, and Skeel*, 54 VAND. L. REV. 331 (2001); *Why are Delaware and New York Bankruptcy Reorganizations Failing?*, *supra* note 7; *Failure in Ascendancy*, *supra* note 7; *Where Do You Get Off?*, *supra* note 9.

<sup>102</sup> Lubben, *supra* note 2, at 280.