SECURED CREDITOR CONTROL AND BANKRUPTCY SALES: AN EMPIRICAL VIEW

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Since the early 2000s, the conventional view held by bankruptcy scholars is that the bulk of Chapter 11 cases are dominated by secured creditors, especially in large cases with more than $20 million of debt. It has been claimed that this creditor domination is so complete that it has been called "The End of Bankruptcy." It is often claimed that this domination in turn has greatly increased sales of entire businesses under section 363 of the Bankruptcy Code in lieu of traditional reorganization.

Analysis of a dataset from a cross section of 2006 Chapter 11 cases reveals that secured creditor control is important, but it is certainly not as pervasive as is commonly believed. This Article makes two major points: first, that the conventional picture of secured creditor control and section 363 sales is misleading and overstated; second, that the focus on very large cases instead of a cross section of Chapter 11 cases leaves a hole in the current research because our data suggest that dominant security interests are not strongly related to the size of the case. The data also make it clear that much more research will be necessary to understand the effects of secured credit on Chapter 11 cases and their outcomes.

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I. INTRODUCTION

Over the last decade, bankruptcy scholars have focused on secured creditor control as the core development in the evolution of Chapter 11.[1] Much of the analysis has spoken of creditor control generally, but, upon examination, the control is most often established by dominant security interests.[2] Since 2003 or 2004, it has become accepted by many experts that the bulk of Chapter 11 cases are dominated by secured creditors[3] and that this domination may be especially commonplace in large cases. Since at least 2002, we have been told that the result of this creditor domination has been "The End of Bankruptcy."[4] One closely related consequence is that many, if not most, Chapter 11 cases are effectively terminated by a sale under section 363, with nothing left for treatment under a plan except the argument over distribution.[5] By this account, most of the rest end in liquidating plans.[6] The net result is said to be that traditional Chapter 11 negotiated cases are no longer the rule but instead are the exception. And some have gone so far as to declare reorganization the

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1. Charles J. Tabb, *Credit Bidding, Security, and the Obsolescence of Chapter 11*, 2013 U. ILL. L. REV. 103, 104–05.

2. *See* Douglas G. Baird & Robert K. Rasmussen, *The End of Bankruptcy*, 55 STAN. L. REV. 751, 754–55 (2002) (describing a fundamental shift in Chapter 11 bankruptcy from a reorganization vehicle to a means of liquidation driven in large part by secured creditors who increasingly view the sales value of a firm's current assets as greater than the going-concern value of those assets in the future); Harvey R. Miller & Shai Y. Waisman, *Is Chapter 11 Bankrupt?*, 47 B.C. L. REV. 129, 131 (2005) (writing that creditors increasingly use bankruptcy to effectuate favorable asset sales with no attempt at reorganization); David A. Skeel, Jr., *Creditors' Ball: The "New" New Corporate Governance in Chapter 11*, 152 U. PA. L. REV. 917, 919–20 (2003) (discussing a shift to increasing secured creditor control in Chapter 11 bankruptcy as a result of the Debtor in Possession financing provisions in Section 364, which skew any incentive the DIP lender otherwise had in the creditor's reorganization); Tabb, *supra* note 1, at 104–05 (writing that fundamental changes in the financial world, including the growing power of secured creditors, has brought an end to Chapter 11 reorganizations); Elizabeth Warren & Jay L. Westbrook, *Secured Party in Possession*, 22 AM. BANKR. INST. J., Sept. 2003, at 12, 12 [hereinafter Warren & Westbrook, *Secured Party*] (expressing concern about secured creditor control of the Chapter 11 process); Jay Lawrence Westbrook, *The Control of Wealth in Bankruptcy*, 82 TEX. L. REV. 795, 843–44 (2004) [hereinafter Westbrook, *Control*] (describing the rise within Chapter 11 bankruptcy of the secured-party-in-possession: secured parties which are able to assert their Article 9 rights to payment, security, and control within the bankruptcy proceeding).

3. Warren & Westbrook, *Secured Party*, *supra* note 2, at 12. We were among the first to express concern about secured creditor control, although we did not make the broad claims that followed in the literature.

4. *See* Baird & Rasmussen, *supra* note 2, at 751 ("Corporate reorganizations have all but disappeared."); Skeel, *supra* note 2, at 918 ("Chapter 11 no longer functions like an antitakeover device for managers; it has become, instead, the most important new frontier in the market for corporate control . . . ."). *But see* A. Mechele Dickerson, *The Many Faces of Chapter 11: A Reply to Professor Baird*, 12 AM. BANKR. INST. L. REV. 109, 110 (2004); Lynn M. LoPucki, *The Nature of the Bankrupt Firm: A Response to Baird and Rasmussen's* The End Of Bankruptcy, 56 STAN. L. REV. 645, 646 (2003) (presenting empirical evidence that "[c]orporate reorganizations are booming").

5. *See* Baird & Rasmussen, *supra* note 2, at 751–52, 787 (claiming section 363 sales in bankruptcy have eclipsed reorganization).

6. *Id.*

rare exception, saying, "Corporate reorganizations have all but disappeared."[7] Often judges and lawyers have joined scholars in supporting this narrative.[8]

This Article makes two major points. The first is that the conventional picture is misleading and overstated. Our data strongly suggest that secured creditor control is less pervasive than has been asserted, that section 363 sales are by no means universal, and that secured credit dominance is not closely related to 363 sales. But the data also reveal the need for much more research about a phenomenon that is complex and nuanced. The academic anomaly here is a consensus on the centrality of secured credit to the Chapter 11 process, but a serious lack of empirical research, leaving us with untested empirical assumptions.[9] Our second point is the need to research a cross section of Chapter 11 cases rather than the current myopic focus on very large cases. Only a study of the entire spectrum of cases is likely to yield reliable answers.

Traditionally, the various institutions of modern Chapter 11 bankruptcy produced a certain balance among the debtor and various creditor constituencies. Secured creditors have by far the most effective tools for upsetting that balance and obtaining control of Chapter 11 cases, converting the Debtor in Possession ("DIP") to a Secured Party in Possession.[10] Thus, secured credit is central to the assertions that creditor control has refashioned Chapter 11. I myself have argued that it is nearly futile to understand Chapter 11 outcomes without more data on the role of secured credit.[11] Yet we remain almost bereft of data about the role secured credit plays in these "reorganization" cases.

We report here data from a 2006 sample of Chapter 11 cases. As with our prior empirical work in Chapter 11,[12] our sample is a cross section of Chapter 11 cases. In that regard, it is unlike most of the existing studies that are limited to large companies.[13] Our data suggest that se-

7. *Id.* at 751.

8. *See In re* Chrysler LLC, 576 F.3d 108, 115 (2d Cir. 2009); *In re* Gulf Coast Oil Corp., 404 B.R. 407, 418–19 (Bankr. S.D. Tex. 2009).

9. LoPucki, *supra* note 4, at 646.

10. Warren & Westbrook, *Secured Party*, *supra* note 2, at 12 (describing the increasing manipulation of Chapter 11 as a mechanism for the secured creditor to assert power over the debtor); Westbrook, *Control*, *supra* note 2, at 855 (identifying the means through which secured creditors assert control over the debtor in the bankruptcy process).

11. Jay Lawrence Westbrook, *The Big Case Bankrupcty Empirical Research Agenda,* UCLA SCHOOL OF LAW: SETTING THE BIG-BANKRUPTCY EMPIRICAL RESEARCH AGENDA CONFERENCE (Feb.11, 2011), http://lopucki.law.ucla.edu/conference_proposals/westbrook_summary.pdf.

12. Elizabeth Warren & Jay Lawrence Westbrook, *Contracting Out of Bankruptcy: An Empirical Intervention*, 118 HARV. L. REV. 1197 (2005); Elizabeth Warren & Jay Lawrence Westbrook, *Financial Characteristics of Businesses in Bankruptcy*, 73 AM. BANKR. L.J. 499 (1999) [hereinafter Warren & Westrbook, *Financial Characteristics*]; Elizabeth Warren & Jay Lawrence Westbrook, *The Success of Chapter 11: A Challenge to the Critics*, 107 MICH. L. REV. 603, 607–10 (2009) [hereinafter Warren & Westbrook, *Success*].

13. *See, e.g.*, Kenneth M. Ayotte & Edward R. Morrison, *Creditor Control and Conflict in Chapter 11*, 1 J. LEGAL ANALYSIS 511, 511 (Summer 2009) (reporting on large public and private Chapter 11 filings made in 2001 and finding "pervasive creditor control"); Michelle M. Harner & Jamie Marincic, *Committee Capture? An Empirical Analysis of the Role of Creditors' Committees in Business*

cured creditor control is indeed important but not as pervasive as many have assumed. Our results may arise in part from the fact that our database includes companies of all sizes, but even the large companies and corporate groups in our sample (which includes Delaware and the Southern District of New York) are less burdened with security than has been asserted. In particular, many of them appear to lack the obviously dominant security interests that would put a secured lender in clear control of a case.[14]

Closely related to the assertion of secured creditor dominance is the idea that liquidation under section 363 has become the commonplace result of a Chapter 11 filing.[15] The view often expressed is that this trend is related to the increasing control by secured creditors.[16] Our data, however, present a somewhat different picture in which section 363 sales are important, but by no means dominant, and they are not strongly tied to secured creditor control.

While there is every reason to suppose secured credit is highly important to the success of Chapter 11 cases and the sorts of outcomes they produce, our data show how difficult it is to identify its effects or to relate

Reorganization, 64 VAND. L. REV. 749, 755 (2011) (finding that Chapter 11 cases with a creditor committee were significantly more likely to result in a plan of liquidation for large corporate debtors). Lynn LoPucki continues to make a wonderful contribution through creation and maintenance of the UCLA-LoPucki Bankruptcy Research Database. Lynn LoPucki, *UCLA-LoPucki Bankruptcy Research Database,* UCLA SCHOOL OF LAW, http://lopucki.law.ucla.edu (last visited Oct. 25, 2014). Yet it too is limited to large companies (where their Annual Report reported assets worth $100 million or more, measured in 1980 dollars; for the most part they are registered with the SEC). *Id.*

14. For the concept of a "dominant security interest," see Westbrook, *Control*, *supra* note 2, at 796 (where the interest "encumber[s] substantially all of the debtor's assets"). For the definition used in our study, see *infra* at 841.

15. There may also be a growing trend toward going-concern liquidation in Chapter 11, including creditors who "lend to acquire" and acquisitions of companies through the purchase of claims, but it is not clear how widespread those phenomena may be or the extent to which those approaches warrant control of a case as opposed to a seat at the table. *See* MAX NEWMAN, BUSINESS BANKRUPTCY LAW: 2010 AND BEYOND, *in* NAVIGATING RECENT BANKRUPTCY LAW TRENDS 65, 65–66 (2010); Lynn M. LoPucki & Joseph W. Doherty, *Bankruptcy Fire Sales*, 106 MICH. L. REV. 1, 43 (2007). Our prior data from two samples across eight years suggests that liquidation under a plan has always been not uncommon but not routine, although the data do suggest that liquidating plans may have become somewhat more common from 1994 through 2002. Warren & Westbrook, *Success*, *supra* note 12, at 627. We are even more bereft of data in that area than we are for secured credit, and this report does not address that issue. However, some preliminary data suggest liquidating plans have become more common, although not necessarily in connection with dominant security interests.

16. Harvey R. Miller & Shai Y. Waisman, *Does Chapter 11 Reorganization Remain a Viable Option for Distressed Businesses for the Twenty-First Century?*, 78 AM. BANKR. L.J. 153, 194 (2004) (stating that "a § 363(b) sale dramatically changes the concept and nature of the Chapter 11 process from one of rehabilitation of the debtor and its business to a potential auction that will leave a pool of cash (or other consideration) to be divided up among the debtor's creditors."); Miller & Waisman, *supra* note 2, at 152 (writing that creditors increasingly use bankruptcy and section 363 to effectuate favorable asset sales with no attempt at reorganization); James H.M. Sprayregen et al., *Chapter 11: Not Perfect, but Better than the Alternative*, 24 AM. BANKR. INST. J. 1, 60 (Oct. 2005) (describing those who "decr[y] the increasing frequency and rise in importance of §363 sales"); Robert E. Steinberg, *The Seven Deadly Sins in §363 Sales*, 24 AM. BANKR. INST. J. 22, 22 (June 2005) (claiming section 363(b) sales "have become the preferred method of monetizing the assets of a debtor company"). The *Lionel* case is often cited as creating a barrier to resolution of a Chapter 11 case by a sale of substantially all the assets of a debtor, but the permeability of the barrier is variable and controversial. *In re Lionel Corp*., 722 F.2d 1063, 1070–71 (2d Cir. 1983).

secured credit to outcome metrics. The data confirm many of the trends we noted in our 2009 report of a 2002 sample of Chapter 11 cases,[17] but make it difficult to relate those trends to the presence or absence of secured credit or of secured creditor dominance. Our data make it clear that secured credit is often a critical factor, but its effects remain quite unclear. We return from a nearly unexplored data wilderness reporting some major landmarks and intriguing prospects but with more questions than answers. Much more exploration will be necessary to understand the effects of secured credit on Chapter 11 cases and their outcomes. We hope that our study will help to identify these difficulties and to stimulate discussion of the next step empirical scholars need to take in understanding the role of secured credit in Chapter 11.

Our data typify empirical results. First, the data reveal that impressions are often mistaken or overstated. Our attention is seized by a new phenomenon, and we are diverted from the familiar, which is naturally less interesting. As Teresa Sullivan has commented, when one is pregnant, suddenly the world seems filled with other pregnant women.[18] Our data also reflect the second constant in empirical research: "More research is needed."

II. THE SECURED CREDITOR CONTROL STORY

The current thinking about secured creditor control of Chapter 11 is perfectly captured by *In re Michael Day Enterprises, Inc*.[19] The Court's first day order justifies the term "hog-tied" to describe the state of the case and the debtor under the order.[20] The debtor acknowledges and the Court finds that the lender has acted at all times with purity of heart and perfection of liens, subject to a possible challenge by other parties who will have to make that attack in the face of a formidable *fait accompli*.[21] The debtor's lawyers are on an allowance. All prepetition debt is rolled up into a secured package tied with a superpriority bow.[22] "Any" creditors' committee will be on a tiny budget and in any case forbidden to spend a dollar of that budget to challenge the lender's security interest. On top of that, all "bankruptcy-related" recoveries are part of the lender's collateral, including, but not limited to, those based on the Bank-

17. *Id.* at 608. *See* data *infra* Part II.

18. Teresa A. Sullivan, Elizabeth Warren, & Jay Lawrence Westbrook, *The Use of Empirical Data in Formulating Public Policy*, 50 LAW & CONTEMP. PROBS. 195, 205 (1987) (explaining how anecdotal evidence skews the perception of data).

19. *In re* Michael Day Enterprises, Inc., Nos. 09-55159, 09-55162, 2009 WL 7195491, at *1 (Bankr. N.D. Ohio Nov. 12, 2009). The judge in the case was a distinguished member of the bankruptcy bench (Marilyn Shea-Stonum). *Id.* The point of the example is not to criticize the judge, but rather to exemplify the relatively routine nature of draconian first day orders.

20. *Id.* at *7–16.

21. *Id.* at *3–6.

22. 11 U.S.C. § 364(c)(1) (2012); In re *Michael Day Enterprises, Inc.*, 2009 WL 7195491, at *8 .

ruptcy Code (the "Code").[23] The debtor is thus a spectator at its own funeral, with most of its creditors weeping at the graveside.

The key point in this understanding is that the secured creditor, through its control of the debtor's assets, has complete charge within Chapter 11.[24] This control makes the Chapter 11 proceeding nothing more than a vehicle for Better-Than-Nine[25] relief for the favored creditor, with the collective aspects of bankruptcy relegated to the sidelines.[26] It is asserted that this result happens in most—maybe virtually all—Chapter 11 cases.[27] Much of the discussion centers on extraordinary DIP orders like the one in *Michael Day*, but there seems to be a consensus that the leverage necessary to hog-tie the debtor with such a DIP order arises from a prepetition security interest covering most, if not all of the debtor's assets.[28] That is, the debtor is helpless to resist the suffocating DIP order because the secured party already controls most of the debtor's assets through its prepetition security interest (what I have described as the "bankruptcy veto"[29]). It is that prepetition interest we have examined in our study sample.

It is also important to the secured creditor control story that its control tends to generate regular recourse to section 363 sales as the normal outcome in Chapter 11 because the secured party wants to realize its collateral quickly;[30] there is no point to negotiation in what is essentially a one-party collection proceeding, with perhaps some scraps from the table for other creditors. Thus, the secured creditor control story predicts that

23. A PACER search reveals that a Creditor's Committee was formed and obtained some useful, but relatively minor concessions in a stipulated settlement that established a litigation trust composed primarily of possible avoiding actions and provided a larger carveout for expenses and counsel fees. *Public Access to Court Electronic Records*, UNITED STATES COURTS, https://www.pacer.gov/.

24. Baird & Rasmussen, *supra* note 2, at 784–85; Warren & Westbrook, *Secured Party*, *supra* note 2, at 12. Baird and Rasmussen seem to limit their claim to large public cases, but the article begins with the flat statement quoted above: "Corporate reorganizations have all but disappeared." Baird & Rasmussen, *supra*, at 788. Assertions are often made about "Chapter 11" where the evidence is drawn only from large cases. Furthermore, the exclusive focus on large cases is itself problematic. *See supra* text in Part VI.

25. Article Nine, that is. U.C.C. art. 9 (2014).

26. *See* Warren & Westbrook, *Secured Party, supra* note 2, at 53; Westbrook, *Control*, *supra* note 2, at 858. See also *supra* notes 1, 3. For a critique of this result, see George W. Kuney, *Misinterpreting Bankruptcy Code Section 363(f) and Undermining the Chapter 11 Process*, 76 AM. BANKR. L.J. 235, 235 (2002).

27. Baird & Rasmussen, *supra* note 2, at 751.

28. *Id.* at 752, 784–85; Westbrook, *Control*, *supra* note 2, *passim.* Other authors make less of the distinction between preexisting security interests and the DIP tie-up. Skeel, *supra* note 2, at 931. Nonetheless, there seems to be a consensus that pre-bankruptcy secured party control is the most frequent avenue to the dreaded DIP order. We are still working on understanding the data about financing orders, which are complex to code and analyze.

29. Westbrook, *Control*, *supra* note 2, at 817.

30. Baird & Rasmussen, *supra* note 2, at 752; Skeel, *supra* note 2, at 937; Warren & Westbrook, *Secured Party*, *supra* note 2, at 12. *See* Miller & Waisman, *supra* note 2, at 156–57 (2005) (writing that creditors increasingly use bankruptcy and section 363 to effectuate favorable asset sales with no attempt at reorganization); Steinberg, *supra* note 16, at 22 (claiming section 363(b) sales "have become the preferred method of monetizing the assets of a debtor company"); Westbrook, *Control*, *supra* note 2, at 844.

section 363 sales would dominate Chapter 11 outcomes as a result of secured creditor dominance.

III. THE STUDY

The study reported here is our third large empirical study of business bankruptcy. We first did a study of Chapter 7 and Chapter 11 cases in twenty-three districts across the United States, including all the judicial circuits.[31] That first study, titled *Financial Characteristics of Businesses in Bankruptcy*, focused on the demographics of businesses, both corporate[32] and individual, that filed for liquidation or reorganization in 1994. It was meant to provide a baseline of data for future studies and a picture of the business bankruptcy process for policymakers. It also marshaled data to test a series of theories or assumptions about the bankruptcy system. That study by the Business Bankruptcy Project remains the largest single gathering of data about the business bankruptcy system as a whole.[33]

In 2009, a second Business Bankruptcy Project study appeared in the Michigan Law Review.[34] It reported the data we obtained from cases filed in 2002 from nine districts.[35] The reduced number of sample districts reflected both the lesser resources available to us for the 2002 study and also its narrower focus. The key data in that study related to the efficiency of the Chapter 11 system.[36] The data showed that Chapter 11 cases were being resolved through both failure and success at a fast clip and that claims of delay and inefficiency in that process were simply wrong.[37]

The new Business Bankruptcy Project ("BBP") data reported here describes data from cases filed in 2006, just a year before the official start of the Great Recession, and well after the secured credit control story was already the well-established conventional wisdom.[38] The BBP data on which this Article is based are derived from a systematic sample taken from the same nine districts as our 2002 study, including the Southern District of New York and Delaware.[39] Once again, we enjoyed the luxury of doing the sampling from our desktops, thanks to PACER.[40] We sam-

31. Warren & Westbrook, *Financial Characteristics*, *supra* note 12, at 499.

32. "Corporate" here includes partnerships and other legal entities.

33. *See* Warren & Westbrook, *Financial Characteristics*, *supra* note 12, at 499.

34. Warren & Westbrook, *Success*, *supra* note 12.

35. *Id.* at 605, 608.

36. *See id.* at 608, 640.

37. *Id.* at 605, 640–41.

38. See articles cited *supra* note 2.

39. The nine districts in both samples were: Colorado, Delaware, Northern District of Illinois, Massachusetts, Nebraska, District of New Jersey, Southern District of New York, Northern District of Texas, and Western District of Washington. *See* Warren & Westbrook, *Success*, *supra* note 12, at 608 n.18. Cumulatively, these jurisdictions accounted for 32.4% of all Chapter 11 filings in 2006: Colorado: 1.8%, Delaware: 4.7%, Northern District of Illinois: 2.4%, Massachusetts: 1.7%, Nebraska: 0.4%, District of New Jersey: 4.4%, Southern District of New York: 8.6%, Northern District of Texas: 6.3%, and Western District of Washington: 2.1%.

40. We have discovered that a small number of cases that were filed in Chapter 11 in 2006 were not listed in Chapter 11 on PACER for reasons we are still trying to understand.

pled fifty Chapter 11 cases filed in each of the districts, with one exception,[41] for a total of 424 cases. As with our 2002 study, we included natural-person filings as long as they were business-related.[42]

While the acquisition of cases is electronic, coding requires a lot of old-fashioned data entry. We coded general demographic information about the debtor companies and their financial circumstances taken from the petition and schedules. We further coded detailed information on security interests and on sales under section 363 of the Bankruptcy Code. Our coding of each was done by or under the direction of a lawyer knowledgeable about bankruptcy law and experienced in performing empirical work in Chapter 11.[43]

We took the figures on assets, debt, and secured credit from Schedule D filed with the petition. We determined the existence of a sale outside the ordinary course by inspection of the file, especially the docket and any sale order. Where we could determine that a debtor that was included in the systematic sample was part of a corporate group,[44] we aggregated the data on assets, unsecured debt, and secured debt from all the group members who had filed. We then treated that group as a single bankruptcy case for most purposes in this article.[45]

IV. A BRIEF DEMOGRAPHIC SUMMARY

Our business debtors ranged in assets and debt from virtually none to billions of dollars. The mean amount of debtor assets for the sample was about $75.2 million, but the median was about $1 million. The mean debt was $150 million, but median debt was much smaller at about $1.8 million. These figures reflect that our sample approaches being a cross section of Chapter 11, including cases from the smallest to the largest. Unsurprisingly, the size of a case often affects its progress and results, as discussed in our earlier work[46] and below. As measured by total debt, the cases were substantially larger than in our 2002 samples in the same dis-

41. Nebraska had only twenty-four cases, and we took them all.

42. Natural person filings generally include both consumer bankruptcies and business-related natural person filings. Since these business-related natural persons filings can contribute to a significant portion of business bankruptcies, they are essential to portraying an accurate picture of business bankruptcy filings. *See* Warren & Westbrook, *Financial Characteristics*, *supra* note 12, at 532.

43. Charles Trenckmann, who was a supervisor and analyst in our 1994 and 2002 empirical projects.

44. Our primary criterion for membership in a corporate group was joint administration with other cases filed in that district. We did not attempt to ascertain if there were other members of the corporate group that had not filed. Delaware cases were far more likely to be part of corporate groups than any other district, including Southern New York, so we ended with thirty-six Delaware "cases" consisting of stand-alone companies (no affiliates filed), plus one "case" for each group of affiliates.

45. The process of combination reduced our "n" to 391, and missing data on assets shrunk our "n" for some analyses a bit more to 354 for most purposes in this paper. Although we continue to look at these problems, we are reasonably confident that none of these adjustments would materially change our findings.

46. *See, e.g.*, Warren & Westbrook, *Success*, *supra* note 12, at 637 (reporting, *inter alia*, that in 1994, cases above the mean total debt took more than three months longer to resolve than cases with debt below the mean and in 2002 the bigger cases took more than four months longer).

tricts, even after adjusting for inflation. Appendix Table A reports overall statistics for assets and debt.[47]

Of the business cases we observed, only eleven began with involuntary petitions. Just over twenty percent were eventually converted to Chapter 7 and forty-three percent were dismissed. On the other hand, about twenty-eight percent of the cases resulted in confirmed plans, close to the same percentage as in our 2002 study.[48]

V. DISTRIBUTION OF SECURED CREDIT

Generally, security is found in a substantial majority of cases, but the level of secured debt varies greatly.[49] About seventeen percent of the cases have no secured debt at all, not even a PMSI on the office water cooler. Where there is some secured debt, we look at the ratio between total secured debt (total Schedule D) and total assets (total Schedules A and B).[50] About sixteen percent of the cases have a secured debt ratio equal to less than a quarter of the scheduled assets. When combined with the cases with zero secured debt, about a third of the cases are very unlikely to be subject to any secured creditor control. Whatever else might be true of those cases, they seem more likely to be controlled by the debtor's management rather than by a secured creditor.

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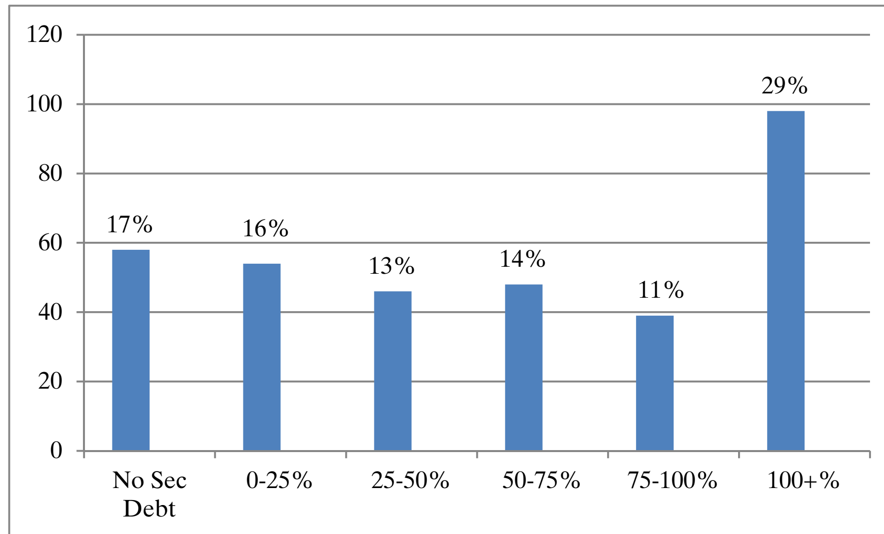
47. *See infra* Appendix Table A.

48. In our 2009 article, we described an overall confirmation figure as a naïve metric because so many Chapter 11 cases are dead on arrival and are culled in the first six to nine months after filing. Warren & Westbrook, *Success*, *supra* note 12, at 615. For example, in our 2002 sample the confirmation rate for debtors who filed a plan and stayed in the process for nine months or more, was 65.5%. *Id.* at 618.

49. One characteristic that is not important is membership in a corporate group. The companies that were and were not group members did not vary significantly in their ratios of secured debt, once outliers are excluded.

50. "Total assets" equals the total of the amounts listed on Schedules A and B. We have not matched secured debt to specific collateral. Given the information demanded by the schedules and, even more importantly, the incompleteness of the information actually provided in the casefiles, that matching would be a task varying from difficult and resource-intensive to impossible. A study developing those data would be helpful, but would probably not have much effect on the conclusions we report here.

TABLE 1: DISTRIBUTION OF CASES BY SECURED DEBT RATIOS



Source: Business Bankruptcy Project 2006; N=343

At the opposite end of the spectrum, the secured debt in about thirty percent of the cases is greater in amount than the total value scheduled for the assets of the debtor (a "dominant security interest"). In those cases, the secured creditor is very likely to be in total control of the Chapter 11 case. Dropping to a lower, but still impressive, level of secured credit, we found that in forty percent of the cases overall (including the blanket security interests), secured creditors were owed an amount equal to at least seventy-five percent of the debtor's assets. Thus, secured creditors in four out of ten Chapter 11 seem likely to control the progress and outcome of the proceeding. Those cases appeared nearly certain to look a good deal like *Michael Day* and thus consistent with the conventional notion of a substantial shift in control over the last twenty years.

Around a quarter of the cases lay in the great middle of the sample, with secured debt amounts from twenty-five percent to seventy-five percent of asset value.[51] These cases are ambiguous as to secured creditor control. The median case in the sample has secured debt equal to fifty-six percent of total assets. We can suppose that a creditor with secured debt equal to at least half of the debtor's assets has a substantial influence over the debtor's conduct and may be able to extract a DIP Financing Order that gives it a security interest over the rest of the estate's assets. On the other hand, a debtor with almost half its assets unencumbered offers at least a hope to unsecured creditors and is not entirely stripped of

51. Taking a ratio of 0.5 as a benchmark, about fifty-four percent of the cases had secured debt equal to at least half of the value of the debtors' assets.

resources. Regarding control, such a debtor has unencumbered assets to sell or offer as security for DIP financing. Its secured creditors may not be in a position to exert control or even decisive influence over a creditor's committee and its counsel or over the debtor's own management and lawyers in the way implied by a *Michael Day*-type order. It is difficult to determine the level of secured creditor influence in these cases without knowing more. The data suggest, however, that there are a substantial number of cases in which secured creditors do not have a level of influence that would amount to control.[52]

In this study, we have a particular interest in dominant security interests that would give a secured creditor a strong measure of control in Chapter 11 cases. Yet the figure for the total secured debt issued by the debtor sometimes reflects amounts lent by more than one secured creditor. In some of those cases, the creditors may be part of a lending group that acts together, while in others the creditors may be of various sorts (e.g., lenders and suppliers) and may be unconnected. None might have the level of control suggested by the conventional view. So we went a step farther to see to what extent a single creditor seemed to have a controlling position in a case.[53] We began by calculating how many of the cases with blanket security interests had only a single secured creditor, the classic case for secured creditor control. Just over one-fifth of these cases (twenty-two of ninety-eight) had only a single secured creditor.

Our next step was to look more broadly for a security interest issued to the debtor's largest single secured creditor in which the amount of the secured debt was at least equal to fifty percent of the debtor's total assets, which we defined as a dominant security interest ("dsi50"). Fewer than half of the cases (forty-six percent) involved a secured creditor with a dsi50. A "dsi75" represents the same sort of proportion, except at the level of seventy-five percent or more. Our notion was that a single secured creditor with debt at those levels was likely to exert strong or even dominant control over the debtor's Chapter 11 case.[54] Less than a third of the cases included a creditor that held such a strong position.

52. There is little significant variation among districts in the percentage of secured debt in our sample. Seven out of nine districts do not significantly vary. Secured debt at fifty percent or more of total assets is most common in Colorado and Massachusetts at sixty-eight percent and sixty-five percent, respectively. Colorado and Massachusetts are significantly different from Illinois and Washington with secured debt levels of forty percent and forty-five percent, respectively. Otherwise a debtor in any given district in our sample is no more likely to have a high level of secured debt than in any other district.

53. *See* Westbrook, *Control*, *supra* note 2, at 855. Our definitions for this purpose bear a rough relationship to the control factors mentioned in that article, although necessarily the study definitions are somewhat blunt instruments.

54. It is possible, however, that a creditor might have a lower level of security at the time of bankruptcy, but obtain a DIP order granting a sweeping security interest or payment priority such that the creditor would be in control. The literature tends to ignore the prepetition situation of debtors (which is not easy to establish, as we demonstrate herein), so we do not know if this often happens. It is our sense that most such hog-tying DIP orders are obtained by creditors in cases that already had a dominant security interest. We continue to poke and tweak the data in an attempt to prove or disprove that intuition.

Table 2 shows that the size of the case had some influence on the likelihood of a high percentage of secured debt in the case. That is, a bigger debtor (measured by size of debt)[55] was somewhat more likely to carry the burden of a higher percentage of secured debt, contrary to what many observers might have assumed. Although the relationship is significant, it is relatively weak and suggests more research is required to investigate the relationship between secured lending and the size of the borrower.

TABLE 2: CORRELATIONS OF KEY VARIABLES

	1	2	3	4	5	6
1. Sale	1.00	0.25**	0.32**	-0.01	-0.13*	0.41*
2. Delaware	0.25**	1.00	0.13**	-0.02	-0.05	0.52**
3 Remain 180 Days	0.33**	0.32**	1.00	0.20**	-0.12*	0.24**
4.SchD/Total Assets %50+	-0.01	-0.02	-0.01	1.00	0.68**	0.11*
5. Dominant Security Int > 50%	-0.13	-0.05	-0.12*	0.68**	1.00	-0.09
6. Total Debt	0.41**	0.52**	0.24**	0.11*	-0.09	1.00

Source: Business Bankruptcy Project 2006; * $p \leq .05$, ** $p \leq .01$

All in all, the data reveal that secured credit is a highly important part of the Chapter 11 system, but not nearly as dominant and pervasive as one might assume from the literature and the word on the street.

VI. LIQUIDATION UNDER SECTION 363

To investigate the near-universal belief that Chapter 11 liquidation sales under section 363 are very common today, we coded whether any sales had taken place during the case and, if so, whether any of the sales were of substantially all of the assets of the debtor. The results raise some real questions about the conventional wisdom.

Section 363(c)(1) does not require approval of ordinary course sales,[56] so the court files reflect only sales outside the ordinary course. Although we coded for both any sale and any substantial sale, the distinction involves several judgment calls and even then sophisticated judgments would fairly often require an in-depth study of the court files at a minimum. Thus, for now we report all cases that had a sale beyond the *de minimis* level. Because of the judgment-call aspect of the coding, it

55. We generally report results using debt as a measure of size, but few results are importantly affected if we use assets instead. The results tend to show stronger connections when related to debt. In any case, debt is regularly used in bankruptcy studies and seems to us to be a better measure to employ. *See* Warren & Westbrook, *Success*, *supra* note 12, at 634. In this Article, when we say total debt we mean "categorical debt." Because using debt as a continuous variable is problematic, we break down the variable into ten categories, with no overlap: 0-500K, 500k-1Mil, 1Mil-2.5Mil, 2.5Mil-5Mil, 5Mil-10Mil, 10Mil-20Mil, 20Mil-50Mil, 50Mil-100Mil, 500-Mil to 1Billion, and Over 1Billion.

56. 11 U.S.C. § 363(c)(1) (2012).

is likely that reporting only substantial sales would be under inclusive, while reporting all sales would be over inclusive. Our sense is that most of the sales were substantial sales, so reporting all sales is likely closer to the right number for substantial sales.[57] In any case, even reporting as if all extraordinary sales were substantial produces a surprisingly small percentage of cases with sales, given the general beliefs about the importance of liquidation sales in the twenty-first century.

Slightly less than thirty percent of the cases had *any* sales sufficiently important and out of the ordinary course to make an appearance in the court files.[58] Even if all of them were liquidating sales, about seventy-one percent of the cases showed no sales under section 363 and, therefore, were attempts at traditional reorganization or liquidation under a plan.[59] When we saw this figure, we kicked the computer three times and went out for coffee, but when we came back we got the same number. Thus our data strongly suggest that the conventional view that 363 sales dominate Chapter 11 practice is simply wrong.

The most important variable related to 363 sales is case size. As shown in Table 2, the correlation is positive and statistically significant. Given that the literature focuses on large cases, this fact may partly explain the distance between the general perception and the reality we found in a sample including cases of all sizes. Nonetheless, size is not a simple answer to the difference between perception and the reality we report here. Almost thirty percent of larger cases (over $10 million in debt) did not include material section 363 sales.[60]

When we consider district variation, Delaware had a far greater percentage of section 363 sales than any other district in our sample, including the Southern District of New York. Over sixty-five percent of the Delaware cases had sales and most of them appeared to be substantial—i.e., liquidating. The correlation between filing in Delaware and 363 sales was positive and statistically significant. See Table 3 and Appendix Table B. However, when we control for other variables, including size and time in Chapter 11, it ceases to be significant.

57. In most cases, we obtained similar results when we used only substantial sales in our queries.

58. *See infra* Appendix Table B.

59. These results tend to vindicate the argument presented by Lynn LoPucki. LoPucki, *supra* note 4, at 650–51.

60. We selected this number because various approaches suggested it as a breakpoint. We got similar results at other breakpoints.

TABLE 3: VARIABLES RELATED TO §363 SALES (ODDS RATIOS AND STANDARD ERRORS FROM A LOGISTIC REGRESSION PREDICTING ASSET SALES)

Variable	**Odds Ratio (S.E.)**
Delaware	1.29 (0.7)
Survive 180 days	3.44 (1.1)**
Total Debt	1.35 (0.1)**
SchD/TA 50% +	0.83 (0.2)
Intercept	0.07 (0.03)
N	329
* p ≤ .05, **p ≤ .01	

Source: Business Bankruptcy Project 2006; N=329

Table 3 shows that survival in Chapter 11 was another factor that correlated significantly with section 363 sales. In our 2002 study, Warren and I showed that the likelihood of plan confirmation increases sharply in cases that survive more than six months without being dismissed or converted.[61] In this 2006 sample, we find that survival past the six month mark strongly relates to a larger percentage of cases involving 363 sales. The percentage of cases with sales rises to forty percent among cases that survive one hundred eighty days or more. Thus, any notion that section 363 sales are the fast alternative to a plan does not seem to be strongly explanatory. Although size and six-month survival are also closely related,[62] the independent significance of survival endures in a regression including the size factor.

VII. RELATIONSHIP OF 363 SALES TO SECURED CREDITOR CONTROL

The conventional narrative assumes that cases that are controlled by secured creditors are likely to involve section 363 sales.[63] That part of the narrative also appears open to serious question. Cases with a high percentage of secured debt seem less likely to have sales of assets, although the relationship is not statistically significant. Even more striking is the negative—although not statistically significant—relationship between the presence of a dominant secured party[64] and a 363 sale. The lack of a strong relationship of any kind—much less a negative one—challenges a good deal of the armchair analysis of the problem of secured creditor control and opens the door to some potentially rich future research.

61. Warren & Westbrook, *Success*, *supra* note 12, at 606, 633.
62. *See id*.
63. One claim has been that secured creditors may be anxious to sell out, especially if they are oversecured. *See*, *e.g*., Westbrook, *Control*, *supra* note 2, at 843–44 (describing the "incentive problem" where secured creditors push for liquidation to recoup their claims).
64. See text at note 54.

VIII. CONCLUSION

The data seem to us to reveal that the secured creditor control story is far too simple and somewhat overstated. *Michael Day* is representative of one important strain in modern Chapter 11 cases, but it appears that a number of cases continue to be initiated and to resolve, in success or failure, in the "traditional" way: an attempt to achieve a negotiated settlement represented by a confirmed plan. At the start of the twenty-first century, certain trends were announced as pervasive, but we have significant data that suggest they had not achieved that influence by the middle of that decade, several years after they were proclaimed. It is possible that those trends have since taken over Chapter 11, but there does not seem to be any evidence that they have done so nor any obvious reason that secured creditor control and section 363 sales should have increased since that time.

Not only do we find that secured creditor control is less pervasive than claimed (even in large cases) and 363 sales far less common, but it also appears that the association between them, quite plausible as it has been to many of us, is undemonstrated and perhaps tenuous.

We do not pretend that the data presented here answer all the extant questions concerning secured credit and section 363 liquidations. On the contrary, what is striking about our findings is that they reveal both phenomena as much more complex and nuanced than contemporary discussions would suggest. The next step may be studies that look deeper but less statistically, like Ronald Mann's path breaking study of secured credit.[65] Whatever the right tool, it is past time for us to gain a greater understanding of the effects of secured credit on Chapter 11. The idea that important recommendations will be made by the American Bankruptcy Institute Commission without hard data on the role of secured credit is problematic to say the least and might lead to wrongheaded reform.

Beyond our specific findings, we see a dissonance between a general conviction that the effects of secured credit are central to understanding Chapter 11 and the lack of serious empirical investigation of its nature and extent. Even the LoPucki database, for which we are all very grateful, is limited in its capacity to inform us about this key phenomenon, and no one seems to be anxious to fill the void. One explanation may be that gathering original data is expensive and time consuming. The difficulties with regard to secured credit are especially great. Another factor may be a trend toward legal empiricists being more interested in demonstrating statistical sophistication than in gathering otherwise unavailable data important to the things we study. Perhaps for both reasons, we risk being like the drunk who looks for the quarter not where he dropped it but across the street where there is more light.

65. Ronald J. Mann, *Strategy and Force in the Liquidation of Secured Debt*, 96 MICH. L. REV. 159 (1997).

Finally, it should be past time that we limit ourselves to discussions of large public companies. At a minimum, data consumers should demand protection from each analysis of "Chapter 11" that is actually limited to large public companies. "Large-Company Chapter 11 cases" (or even "Large-Public-Company Chapter 11 Cases") should be the subject stated in the abstract. Beyond accurate description, it is a mistake to make policy on the basis of large companies alone, ignoring the central importance of small and medium size enterprises to our economy and distorting the policy debate. It matters greatly that the machinery designed to manage the financial distress of SMEs should be effective and efficient. The study of SMEs may also assist in the study of large companies by contrast, revealing those characteristics of large debtors that may produce different results.

APPENDIX

TABLE A. DESCRIPTIVE STATISTICS FOR TOTAL ASSETS AND TOTAL DEBT FOR 2006 AND 2002

	2006		**2002**	
	Total Assets	Total Debt	Total Assets	Total Debt
Min	0	3000	15	7009
25th Percentile	269,700	633,617	257,600	570,267
Mean	75,200,000	150,000,000	137,000,000	101,000,000
Median	1,036,018	1,836,736	1,232,000	2,036,582
75th Percentile	4,591,945	6,392,492	5,643,416	9,150,934
Max	11,800,000,000	18,500,000,000	18,600,000,000	6,810,000,000
N	354	341	389	396

Source: Business Bankruptcy Project 2002 & 2006
Note: The 2002 data was multiplied by 1.12 to adjust for inflation and make it comparable to the 2006 data. *CPI Inflation Calculator*, BUREAU OF LABOR STATISTICS, http://www.bls.gov/data/inflation_calculator.htm (last visited Jan. 29, 2015).

TABLE B. ASSET SALES BY DISTRICT

District Where Case was Filed	**Asset Sale**		
	No	Yes	Total (100%)
Colorado	37 (75.5%)	12 (24.5%)	49
Delaware	12 (34.3%)	23 (65.7%)	35
Illinois	39 (81.2%)	9 (18.8%)	48
Massachusetts	35 (70%)	15 (30%)	50
Nebraska	13 (68.4%)	6 (31.6%)	19
New Jersey	36 (75%)	12 (25%)	48
New York	29 (67.4%)	14 (32.6%)	43
Texas	37 (77.1%)	11 (22.9%)	48
Washington	37 (75.5%)	12 (24.5%)	49
Total	275 (70.7%)	114 (29.3%)	389

Source: Business Bankruptcy Project 2006; N=389